NEWS ANALYSIS

Deconstructing Hillary Clinton's Tax Returns

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Like your correspondent, the president might have missed his calling as a stand-up comic. His timing and delivery are impeccable — better than many professional comedians. One memorable zinger from his wickedly funny monologue at the 2015 White House Correspondents' Dinner was the following comment on the tough state of the economy:

> For example, I have one friend. Just a few weeks ago, she was making millions of dollars a year. But now she's living out of a van in Iowa.

On the last day of July, when the chattering classes were headed to the beach, former Secretary of State Hillary Clinton released many years of tax returns and a doctor's letter about her medical condition. The State Department released more e-mails from her private server, with the admonition that more of them are retroactively classified (there are three levels of classification). (Related coverage: p. 592.)

Vice President Joe Biden may have informally entered the presidential contest because Clinton's poll numbers are degenerating — her untrustworthy rating is 57 percent, according to a *Wall Street Journal*/NBC News poll. The same pollsters found declining favorability ratings among white women. The Obama administration has not endorsed either Biden or Clinton, both of whom are tagged with the administration's whimsical foreign policy.

Biden's chief talents are sound political instincts — on which the president has relied — and an ability to relate to regular people. He obviously saw blood in the water. Readers, old pro politicians like him specialize in identifying weakness in opponents and taking advantage of it. And his reputation as a bumbler doesn't hurt with voters.

As a 72-year-old himself, Biden or a doctor at his elbow would have been able to read between the lines in Clinton's health letter. She takes Coumadin (warfarin), a heavy-duty anticoagulation medication prescribed for stroke victims. This might indicate that the thrombosis described in the letter was an understatement and that Clinton might have had a stroke in 2012. A stressful event could produce another stroke.

So the smart betting is that Clinton will pull out of the race for medical reasons rather than lose a primary to Biden. Does Biden then win the election? The election is the Republicans' to lose, and they seem to be doing everything possible to screw it up — but not for the reasons the mainstream newspapers think. Donald Trump can't be all bad — he thinks the Fed's quantitative easing policy is crazy because it is pushing up asset prices.

Republican voters like The Donald, and donors like former Florida Gov. Jeb Bush. Clinton and Bush are similar not merely because they represent political dynasties, but also because they both have the wallets of donors and not the hearts of voters. Meanwhile, everyone and his dog who has ever registered Republican is running for president, because, like Biden, many correctly discern that their opponents lack charisma.

This article examines the last eight years of the Clinton tax returns with the help of Steven Bankler, the San Antonio CPA who regularly assists with analysis of political tax returns. Yes, the Clintons made a lot of money and paid a lot of taxes on ordinary income. And that's the best that can be said, given the dubious origins of their income — they pay a lot of taxes.

> ***For people with so much money, the Clintons have relatively uncomplicated tax lives, because their income is ordinary income and they don't invest.***

''Families like mine that reap rewards from our economy have a responsibility to pay our fair share,'' Hillary Clinton said in a statement, in an unwitting admission that the U.S. economy has become a rent-seeking plutocracy. Indeed, they made so much money that one wonders why they don't just retire from politics and golf at Mar-A-Lago.

For people with so much money, the Clintons have relatively uncomplicated tax lives, because their income is ordinary income and they don't

Larry W. Smit/EPA/Newscom

Hillary Clinton and her hot rod.

invest. But like other politicians, they scramble to clean up things on their returns that don't look good above the fold when a political campaign is imminent.

Income Summary

By now readers know that the Clintons made $139 million speechifying, writing books, and consulting in the last eight years. They paid $44 million in federal income taxes over that period, for an effective rate roughly equal to the top statutory rate in the last two years. Their New York state income taxes pushed their total effective rate to roughly 45 percent. The couple also receive pensions; as a former president, Bill gets a $200,000 annual pension.

