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FROM THE CHAIR

It Was a Very Good Year

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

As the song says, it was a very good year! It has been my honor to serve as Chair of the Tax Section for 2016–2017. The year seems to have passed too quickly. There were many good times and some disappointments, but I am proud to have had the opportunity to lead and carry out the best job in the Section.

Initial Objectives

My objectives for this past year were as follows:

- Focusing on high quality output of our Committees in cutting-edge tax programming and government submissions;
- Continuing the Section’s pro bono and public service efforts; and
- Attracting new members.

Committee Output

We had three successful Section Meetings this past year with timely and thought-provoking plenary presentations by Barbara Angus, Chief Tax Counsel, House Ways and Means Committee; Bill Hoagland, Senior Vice President, Bipartisan Policy Center; and Mark Prater, Deputy Director and Chief Tax Counsel of the Senate Finance Committee. All three meetings were well-attended, and our 54 committees (35 of which addressed substantive tax topics) put on over 150 high quality presentations at each meeting. The networking at these events has always been one of the main attractions, and the committee programming this year featured over 100 government speakers at each meeting. The May Meeting alone attracted over 500 attendees from government, including 120 speakers. There is always as much going on in the hallways as there is in the meeting rooms at our meetings, and this year was no different. We have all had much to ponder and discuss as we try to predict what will happen with tax reform while we maintain our everyday practices, and I would like to congratulate our committees for organizing such great programs even in a time of such uncertainty. One thing is certain: the job of a tax lawyer will continue!

Our committees produced 21 government submissions on topics ranging from the effects of audits on small businesses to recent changes at Appeals this year reflecting a depth of technical experience for which our Section is well-known and can be proud. As I reported in my last column, our government courtesy calls
resulted in the estate tax lien release program being modified last April, and we have participated in the development of eight LB&I Campaign webinars. All of these are accessible by Tax Section members on the Section’s website.

Pro Bono and Public Service

In the area of pro bono and public service, we were able to select one new Brunswick Fellow for the coming two-year term: Catherine Martin will be working with Community Legal Services, Inc., in Philadelphia, PA, to provide legal representation to low-income Philadelphians, some of whom might be facing tax foreclosure of their properties. Our other pro bono efforts progressed well under the leadership of Bahar Schippel, Vice-Chair (Pro Bono and Outreach), and Christine Speidel, Chair of the Pro Bono and Tax Clinics Committee. Our Tax Court Calendar Calls, Adopt-a-Base, and Volunteer Income Tax Assistance efforts have also proceeded like a well-oiled machine, again under the leadership of Bahar Schippel and the previous work of Wells Hall, this year’s recipient of the Janet Spragens Pro Bono Award. The efforts of the TAPS Endowment Task Force succeeded in securing sufficient funds to make operational the next year’s support of the Brunswick Fellows. Nonetheless, there is still much that should be done on the TAPS Endowment, and I encourage each of you to contribute generously to this important cause.

Code Responsibility List

As the year progressed, we noticed that our Code Section Responsibility List—the list which informs our committees as to the sections for which they have primary and secondary jurisdiction—was in need of updating. For example, the relatively new economic substance doctrine of section 7701(o) had not been assigned to any committee. It was a daunting task involving thousands of Code sections (§§ 1 – 9834) and many non-Code provisions (e.g., the ABA Model Rules, ERISA, Tax Court Rules, and Circular 230), but it needed to be done. I asked Scott Michel, Vice-Chair (Committee Operations) to undertake the task. With the expert assistance of his firm’s librarian, Mary Abigail Dos Santos, and our Young Lawyers Forum, followed by a number of late nights on the part of Scott and me and subsequent “conflict resolution” discussions with certain committees who had differing opinions over assignments, we presented a revised list in conjunction with our May Meeting. This full revision was approved as a draft by Council, subject to one last review by the committees before the final revised list is presented for approval by Council at the Joint Fall Meeting in September 2017.

The Value of Membership

We have worked to attract new and younger members. Our Young Lawyers Forum has held three highly successful Tax Bridge to Practice programs at our Joint Fall, Midyear and May Meetings. In addition, the Law Student Tax Challenge was a great success at our Midyear Meeting. Going into its 17th year and thriving, this program continues to show participating law students the significant benefits of membership in the Tax Section. Another development this past year was the addition of Vlad Frants, the Tax Section’s liaison from the larger ABA’s Young Lawyers Division. Vlad organized a Young Lawyers’ Networking Reception at the May Meeting, which was an overflow success.

Membership in the Tax Section is a valuable commodity, and we should all strive to communicate why it is valuable and recruit young tax lawyers and other new members to the Section. Our membership reflects the full range of areas of tax practice. We have members who have served at the highest levels of government—for example, as Commissioner of the IRS, Director of the Office of Professional Responsibility, Assistant Secretary of the Treasury for Tax Policy, Assistant United States Attorney General for the Tax Division,
United States Tax Court Judge. We have members who devote their entire practice to serving low-income taxpayers, but the majority of our members fall somewhere in between. It is our job to show prospective members from many backgrounds that the Section has much to offer all tax lawyers.

**CLE and Diversity**

As I have reported previously, this year the ABA Board of Governors voted in favor of a new policy requiring speaker diversity on all our panels at a regular Tax Section meeting. The first meeting where this policy will be in force will be our Joint Fall Meeting in September 2017. Historically we have shown compliance with the new diversity requirement, as diversity in many facets has always been the goal of the Tax Section. There still remain operational and technical questions regarding the implementation of this policy. The Joint Fall Meeting in September 2017 will provide a good test for the Tax Section.

The Section's efforts to comply with this CLE diversity policy represent a very small aspect of how the Section addresses diversity in all of its educational programs and resources, which are designed not only to provide value to our members but also to reach a wider audience and bring in new members. For example, our international conferences (Europe and Latin America) have reached beyond our borders to attract foreign tax lawyers, and the Section has developed strong organizational partnerships as a result of these longstanding efforts.

In addition, the Section presented 22 webinars this year designed to reach our broader membership—and specifically members who are unable to attend Section Meetings in person. A couple of highlights included: (1) a member benefit webinar on “LLCs, Taxes and the IRS—What Could Possibly Go Wrong?,” which attracted 544 participants; and (2) for Pro Bono Week, “Twenty Years After ‘The End of Welfare’: Workfare Delivered Through Federal and State EITC Systems,” which had 293 participants. It’s clear that members appreciate these benefits.

**Internal Developments**

While we made significant progress in carrying out my main objectives for the year, I am most pleased to have been able to lead the Section in addressing two critically important internal matters that required attention during my term: the Section's budget deficit and an executive search for a new director.

**Budget Deficit**

As I have reported previously, early in my tenure it became imperative to address the Section's growing budget deficit, brought on by declines in membership and revenues that are being felt across the entire ABA. With the support of the Immediate Past Chair George Howell, I formed a Budget Task Force to review carefully every expenditure and recommend reduction strategies aimed at cutting our deficit by half (several hundred thousand dollars) during my term. I would like to thank the members of the Budget Task Force, including George Howell, Vice Chairs Chuck Rettig (Administration) and Scott Michel (Committee Operations), Section Delegate Dick Lipton, and Chair-Elect Karen Hawkins, and from the staff, Ty Hansen (then Acting Director) and Haydee Moore (Meetings Director). We commenced the process in my Houston offices in June 2016 and presented our strategies to be carried out over three years to Council in September 2016. Council approved our plans, and I am pleased to report one year later that the deficit has been reduced by more than half. I am confident that Karen Hawkins and Eric Solomon (Incoming Chair-Elect) will drive it home to a balanced budget over the next two years.
New Director

Last November we said farewell to Janet In, who had been promoted from staff counsel to executive director four years ago and who had decided to relocate with her family to the Northwest, which put an unexpected objective on my plate to lead the search and hiring of a new executive director. In April, we welcomed John Thorner as our new executive director. John has both the academic training and work experience to perform at the highest level for us. Read an interview with John inside this issue of ABA Tax Times. With John at the helm and a budget deficit that is well on its way to zero, I believe we have righted our ship and are well-poised to sail into the future.

Thank You

In closing, I would like to thank the talented and energetic team composed of the officers, Council Members, and staff who have all worked hard and contributed over this past year. They made my job possible. I am grateful to our Vice-Chairs: Chuck Rettig (Administration), Scott Michel (Committee Operations), Joan Arnold (Continuing Legal Education), Julian Kim (Government Relations), Bahar Schippel (Pro Bono and Outreach), and Julie Divola (Publications). I would also like to thank our Council Members: Allen Appel, Larry Campagna, Keith Fogg, Kurt Lawson, David Wheat, John Bergner, Tom Greenaway, Roberta Mann, Carol Tello, Gary Wilcox, Adam Cohen, Sheri Dillon, Ron Levitt, Chris Rizek, and Melissa Wiley. Our Secretary and Assistant Secretary were Cat Engell and Katy David. I would be remiss in not mentioning Dick Lipton and Armando Gomez, our delegates to the ABA House of Delegates. I must also acknowledge the wise counsel received from our Immediate Past Chair George Howell; our Chair-Elect Karen Hawkins; and our incoming Chair-Elect Eric Solomon. Last, but not least, were the staff, whose performance and commitment during this transitional year were unparalleled. Thank you to Ty Hansen (who served admirably in the acting director role for much of my term), Tom Blandi, Tim Brady, Sarah Deschauer, Anne Dunn, Sadia Ferguson, Haydee Moore, Greg Peacock, Isel Pizarro, Dan Swenson, Chris Tank, Jesse Tsai, and Derek Wagner.

My predecessor, George Howell, expected that we would continue his good works and propel the Section forward. With my thanks to George for his confidence, I believe we did just that. Now it is time for me to encourage my successor, Karen Hawkins, and turn the Section over to her and her officers and Council. It is with an easy confidence that I look to Karen to continue the goals and agendas already formulated, together with what will undoubtedly be exciting initiatives of her own. I believe that Karen will, with the support of all of us, move the Section forward. ■
I undoubtedly hold the record in the history of the Tax Section for taking the longest time to get from the Chair-Elect to Chair position: eight years, four months, and three days. But who's counting?

I was first honored to serve as Chair-Elect of the Section in FY2008-2009. Four months before my scheduled assumption of the Chair position, I resigned to join then-Commissioner Doug Shulman at the IRS as Director of the Office of Professional Responsibility. The decision was a very difficult one. The Tax Section has been (and continues to be) a major source of academic improvement, skill development, and strong personal bonding for me. It is no exaggeration to say that I am who, and where, I am today because of my 39-year engagement with the Section and its members. In 2009, I was eager to give back to the Section in recognition of all the benefits I had received as a member. My enthusiasm in that regard has not wavered with the passage of time. It is this history and relationships that I think of as I assume the Chair position in August.

Every chair wants to leave a legacy of some sort, and unquestionably, each has. I don't want to fumble my opportunity. Of course, much of what happens during my year as Chair will not be in my control. External forces, such as tax legislation, government allocation of resources, and unanticipated political events, will all undoubtedly impact my personal agenda as well as the Section's activities and involvement. I, however, have several broad goals on which I hope to focus during the year, with the assistance of the strong leadership team of Committee Chairs, Council Vice-Chairs, and Directors joining me on this adventure.

Inclusivity

The Tax Section has a long history of supporting diversity and inclusion at all levels. To that end, in 2001, the Section leadership adopted and published the Section's Diversity and Inclusion Plan setting forth a series of long-term goals. In 2015, the leadership revisited the plan to assess the progress made and recommit to its goals. The broad focus of the 2015 Plan emphasizes diversity in all its iterations, as I hope you will read. This commitment will continue to be a top priority for me over the next year. I hope to focus on one area in particular, which speaks to the future of the Section itself: inclusion of those who are not necessarily “like us”—those with different skill sets; those from smaller firms and solo practitioners; those of different political persuasions; and beginners in tax law. Throughout this coming year, I encourage each of you to join me in reaching out and getting to know at least one “stranger” at each of our three Section meetings. I encourage you to be mindful of both the explicit and implicit biases that might affect your judgments of, and associations with, others. Be mindful of who you are selecting as panelists, as dinner companions, and
who you spend time with during receptions. Take some risks; get a little uncomfortable. The Section cannot afford to leave out interested and interesting people.

Pro Bono & Public Service

Pro bono services have been near and dear to my heart since I started the first formally recognized Pro Se–Pro Bono Tax Court program in San Francisco, California, in 1992. The expansion of that concept to all calendar call locations, coupled with the tremendous work done by the Low-Income Taxpayer Clinics (unequivocally supported by the Section’s membership) has resulted in something of which we can all be proud. The same can be said of our VITA and Adopt-a-Base programs, which now encompass over 40 military bases. All of these activities provide wonderful examples of how generous and committed our membership has been in assisting those who would not otherwise be able to afford the tax and legal services provided.

The Section has another opportunity to be of service to an underserved and growing part of the U.S. population: seniors. The 2010 census counted more than 40 million individuals in the U.S. aged 65 and older. As the “baby boomers” age, it is estimated that by 2020 nearly 55 million individuals will be aged 65 or over; and more than 6.5 million of them will be 85 or older. Many are opting to live in assisted living facilities not because of any debilitation, but because they have no (or geographically distant) children. Others are “aging-in-place” with the assistance of home-care providers (sometimes relatives, sometimes strangers). According to the U.S. Department of Health and Human Services, there were about 22,200 assisted living facilities in the U.S. in 2014, housing nearly 900,000 seniors—70% of whom are women, and 83% of whom are aged 75 or older. The majority of these seniors will be in assisted living for a year or longer, with 16% remaining for three years or more. I also suspect, but only from anecdotal evidence, that a large portion of this aging population has connections to the military. Financial abuse of the elderly is on the rise, and many state laws provide insufficient protection. I believe this population of seniors deserves some of our pro bono attention.

Consequently, I have asked Bahar Schippel, Vice-Chair (Pro Bono and Outreach), to begin the process of identifying partners with whom the Tax Section can collaborate in providing pro bono forms of legal assistance in which our members have expertise: estate and trust advice and planning; Medicare and employee benefits advice and assistance; general financial and income tax advice. We will be starting preliminary conversations with AARP, ABA Senior Lawyers Division, ABA RPTE, and the ABA Commission on Law and Aging to determine their interest in such a collaboration. I hope, before the end of this year, to call upon Tax Section members to lend their support, time and expertise to this new tax assistance for elders pro bono project in concrete ways.

Continuing Legal Education

One of the Section’s most powerful member benefits comes in the form of timely, high quality continuing education presented during our three annual meetings and through webinars and other specialty conferences—like the Philadelphia Tax Conference and the International Tax Enforcement Conference—held throughout the year. I am committed to maintaining the current high quality of these educational products and in expanding the delivery options and topics. To that end, I have asked Fred Murray, our in-coming Vice-Chair (CLE), to collaborate with the Government and Public Sector Lawyer’s Division of the ABA to offer a webinar in the coming months on the ethical obligations and dilemmas of federal government lawyers. Fred is also exploring the use of podcasts to deliver some of the live meeting panels to those who are unable to attend in-person meetings. Of course, I also anticipate providing timely and quality programming by members, for members, once we see any proposed tax-related legislation from Congress.
Austin Meeting

Most of you are aware that our Joint Fall CLE Meeting with RPTE will be in Austin, Texas, on September 14 – 16, 2017. This will be my first meeting as Chair so I hope to see you all there. Professor Michael Graetz has committed to speak at the Joint Plenary Session and Luncheon on Saturday, September 16. Statistically, many of you have skipped the Plenary Session and Section Luncheon at past meetings. I’d like to make a “pitch” for why you should come to the Austin session to hear Professor Graetz speak.


From January to June 1992, Professor Graetz served as Assistant to the Secretary and Special Counsel at the U.S. Treasury Department. In 1990 and 1991, he served as Treasury Deputy Assistant Secretary for Tax Policy. In 2013, Graetz was awarded the Daniel M. Holland Medal by the National Tax Association for outstanding contributions to the study and practice of public finance. He has been a John Simon Guggenheim Memorial Fellow, and he received an award from *Esquire* magazine for courses and work in connection with the provision of shelter for the homeless. He served in the Treasury Department in the Office of Tax Legislative Counsel. He is a fellow of the American Academy of Arts and Sciences.

Professor Graetz is a dynamic and knowledgeable speaker, and I am delighted he has agreed to join us in Austin. No doubt he will be prepared to comment on the current state of both tax and health care legislation. Don’t miss Professor Graetz’s timely comments at the Plenary Session.

Leadership Team

I am incredibly lucky to serve this year with an extraordinary group of individuals. As many of you know, Eric Solomon is the Chair-Elect. I couldn’t be happier to have someone of such stature and competence as my back-up. I look forward to having the benefit of Eric’s vast government experience and his boundless energy throughout the year.

Scott D. Michel, who has done a stellar job of helping the Section’s committees operate smoothly during his first year as Vice-Chair (Committee Operations), will be returning for a second year. Julian Y. Kim also has his first year as Vice-Chair (Government Relations) behind him, displaying considerable style and grace in navigating the labyrinths of the Section’s relationships with government. I have no doubt he will rise to the occasion as we wait for the tax legislation which is bound to come before year-end. Bahar Schippel is returning as Vice-Chair (Pro Bono and Outreach) and will continue to ensure that the Section’s enormously successful Pro Bono and Outreach activities, such as the Tax Court Calendar Call and the Adopt-A-Base programs, will continue to run smoothly. As previously mentioned, Bahar will be a key player in my efforts to establish the new Pro Bono Tax Assistance for Elders. The other continuing Vice-Chairs include Charles P. Rettig (Administration), an indispensable overseer of Section financial activity, and Julie A. Divola...
(Publications), who oversees multiple successful Section publications without ever getting ruffled. Last, but certainly not least, our newest Vice-Chair (CLE), Fred F. Murray, has already hit the ground running as he works with the Section staff to develop new products and delivery methods to ensure Section members have timely and quality educational products—particularly as we anticipate a high level of tax-related legislation activity from Congress within the year. I am excited and honored to work with such talented and dedicated professionals.

The bulk of the work for which the Section receives recognition throughout the tax system is done by our committees, of course. We are fortunate to have a committed group of Council Directors who work tirelessly on behalf of the Section to assist the committees in their efforts. The 2017–2018 Council Director contingent includes Sheri A. Dillon, Christopher S. Rizek, Adam M. Cohen, Melissa G. Wiley, Ronald Levitt, R. David Wheat, John F. Bergner, Thomas D. Greenaway, Roberta D. Mann, Carol P. Tello, Gary B. Wilcox, Catherine B. Engell, Gregg D. Barton, Michael J. Desmond, and Peter A. Lowy. Moving into the Secretary position will be Katherine E. David, and our new Assistant Secretary is Robb A. Longman.

I want to thank Joan C. Arnold for her excellent contributions during her tenure as Vice-Chair (CLE). And a big “thank-you” also for the tireless efforts of outgoing Council Directors Alan I. Appel, Larry A. Campagna, and T. Keith Fogg.

I will be most fortunate to receive continuing support and counsel regarding the Section's relationship with the American Bar Association from our Section Delegates to the ABA House of Delegates, Richard M. Lipton and Armando Gomez. Their guidance and historical perspective is invaluable.

Staff Team

The Section is lucky to have a talented staff to support it in all its many endeavors. A new Executive Director, John Thorner, joined the team in May and has hit the ground running. None of our accomplishments will be possible without the continuing efforts and support of Ty Hansen (Associate Director), Anne Dunn (Director of Publishing), Jessie Tsai (Staff Counsel), Haydee Moore (Director of Meetings), Chris Tank (Director of CLE), and their incredibly talented support staff who make it possible for the Section to function smoothly. I am fortunate to have such a first-rate administrative team behind me. We anticipate filling the vacant positions for the Director of Membership and Marketing and the Pro Bono Staff Counsel before the end of the year.

It is daunting to follow in the footsteps of the former Chairs of the Section. I am grateful to William H. Caudill for his graciousness in including me early and often in the business of the Section, so the baton could pass without a misstep. Bill steered the Section during challenging financial times with determination and humor while demonstrating a level of style and grace I can only aspire to emulate.

I am ready for the challenges to come and hope you will join me in keeping the Section of Taxation at the forefront of tax professionalism. I also hope that if you see me in the hallways during one of the Section meetings, you will feel free to say “hello” and anything else that’s on your mind. I may not always be able to accommodate, but I will always listen.

See you in Austin!
Interview with John Thorner, Director, ABA Section of Taxation

By Thomas D. Greenaway, KPMG LLP, Boston, MA

Editor’s Note: John Thorner joined the Tax Section staff as director on April 10, 2017, after more than 20 years of high-level association management and board experience at the Academy of General Dentistry, the American Society of Anesthesiologists, and other organizations. He received a B.A. from Duke, a M.S. in Journalism from Columbia, and a J.D. from the University of Georgia School of Law.

Q John, can you tell us something about your background?

A My background is somewhat eclectic. It has included stints as a journalist, as a lawyer, and as a manager of professional associations.

I started my career as a journalist and worked for various news organizations, including the Washington Post and Associated Press. I was working for the Atlanta Constitution as a reporter when I decided to go to law school. When I finished law school, I took a position with the National Labor Relations Board (NLRB) as an attorney advisor for one of the Board members. However, I was more interested at the time in combining my journalism and law backgrounds, so after three years at the NLRB, I jumped at the opportunity to work for Legal Times of Washington, a startup newspaper aimed at helping lawyers in their practice.

Still wanting to combine my journalism and legal backgrounds, I left Legal Times for a communications/legislative/regulatory lobbyist position at an industry trade association. After that, I became a general counsel of an environmental engineering professional association. I moved from that general counsel position to an executive director position at another environmental engineering association. And from there, I took a post as an executive director of an organization of physicists. I moved to Chicago about nine years ago for executive director positions with first a medical and then a dental professional association.

I returned to D.C. to be closer to family. I heard about the position with the Tax Section and thought it would be a great fit. I enjoy working for professional associations, and I especially enjoy working in an area that is current and exciting. It was energizing to work for a medical association during the Obamacare debate, and now I find it very exciting to work for a legal organization involved in tax issues at a time of tax reform.
Q So with your extensive background working with professional organizations, what do you see as some of the best strengths of professional organizations generally?

A Members of professional organizations tend to have a strong desire to elevate their profession. They want to continually educate themselves to better serve their clients. They want to conduct research to assure their profession is evolving. They want to assure that government officials have the best information on which to base their decisions, and they want to do something for the public good.

The collective brainpower of association members can make all these things happen and more!

Q And how about common challenges that you faced working inside professional organizations?

A Common to all associations is the challenge of membership: keeping people interested and excited about being a member of the organization and about actively supporting the organization with their time and money. So finding the set of activities and services and pro bono activities that capture the enthusiasm of the members is common across-the-board.

Q You’ve been at the Tax Section now for four months. What are your first impressions?

A I am very impressed with the quality of the Tax Section’s educational programming and publications. There is a strong involvement of members. The Section has strong, dedicated leaders. And I’ve been very, very impressed with our staff, who have the skills and experience to serve the members well.

Q We have a core of members who are active in our meetings. But the vast majority of our members do not attend our three annual Section meetings. Do you have any ideas of how we can use technology to do a better job of connecting to and activating those members?

A We have to be mindful of the pressures and challenges our members face. I’ve heard from many that law firms are not enthusiastic about paying for member dues and even less enthusiastic about paying for continuing legal education. We have to recognize that the cost of travel is not only airfare and hotels, but also fewer billable hours due to the time out of the office. Only if we offer benefits that are crucial to our members’ professional lives will they or their firms be likely to pay for those benefits.

So one of the main things we have to do is constantly look at how we can provide a valuable, worthwhile, cost-effective educational experience for members. We have to provide comprehensive, quality education remotely through webinars. We also are exploring podcasts as another mobile educational medium.

We also need to improve our onsite meeting experience. We need to assure the best education by paying attention to impediments to learning, such as overlapping topics or overcrowded meeting rooms. We need to pay attention to distractions such as attendees walking in and out of sessions.

I believe it’s really important that we first understand that we have to be doing things that are useful and valuable to our members. They have to be current. They have to be exciting. Second, I believe we need to continue to understand our audience by reaching out to them for their feedback. Today’s technology makes it easier to get member feedback, and we need to utilize these tools.
Q Well, let's shift gears a little bit and talk about the finances of the Section. I'd like to get your thoughts on two things. Are we in a sustainable mode with respect to our operations and our budget? And what do you see in terms of financial changes, if any, going forward?

A For the past few years, the Section has been spending far more than it makes in revenue. The Section has reserves that cover this deficit, but these reserves would soon be exhausted at the current pace. So we will not be in a sustainable mode unless we change how we do things.

Much to his credit, Section Chair Bill Caudill has done a tremendous amount to cut unnecessary expenses. This trend definitely will continue under the leadership of Chair-Elect Karen Hawkins and incoming Chair-Elect Eric Solomon. Staff will do everything it can to assist with this effort. Hopefully we can accomplish a balanced budget without too much impact, but we cannot do things the way we've always done them. We need to do things more efficiently and economically, and we need to cut down on some amenities to concentrate our resources on educational programming.

We also need to grow our membership and find other ways to generate new revenue. We need to develop new products and services that members will find valuable and will be willing to pay for.

Q Let's talk a little bit about tax. Are you going to plan to bone up on tax law? Are you going to treat us as the animals, and you're the zookeeper?

A Our members are the experts in tax law. With only two courses in law school and no experience practicing tax law, I don't expect to be offering members any competition soon. But I do hope to learn enough about tax law to better understand our members' needs.

I smiled at your “zookeeper” metaphor; it implies a level of staff dominance and member submission. We work for and with the members. Our job is to understand member needs and to facilitate a clear direction from members and leaders as to the best ways we can work together to make membership in the ABA Tax Section a beneficial experience.
PRACTICE POINT

Tax Planning Under the (Hypothetical) Tax Reform Act of 2017

By Kathleen L. Ferrell, Davis Polk & Wardwell LLP; Shane Kiggen, Ernst & Young LLP; David S. Miller, Proskauer Rose LLP; and Michael L. Schler, Cravath, Swaine & Moore LLP

I. Introduction.

This article summarizes some of the tax planning opportunities that would be available if the Blueprint released on June 24, 2016, by the Republican members of the House Ways and Means Committee or the 2017 Trump Proposal is enacted.

A. Summary of the Blueprint.

The Blueprint would reduce the current seven individual brackets to three: 12%, 25%, and 33%. The maximum rate for capital gains, dividends, and interest under the Blueprint would be 16.5%. The 3.8% Medicare tax on investment income that applies at higher income levels would be repealed.

Under the Blueprint, the corporate tax rate would be reduced to 20%. Active business income of pass-through entities, after payment of reasonable salaries, would be subject to a maximum rate of 25%. Tangible and intangible business assets (other than land) would be expensed when purchased. (The treatment of inventory is uncertain.) Financial assets, including stock of corporate subsidiaries, would remain subject to the income tax. Net interest expense would not be deductible, although net interest expense could be carried forward indefinitely and allowed as a deduction against net interest income in future years.

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1 This article is based on a presentation by the authors for the Corporate Tax Committee at the 2017 May Meeting in Washington, D.C. on May 13, 2017. The slides for the presentation are available on TaxIQ.
3 White House Fact Sheet, 2017 Tax Reform for Economic Growth and American Jobs. We also refer to President Trump’s prior campaign proposal, which was described in various 2016 speeches. See Transcript of Donald Trump’s economic policy speech to Detroit Economic Club, The Hill (Aug. 8, 2016); Donald Trump Speech in Aston, Pennsylvania (Sept. 13, 2016); Read Donald Trump’s Speech on Jobs and the Economy, Time (Sept. 15, 2016).
Net operating losses would not be permitted to be carried back. They could be carried forward indefinitely and would be increased by an interest factor, but could be used to offset only 90% of taxable income in any year.

The Blueprint would move to a territorial tax system. Accumulated foreign earnings, whether or not repatriated, would be subject to a one-time tax of 8.75% to the extent of cash or cash equivalents and otherwise at 3.5%, with the liability payable over eight years. All future foreign earnings, other than foreign personal holding company income (FPHCI), would be exempt from U.S. federal income tax.

The Blueprint proposes a border adjustment feature under which revenues from exports of goods, services, and intangibles would be exempt from inclusion in income, although the related costs of the goods, intangibles, and expenses would be fully deductible (unless subject to disallowance under the rule for the cost of imports). In addition, the cost of goods, services and intangibles imported into the United States would not be deductible or increase tax basis, but the sale proceeds of those goods, services or intangibles would be fully included in income (unless exempt under the rule for proceeds of exports).

B. Summary of the 2017 Trump Proposal.

The 2017 Trump Proposal contemplates three individual brackets: 10%, 25%, and 35%. The tax rates for capital gains and dividends would remain at 20%, but the 3.8% Medicare tax on investment income would be repealed. The 2017 Trump Proposal would reduce the corporate rate to 15%, and would provide for a maximum rate of 15% on income of pass-through entities. It also would move to a territorial tax system, and contemplates a one-time tax on offshore earnings.

II. Tax Planning Arising From Differentials In Tax Rates.

A. A Lower Pass-Through Rate Than Individual Rate.

1. In General.

As mentioned above, both the Blueprint and the 2017 Trump Proposal contemplate a maximum pass-through rate that is significantly lower than the highest individual rate. This disparity would invite pass-through businesses to reclassify their highly paid employees as partners for tax purposes, and to minimize salaries (because salary is taxable at a higher rate than pass-through income). Employees of a C corporation or pass-through entity also could form their own pass-through entity that would be hired by their employer, thereby converting their wage income into pass-through income taxable at the lower maximum rate.
2. Possible Legislative Responses.

Some of these planning techniques could be addressed legislatively. For example, the pass-through rate could be disallowed for specified service businesses, or if services are a material income-producing factor of the entity providing the service.\(^4\) Further, a specified percentage of net income could be deemed to be compensation income and taxable at normal graduated rates.\(^5\) Finally, the pass-through rate could be limited to a normal return on capital and all other earnings would be taxable at graduated rates.

It would not be effective for Congress or the Service to simply require that a pass-through entity pay reasonable compensation to its service providers. This is a factual determination that depends on the facts of each case, and it is impossible for the IRS to audit every case and litigate the reasonableness of compensation on the particular facts of each case. It would also not be effective to deny the pass-through rate for structures designed to avoid the purposes of the lower rate on pass-through income. Anti-abuse rules are also virtually impossible for the Service to enforce, since they rely on case by case determinations. In addition, there would be no basis to enforce such a rule without a clear explanation of the policy rationale for the lower pass-through rate.

B. Lower Corporate Rate than Individual or Pass Through Rate.

The Blueprint contemplates a corporate rate (20%) that is lower than the individual (33%) or pass-through rate (25%). The 2017 Trump Proposal also contemplates a corporate rate (15%) that is significantly lower than the highest marginal individual rate (35%). An incentive would exist under either proposal for pass-through businesses to incorporate and for individuals to hold assets that generate ordinary income and collectibles in C corporations. If the step-up basis at death is retained, undistributed earnings at death would escape shareholder-level tax.

The accumulated earnings tax has not been successful at preventing earnings from being accumulated in C corporations that are taxed at a lower rate than individuals.

III. Expensing.

A. General.

As mentioned above, the Blueprint contemplates expensing for all business assets except financial assets, land, and possibly inventory. As a result, the buyer of most business assets would get an immediate deduction for the full purchase price.
B. Deferral of Tax Liability.

Expensing may allow taxpayers to defer their tax liability indefinitely by buying business assets. When business assets are no longer needed, taxpayers can buy business assets (such as a building) subject to a triple net lease. Deductions generated by the purchases would offset taxable income from other sources.

Taxpayers that can use current deductions will have a greater incentive than today to buy assets; taxpayers that cannot use a current deduction (such as exporters if the border adjustment feature is adopted) will have a greater incentive than today to lease and, if they own property, to sell it (so that their counterparty would receive an immediate deduction) and lease it back. A portion of the benefit of the buyer’s tax deduction would be passed along to the lessee through lower rent. Also, because taxpayers will have a zero basis in an expensed asset, taxpayers wishing to sell will be more inclined to lease the asset on a long-term basis.