The Clintons' disclosure included an inventory of speeches; fees were $225,000 a pop for Hillary and much higher for Bill. Wall Street firms were the most frequent hosts; foreign hosts paid the largest fees. Bill's highest-paying speech garnered a $1.5 million fee from UBS AG, the Swiss bank that got off easy for accusations of assisting in tax evasion by U.S. residents because of State Department intervention by Hillary.

The State Department saved UBS and made sure the federal government went easy on it. The Swiss government called State in March 2009 after the IRS sued UBS to get the names of undisclosed U.S. resident depositors, who had stashed $20 billion with the bank. The Swiss foreign minister met with Secretary of State Hillary Clinton to resolve the matter. The IRS was told to back off (Reuters, Apr. 9, 2010).

In February 2009, after the deferred prosecution agreement had been signed, UBS and the IRS were still wrangling about disclosure of the identities of 52,000 account holders pursuant to a subpoena the IRS sought to enforce in federal district court in Florida. In August of that year, the IRS dismissed its suit and accepted a tenth of the number of names it sought, to be decided according to criteria agreed to by both sides. The IRS admitted that some taxpayers got away in the deal. (Prior analysis: *Tax Notes*, Aug. 31, 2009, p. 847.)

Much has been made of UBS's donations to the Clinton Foundation after Clinton caused the U.S. government to go easy on the bank. UBS gave $600,000 to the foundation after its case was resolved, lent $32 million to a foundation lending project, and paid Bill Clinton $1.5 million for a speech (*The Guardian*, July 31, 2015).

State Department approval was necessary for any deal Justice made with UBS. And Clinton probably would have gone easy on UBS anyway, because State institutionally sees Switzerland as a necessary geopolitical facilitator. The United States — even in the Obama administration — has the bad habit of shunning countries it doesn't like. But it still has to talk to them. So talks are held through back channels. Switzerland is a back channel.

Bill and Hillary give $3 million in cash to their foundation each year. Nearly all of their total charitable giving of $15 million over eight years went to the Clinton Foundation, which has an IRS determination letter that it is a section 501(c)(3) organization, so that donations would be subject to the 50 percent adjusted gross income limit (section 170(b)). For 2013 and 2014, they earned $27 million and $28 million, respectively, so no limit would have affected their $3 million contributions. The same preparer prepared all eight years of returns.

Middle-Class Jobs

Bill and Hillary Clinton have LLCs that are disregarded entities through which they earn their income. Each reported the LLC income and expense on a personal Schedule C. Each LLC has employees. Each LLC paid salaries but little or nothing in the way of employee benefits until the 2014 return.

Contrast their foundation, which in 2012 had a $14 million payroll and paid $2.75 million in employee benefits. Bankler noted the irony of the generosity of the foundation regarding employee benefits and the apparent parsimony of the Clintons with their own employees.

In 2014 Bill Clinton grossed nearly $10 million from speaking engagements. He paid $700,000 in commissions to the Harry Walker Agency. He appears to have one employee to whom he paid $62,000 plus $5,000 in employee benefits — the latter amount would cover health insurance for one person. In 2013 he earned $13 million from speaking and paid $55,000 in wages and $1,500 in employee benefits. In 2012 he earned $16 million from speeches, related to which he paid $237,000 in wages and no employee benefits.

Through WJC LLC, he also made $6 million from consulting for two education organizations, offsetting which he paid $250,000 in consulting fees. Bill was honorary chair of Laureate Education, a for-profit college. Laureate paid him $4 million in each of 2013 and 2014. He resigned that post when Hillary announced her candidacy. The other $2 million in 2014 came from Dubai-based GEMS Education, which runs elementary school programs.

Related to the income from the two educational organizations that pay him consulting fees, Bill paid $9,000 in wages and $500 in employee benefits. It may be that a single assistant's time is allocated between his income sources. He earned a like amount from consulting in 2013. But he paid $102,000 in wages and a mere $200 in employee benefits. He paid $400,000 in self-employment taxes.

We asked Hillary Clinton's flack this question:

> What is the nature of Bill's consulting from which he earns $6 million annually?