C. Inventory.

The Blueprint indicates that the “last in first out” (LIFO) method would be retained for inventory, which suggests that inventory would not be expensed. If inventory is not expensed, the tax law would discourage U.S. businesses from buying inventory and encourage them to buy the equipment to produce inventory. In addition, the costs of raw materials would still have to be capitalized.

D. Earnings and Profits Under Expensing.

If existing earnings and profits rules are not retained (i.e., earnings and profits are computed on a cash-flow basis), a taxpayer could buy a building subject to a net lease, use the deduction to offset earnings, borrow to pay tax-free dividends, and use the rental income to pay off the debt. Likewise, a United States shareholder of a controlled foreign corporation (CFC) could shelter foreign personal holding company income, or a U.S. investor in a passive foreign investment corporation (PFIC) could shelter the income of a qualifying electing fund (QEF) PFIC, when the CFC or PFIC purchased business assets. If earnings and profits rules are retained, the concepts of tax basis and depreciation will also have to be retained to calculate earnings and profits.

E. Purchases From U.S. Exempt Sellers.

Expensing apparently applies even to assets purchased from U.S. tax-exempt sellers. Moreover, capital gain would not normally constitute “unrelated business taxable income” (UBTI) to a tax-exempt seller. As a result, U.S. taxpayers could purchase the dormitories or classroom buildings of an educational institution, claim an immediate deduction, and lease them back on a long-term lease with an option to purchase.

F. Purchases from Foreign Sellers.

Also, absent a border adjustment, expensing would also apply to assets purchased from a non-U.S. seller. Therefore, expensing without a border adjustment would encourage asset purchases from non-U.S. sellers that have tax basis in the assets for foreign tax purposes, or
are resident in a low-tax jurisdiction. The U.S. buyer would claim an immediate deduction. These assets could then be leased back to the seller.

G. Sections 351 and 721.

Section 351 could be used to allow a parent and its subsidiary to choose which of the two is entitled to claim the expensing deduction for assets that would be used by the subsidiary.

If the parent wants the deduction, it would purchase the asset, claim the deduction, and contribute the asset to its subsidiary. Otherwise, the parent would contribute cash to its subsidiary, and the subsidiary would buy the asset and claim the deduction.

Likewise, a partner could either buy assets, claim a deduction, and contribute the assets to the partnership under section 721, or else contribute cash to the partnership that the partnership uses to buy the assets. This choice could result in very different tax effects if the partners were in different tax brackets or if some partners were tax exempt.

H. Effect on Merger and Acquisition Transactions.

The tax incentive to buy assets rather than stock would be increased by an expensing regime. Under current law, a buyer that acquires assets instead of stock is entitled to future tax benefits in the form of the amortization of the step-up in asset basis. Under expensing, an asset purchase would allow immediate deduction of the full purchase price, and the assets would have no basis. On the other hand, a buyer of stock of a corporation that holds assets eligible for expensing would not be entitled to any tax benefits ever.

Sellers of assets would have more taxable gain under expensing than under present law by reason of expensed assets having a zero basis, but the tax could be deferred by reinvesting the proceeds in new business assets.

If a section 338(g) election is made, we presume that the “old target” would recognize gain on its one-day return and the “new target” would have a deduction on its first post-closing return that it could carry forward. On a sale of assets of an entire business or a section 338(g) election, Congress could choose to allow the buyer and seller to make an election to avoid both income and deduction.

I. Selling Stock or Assets of a Consolidated Subsidiary.

Stock basis in consolidated subsidiaries will be zero except for transition basis and basis attributable to the subsidiary’s financial assets and land.

We presume that a section 338(h)(10) election would still be available. The seller of stock of a historic consolidated subsidiary would still generally be indifferent as between a stock and asset sale because stock basis would continue to be the same as asset basis. Therefore, just as today, sales of historic consolidated subsidiaries would generally be asset sales, or stock sales subject to a section 338(h)(10) election.

If a seller has a purchased basis in the stock of a consolidated subsidiary, the excess of stock basis over asset basis will likely be higher than today because of the reduced asset basis at the time of purchase. Even so, there would likely be more asset sales or section 338(h)(10) elections in this situation than today because expensing produces a greater benefit to a buyer than current law amortization, and because sellers will be able to defer their tax by reinvesting in other assets.
J. Other Effects on Consolidated Returns.

Because there would be less basis in the stock of consolidated subsidiaries, there would be less opportunity to extract cash before a spin-off or other tax-free disposition. Second, intercompany gains on sales of business assets would be offset by an immediate deduction for the buying member and therefore would be triggered immediately under regulation section 1.1502-13. Third, the loss duplication rules under regulation section 1.1502-36(d) would be less likely to be relevant because business assets would not have built-in loss although net operating losses (NOLs) could still result in application of the section.

Finally, the anti-son-of-mirror rule in regulation section 1.1502-36(c) would still be needed. For example, assume that a parent buys the stock of target for $100 and target has a single asset with a basis of $0. If target were to sell the asset to a third party for $100, parent’s basis would increase to $200. Under current law, parent’s loss of $100 on a sale of target stock would be inconsistent with General Utilities (GU) repeal because the buyer received a stepped-up basis in the assets. Under expensing, while there would be no step-up in asset basis, the buyer would receive an immediate deduction, which is even more favorable (and would provide even more reason for GU repeal to deny parent’s stock loss).

K. Other Subchapter C Effects.

We would expect more net unrealized built-in gain (NUBIG) and less net unrealized built-in loss (NUBIL) under section 382, more NOLs, and more liabilities in excess of basis under section 357(c). Finally, the rules for allocating earnings and profits would have to be revisited. For example, in a “proper case,” earnings and profits are allocated in a spinoff based on the net basis of assets. It is unclear whether fair market value, or earnings and profits basis, would be required under an expensing regime.

L. Partnership Transactions.

We presume that the purchaser of a partnership interest with a section 754 election would be entitled to deduct the full purchase price allocable to business assets subject to expensing. Thus, section 754 elections would be more important than under current law. Whether or not a section 754 election is in effect, if a partner has basis in its partnership interest, the liquidating distribution of partnership business assets (other than land, financial assets and possibly inventory) would entitle the partner to a deduction for its basis in the partnership interest.

M. Foreign Transactions.

In the absence of a border adjustment, a foreign parent could contribute cash to its U.S. subsidiary, the U.S. subsidiary could buy business assets from the foreign parent and the U.S. subsidiary would receive a deduction. By contrast, if the parent bought the asset and contributed it to the U.S. subsidiary, the parent would have a zero basis for U.S. tax purposes and the U.S. subsidiary would obtain a zero basis in the asset and no deduction. Conversely, a U.S. corporation could buy a business asset and contribute it to a foreign subsidiary in a transaction that is exempt from section 367. The U.S. corporation would claim a deduction which it could not have claimed if it had contributed cash to its foreign subsidiary and the foreign subsidiary had purchased the asset.

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6 Treas. Reg. § 1.312-10(a).
In the absence of territoriality, we presume that expensing would apply to purchases by a foreign branch. However, if territoriality is adopted, we presume that no deductions would be permitted by a foreign branch and no income would be reported on the sale of business (i.e., non-FPHCI-generating) assets by a foreign branch.

Congress could reduce tax planning opportunities by allowing taxpayers to use their losses to offset payroll taxes. Allowing refunds or offsets would, however, increase the costs of expensing, increase fraudulent refund claims, and create the perception of the government providing cash subsidies to multinational corporations.

N. Possible Legislative Responses to the Issues Presented by Expensing.

Congress could moot most of the tax planning opportunities with respect to expensing by providing that losses are refundable allowing taxpayers to use their losses to offset payroll taxes. Allowing refunds or offsets would, however, increase the costs of expensing, increase fraudulent refund claims, and create the perception of the government providing cash subsidies to multinational corporations.

Second, Congress could treat any business assets contributed to a subsidiary under section 351 or as a capital contribution, or to a partnership under section 721, as a deemed sale for cash, followed by a contribution of the cash. Unless such rules were limited to recently purchased assets, however, they would have far-reaching effects on section 351 and section 721 transactions with long-held assets that are routinely treated as tax-free today.

Third, Congress could deny a deduction for any purchase from an exempt or foreign entity if the asset is leased back. If Congress did deny a deduction under these facts, it should provide “basis credit” for the portion of lease payments that are not treated as interest. It might also be possible to avoid these rules by a lease of a similar but different asset.

Finally, if Congress enacts territoriality (so that income of foreign branches is exempt from U.S. tax), then it could treat a foreign branch as a corporation and therefore deny a U.S. deduction for the purchase of an asset by the foreign branch and outbound transfers to the foreign branch.

O. Transition Issues.

Existing tax basis of business assets could be (i) permanently eliminated with no tax basis, (ii) allowed as an immediate deduction, (iii) amortized under existing rules, or (iv) phased out in some other manner. If existing tax basis is amortized under existing rules or otherwise, there would be an incentive for the owner of an asset to sell it in order to create the net result of an immediate deduction for the existing tax basis of the asset. Moreover, absent anti-churning rules, the seller could lease back the old asset. Even if anti-churning rules were adopted, the seller could potentially avoid those rules by buying a similar asset from a third party and obtaining a full deduction.
IV. Denial of Net Interest Deductions.

The Blueprint would deny net interest deductions. Net interest income would be fully taxable.

A. Converting Interest Expense to Non-Interest Expense.

Several strategies exist to avoid the denial of net interest deductions. First, a taxpayer that would have borrowed to buy a building could enter into a “true” lease for tax purposes.

Second, on a bank borrowing, a portion of the interest expense could be relabeled a deductible service fee.

Third, on an installment purchase, the purchase price could be maximized and the interest limited to the applicable federal rate (AFR).

Fourth, a taxpayer could enter into a prepaid forward sale of a financial asset and simultaneously forward purchase the same asset on the same future date. The difference in price would be an interest factor, but the taxpayer would have a capital loss on the forward purchase date.\(^7\)

Fifth, instead of issuing debt, a pass-through entity could issue debt-like partnership interests paying guaranteed payments or providing for allocations of fixed amounts of gross or net income. These allocations would be economically similar to interest, and would give rise to ordinary deductions that would not be treated as interest, or would divert income away from the taxpayer.

B. Methods to Convert Non-Interest Income to Interest Income.

The Blueprint allows interest expense to be deductible to the extent of interest income. This encourages taxpayers to convert non-interest income into interest income. For example, a taxpayer could sell goods to consumers or foreigners at low prices financed with loans at high interest rates. Alternatively, a taxpayer could loan funds in exchange for a note that provides for interest equal to the total return on a specified number of shares of the S&P 500, and hedge its exposure by selling short that number of shares of the S&P 500. If the S&P 500 increases, the note will generate net OID income that will eventually be offset by a capital loss. (If the S&P 500 declines, the taxpayer would have no net OID income and a short-term capital gain.)

C. Avoiding the Denial of Interest Expense By Borrowing Offshore.

If interest expense reduces earnings and profits for CFCs and PFICs, then borrowings by CFCs and PFICs with a QEF election could be used to offset the FPHCI of a CFC, or all of the income of a PFIC that had made a QEF election.

Also, in the absence of border adjustments, a foreign affiliate could borrow to buy an asset and then lease or license it to a U.S. affiliate. The U.S. affiliate would deduct the lease or license payments, which would be used by the affiliate to pay interest and principal on the loan.

Alternatively, if a U.S. corporation has a foreign parent and the foreign parent’s jurisdiction allows interest deductions for debt used abroad (i.e., in the United States), the foreign parent could borrow and contribute

\(^7\) If the taxpayer is permitted to mark-to-market the two positions, which the Modernization of Derivatives Tax Act of 2017, S. 1005 (115th Cong.), introduced on May 2, 2017, would allow, then the taxpayer’s annual net ordinary loss with respect to the two positions would be exactly equal to interest on a loan, but would not be treated as interest.
cash to the U.S. corporation, and the U.S. corporation could buy assets and expense the purchase price to
offset its taxable income. If the treaty between the United States and foreign parent’s country provides for
a zero rate of withholding tax on dividends, the U.S. corporation could pay dividends to its foreign parent
tax-free and, if the dividend is eligible for a participation exemption in the foreign parent’s jurisdiction, the
foreign parent’s interest expense could shelter other income of the foreign parent, with the same result as if
an interest deduction were allowed in the United States.

V. The Border Adjustment.

The Blueprint proposes a border adjustment under which proceeds from an export would be exempt from
tax, but imports would not be deductible. The cost of exports would be fully deductible as today, unless
the cost was a disallowed import expense. As a result, exports would generate expenses, but not taxable
income. Since the Blueprint does not contemplate refunds for losses, exporters will be in perpetual loss
positions. Several tax planning opportunities will be available to them to obtain a tax benefit from these
losses.

First, they could merge with the importers who will be denied deductions or tax basis for their imports and
therefore have relatively high tax bills.

Second, the exporter could buy imported goods directly from abroad and sell the goods to the U.S. importer.
This would result in net income to the exporter and a net deduction to the importer, effectively shifting part
of the exporter’s NOL to the importer.

Third, the importer could buy from the exporter the goods to be exported and export the goods itself, also
effectively shifting the exporter’s NOL to the importer.

Finally, the importer and the exporter could form a “splitter partnership” that both imports and exports,
allowing net export deductions to offset the partnership’s net import income, again with the effect of shifting
the exporter’s NOL to the importer.

U.S. sellers or licensors would tend to maximize the sales price or license fee received from a non-U.S.
affiliate. This would maximize the tax basis or deduction in the foreign jurisdiction, with no U.S. tax effect
because sales proceeds would be exempt.

Conversely, a U.S. purchaser or licensee from a non-U.S. affiliate will minimize the sales price or license fee
paid to its non-U.S. affiliate because the sales price or license fee would not be deductible and license fees
would be FPHCI if the affiliate is a CFC.

U.S. taxpayers would be likely to sell all of their existing non-U.S. intangibles to their non-U.S. affiliates
because this would allow the U.S. taxpayer to receive tax-free proceeds and avoid the possibility of the
future repeal of the border adjustment.

A. Incentives for Inversions.

The border adjustment may also create incentives for inversions. If a U.S. corporation owns intangibles
that relate to foreign sales and a foreign corporation could borrow locally, buy intangibles from the U.S.
corporation if it was a subsidiary, and obtain local amortization and interest deductions, there would be
tax benefits for the foreign corporation to buy the U.S. corporation. The U.S. corporation would develop
intangibles and deduct the costs associated with their development. The foreign parent would borrow to
purchase the intangibles. There would be additional tax benefits at the shareholder level if the foreign parent earns FPHCI and its interest deductions are permitted to reduce its earnings and profits.

**B. Direct Foreign Sales to Consumers.**

If the border adjustment for imported goods is implemented solely by denying importers a deduction, it would be easily avoided by foreign direct sales to U.S. consumers. In fact, a U.S. retailer could organize a foreign affiliate to sell directly to U.S. consumers and avoid the border adjustment.

To prevent these results, tax would need to be imposed on the foreign seller, which raises tax treaty issues if the seller does not have a permanent establishment in the United States, or on the consumer, possibly by requiring the foreign seller to withhold a U.S. excise tax. Imposing a tax on direct sales by foreigners to U.S. consumers would require an army of border agents to check goods sent to U.S. consumers, but border agents could not prevent computer downloads of intangible products and fraud is still possible. U.S. consumers could purchase consumables through U.S. limited liability companies and claim that the consumables are being used for business, or consumers could use property legitimately purchased by businesses for their own personal use. These activities exist to some extent now, but will be much more prevalent if a tax is imposed on consumable goods imported directly by U.S. consumers from foreigners.

The border adjustment presents other tax planning opportunities. Suppose a U.S. hedge fund manager manages funds for offshore investors and receives a carried interest. If the carried interest is restructured as an incentive fee for services provided to a foreigner, under the border adjustment, it would not be subject to tax. Assume instead that a hedge fund manager provides services to a Cayman Island corporation that happens to be owned by U.S. tax-exempt investors. Would the manager be able to treat its fee income as exempt under the theory that it is providing services to a foreign corporation, or would the manager have to look through the Cayman Islands corporation? If the manager is not required to look through the Cayman Islands corporation, would the Cayman Islands corporation be treated as rendering services to the U.S. tax-exempt investors (i.e., an import of services) so that the tax-exempt investors would be subject to an excise or withholding tax?

Similar issues would exist if a U.S. law firm provides services to a multinational group for worldwide corporate planning. Would the U.S. law firm be able to treat its nominal client (which will always be a foreign person) as the client for purposes of applying the border adjustment, or would the bill have to be substantively allocated between export service income and domestic service income? Similarly, if a U.S. law firm advises a foreign parent on the acquisition of a U.S. target, would the characterization of the service as an export depend upon whether the foreign parent makes the acquisition directly and then contributes the target into its U.S. group, or the U.S. subsidiary in the group acquires the target directly?

Likewise, if a U.S. taxpayer buys cloud computing services, is the determination whether the services are a nondonatable import dependent upon the residence of the seller or where the servers are actually located (or some other factor)?

**C. Inbound Related-Party Transactions.**

Suppose a foreign parent contributes inventory to the capital of a U.S. subsidiary. If inventory is not subject to expensing, the foreign parent would have tax basis in the inventory and then, under section 362(a), the U.S. subsidiary would have tax basis in the inventory. This result would be much better than had the foreign parent contributed cash to the U.S. subsidiary and the U.S. subsidiary had purchased the inventory because the purchase of the inventory from the foreign parent would be an import and the U.S. subsidiary
would not get any basis. To achieve symmetry if inventory is not expensed, inventory that is contributed by a non-U.S. parent to a U.S. subsidiary should not have any basis in the hands of the U.S. subsidiary.

**D. Outbound Related-Party Transactions.**

Assume a U.S. parent buys an asset from a U.S. seller and immediately sells it to a foreign subsidiary. The U.S. parent should be able to expense the purchase and exclude the gross proceeds of the sale. This result makes sense because the U.S. seller reported income on the sale.

If the U.S. parent had contributed cash to the foreign subsidiary and it had purchased the asset from the U.S. seller, then the U.S. parent would not have received a deduction. This result also makes sense because the seller would be selling to a foreign person (the foreign subsidiary), and the seller would be able to exclude the export income.

If a U.S. parent contributes the asset to the foreign subsidiary, the contribution should not be taxable because a sale to the foreign subsidiary would not be taxable.

**E. Tax Planning by U.S. Tax Exempts.**

Under the border adjustment feature, the tax exemption of tax-exempt entities is “wasted”. As a result, taxable entities may receive more favorable treatment than tax-exempt entities. For example, instead of selling an asset to a non-U.S. person, a tax-exempt entity would first sell the asset to a U.S. intermediary which would resell to the non-U.S. person. The intermediary would receive a deduction but not report any income and would share its tax benefit by increasing the price it pays for the asset.

Likewise, it would make more sense for a non-UBTI “export” business of a tax-exempt entity to be operated through a taxable subsidiary, in order to obtain a net deduction for the costs. (A tax-exempt operating a non-UBTI business directly today does not obtain a deduction for the costs, since the related income is not taxable.) Assume that a tax-exempt college conducts a “massive open online course” (MOOC) that is offered to foreign students. It would make more sense to operate this business through a taxable subsidiary. The taxable subsidiary would take deductions for creating and operating the MOOC, but the fees and royalties received from the foreign students would be exempt export receipts. The subsidiary would then have losses that could be utilized against other income. For example, the tax-exempt could then contribute to the subsidiary any assets that would otherwise generate UBTI to the tax-exempt.

**F. Earnings and Profits Partnerships, and Consolidated Subsidiaries.**

We assume that exempt export income will increase earnings and profits and nondeductible import expense will reduce it. Under this approach, shareholders would be taxable on dividends arising from export profits.

We also assume that tax basis in a partnership interest, or in stock of a consolidated subsidiary, is reduced by nondeductible import expense and is increased by exempt export income. Otherwise, the loss of deduction for importing and the exemption of export income would be mere matters of timing rather than a permanent penalty or benefit.

**G. States.**

We believe that states will be reluctant to adopt conforming legislation.
H. Transition Issues.

Prior to enactment, there is an incentive for taxpayers to accelerate imports (to obtain tax basis) and defer exports. It is unclear whether pre-enactment payments for post-enactment imports would be deductible or create basis (e.g., a prepaid royalty paid to a non-U.S. person for intangibles used in the United States). It is not clear whether a pre-enactment installment sale of export property would result in tax-free receipt of post-enactment installment payments.

VI. Conclusion.

The Blueprint promises a simpler tax code.8 This will be a broken promise. As we have illustrated, every major aspect of the Blueprint—the significant reduction in the corporate rate, the special pass-through rate, expensing, the denial of net interest deductions, and the border adjustment—would create tax planning opportunities that either do not exist under current law or would be much greater under the Blueprint. These opportunities will inevitably require special statutory or regulatory rules to address them or else will give rise to transactions to exploit them.

8 Blueprint at 6, 15, 16, 26, 30, 31, 32, 34.
PRACTICE POINT

Can I Take a Theft Loss? The Unwitting Individual Taxpayer’s Dilemma

By Rafi W. Mottahedeh, Jenner & Block LLP, Chicago, IL

When most people receive an e-mail from a Nigerian prince who is in need of assistance with his inheritance, they either delete the e-mail without fully reading it or read it, chuckle, and then delete it. Nonetheless, many taxpayers still fall victim to con artists, internet fraud, and a panoply of other schemes. In addition to these unfortunate souls, many sophisticated individuals fall victim to more elaborate frauds or forms of deceit. The Madoff scandal, the Bayou scandal, and many other investment scandals caused profound financial damage to taxpayers one would normally view as sophisticated. What links all of these together is the fact that the taxpayer suffered a real economic loss and is left feeling that they have been robbed.

What adds insult to injury for so many of these taxpayers is that, unlike a business, they cannot simply deduct losses for the events described above. Individuals can only offset their ordinary income with losses that: (i) are incurred in a trade or business; (ii) are incurred in any transaction entered into for profit, though not connected to a trade or business; or (iii) are casualty losses (e.g., theft and fire). These three options are subject to myriad restrictions and caveats. Other types of losses are available, but they are typically capital losses that do little good for most individual taxpayers, such as losses for nonbusiness bad debt and worthless securities.

I. Theft Losses

In most cases, taxpayers want to take a theft loss. Theft loss deductions must satisfy two separate tests. The first is whether there was in fact a theft; and the second is whether the converted property was used in a trade or business, held for investment purposes, or simply owned for personal use.

A. What Constitutes a Theft?

Section 165 does not define what constitutes a theft for federal income tax purposes. The regulations offer a modicum of additional information, stating that “the term ‘theft’ shall be deemed to include, but shall not include:

1 IRC § 165(c)(1).
2 IRC § 165(c)(2).
3 IRC §§ 165(c)(3), 165(h). Certain immaterial exceptions apply, such as being able to take $3000 of capital losses against ordinary income per year.
4 IRC § 166(d). Note that business bad debt is an ordinary loss.
5 IRC § 165(g).
necessarily be limited to, larceny, embezzlement, and robbery." Case law has clarified that the term “theft” is to be “broadly interpreted for the purposes of Section 165,” and that it covers “a broad field of illegality, including...’swindling, false pretenses, and any other form of guile.’”

The Service takes the position that this means the theft must be illegal in the jurisdiction in which it occurred and done with criminal intent. Although criminal intent is a requirement to take a theft loss, a criminal conviction is not. In other words, giving money to a grossly incompetent investment adviser who charges astronomical fees for atrocious advice to grossly mismanage money (and perhaps even charges fees for low quality investment conferences in beautiful beach locales) would not necessarily count as theft, even if a taxpayer felt as though he or she had been “robbed,” because the investment adviser may not have had criminal intent.

Finally, one often overlooked factor is that the theft must be direct. In other words, the taxpayer’s property must have been stolen. The fact that a taxpayer’s property becomes worthless because of a related theft or fraud does not in and of itself generate a theft loss for an individual. Thus, a taxpayer who invests in a corporation whose stock becomes worthless after it is discovered that the CFO is embezzling money will generally be unable to take a theft loss.

**B. When Can an Individual Take a Theft Loss?**

Theft losses are treated as sustained during the year the taxpayer discovers the loss, as opposed to when the loss actually occurs. Further, a theft loss can only be taken when there is no “reasonable prospect of recovery” and when it can be “ascertained with reasonable certainty that no recovery or reimbursement will be received with respect to the stolen property.” There will generally be some recovery for stolen property (from insurance or otherwise), but when the taxpayer has “ascertained with reasonable certainty” that there will be no further recovery, the taxpayer may take his or her loss.

What constitutes a reasonable prospect of recovery is a question of fact. Nonetheless, a good legal adviser must take into account that having a claim for reimbursement may spoil a theft loss claim. Widely experienced losses may lead to special arrangements. Due to the outcry from wealthy individuals following

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6 Treas. Reg. § 1.165-8(d).
11 See, e.g. Riley v. Comm’r, T.C. Memo. 2016-46 (holding that the taxpayer could not take a theft loss because she could not prove an individual whose business she had invested $1.3 million had the intent to defraud her or made false representations, even though the individual bought himself luxury products and absconded); People v. Ashley, 267 P2d 271, 282 (Cal. 1954); Paine v. Comm’r, 63 T.C. 736 (1975); MTS International v. Comm’r, 169 F.3d 1018 (1999).
12 Rev. Rul. 77-17, Treas. Reg. § 1.165-4(a).
14 Treas. Reg. § 1.165-1(d)(2).
15 Treas. Reg. § 1.165-1(d)(2)(i); Adkins v. US, 117 AFTR 2d 2016-779 (Cr Fed Cl 2016) (holding that although taxpayers had clearly suffered a theft loss, their failure to abandon their claim for reimbursement that had been inactive for a number of years was fatal to their claim that there was no reasonable prospect of recovery), rev’d 856 F.3d 914 (Fed. Cir. 2017) (holding that Treas. Reg. § 1.165-1(d)(2)(i) sets forth a general totality-of-the-circumstances test, that the abandonment of a claim for reimbursement is one potential test for determining the year of loss, and that an outstanding claim for reimbursement is not fatal to the claim that there is no reasonable prospect of recovery).
the widespread investment fraud that swept the country during the Great Recession, Treasury and the Service provided a truncated procedure for determining when certain investment losses could be taken.\textsuperscript{16}

**C. How Much of a Theft Loss Can an Individual Take?**

An individual taxpayer is only allowed to deduct any specific theft loss to the extent the loss exceeds $100.\textsuperscript{17} Additionally, an individual taxpayer is only allowed to deduct theft losses sustained during a given taxable year to the extent all such losses exceed 10\% of the individual’s adjusted gross income.\textsuperscript{18} Importantly, these limitations on casualty losses only apply to casualty losses that are \textit{not} incurred in a trade or business or a transaction entered into for profit.\textsuperscript{19} Thus, a taxpayer whose broker turns out to be a fraud who absconded with cash and never purchased securities will be able to deduct the full amount of the loss against ordinary income, provided the other rules for theft losses are met.

**II. Where Does This Leave Us?**

Sadly, all of this means that elderly victims of internet scams who wired money to what they presumed was the Service will often not be able to make full use of their losses.

The situation is even worse for those who lend money. Unlike theft losses, bad debt losses are only ordinary if they are tied to a trade or business.\textsuperscript{20} Otherwise, bad debt losses are capital losses, even if the loan was entered into to make money. All too often taxpayers document their ill-advised or foolish investments as loans. When an individual makes a loan to a business, and the business is incompetently run by wasteful individuals who take investor money and pay themselves generous salaries, the taxpayer will have a herculean task of proving theft. Without being able to prove theft, they are left with an often worthless capital loss.

A careful and conscientious tax counselor should make the strongest case possible for a loss that benefits a taxpayer, especially given the disparate and perhaps even unfair treatment of individuals who have suffered the same economic loss. ■

\begin{itemize}
\item \textsuperscript{16} Rev. Proc. 2009-20.
\item \textsuperscript{17} IRC § 165(h)(1).
\item \textsuperscript{18} IRC § 165(h)(2).
\item \textsuperscript{19} Rev. Rul. 2009-9. Prior to Rev. Rul. 2009-9, there was considerable confusion as to what was the appropriate manner in which to handle theft or other casualty losses related to transactions entered into for profit and whether a taxpayer could deduct the loss under a provision other than section 165(c)(3).
\item \textsuperscript{20} IRC § 166(a), 166(d)(1).
\end{itemize}
PRACTICE POINT

State Corporate Income Tax Rules for Sourcing of Revenue for Law Firms


Historically, law firms subject to state corporate income taxes generally sourced receipts from sales of legal services by using a cost-of-performance method. Law firms with a taxable presence in multiple states may be impacted, however, by the growing trend of sourcing service revenue using the market-based sourcing method.

Due to the difference in treatment between the two revenue sourcing methods, the following common questions arise:

- How should a law firm doing business in multiple jurisdictions source its revenue for compliance purposes when some of the jurisdictions in which it operates use the cost of performance approach and others use the market-based sourcing approach?
- If legal services are provided in one state for a client in another state, where should the revenue from such services be sourced?
- If legal services are provided in one state for a client in another state relating to an issue which occurred in a third state, where should the revenue from such services be sourced?
- Are the sourcing rules for individual clients different from the rules for business clients?

Some of the answers are found in the market-based sourcing laws and regulations recently enacted in several states. Nonetheless, lack of uniformity in these laws and regulations significantly increases the complexity and potential pitfalls for practitioners. Misunderstanding of laws and regulations may cause an improper collection of data necessary for compliance resulting in an incorrect calculation of the apportionment formula’s sales factor and state income tax liability.
This article considers law firms subject to corporate income tax, as opposed to firms treated as flow-through entities or otherwise not subject to state corporate income tax; however, such firms may face similar issues when addressing the sourcing of their receipts. For instance, while a law firm organized as a partnership may be subject to varying sourcing rules by state, it would still need to determine the market-based sourcing for any cost of performance states to the extent the law firm partnership has any corporate partners (i.e., Professional Corporations). That creates an additional level of compliance complexity.

The Cost of Performance Method

The cost of performance method generally looks to where the costs associated with the performance of the service occurred. Receipts are sourced either to the location where the greatest of those costs occurred compared to all other locations, or on a proportionate basis to each location where costs were incurred while providing services to the client.

Under the greater cost of performance method, receipts are generally sourced based on an “all or nothing” approach to the state with the greatest amount of these costs. For instance, where a multistate taxpayer performs services in three states and incurs costs at a ratio of 34/33/33 per state, all of the receipts should be sourced to the state where 34 percent of the costs were incurred. Under this example, no receipts would be sourced to either of the states where 33 percent of the costs were incurred, assuming of course that all three states imposed the same rule in regard to the sourcing of receipts. Conversely, the pro rata method sources the receipts on a proportionate basis in line with the costs incurred in each state. Under this approach, based on the example above, each of the three states where costs were incurred in the performance of services would have a portion of the receipts sourced to them.

The process for sourcing revenue under the cost of performance method involves identifying each income-producing activity and then allocating the cost to each such activity. For law firms, the income-producing activity could be an individual client, case, project, or similar category. Additionally, some states (e.g., Colorado) have professional services sourcing in their cost of performance rules that could pull in a law firm where the sourcing would be based on individual hours in each state.

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1 Note that some states (e.g., California) refer to their corporate income taxes as a "franchise tax." For the purposes of this article, franchise taxes are referred to as income taxes.
2 Law firms not taxed as corporations generally encounter personal income tax sourcing issues which are outside the scope of this article.
3 See generally UDITPA Sec. 17.
4 Giles Sutton, Jamie C. Yesnowitz, Chuck Jones, & Shaya Rubenstein, California’s Market-Based Sourcing Reg: Fairness or Muddying the Waters?, 65 State Tax Notes 709 (Sept. 10, 2012).
Under current law, approximately 20 states use some form of the cost of performance approach for sourcing receipts from sale of services.6

The Market-Based Sourcing Method

The market-based sourcing method assigns the receipts from sales of services to the location of a service provider’s customers or the destination where its customers receive the benefits of the service. This method attempts to identify the jurisdictions where the taxpayer has a market for services and where the users of the services are located.