From 2008 onward, Bill claimed to use 25 percent of the couple's converted barn behind their Chappaqua house for business, claiming a tiny depreciation deduction on a depreciable basis of $148,000. Bankler found it odd that the deduction he took in 2007 was for 50 percent use of the barn and that operating expenses like utilities and insurance were never deducted.

Throughout the Clintons' returns, there are Forms 4562 showing section 179 expenses for computers. It is not clear when the Clintons obtained the infamous server that Hillary used for her e-mails while Secretary of State. Bill's travel isn't always comped — in 2013 he reported $2 million in travel expenses for speeches.

Hillary earned $10 million from speaking in 2014, which ran through her LLC, ZES Holdings. She also paid nearly $700,000 in commissions. She paid $82,000 in wages and nearly $5,000 in employee benefit expenses. Again, we may be looking at a single assistant with an individual health insurance policy. She paid nearly $400,000 in self-employment taxes. But in 2013, she earned $10 million from speaking, paid a whopping $372,000 in wages, and reported no employee benefit expense.

She has another LLC, ZFS Holdings, for her book royalties of more than $5 million. There must be a ghostwriter or coauthor for her book *Hard Choices*, because in 2014 this LLC paid $32,000 for research, $24,000 in consulting fees, $310,000 in wages, and $18,000 in employee benefits. In 2013 this LLC paid $124,000 in wages and reported no employee benefit expense.

The patchwork laws on employee benefits essentially say that employers don't have to offer benefits (except for health insurance if the employer has more than 50 employees). As with pension plans, employers that want to be generous get stuck in a regulatory regime when the decision is made to offer fringe benefits. And all of these regimes were premised on the idea that employers would grow into offering a full plate of benefits!

As with pension plans, employers that want to be generous get stuck in a regulatory regime when the decision is made to offer fringe benefits.

Once an employer does offer benefits, two different types of rules might kick in, depending on the type of benefit. The first type of rule is an aggregation rule. If one company in a controlled group offers benefits, all other affiliates must, because the group is treated as a single employer (sections 414(t) and 4980H(c)(2)(C)(i)). Aggregation applies to many types of benefits (sections 79, 106, 117(d), 125, 127, 129, 132, 137, 274(j), 505, and 4980(b)).

If two unincorporated sole proprietorships are owned by husband and wife, the aggregation rules treat them as a single employer, so that they must offer the same benefits, including health insurance (sections 105(h)(8) and 414(c)). Because Bill's business appears to offer health insurance to employees, so must Hillary's business. Moreover, because Bill is a director of the Clinton Foundation and daughter Chelsea is vice chair, their businesses could be aggregated and required to offer benefits on a par with it (reg. section 1.414(c)-5(b)).

The second type of rule is a nondiscrimination rule, applicable to health insurance, cafeteria plans, and group life insurance. For years, there have been general nondiscrimination rules for health insurance, given employers' habit of giving top employees gold-plated plans (section 105(h) and reg. section 1.105-11). But even when nondiscrimination rules are present, there is no universal coverage requirement, so discrimination can take the form of not being covered.

In their individual LLCs, the Clintons are unlikely to meet the 50-employee threshold to be subject to health insurance coverage requirements of the Affordable Care Act (section 4980H). Somehow we doubt that Hillary's loyal retainer Huma Abedin and other factotums are scrounging around the New York state health insurance exchange. Given the increase in employee benefit expense reported by the Clinton LLCs between 2013 and 2014, it may well be that they began to offer health insurance in 2014 in the run-up to Hillary's declaration for president or in reaction to IRS guidance.

Some employers that are subject to ACA coverage requirements sent employees to the health insurance exchanges to get subsidies and then reimbursed the cost of their low-cost coverage. The IRS has put them on notice that so-called employer payment plans are subject to excise tax for failure to comply with ACA market reforms (section 4980D and Notice 2013-54, 2013-40 IRB 287).