Currently, approximately 26 states use the market-based sourcing approach for the sourcing of service receipts.7 At least 10 of those jurisdictions—Connecticut, the District of Columbia, Louisiana, Massachusetts, North Carolina, Nebraska, New York, Pennsylvania, Rhode Island, and Tennessee—have adopted the market-based sourcing approach since 2010. In recent years several states have provided specific guidance for sourcing of receipts generated through legal services which are further discussed here.

California

California has provided detailed market-based sourcing regulations and introduced hierarchy rules for determining where the receipt from services should be sourced based on the information available to the taxpayer. In general, California requires that receipts from the sale of services be sourced to California “to the extent the purchaser of the service received the benefit of the services in [California].”9 To identify where

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8 North Carolina has been moving towards using market-based sourcing rules since 2015. The regulations, however, “will not be entered into North Carolina’s administrative code unless and until the legislature enacts statutory market-based sourcing changes.” See Amy Hamilton, North Carolina Rules Review Commission Approves Market-Based Sourcing Regulations, 2017 STATE TAX NOTES 33-2 (Feb. 21, 2017).

9 Cal. Rev. & Tax. Cd. § 25136(1).
the benefit of the services is received, California differentiates in its law firm sourcing rules between receipts from individual clients and receipts from business entities.¹⁰

Specifically, when a law firm's client is an individual with a California billing address the benefit is presumed to be received in California.¹¹ The presumption may be overcome if, by a preponderance of evidence, the law firm proves that its contract with the client, or the law firm's books and records kept in the regular course of business, provide a location where the benefit is received.¹²

When a law firm's client is a corporation or other business entity, however, the benefit is presumed to be received at the location indicated in a contract between the law firm and the client, or on the law firm's books and records.¹³ This presumption may be rebutted by proving that the benefit of the service was received at a location other than the location identified in the contract or on the books and records.¹⁴ If the contract or the books and records do not identify the location where the benefit of the service is received, or if the presumption is rebutted, then the location where the benefit of the service was received should be reasonably approximated.¹⁵ If the location cannot be determined or reasonably approximated, it is presumed that such location is where the client ordered the service.¹⁶ If the location still cannot be determined under these rules, the benefit of the service is generally sourced to the client's billing address.¹⁷

California market-based sourcing regulations provide the following example regarding sourcing of receipts for law firms:

Law Corp located in State C has a Client Corp that has manufacturing plants in this state and State B. Law Corp handles a major litigation matter for Client Corp concerning a manufacturing plant owned by its client in this state. All gross receipts from Law Corp's services related to the litigation are attributable to this state because Law Corp's books and records kept in the normal course of business indicate that the services relate to Client Corp's operations in this state.¹⁸

California regulations include another example for a corporation that provides consulting and tax services. This example permits the receipts to be bifurcated based on where the employees physically performed the services. It is our understanding that some law firms may source their receipts based on this example:

Audit Corp is located in this state and provides accounting, attest, consulting, and tax services for Client Corp. The contract between Audit Corp and Client Corp provides that Audit Corp is to audit Client Corp for taxable year ended 20XX. Client Corp's books and records kept in the normal course of business, as well as Client Corp's internal controls and assets, are located in States A, B and this state. As a result, Audit Corp's staff will perform the audit activities in States A, B and this state. Audit Corp's business books and records track hours worked by location where its employees performed their service. Audit Corp's receipts are attributable to

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this state and States A and B according to the taxpayer’s books and records which indicate
time spent in each state by each staff member.19

Massachusetts, North Carolina, Rhode Island, and Tennessee

The language of the market-based sourcing regulations in Massachusetts, North Carolina, Rhode Island, and Tennessee closely resembles the Multistate Tax Commission model regulations designed to promote uniformity among states. Regulations in these states define legal services as “professional services” that require specialized knowledge, professional certification, license, or a degree,20 and may include transmission of documents and other communication by mail or email.21 Similar to the California regulations, Massachusetts, North Carolina, Rhode Island, and Tennessee differentiate sourcing rules for services delivered to an individual versus to a business customer.22 A customer is the person who contracts for services regardless of whether someone else pays for or benefits from the services.23 A business customer is “a business operating in any form” including a sole proprietorship and an “individual customer” is “any customer that is not a business customer.”24 If in good faith it cannot be reasonably determined whether the customer is an individual or business, the customer is considered to be a business customer.25

When a legal service is provided to an individual customer, the sale is assigned to the “customer’s state of primary residence.”26 If this information is unavailable or cannot be determined, Massachusetts, North Carolina, Rhode Island, and Tennessee require the taxpayer to reasonably approximate the location and source the sale to the state of the customer’s billing address,27 which is the location indicated “in the books and records of the taxpayer as the primary mailing address relating to a customer’s account as of the time of the transaction as kept in good faith in the [normal / regular] course of business and not for tax avoidance purposes.”28 If a law firm derives more than 5 percent of its sales from this individual customer, however, it “is required to identify the customer’s state of primary residence and must assign the receipts from the service or services provided to that customer to that state.”29

The Massachusetts, Rhode Island, and Tennessee regulations provide the following example with respect to legal services provided to individual customers:

21 830 CMR 63.38.1(9)(d)(4)(d)(i); 17 NCAC 05G .1002(c); R.I. Reg. CT 15-04(8)(i)(8)(B)(iii)(a); Tenn. Comp. R. & Regs. 1320-
06-01-.42(4)(d)(2)(ii).
22 830 CMR 63.38.1(9)(d)(4)(d)(iii); 17 NCAC 05G .0801, -.1000; R.I. Reg. CT 15-04(8)(i)(8)(B)(ii)(b); Tenn. Comp. R. & Regs.,
1320-06-01-.42(4)(d)(3).
23 830 CMR 63.38.1(9)(d)(4)(d)(iii); 17 NCAC 05G .1003; R.I. Reg. CT 15-04(8)(i)(8)(B)(ii)(b); Tenn. Comp. R. & Regs. 1320-
06-01-.42(4)(d)(3).
24 830 CMR 63.38.1(9)(d)(1)(c); 17 NCAC 05G .0102(2), -.6; R.I. Reg. CT 15-04(5); Tenn. Comp. R. & Regs. 1320-06-
01-.42(4)(d)(3).
25 830 CMR 63.38.1(9)(d)(4)(d)(iii); 17 NCAC 05G .0103; R.I. Reg. CT 15-04(8)(i)(8)(B)(ii)(b); Tenn. Comp. R. & Regs. 1320-06-
01-.42(4)(d)(3).
28 830 CMR 63.38.1(9)(d)(1)(c); 17 NCAC 05G .1004(1); R.I. Reg. CT 15-04(5); Tenn. Comp. R. & Regs. 1320-06-01-.42(1)(c).
[Example 1.] Law Corp provides legal services to individual clients who are resident in [this state] and in other states. In some cases, Law Corp may prepare one or more legal documents for its client as a result of these services and/or the legal work may be related to litigation or a legal matter that is ongoing in a state other than where the client is resident. Assume that Law Corp knows the state of primary residence for many of its clients, and where it does not know this state of primary residence, it knows the client’s billing address. Also assume that Law Corp does not derive more than 5% of its sales of services from any one individual client. Where Law Corp knows its client’s state of primary residence, it shall assign the sale to that state. Where Law Corp does not know its client’s state of primary residence, but rather knows the client’s billing address, it shall assign the sale to that state. For purposes of the analysis it is irrelevant whether the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or the litigation or other legal matter that is the underlying predicate for the services is in another state.\(^{30}\)

With respect to a business customer, a law firm is required to assign the receipts “to the state where the contract of sale is principally managed by the customer.”\(^{31}\) If the place of customer management is not reasonably determinable under the rules of reasonable approximation, then the receipts are assigned to the “customer’s place of order” or “if such customer place of order is not reasonably determinable, to the customer’s billing address.”\(^{32}\) If a law firm derives more than 5 percent of its sales from a customer, however, the law firm “is required to identify the state in which the contract of sale is principally managed by the customer.”\(^{33}\)

The Massachusetts, Rhode Island, and Tennessee regulations provide the following two examples with respect to legal services provided to business customers:

[Example 2.] Law Corp provides legal services to several multistate business clients. In each case, Law Corp knows the state in which the agreement for legal services that governs the client relationship is principally managed by the client. In one case, the agreement is principally managed in [this state]; in the other cases, the agreement is principally managed in a state other than [in this state]. Where the agreement for legal services is principally managed by the client in [in this state] the sale of the services shall be assigned to [this state]; in the other cases, the sale is not assigned to [this state]. In the case of the sale that is assigned to [this state], the sale shall be so assigned even if (1) the legal documents relating to the service are mailed or otherwise delivered to a location in another state, or (2) the litigation or other legal matter that is the underlying predicate for the services is in another state.\(^{34}\)

\(^{30}\) 830 CMR 63.38.1(9)(d)(4)(d)(iv); R.I. Reg. CT 15-04(8)(i)(8)(B)(IV); Tenn. Comp. R. & Regs. 1320-06-01-.42(4)(d)(3)(ii). North Carolina’s proposed regulations provided the same example, but it was removed from the final version approved by North Carolina’s Rules Review Commission. See 17 NCAC 05G .1006 – Examples (proposed regulation 10/03/2016). The new provision in the North Carolina regulations, however, requires the North Carolina Department of Revenue to publish examples of application of these rules on its website. See 17 NCAC 05G .0601.


Massachusetts, North Carolina, Rhode Island, and Tennessee provide for a “safe harbor” rule which permits assignment of sale to a particular customer to be based on the customer’s billing address. To qualify for the safe harbor, a law firm must engage “in substantially similar service transactions with more than 250 customers, whether individual or business,” and not originate more than 5 percent of its sales of services from the particular customer.35

Despite similar regulatory language and the Multistate Tax Commission's uniformity efforts, Massachusetts, Rhode Island, and Tennessee have enacted their own unique provisions. For instance, in Massachusetts if a law firm is not subject to tax in the state to which the sale is sourced, the sale is excluded from the numerator and denominator of the law firm’s sales factor.36 This throwout provision impacts taxpayers by requiring extensive collection of the market-based sourcing data from all jurisdictions in order to conduct an analysis to determine which revenue may be excluded from the numerator and denominator of the sales factor. Excluding revenue from the sales apportionment factor can have a dramatic effect on the overall tax liability for a company.

Following up on two examples above and footnotes 30 and 34, Massachusetts provides two additional examples regarding this provision:

Same facts as in [Example 1 above], except that Law Corp provides legal services to several individual clients who it knows have a primary residence in a state where Law Corp is not taxable. Receipts from these services shall be excluded from the numerator and denominator of Law Corp’s sales factor even if the billing address of one or more of these clients is in a state in which Law Corp is taxable, including Massachusetts.

Same facts as in [Example 2 above], except that Law Corp is not taxable in one of the states other than Massachusetts in which Law Corp’s agreement for legal services that governs the client relationship is principally managed by the business client. Receipts from these latter services shall be excluded from the numerator and denominator of Law Corp’s sales factor.37

Rhode Island provides for a more explicit definition of what is included in the professional legal services. Specifically, Rhode Island states that “receipts for the sale of professional services involving the initiation, defense or maintenance of a judicial or administrative proceeding within this state shall be assigned to this state.”38

37 830 CMR 63.38.1(9)(d)(4)(d)(iv).
Tennessee provides for an annual election to apply a cost of performance sourcing methodology if the application of market-based sourcing “results in a lower apportionment factor than” the cost of performance.\(^{39}\) To be eligible, “the election must result in a higher apportionment factor for the tax year” and “the taxpayer must have net earnings, rather than a net loss, for that tax year.”\(^{40}\) A law firm may use this election to retain its cost of performance calculation for reasons of administrative ease, among others.

**New York**

Receipts from legal services are sourced to New York if the benefit is received in New York.\(^{41}\) This sourcing is completed pursuant to a hierarchy method if it is unknown whether the benefit from the legal services is received in New York. Specifically, if the location where the benefit was received is unknown, then the receipts are sourced to the delivery destination.\(^{42}\) If the destination is unknown, the apportionment fraction for service receipts within New York may be determined by using the prior year’s apportionment factor.\(^{43}\) If none of the above is known, the receipts may be sourced using the apportionment fraction in the current taxable year for the receipts from the services that can be sourced, using the location where the benefit was received and the services delivery destination.\(^{44}\)

New York proposed regulations provide one example, factually similar to an example provided by the California regulations, pertaining to sourcing of receipts for law firms:

Law Corp, located in State C, is hired by Client Corp to handle a major litigation matter concerning the sale of its manufacturing plant located in New York. Client Corp has manufacturing plants in New York State and State B. The trial takes place in State C, which is the location of the opposing party in the lawsuit. Because Law Corp’s entire service is related to the manufacturing plant, which is real property, the benefit is received by Client Corp at the location of the manufacturing plant in New York State.\(^{45}\)

**Washington - Business & Occupation Tax**

The Washington Business and Occupation tax is not an income-based tax and is generally imposed on the value of products, gross proceeds of sales and gross income of business.\(^{46}\) While most of this article concentrates on corporate income tax aspects of market-based sourcing, Washington provides an example of how a state with a different taxing regime (i.e., where the tax is based on gross proceeds) may approach sourcing of revenue from law firms centered on market-based sourcing concepts.

Washington sources receipts “based on a cascading method or series of steps.”\(^{47}\) As a general rule, Washington requires a receipt from services to be sourced to the state in which the benefit is received.\(^{48}\) In circumstances when a customer receives services in Washington and other states, an amount for a portion

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42. N.Y. Tax Law § 210-A (10)(b)(2); N.Y. Comp. Codes R. & Regs. tit. 20, § 4-4.6(d) (draft of 10/15/15).
43. N.Y. Tax Law § 210-A (10)(b)(3); N.Y. Comp. Codes R. & Regs. tit. 20, § 4-4.6(e) (draft of 10/15/15).
44. N.Y. Tax Law § 210-A (10)(b); N.Y. Comp. Codes R. & Regs. tit. 20, § 4-4.6(f) (draft of 10/15/15).
of services received in Washington must be attributed to Washington. This may be accomplished by use of “a reasonable method of proportionally attributing the benefit among states.” If it cannot be determined which receipts from services should be attributed to specific states, the receipt is attributed to the state in which the benefit of the service was primarily (more than 50 percent) received.

If the receipts cannot be sourced under the general rule, the receipts must be sourced in the following order:

- To the state from which the customer ordered the service;
- To the state to which the billing statements or invoices are sent to the customer by the taxpayer;
- To the state from which the customer sends payment to the taxpayer;
- To the state where the customer is located as indicated by the customer’s address shown on the taxpayer’s business records maintained in the regular course of business, or obtained during consummation of the sale or the negotiation of the contract, including any address of a customer’s payment instrument when readily available to the taxpayer and no other address is available; or
- To the commercial domicile of the taxpayer.

To illustrate the application of its market-based sourcing rule relating to the sourcing of receipts from legal services, Washington provides the following two examples:

[Example 1]: Assume Law Firm has thousands of charges to clients. It is not commercially reasonable for Law Firm to track each charge to each client to determine where the benefit related to each service is received. Assume the scope of Law Firm’s practice is such that it is reasonable to assume that the benefits of Law Firm’s services are received at the location of the customer as reflected by the customer’s billing address. Under these circumstances, Law Firm can use the billing addresses of each client as a reasonable method of proportionally attributing the benefit of its services.

[Example 2]: Same facts as Example [1] except, Law Firm has a single client that represents a statistically significant portion of its revenue and whose billing address is unrelated to any of the services provided. In this case, using the billing address of this client would not relate to the benefit of the services. Using the billing address for this client to determine where the benefit is received would significantly distort the apportionment of Law Firm’s receipts. Therefore, Law Firm would need to evaluate the specific services provided to that client to determine where the benefits of those services are received and may use billing address to attribute the income received from other clients.

Nonconformity in the state sourcing rules breeds complexity, compliance burdens, and potential pitfalls for taxpayers. As a result of nonconformity among state income tax sourcing laws and regulations, multistate law firms may need to create and run separate sourcing analyses under variations of the cost of performance and market-based sourcing methods, and assign the receipts from their legal services accordingly.

Conclusion

Due to the states’ continuing move towards market-based sourcing, law firms should pay more attention to the location at which they perform legal services, how such services are delivered to their clients, how their services are invoiced and documented, where their clients may be located, and where their legal services may be used.

Historically, non-filers may have been identified through court docket searches, filing fees for pro hac vice appearances, contracts, press-releases, registrations for personal income tax withholding and other means. Today, with the trend to source law firm revenue under the market-based method, additional filing implications could be created, especially in states with factor presence nexus standards (e.g., Alabama, California, Colorado, Connecticut, and Michigan).

Nonconformity in the state sourcing rules breeds complexity, compliance burdens, and potential pitfalls for taxpayers. As a result of nonconformity among state income tax sourcing laws and regulations, multistate law firms may need to create and run separate sourcing analyses under variations of the cost of performance and market-based sourcing methods, and assign the receipts from their legal services accordingly. For instance, in California, Massachusetts, North Carolina, Rhode Island and Tennessee, law firms should track whether the services are provided to individual or business clients, and apply a specific set of cascading rules to each group of clients. Among these states, additional attention should be given to unique provisions such as Massachusetts' throw out rule, Rhode Island's sourcing rule regarding judicial or administrative proceedings, and Tennessee's cost of performance election. In New York and Washington if the location of the benefit of the service is unknown, specific state hierarchy methods should be followed.

It is important to note that even though one state determines that a receipt is properly sourced to it under a market-based sourcing approach, another state is not precluded from claiming the same receipt under its cost of performance or its own market rules. Consequently, depending upon the facts and the particular states involved, it is entirely possible for a receipt to be counted twice or not at all. Further, because market-based sourcing rules are relatively new, there is some uncertainty as to the interpretation and application of these complex rules.

Safe harbor rules, which may permit a taxpayer to source receipts from services to the client’s billing address, may simplify some of the compliance burden. At this time, however, only a limited number of states have a safe harbor rule, and it may apply only to law firms that engage in substantially similar service transactions with more than a specific number of clients. Further, reliance on the safe harbor may require additional attention to be paid to the client’s billing address. Questions may arise if the client’s billing address is associated with its accounts receivable address located in a state different from the one where the services were received.
Examples provided by the states referenced in this article answer some of the questions about application of the sourcing rules. The examples, however, may not consider all potential fact patterns and additional guidance may be needed. Accordingly, multistate corporate law firms will likely experience additional internal administrative compliance burdens as they will need to account for each state-specific rule, including its unique provisions, and track the data essential for accurate compliance.

Multistate law firms will need to consider the impact of the shift towards market-based sourcing and establish appropriate processes to track the various sourcing rules described in this article. Specifically, law firms should tailor processes and technology into their matter intake process so that they can capture the relevant information upfront. A good starting point for facilitating an automated market-based sourcing data analysis is building into a firm’s electronic intake process questions that identify data points such as client addresses for each matter’s billing, engagement letter, client headquarters, and the buyer responsible for supervising the matter, as well as questions that elicit information about the matter’s location such as where litigation is filed, where services will be performed, and the situs of the property or matter that is the subject of the legal services. This intake implementation, among other items described in this article, should automate data mining and analytics of market-based sourcing issues with actual data captured up front, and should help to support the return position if the state audits it in the future.
A petition was recently filed in U.S. Tax Court by Kings River Commodities, LLC (Kings River)1 challenging the denial of deductions related to insurance premiums, among other items. The premiums were paid to an insurance company that made an election to be taxed on its investment income (as opposed to all of its taxable income) under Section 831(b) (referred to as a “micro-captive” by the Service in its discussion of 2017 abusive tax shelters).2 According to the Petition, Kings River is a non-traditional feed supply company that sells poultry and dairy cattle feed. The feed is non-traditional because Kings River “acquires excess products such as nuts, crackers, cookies, fruit, and yogurt from businesses and then reprocesses that product into feed.” The use of a micro-captive is implicated in the Petition, which provides that Congress “encourages the use of small captive insurance companies through Section 831(b).”3

The Petition briefly addresses its claim that JCH Insurance Company (the Captive) met the basic requirements of an insurance company (such requirements having been established over decades of case law) but also raises some issues specific to micro-captives.

The basic requirements, which apply to all captives seeking insurance treatment for Federal tax purposes, were recited in the Securitas Holdings Tax Court case:

Neither the Code nor the regulations define “insurance”. However, the Supreme Court has stated that “[h]istorically and commonly insurance involves risk-shifting and risk-distributing.” Over time, courts have looked primarily to four criteria in deciding whether an arrangement constitutes insurance for Federal income tax purposes: (1) the arrangement must involve insurable risks; (2) the arrangement must shift the risk of loss to the insurer; (3) the insurer must distribute the risks among its policyholders; and (4) the arrangement must be insurance in the commonly accepted sense. Although these criteria are not independent or exclusive, they establish a framework for determining whether insurance exists under the Federal tax law.4

The Petition provides that risk-shifting occurred as a result of the use of policies that were legally enforceable, memorialized in writing, reflected an exchange of consideration, and created an obligation on the part of

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1 Petition in Kings River Commodities, LLC, John C. Hurst, Ill, Tax Matters Partner, Docket No. 010448-17 (available on BNA).
3 Petition, supra n. 1, at 10.
the Captive to indemnify the insured against specified loss up to limits stated in the contract. It states that risk was distributed through the use of an insurance pool; however, no more information regarding the mechanics of the pool is provided. Insurance in the commonly accepted sense was addressed, as the Captive is a duly licensed insurance company in the State of Delaware and has met all required capital, reserve, and other regulatory requirements imposed by the State of Delaware. No information regarding the actual terms of the policies was provided (nor would that be required in the Petition). However, one could speculate as to the policies written based on the Petition’s reference to rescuing the insured in the event of “overwhelming catastrophe or business interruption.”

The Petition sets forth several non-tax motivated and “unique business benefits” as reasons for using the Captive, including asset protection (referring to the availability of an “asset-protected reserve to rescue the insured in the event of an overwhelming catastrophe or business interruption”), obtaining “new types of coverage such as cyber coverage”, “greater control over the processing of claims and minimize[ing] unproductive disputes”, and the suggestion that the opportunity to obtain insurance through a captive is “more responsive to…customers.” Explaining how the Captive fits into Kings River’s existing risk mitigation program, the Petition notes that the Captive’s policies “provided insurance coverage to Kings River for both uninsured risks and risks that were underinsured due to the exclusions and coverage limits of its commercially purchased policies.”

The Petition also makes several public policy arguments that are somewhat intertwined with the economic substance argument, at least as far as establishing congressional intent goes. For instance, the Petition provides that over 90 percent of Fortune 500 companies use captive insurance companies as part of their risk management programs, and Congress encourages the use of small captive insurance companies through Section 831(b). One of the key points that could carry over into the economic substance argument is that Congress “reaffirmed [the encouragement of Section 831(b) captives] by raising the cap on insurance premiums subject only to net investment tax from $1.2 million to $2.2 million as part of the [PATH Act].”

The Petition addresses a few points that are somewhat specific to 831(b) captives, primarily dealing with whether the Captive should be respected under an economic substance argument. Under an economic substance argument, the Service may argue that the disputed tax benefits are not what Congress intended in establishing an election to exclude underwriting income from the gross income of an insurance company. This argument necessarily stems from the use of what the Service labels as “illusory” coverages that result

5 Presumably, the risk pool allows the Captive to write a sufficient amount of third-party business. See id. at 25 (“The insurer achieves risk distribution when it pools a large enough collection of unrelated risks, those that are not generally affected by the same circumstance or event. ‘Distributing risk allows the insurer to reduce the possibility that a single costly claim will exceed the amount taken in as a premium * * *. [because] [b]y assuming numerous relatively small, independent risks that occur randomly over time, the insurer smooths out losses to match more closely its receipt of premiums.’”). See also Rev. Rul. 2002-89 (concluding that a wholly owned domestic captive with more than 50% of its premiums and liability coverage from other entities amounted to “insurance in the commonly accepted sense”); Harper Grp. & Includible Subsidiaries v. Commissioner, 96 T.C. 45, 59–60 (1991) (finding sufficient risk distribution when “the relatively large number of unrelated insureds comprise approximately 30 percent of [the captive’s] business”), aff’d sub nom. Harper Grp. v. Commissioner, 979 F.2d 1341 (9th Cir. 1992).

6 See Securities Holdings, supra n. 4, at 27 (noting that the Court considers “whether: (1) the insurer was organized, operated, and regulated as an insurance company; (2) the insurer was adequately capitalized; (3) the insurance policies were valid and binding; (4) the premiums were reasonable; and (5) the premiums were paid and the losses were satisfied”).

7 See I.R.S. P.L.R. 201609008 (Feb. 26, 2016) for recent Service analysis dealing with various forms of business interruption and cyber risk coverage.

8 See Knetsch v. United States, 364 U.S. 361, 367 (1960) (“The petitioners contend, however, that the Congress in enacting s 264 of the 1954 Code, 26 U.S.C.A. s 264, authorized the deductions.”). A full discussion of Section 7701(o)’s economic substance provision, as applicable to transactions entered into after March 30, 2010, is beyond the scope of this case summary.
in no claims, resulting, at least in some cases, in the passage of wealth through a captive without the payment of transfer taxes.

Whether a micro-captive transaction lacks economic substance is always a matter of interpretation based on facts and circumstances. From the Service’s perspective, the abuse necessarily stems from the use of overpriced and unnecessary policies between related parties involving the payment of premiums that provide an income tax deduction to the insured and exclusion from the captive’s income. Further, since the policies chosen do not result in claims, an opportunity exists that permits wealth to be transferred (via dividend or liquidation) to third parties free of transfer tax. While parked in the captive, the wealth can be utilized for various purposes, such as loans to family members or other financing transactions with ancillary benefits, all of which were highlighted in Notice 2016-66. Simply put, the estate planning (via dividend or liquidation) to third parties free of transfer tax.

Whether a micro-captive transaction lacks economic substance is always a matter of interpretation based on facts and circumstances. From the Service’s perspective, the abuse necessarily stems from the use of overpriced and unnecessary policies between related parties involving the payment of premiums that provide an income tax deduction to the insured and exclusion from the captive’s income.

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9 The Service has challenged transfers involving related parties in various other contexts, such as the reallocation of income using standards of comparability. See Auditor v. United States, 428 F.2d 251, 256–57 (5th Cir. 1970) (stating that satisfying the arms’ length standard will not save a deduction when the sole purpose for a payment is to camouflage an assignment of income); compare B. Forman Co. v. Commissioner, 453 F.2d 1144, 1151 (2d Cir. 1972) (noting that transactions between controlled parties are subject to special scrutiny regarding tax avoidance) with Simon J. Murphy Co. v. Commissioner, 231 F.2d 639, 644 (6th Cir. 1956) (noting that the IRS cannot reallocate income among controlled organizations without justification, create income, disallow a deduction authorized by another provision, require consolidation of the incomes of separate controlled organizations, or reallocate items satisfying arms’ length standards).

10 Such parties could include a non-citizen spouse.

11 See Notice 2016-66.

12 The payment of claims would also deplete the funds available for use in financing transactions targeted in Notice 2016-66. Focusing on overpriced policies would be only a temporary fix, since a captive could substitute 30 conservatively priced policies for 5 overpriced policies to achieve the same result. The lack of claims could be viewed as not shifting risk, in addition to resulting in the arrangement not being considered insurance in the commonly accepted sense. See Steere Tank Lines, Inc. v. United States, 577 F.2d 279, 283 (5th Cir. 1978) (stating that the agreement at issue did not appear to be a legitimate insurance arrangement but rather a “clever estate planning device”).

13 See United States v. Owensboro Dermatology Associates., P.S.C., No. CV 4:16-MC-00003-JHM, 2017 WL 2926026, at *2 (W.D. Ky. July 7, 2017) (“...the purported insurance and/or reinsurance transactions lack economic substance, the substance of the transactions do not comport with their form, the various steps involved in the transactions were engaged in for no purpose other than to avoid or evade tax, the expenses were not ordinary and necessary to Owensboro's business, and the amounts were not paid to an insurance company and were not paid for insurance...”); Ax v. Commissioner, 146 T.C. 153 (2016) (“After the case was stricken from a trial calendar and continued generally, [the Service] moved for leave to amend his answer to assert “that a) Petitioners' use, through solely controlled flow-through entities, of a micro-captive insurance arrangement in 2009 and 2010 lacked economic substance; and b) Amounts paid as premiums through the micro-captive arrangement were neither ordinary nor necessary” and to allege facts in support of those assertions”).

14 Certain employee benefits captive arrangements for which the Employee Benefits Security Administration of the Labor Department has issued a prohibited transaction exemption are not considered a transaction of interest and thus are exempted from reporting under Section 2.03 of Notice 2016-66.
such policies is obvious, and the ability to manipulate claims is limited. Further, the use of policies that do not pay claims and do not make sense for the insured reflects a lack of business purpose and can be considered as part of an economic substance analysis.15

From the taxpayer’s perspective, since Congress took action based on Treasury’s study of estate planning abuse, the amendments to Section 831—arguably, a vote of approval for the micro-captive through an increased exclusion from $1.2 million to $2.2 million—could be viewed as creating a statutory safe harbor: simply meet the new premium or ownership diversification test and assume such compliance cleanses the captive of abuse. Further, captive owners claim legitimate business purposes for lowering the number of claims. For example, the lack of claims and build-up of funds can permit taking on new risk and can also provide funds for distributions to shareholders, permitting them to benefit from the improved risk management. Additionally, the use of a captive as a means of providing “asset protection” highlights a non-tax motivated purpose: for some, this rekindles memories of family limited partnership disputes involving economic substance and valuation discounts.16 Some policies address “emerging risks” that do not result in predictable claims but are still risks that should be managed. Finally, captive owners question why the government should second-guess a business owner’s decision regarding a risk mitigation program.

In arguing for the viability of the Captive, the Petition highlighted the various exposures faced by the feed supply company, such as danger that the feed contains trash or chemicals posing a health risk to animals, undetected spoilage rendering the end product unpalatable, spontaneous combustion related to storage, hazardous dust emissions from storage and associated fines, and acquisition of products from food manufacturers that rely heavily on supply chain operations. It also expressed displeasure over the issuance of Notice 2016-66, accusing the Service of inappropriately issuing the Notice given congressional and state “encouragement” for captives, as evidenced by the availability of Section 831(b) and “reaffirmed” through the increase in the income exclusion from $1.2 million to $2.2 million.

Ultimately, if the basic requirements of an insurance company can be proven, the issue could come down to an economic substance analysis—something that was not a central issue in prior Service defeats. A win based on such a fact-intensive inquiry will not make things easier going forward for the Service (which already has a large number of cases in audit and pending in Tax Court); however, the same lack of certainty (and associated risk) creates a paradoxical situation for those who are promoting certain forms of risk mitigation.

15 See Block Developers, LLC v. Commissioner, T.C.M. (RIA) 2017-142 (T.C. 2017) (“Because a DISC's congressionally sanctioned purpose was tax avoidance, the Sixth Circuit held that neither the Commissioner nor the courts had any basis to recharacterize the transactions at issue according to their substance. Summa, 848 F. 3d at 782, 786. But Summa's facts are not the Janssons'; LLCs, unlike DISCs, are meant to have a real business purpose.”).

16 See Estate of Turner v. Commissioner, 102 T.C.M. (CCH) 214 (T.C. 2011), supplemented sub nom. Turner v. Commissioner, 138 T.C. 306 (2012) (agreeing that asset protection may be a legitimate reason for forming a family limited partnership, but concluding that there was no credible argument that the company at issue was formed for that reason).
Can the Failure to Obtain a “Should” Tax Opinion from External Attorneys Invalidate a Merger?

By Kevin A. Diehl, Western Illinois University, Moline, IL

Introduction

Even though it discusses corporate governance principles in its background, The Williams Cos., Inc. v. Energy Transfer Equity, LP case is an important federal income tax ruling. Namely, the case considers whether a “should” tax opinion under section 721 could be issued supporting tax-free treatment of the transfer of the Williams Cos., Inc. (Williams) assets to Energy Transfer Equity, LP (ETE) for its Class E partnership units. Obtaining this “should” opinion was a condition precedent to the closing of the merger. ETE faced this litigation because it was unable to obtain the “should” opinion after representing that it could.