The IRS granted temporary relief from excise taxes so these employers could get into group coverage. What if a small employer just pays the employee more taxable wages and doesn't condition the increase on purchase of health insurance from an exchange? No problem, according to the IRS, and the arrangement would not be a group health plan for ERISA purposes either (Notice 2015-17, 2015-14 IRB 845). And it's OK to drop hints about the premium tax credit (section 36B).

So we asked Hillary Clinton's flack this question:

> Why do the employee benefits expenses reported on Schedule C suddenly increase between 2013 and 2014? Are the Clintons buying health insurance for their employees? Did they not buy insurance for them in the past? How many employees do they have?

Personal Finances

Readers, pay off your mortgages. Investing in bonds and Treasuries in a zero-interest-rate environment while paying positive interest on a mortgage makes no financial sense. Tax deductions, especially for alternative minimum tax payers, do not overcome financial nonsense. Yet the Clintons wouldn't be the first politicians to be doing that, as these articles have shown over the years. Biden has so much mortgage debt that many regular people could relate to his situation.

The Clintons still have $1 million in mortgage debt. In 2014 they earned $25,000 in interest and deducted mortgage interest of $41,000. For many years, the Clintons had more mortgage principal outstanding than the statutory limit for deductions of $1 million (section 163(d)). Only in 2013 and 2014 were the Clintons not subject to mortgage interest deduction limits. Bankler commented that they are putting a tax deduction before the big picture. ''Paying off the mortgage is like earning 5 percent on your money,'' he said.

Mortgage interest has to be allocated to foreign-source income, which for the Clintons was about a quarter of their income in 2013 because many of the payers of Bill's hefty speaking fees are foreign. Paying the mortgage would also save their preparer the trouble of that task.

The Clintons are not investors. Most of their stash is kept in highly liquid assets. They have an Article 4 trust that earns no income. They have no capital gains except for what is still rattling around in their blind trust, which they liquidated in 2007 for a $3 million gain. They incurred a whopping capital loss in 2008, of which they are permitted to use $3,000 per year.

In 2008 the Clintons reported a $727,000 capital loss from the sale of their limited partnership interest in billionaire and Clinton contributor Ron Burkle's Los Angeles investment partnership Yucaipa, which was slagged for its Cayman Islands feeder funds during the 2008 campaign.

Bill Clinton earned $15 million between 2003 and 2008 for services rendered to Yucaipa in the form of advocacy and looking for opportunities, but not making investment decisions. He reported $1 million in 2003, $4 million in 2004, and $5 million in 2005. Those were guaranteed payments for services, because Bill Clinton reported them as self-employment income and as non-passive income. For 2006 he reported a guaranteed payment of $2.5 million from the fund on Schedule E.

He appears to have had a profits interest in a couple of Yucaipa deals that entitled him to compensation if two of its domestic funds that invested in supermarkets met profit hurdles. Apparently those funds never met the hurdle rates. He also owned a small limited partner interest in Yucaipa Global Partnership Fund and a small interest in the general partner of that partnership, Yucaipa Global Holdings. (Prior analysis: *Tax Notes*, Apr. 14, 2008, p. 123.)

Clinton and Burkle are friends. Clinton invested in Yucaipa and responded to capital calls. There is a possibility that Burkle sold Clinton the partnership interests at a bargain price. If Clinton received his Yucaipa partnership interests through a bargain purchase, he would have an initial tax basis equal to the greater of the amount he paid for the interest or the donor's basis, according to Monte A. Jackel of Jackel Tax Law (reg. section 1.1015-4(a)(1)).

Yucaipa had debt, and small amounts of partnership investment interest expense were passed through to the former president during his period of ownership. Because Clinton was active in the partnership, and getting large guaranteed payments, he may have had only a small allocation of nonrecourse debt that was relieved on his exit from the partnership. Losses in excess of his amount at risk would be recaptured (section 465). No amount is reported as not being at risk on the 2008 return.

Relief from partnership liabilities is a deemed distribution to the partner (section 752). Relief from liabilities calls for sale or exchange treatment (section 731). The resulting gain or loss is capital. A partner's share of the partnership debt goes into basis, unless the partner will never be called upon to pay it, as the Tax Court held in case of a bottom-dollar guarantee (*Canal Corp. et al. v. Commissioner,* 135 T.C. 199 (2010)).