Facts

ETE sought to acquire the assets of Williams. The two-step merger involved a merger of Williams into Energy Transfer Corp. LP (ETC), a Delaware limited partnership subject to corporate taxation.

As the first step, ETE would transfer $6.05 billion in cash to ETC for 19 percent of ETC’s stock. That $6.05 billion in cash and 81 percent of ETC’s shares would be transferred to Williams shareowners in exchange for their Williams’ shares.

As the second step, ETC would contribute the Williams’ assets to ETE for newly issued ETE Class E partnership units. The Class E units and ETC shares distributed would be equal in number and close in value.

ETE represented that it would be able to get an opinion from its outside attorneys that the transaction “should” qualify for section 721 nonrecognition treatment. During the merger’s pendency, however, the energy market plummeted and the transaction was no longer favorable for ETE. Suddenly, ETE’s internal attorneys argued that the IRS could view some of the $6.05 billion in cash as a partial payment for the Williams’ assets rather than an exchange for ETC stock. ETE’s external attorneys then no longer seemed willing to issue a “should” opinion on nonrecognition. The result was termination of the merger upon failure of this condition precedent.

Procedurally

Williams tried to enjoin ETE from terminating the merger on the grounds that ETE had breached its duties by failing to “use commercially reasonable efforts” to get the section 721 opinion and “reasonable best efforts” to initiate the merger’s closing. Williams believed ETE was estopped from terminating because of its prior representation that it knew of no facts preventing the second step from qualifying as tax-free.

The Court of Chancery denied the arguments. Williams wanted the Supreme Court to find greater responsibilities in those representations than just a negative duty not to obstruct. The key language from the merger agreement was that ETE did not “know [] of the existence of any fact that would reasonably be expected to prevent [the second step] from qualifying as an exchange to which [section] 721(a) . . . applies.”

Ruling

Equitable estoppel is available where a party leads another to change position detrimentally because of reliance on that original party. As ETE became concerned about getting the “should” opinion, Williams argued that nothing had changed. Nevertheless, ETE did not fail in its obligation to disclose any facts known at the time of the merger agreement. The Supreme Court found that only the external firm’s opinion had changed. Nothing shows that the external firm did anything but act in good faith reliance on the information available. While ETE may have wanted to use the lack of ability to get a “should” opinion as an excuse from completing a then-unprofitable combination, there is nothing to show collusion between ETE and the external firm. Accordingly, the Delaware Supreme Court upheld the Court of Chancery’s opinion allowing ETE to terminate the merger.

Implications

Given the specificity of the opinion condition precedent in the merger agreement at stake in the Williams case, it was perhaps too easy for ETE to get out of the deal once it turned unprofitable for it. There is always some amount of subjectivity in the level of opinion a firm is willing to provide. Tax attorneys on these kinds of deals may want to weigh carefully whether it is necessary to include a high level of opinion certainty as a merger condition.

Merger termination fees are generally quite large. Because of the Williams case, firms that provide tax opinions for mergers and similar transactions may need to review their determinations of proper malpractice insurance coverage.

Although there was a dissent in the case, the vote was 4 to 1, suggesting that the dissent is relatively unimportant for immediate purposes. The case does illustrate basic corporate governance principles in the hotbed for corporate governance that Delaware is. It provides insight into the approaches internal and external tax advisers may take in a merger and the consequences for the parties.

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2 Merger Agreement, section 3.02(n)(i).
PRO BONO MATTERS

Tribute to Chief Special Trial Judge Peter Panuthos

By Special Trial Judge Diana Leyden, U.S. Tax Court, Washington, DC

Special Trial Judge Peter Panuthos is stepping down as Chief Special Trial Judge effective September 1, 2017.¹ While Judge Panuthos will remain as a Special Trial Judge, a position he has held for 34 years, it is fitting that we take this opportunity to pay tribute to all that he has done for the United States Tax Court, low income taxpayer clinics (LITCs), and pro se petitioners.

Judge Panuthos has served as Chief Special Trial Judge for 25 years. During his remarkably long tenure, he has provided steady, consistent, and exceptional service to the Tax Court. As Chief Special Trial Judge he has collaborated with the Tax Section and the LITCs to make the Tax Court a forum that internalizes the phrase “Equal Access to Justice”. While it is impossible to capture all that Judge Panuthos has done and the impact of his service, I will try to summarize his contributions as a professional, colleague, and mentor during his tenure as Chief Special Trial Judge.

Humble Beginnings and the Importance of Family

Judge Panuthos grew up in Brooklyn, the son of Greek immigrants. His father operated a family business, the Regent Bar & Grill, on 116th Street and 7th Avenue. Judge Panuthos started working for his father at the bar and restaurant at age 15. He recalled that his judicial philosophy started at that time. He observed merchant seamen, teachers, and police come by to eat, some treating it as a family dining room. He also observed his father reach into a cigar box that he kept under the counter to hand cash to a customer who needed money in exchange for an IOU. When the bar and restaurant was closed in the sixties, his family found many IOUs still in the cigar box. His mother taught him by example how to help people for whom English was not their first language to navigate the systems.

Later when Judge Panuthos joined the IRS Chief Counsel Office as a trial attorney in Boston, he encountered taxpayers who reminded him of the people he met in Brooklyn. He understood that without an attorney...
unrepresented taxpayers had difficulty in navigating the complex world of taxation. Later, as a Special Trial Judge, he discovered that the Tax Court proceedings scared pro se taxpayers. From the beginning of his tenure as a Special Trial Judge through his tenure as Chief Special Trial Judge, Judge Panuthos has worked tirelessly to make the Tax Court easier to navigate and to fulfill the Tax Court’s mission for equal access to justice.

Exceptional Service to the Tax Court

As Chief Special Trial Judge, Judge Panuthos has also devoted himself to effective leadership and efficient administration. In 2012 he was recognized for his exceptional service to the Tax Court with its highest award, the J. Edgar Murdock Award. As the late Judge Howard A. Dawson remarked in the ceremony to award Judge Panuthos the Murdock Award: “In Act II, scene 5 of Twelfth Night, William Shakespeare wrote: [S]ome are born great, some achieve greatness, and some have greatness thrust upon them.” You, Peter, fit squarely in the second category because you have achieved greatness as a Chief Special Trial Judge of this Court.”

Judge Panuthos is both a wonderful leader and skillful administrator. He served as a vital member of and an adviser to several important committees of the Tax Court—the Human Resources Committee, the Legislation Committee, the Security Committee, and the Employee Dispute Resolution Committee. At one time, he had as many as 13 Special Trial Judges under his direct supervision. Barely a day goes by when the Special Trial Judges don’t ask Judge Panuthos for guidance or advice. He is the author of more than 1,000 opinions, more than 500 of which have addressed novel issues regarding the Tax Court’s jurisdiction in cases involving transferee liability, interest abatement, collection due process hearings, and innocent spouses.

Judge Panuthos has also mentored many law clerks during his tenure. At the ceremony awarding Judge Panuthos the Murdock Award, his first law clerk, Mark Dinkel, recalled that while Judge Panuthos would challenge his research and missing facts, Judge Panuthos treated him with kindness, shared insights, and made him a better lawyer. Another law clerk, Jean Boyle, remarked that Judge Panuthos not only has the intellect, passion, and dedication to be a Special Trial Judge, but is also caring, incredibly respectful, dedicated to friends and family, and has a devilish smile and an infectious laugh.

Judge Panuthos has also participated in organizations and conferences that consider the similarities and differences of tax courts in other countries. He was one of the initial members of the International Association of Tax Judges (IATJ), an organization representing tax judges from all around the world. As a member he volunteered his expertise, his contacts, and his skills to help develop the organization, and he currently sits on the board of the IATJ. He has stepped up and volunteered to assist any and all attendees at IATJ conferences with his advice and direction. Judge Panuthos has also participated in the first two International Taxpayer Rights conferences sponsored the IRS National Taxpayer Advocate. At both the inaugural and second conferences, he participated in the panel: “Building Trust II: Safeguards on Tax Agency Power”. Judge Panuthos’ participation in these programs generated robust and informative exchanges about procedures and programs of tax courts to assist pro se petitioners.
Exceptional Service to Pro Se Petitioners

Judge Panuthos used his appointment to the Tax Court to continue his dedication to assisting the unrepresented in navigating the Tax Court’s rules and procedures. Judge Panuthos served on the Tax Court’s Pro Bono Committee, always providing thoughtful ideas. Before 2007, LITCs could enter into a contract with the Tax Court whereby LITCs could send information to pro se petitioners and appear before the Tax Court. These LITCs agreed to certain conditions and, in exchange, the Tax Court agreed to send out stuffer notices to unrepresented taxpayers with contact information for the LITCs. Judge Panuthos worked with then Chief Judge John Colvin in 2007 to replace individual contracts with LITCs with a transparent procedure to articulate the requirements for participation by LITCs and to add that information to the Tax Court’s website.

The new procedure provided the Tax Court with current information about the LITCs that participated in the Tax Court’s stuffer notice program and provided an easy way for a participating LITC to contact the Tax Court to obtain information about the its LITC stuffer notice program. In 2008, Judge Colvin and Judge Panuthos worked to make a similar change to the bar-sponsored calendar call program. In 2017, the number of participating LITCs and bar-sponsored calendar call programs is 136.

Judge Panuthos has also actively contributed to the ABA Pro Bono and Tax Clinics Committee programs at the Section meetings. Even in the early days when the committee was assigned a meeting time of 7:00 a.m. on Saturdays at the Section meetings, Judge Panuthos would show up prepared to update members on the Tax Court’s caseload and its LITC program. He always prepared by bringing original statistics, comments, and observations aimed at clearly, courteously, and accurately giving the audience information regarding the Tax Court.

In 2014, the Section of Taxation, in recognition of Judge Panuthos’ outstanding and sustained achievements in pro bono activities and his inspiration to countless practitioners to participate in pro bono nationwide, awarded him the Janet R. Spragens Pro Bono Award. In an article in the Section Newsletter, Armando Gomez, now former chair of the Section, wrote: “Those who have seen [Judge Panuthos] on the bench know that he strives day after day to ensure that every taxpayer who appears before him has a fair and just experience.”

We thank Judge Panuthos, for his 25 years of service as Chief Special Trial Judge of the Tax Court. While Judge Panuthos will be stepping down as Chief Special Trial Judge, he will continue to serve as a Special Trial Judge. Therefore, this is farewell, but not goodbye.
PRO BONO MATTERS

Shining a Light on the PATH

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

We cannot hold a torch to light another’s path without brightening our own. Ben Sweetland

The Protecting Americans from Tax Hikes Act of 2015 (the PATH Act), enacted on December 18, 2015, among other provisions requires many millions of taxpayers to renew their Individual Taxpayer Identification Numbers (ITINs) over the next several years. ITIN holders are taxpayers who do not qualify for a Social Security Number. Since 1996, the Service has issued more than 21 million ITINs, although just over 5 million are currently being used on tax returns.¹ Prior to the PATH Act, ITINs, like Social Security Numbers, were issued after a qualifying application without an expiration date. ITINs are nine digits long beginning with a 9 and have middle digits in ranges from 50–65, 70–88, 90–92, and 94–99. The Service issues ITINs in a letter as compared to the Social Security Administration’s issuance of Social Security Numbers on a card. ITINs do not authorize work and are only issued to individuals with a tax filing obligation.²

Under Section 203(a) of the PATH Act, codified in Section 6109(i)(3), ITINs issued before 2013 are set to expire over several years beginning on January 1, 2017, and ending on January 1, 2020. In addition, ITINs that are not used on a federal income tax return for three consecutive years will expire on the first day of the next calendar year. For example, an ITIN not used on a tax return as either a primary or secondary taxpayer, or a dependent filed in 2014, 2015, or 2016, expired as of January 1, 2017.

In early August of 2016, the Service issued a News Release,³ notifying non-filing ITIN holders as well as about 400,000 more ITIN holders with the middle digits of 78 or 79 of the pending expiration of their ITINs as of January 1, 2017. The Service also mailed approximately 400,000 letters to ITIN holders with middle digits 78 or 79 that had been issued between 1996-2000. In October of 2016, the Service began accepting ITIN renewals in accordance with Notice 2016-48.⁴ About 90,000 ITIN holders renewed their ITINs during the renewal period from October – December 31, 2016.

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¹ IRS, Prepared Remarks John A. Koskinen Commissioner Internal Revenue Service before the CERCA Fall Meeting Arlington, VA November 2, 2016.
² IRS, Individual Taxpayer Identification Numbers.
³ IRS News Release IR-2016-100, IRS Works to Help Taxpayers Affected by ITIN Changes; Renewals Begin in October (Aug. 4, 2016).
Consistent with the PATH Act, the Service deactivated 12.4 million ITINs as of January 2017. During the 2017 filing season through about the end of April, 163,000 ITIN returns were filed with expired ITINs. About 110,000 of those returns filed with expired ITINs were eventually processed with renewed ITINs. Returns filed with expired ITINs are processed and notices are sent to ITIN taxpayers notifying them that their ITIN has expired and must be renewed. Until the ITIN is renewed, a return with an expired ITIN will be processed and treated as timely filed, but it will be processed without any exemptions and/or credits claimed and no refund will be paid. Once the ITIN is renewed, any exemptions and credits will be processed and any allowed refund will be paid. If the ITIN isn’t renewed, the taxpayer may be subject to interest and penalties for any tax owed due to disallowed exemptions and credits. If the taxpayer does not timely respond, the Service has math-error authority to process these returns without any exemptions, credits and other tax benefits related to the expired ITIN. Through the end of April, 2017, the Service made approximately 183,000 math-error adjustments on ITIN returns.

After lessons learned from its first ITIN expiration period, the Service has accelerated the process. On June 21, 2017, it announced the next batch of ITINs scheduled to expire as of January 1, 2018. These are ITINs with the middle digits of 70, 71, 72, or 80. The Service has estimated that this is about 1.2 million ITINs. In addition, the Service expects approximately 100,000 more ITINs will expire due to failure to file in the last three calendar years. Immediately after this announcement the Service began accepting renewals for these taxpayers. The Service will also continue to accept renewals for ITIN holders with middle digits of 78 or 79. Moreover, family member ITIN holders whose numbers have not expired but are included on the same tax return, and for whom a renewal at the same time would be efficient, may also renew their ITINs now.

While ITIN holders do not have to file their Form W7 renewal applications with a tax return, they do have to submit original identification and foreign country identification documents (e.g., passports, birth certificates, driver’s license, etc.). Not surprisingly, many immigrants will not want to send original documents to the IRS. In lieu of sending original documentation, taxpayers may be eligible to use an IRS authorized Certified Acceptance Agent (CAA) or make an appointment at a designated IRS Taxpayer Assistance Center location. CAAs often charge significant fees for authentication services rendered. The Consumer Federation of America, among others including myself, have written about the high cost of tax assistance services for low-income taxpayers and the potential for consumer abuse including price gouging.

To better serve this population who are disproportionately lower-income, increasingly chilled by anti-immigrant rhetoric, and now burdened by this time-consuming and potentially expensive renewal process, the Service is actively recruiting CAAs. The goal is to increase the availability of CAAs nationwide, particularly in communities with higher concentrations of ITIN holders. As a low-income taxpayer advocate, I recently became a CAA and have been providing pro bono CAA services to underserved immigrants in my community. I hope you will consider joining me in shining a light on the PATH to tax justice and become a CAA. If you

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6 Individual Taxpayer Identification Number, FAQs.
7 Taxpayer Advocate Service, Fiscal Year 2018 Objectives Report to Congress, 2017 Filing Season, Deactivation of Individual Taxpayer Identification Numbers, at 11 (noting that more than one math-error adjustment may occur on a return with an expired ITIN).
8 IRS Acceptance Agent Program
10 IRS, New ITIN Acceptance Agent Program Changes.
are involved with a Volunteer Income Tax Assistance program in your community, adding a CAA to the team is especially valuable to provide this service during tax season. While it is preferable that ITIN holders renew now, many wait until tax season and then file their ITIN renewals with their income tax returns. This certainly delays the refund process, but it is perhaps more cost beneficial to have the tax return prepared and filed together with the Form W7 and saves precious time and energy.

The CAA application process involves three steps. The first is to complete an Application to Participate in the IRS Acceptance Agent Program (Form 13551). Next, the applicant must complete the Mandatory Acceptance Agent training and submit the certification form. IRS, How to Become An Acceptance Agent for IRS ITIN Numbers. Finally, the applicant must complete forensic training and submit the certificate of completion to the Service. IRS, Forensic Training for Certified Acceptance Agents. The Service will perform background checks and tax compliance checks after they receive the completed application. After three to four months, you should receive a contract to serve as a CAA and you too can begin to serve as a passion warrior for tax justice and join me in shining a light on the PATH to accessible tax compliance.

This little light of mine
I'm going to let it shine
Oh, this little light of mine
I'm going to let it shine
Let it shine, let it shine, let it shine

11 IRS, How to Become An Acceptance Agent for IRS ITIN Numbers.
12 IRS, Forensic Training for Certified Acceptance Agents.
13 “This Little Light of Mine’ is a gospel song that came to be an anthem of the civil rights movement in the 1950s and ‘60s. Often mistakenly believed to have been sung on plantations during slavery, it was originally written by Harry Dixon Lopes around 1920 as a children’s song.” Operation Respect, This Little Light of Mine. To listen to a Smithsonian Museum version of This Little Light of Mine, click here.
IN THE STACKS

A Good Tax

By Bree Ermentrout, Springfield, VA


The term “good tax” may raise eyebrows outside the tax community, but Joan Youngman’s well-written and jargon-free book, A Good Tax: Legal and Policy Issues for the Property Tax in the United States, may convince even non-practitioners of the property tax’s merits. Youngman is the Senior President and Chair of the Department of Valuation and Taxation at the Lincoln Institute of Land Policy in Cambridge, Massachusetts. She is not an uncritical cheerleader and squarely recognizes weaknesses of the property tax., but she argues any deficiencies can be corrected by administrative and legislative fixes. She tries to redress what she calls an “unbalanced” public debate stemming largely from the key attributes that make the property tax a good tax—its visibility and transparency. Visibility and transparency ensure that the property tax is understandable and reveal the true cost of public services, but the spotlight they create can also attract debate.

Youngman lauds property taxes as an important source of locally controlled revenue. “At a time when many governments are facing fiscal difficulties and the need to address delayed or deferred financial obligations of all types, an effective property tax can be a valuable instrument for the common good.” Numbers tell the tale: over the 2005-2015 period, average inflation-adjusted collections from federal corporate income tax totaled $297 billion compared with $472 billion average local property tax collections. Unlike sales or wage taxes “immovable property is a tax base well suited for local identification, administration, and decision making.” Localities can align property tax with local needs and budget. In contrast, state income and sales taxes reflect state priorities. Cities that try to raise local sales taxes will lose revenue to neighboring cities while higher wage taxes will drive businesses to relocate to lower tax districts. The point is valid but Youngman doesn’t address the role of property taxes in driving mobile capital to new jurisdictions. Presumably both businesses and individuals will seek out lower tax jurisdictions (except, of course, for those most vulnerable low-income residents who have worked hard over years to pay for their home but have scarce resources to pay a continually increasing local tax on its value).

2 Id. at X.
3 Id. at 2.
In an excellent primer, Youngman devotes the first four chapters of *A Good Tax* to explaining the basics of property taxes. The Constitution’s prohibition on direct taxation means that property tax is the domain of state and local governments. Youngman considers this appropriate since schools and local services can have a direct impact on property value. Originally a tax on all property, the property tax evolved into what is today primarily a tax on buildings and land. Youngman advocates for limiting the tax to land as only the land is truly immovable and in fixed supply and typically its value does not reflect additional investment or improvements. While recognizing that an asset tax may result in increased taxes without corresponding cash flow, she believes that this difficulty can be resolved through administrative adjustments such as deferral programs for senior citizens.

Youngman rebuts the argument that property taxes are regressive. First, as a semantic matter, she notes that the word “regressive” is often used by non-economists as a synonym for “unfair.” Yet some regressive revenue sources—cigarette taxes and lotteries, for example—are very popular. The unfairness argument is particularly apparent in the debate over property tax and school financing, which she notes would be contentious regardless of funding source. Consistent with her point that property tax weaknesses can be corrected, Youngman argues that a regressive property tax can be balanced by subsidies or progressive taxes. Finally, even economists differ on whether the tax is regressive, depending on variables such as the definition of income or who bears the incidence of the tax. As a result, “[w]hether the property tax takes a higher percentage of income from poorer households than from wealthier ones turns out to be a remarkably complex inquiry.”

After the overview, the book’s remaining eight chapters are devoted to more specialized topics. Topics covered include tax incremental financing (TIF) issued by localities to finance economic development, and classified and differential taxation which gives preferences for various property categories such as energy efficient and historical structures. These classifications, often driven by political deals, may create economic efficiencies. They may also correct problems and inequities of the property tax.

Youngman covers two other notable topics. Conservation easements are relatively new instruments which started to increase in popularity in the 1960s. They provide for the long-term preservation of land held in private ownership and protect open spaces. As of 2014, 20 million acres were subject to conservation easements. Part of their popularity can be attributed to their qualification for charitable deduction if they meet statutory requirements. The property tax implications are more complicated. States differ in their treatment, but must all face the problem that some easements may increase property values, while others may decrease them.

Farmland assessments often prove controversial. “The appropriate taxation of farmland touches on many complex issues: equitable distribution of the tax burden; assistance to family farmers in difficult financial straits; land use planning to avoid sprawl and protect open space; and promotion of agriculture as a source of production, a landscape amenity, and a way of life.” Taxing property for its agricultural use rather than its market value may increase farm preservation, but at the cost of current revenue. It is hard to reconcile

4. Id. at 57.
5. Id. at 20.
6. Id. at 21.
7. Id. at 94.
8. Id. at 109.
9. Id. at 134.
the goal of providing assistance to family farmers with Youngman’s examples of New Jersey’s farmland assessment holders including the King of Morocco, Bruce Springsteen, Steve Forbes, Exxon, and Merck.10

The last two chapters of A Good Tax address tax limitations and market value assessments. Perhaps the most famous effort to limit the property tax is California’s Proposition 13, a populist property tax revolt which limited the assessed value of California property and made purchase price, not market value, the basis for assessment. Youngman points to the two-fold inequity of Proposition 13. First, a property’s original purchase price doesn't reflect benefits received from public services or the owners’ ability to pay. Second, a homeowner who has lived in a property for years will probably have benefited from rising market values. Purchasers of identical property, possibly next-door neighbors, will pay tax based on a higher purchase price.11 As an example, Stephanie Nordlinger, who unsuccessfully challenged Proposition 13 in the Supreme Court case of Nordlinger v. Hahn, paid taxes five times greater than neighbors in comparable homes.12 This inequity creates a disincentive to sell, a problem magnified by Proposition 13’s provision allowing heirs to inherit tax assessments.13 Youngman quotes Justice Stevens’s dissent in Nordlinger v. Hahn: “Such a law establishes a privilege of a medieval character: Two families with equal needs and equal resources are treated differently solely because of their different heritage.” Youngman discounts the effectiveness of a portability feature allowing homeowners to transfer tax savings to new residences as a possible fix because it creates complexities and is divorced from market or purchase price.14

The final chapter discusses Massachusetts Proposition 2 ½, Massachusetts’s attempt to check rising property taxes with a limit on tax rates. Youngman does not ignore weaknesses of Proposition 2 ½, but believes that many of its negative effects, including local revenue losses resulting in layoffs of municipal employees and reductions of local services, were alleviated by municipalities who implemented market value assessments and legislation allowing property classification as residential, open space, commercial, and industrial.15 She makes clear her preference when she notes the resulting tax “structure has remained relatively stable for over 30 years. This achievement represents an effective tax limitation that succeeded in preserving accurate market value assessments.”16

As befitting a lawyer who has authored a case book on property taxation, Youngman includes extensive citations to legal decisions. The book is not just for lawyers, though, but anyone interested in clear analysis of property tax policy. One quibble is that the book ends without a conclusion, either a summation or a roadmap for future initiatives. This is a small point in a book that covers the landscape thoroughly to provide legal and policy guidance. ■

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10 Id. at 141.
11 Id. at 40-41.
12 Id. at 197.
13 Id. at 40-41 (quoting Nordlinger v. Hahn, 505 U.S. 1, 29–30, 112 U.S. 2326, 2341–2342, 120 L. Ed. 2d. 1, 24–25 (1992) (Stevens, J. dissenting)).
14 Id. at 211.
15 Id. at 217-219.
16 Id. at 222.
IN THE STACKS

Call for Book Reviews

ATT welcomes the submission of book and article reviews on tax topics that might be of interest to our members. 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**, Alyssie Hollis & Richard M. Froehlich (ABA 2016)
- **Carbon Pricing**, ed. Larry Kreiser et al. (Edward Elgar 2016)
- **Economic Behaviour and Taxation**, James Alm & J. Sebastian Leguizamon (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 ideas for ATT, contact Supervising Editor, Linda M. Beale at lbeale@wayne.edu.
YOUNG LAWYERS CORNER

Save the Date: 17th Annual Law Student Tax Challenge (2017-2018)

An alternative to traditional moot court competitions, the Law Student Tax Challenge asks two-person teams of students to solve a cutting-edge and complex business problem that might arise in everyday tax practice. Teams are initially evaluated on two criteria: a memorandum to a senior partner and a letter to a client explaining the result. Based on the written work product, six teams from the J.D. Division and four teams from the LL.M. Division receive a free trip (including airfare and accommodations for two nights) to the Section of Taxation 2018 Midyear Meeting, February 8-10, in San Diego, CA, where each team will defend its submission before a panel of judges representing the country's top tax practitioners and government officials, including Tax Court judges.

The competition, sponsored by the Young Lawyers Forum, is a great way for law students to showcase their knowledge in a real-world setting and gain valuable exposure to the tax law community. On average, more than 60 teams compete in the J.D. Division and more than 40 teams compete in the LL.M. Division.

IMPORTANT DATES

Problem Release Date: September 5, 2017, released by 5pm EST

Submission Deadline: November 3, 2017, by or before 5pm EST

Notification of Semifinalists and Finalists: December 15, 2017

Semifinal and Final Oral Defense Rounds: February 9, 2018, in San Diego, CA
When the Taxman Comes Along

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

(To tune of, “The Man That Got Away,” by Harold Arlen and Ira Gershwin, made popular by Judy Garland in the 1954 movie A Star Is Born. 1)

Verses:
The tax man’s coming
He’s whistling and humming
In fear you shiver
He’ll send you up the river
It always happens
When the taxman comes along.

No more that savior faire
That attitude, “Who’ll care?”
Deductions from thin-air
Don’t belong.

The tax preparer
Who was your secret-sharer
Has all the papers
That document your capers
He’ll be the witness,
The one who gets you jailed.

No more big-ego thrills
From lowering tax bills
Deductions from those shelter mills
Have all failed.

Bridge:
Good lessons come hard
And the hardest one you’re learning
That fools keep the wheels
Of justice turning.

Verse:
The trial is over
So ends a life in clover
You’re no short-termer
The sentence is much firmer
What cash you’ve hidden
Bid good-bye, goes the song.

Since the first tax-law was passed
There’s been no one more aghast
Than a scared tax-cheater
When the taxman comes along.

1 For readers who are unfamiliar with the tune: https://www.youtube.com/watch?v=UzyPMRo8ZUQ.
**SECTION News & Announcements**

**Government Submissions Boxscore**

Government submissions are a key component of the Section's government relations activities. Since September 1, 2016, the Section has coordinated the following government submissions. The full archive is available to the public on the website: [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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The technical comments and blanket authority submissions listed in this index represent the views of the ABA Section of Taxation. They have not been approved by the ABA Board of Governors or the ABA House of Delegates and should not be construed as representing the policy of the ABA.
SECTION NEWS & ANNOUNCEMENTS

Accepting Applications for the 2018-2020 Christine A. Brunswick Public Service Fellowship

The American Bar Association Section of Taxation is pleased to announce that it is now accepting applications for its Christine A. Brunswick Public Service Fellowship program class of 2018-2020. Developed in 2008, the Fellowship program seeks to address the growing need for tax legal assistance and to foster a greater interest in tax-focused public service through funding and other support to young lawyers engaged in tax work for underserved communities.

The deadline for applications is November 17, 2017. Visit the Christine A. Brunswick Public Service Fellowship page for more information about the award criteria and to download the application form.

Save the Date: 17th Annual Law Student Tax Challenge (2017-2018)

The Law Student Tax Challenge, sponsored by the Young Lawyers Forum, is a great way for law students to showcase their knowledge in a real-world setting and gain valuable exposure to the tax law community. More information regarding the competition may be found here: http://www.americanbar.org/groups/taxation/awards/law_student_tax_challenge.html.

The Tax Lawyer – Spring 2017 Issue Is Available

The Spring 2017 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.

Contents

Karen L. Hawkins, 2017 Erwin N. Griswold Lecture Before the American College of Tax Counsel: A (Not So) Modest Proposal

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American Bar Association Section of Taxation, Comments on Proposed Regulations Under Section 751(b)

Articles

Karen C. Burke, Hot Asset Exchanges: Integrating Sections 704(c), 734(b), and 751(b)

Andrew Walker, Proceed with Caution: D(e)riving a Hybrid Down the Tax Treaty On-Ramp

Notes


Spencer P. Williams, Kuretski v. Commissioner: The Tax Court’s Identity Crisis
Spring 2017 Audio Edition of *The Tax Lawyer* Available from ModioLegal

What is an hour of your time worth? Listen to the same content as the print edition of *The Tax Lawyer* without forgoing billable time at your desk – approximately 40 hours of content per year!

The Practical Tax Lawyer – Summer 2017 Issue Is 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 Spring issue features the following articles.

Ted David, *Learn to Love the IRS* (regular feature)

Bradley R. Gould and Stephen R. Looney, *Update On S Corporations*


Robert G. Nassau, *An Introduction to District Court Income Tax Jurisdiction*

Casey S. August, *The New Section 385 Debt-Equity Regulations – Who’s Impacted and What Does It Mean for the Rest of Us?*

Robert F. Reilly, *What Tax Lawyers Need to Know About Unit Valuations, Summation Valuations, and Business Valuations for Property Tax Purposes*

Index to Volumes 30 and 31 (2016-2017)

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](https://www.ali-cle.org//index.cfm?fuseaction=publications.periodical&pub=PTL).
Support the Section’s Public Service Efforts with a Contribution to the TAPS Endowment

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.

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.
### ABA Section of Taxation Meeting Calendar

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

**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/](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](http://westlegaledcenter.com).
# Section CLE Calendar

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

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<td></td>
<td>Free CLE Webinar</td>
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<td>December 4, 2017</td>
<td>2017 Low Income Taxpayer Representation Workshop</td>
<td>Tax Section 202.662.8670</td>
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<tr>
<td></td>
<td>Washington, DC</td>
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<tr>
<td>February 8-10, 2018</td>
<td>MIDYEAR MEETING</td>
<td>Tax Section 202.662.8670</td>
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<td>Hilton San Diego – San Diego, CA</td>
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SECTION EVENTS & PROMOTIONS

ABA Section of Taxation CLE Products

Listen at your convenience to high-quality tax law CLE on a variety of topics. 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 at www.shopABA.org.

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Tax Tales: Seminal Cases of Subchapter C

20 Years After ‘The End of Welfare’: Workfare Delivered through Federal and State EITC Systems

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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

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<th>Date</th>
<th>Event</th>
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<tr>
<td>September 14 – 16, 2017</td>
<td>JOINT FALL CLE MEETING</td>
<td>Hilton Austin – Austin, TX</td>
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<td>February 8 – 10, 2018</td>
<td>MIDYEAR MEETING</td>
<td>Hilton San Diego – San Diego, CA</td>
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<tr>
<td>May 10 – 12, 2018</td>
<td>MAY MEETING</td>
<td>Grand Hyatt – Washington, DC</td>
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