Proposed section 752 regulations (REG-119305-11) would impose a set of six requirements for payment obligations and require the partner to satisfy a minimum net value requirement. Among other things, a guarantor must maintain a reasonable net worth and receive arm's-length compensation for the guarantee. The payment obligation must not be a bottom-dollar guarantee, must not require excess liquid assets, and must not end before the liability ends.

Relief of nonrecourse debt would increase the amount realized on a disposition; it would not be separately broken out on the return. A loss on disposition is reduced by partnership liabilities relieved (*Gershowitz v. Commissioner*, 88 T.C. 984 (1987), *Tufts v. Commissioner*, 461 U.S. 300 (1983), and *Crane v. Commissioner,* 331 U.S. 1 (1947)). (See also ILM 201415002.)

On Schedule D for 2008, the Clintons reported a disposition of the Yucaipa holdings with the word "none" in the box for proceeds and $727,000 in the boxes for capital loss on disposition. In connection with the disposition, the Clintons deducted $35,000 in legal fees. No passthrough items appear on Schedule E for 2008.

How is it possible to have no proceeds? Did Clinton just walk away from his interests? Abandonment when there is no relief of partnership liabilities produces an ordinary loss (*Citron v. Commissioner,* 97 T.C. 200 (1991)). Abandonment when there has been relief of partnership liabilities produces a capital loss because the concomitant deemed distribution is consideration for a sale or exchange (Rev. Rul. 93-80, 1993-2 C.B. 239).

Were we IRS examiners, we would want to know where that $727,000 loss figure came from. Not that it produced a huge tax benefit — in the seven years since it was claimed, the Clintons have been able to use only $26,000 of it, usually $3,000 per year because they have little or no capital gains.

Maybe Clinton was relieved of a small amount of nonrecourse debt allocated to him by the Yucaipa partnership. "Or they could have taken the position that section 1234A applied to automatically make it capital," said Jackel (*Pilgrim's Pride v. Commissioner,* Dkt. No. 14-60295 (5th Cir. Feb. 25, 2015)).

In *Pilgrim's Pride,* the Fifth Circuit reversed a Tax Court decision that a corporation's abandonment of securities produced a capital loss (section 1234A). The taxpayer had rejected the issuer's redemption offer of roughly 20 percent of the taxpayer's cost basis in the securities, on the view that an ordinary loss would produce tax savings in a larger amount. The parties stipulated that the securities, which the taxpayer held as capital assets, were worth the offered redemption price.

Parsing section 1234A(1), the court reasoned that the statute — which speaks of "rights or obligations" — was meant to apply to terminations of derivatives, not abandonment of capital assets. The court found the government's argument that the taxpayer had terminated its intangible rights in the securities attenuated. "Congress does not legislate in logic puzzles," Circuit Judge Jennifer W. Elrod wrote. The court also rejected the government's worthlessness argument because the securities had an agreed positive value (section 165(g)).

We asked Hillary Clinton's flack this question:

> How did the Clintons dispose of their Yucaipa partnership interest in 2008? Schedule D for that year says there were no sales proceeds. How did the $727,000 loss come about?

The Clintons reported imputed interest from family members in 2007 and 2008 (section 7874). No imputed interest was reported for later years. Chelsea Clinton got married in 2010, in a wedding that cost her parents $3 million. She denies that the Clintons helped the newlyweds buy a $9 million New York apartment. Nonetheless, the loans might have been to cover Chelsea's living costs while she was living by herself (even though her jobs paid pretty well).

We asked Hillary Clinton's flack this question:

> In 2007 and 2008, the Clintons reported imputed interest on loans to a family member. Who was the borrower? How much was the loan amount? What happened to it — no imputed interest is reported from 2009 onward? Was the loan paid?

At press time, the Clinton campaign had not responded to any of our inquiries. ■