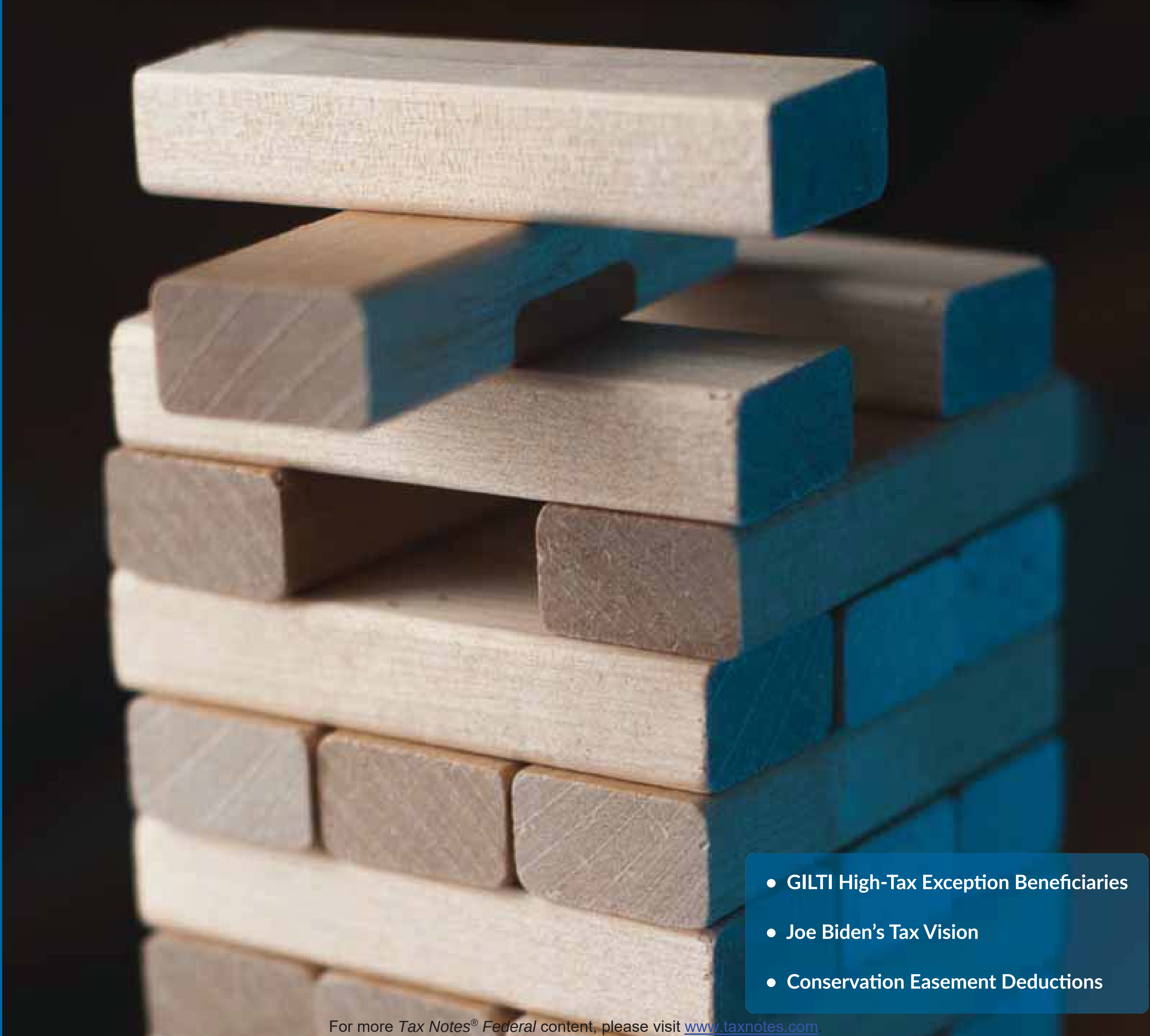
taxnotes® federal

Volume 168, Number 8 ■ August 24, 2020

How the Tax Court Can Account for Risk in *Medtronic* Transfer Pricing



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NEWS ANALYSIS

Candidate Biden's Tax Returns

by Lee A. Sheppard

Joe Biden played high school and college football as a running back.

A substantial chunk of the base is being asked to vote for a figurehead to get the Obama team back together. Biden's acceptance speech sought to emulate his former president — both in its vague hopefulness and its Trump trolling. He tried to reclaim lunch-bucket issues. He vowed to "end this chapter of American darkness." There would be a mask mandate, more virus testing, and more money for schools. Biden exceeded the low expectations for his speech — some of which emanated from his own side.

"Twelve years ago, when I began my search for a vice president, I didn't know I'd end up finding a brother. Joe and I came from different places and different generations. But what I quickly came to admire about him is his resilience, born of too much struggle; his empathy, born of too much grief," former President Obama said, emphasizing personality in his lukewarm endorsement. He discouraged Biden from running and is said to be privately worried that Biden will mess things up (*Politico*, Aug. 14, 2020).

Even if he were healthy, which is not a given, Biden would be a poor candidate. During the primaries he lost his train of thought and got into inexplicable dust-ups with voters. He can't tolerate questions, even by friendly interviewers. He had two aneurysms in 1988, which required surgery. We don't know.

Although it lacks a bench of experienced governors, the Democratic Party did have better presidential possibilities, such as Ohio Sen. Sherrod Brown. Where were they? Back when a potential candidate had to make a decision, the economy looked good and was at full employment as it is measured by the government's funny numbers. People had jobs, and wages had ticked up. At the low-wage end, immigration had been somewhat reduced and U.S. manufacturing output had increased, although manufacturing no longer employs many people. The president seemed in a stronger position, and no candidate wants to run to lose.

The coronavirus lockdowns and racial discord put paid to all that, but these phenomena came too late for good candidates to enter the race. The primaries were essentially over. Primary voters were threatening to pick Sen. Bernie Sanders, I-Vt. — the primary electorate being notably to the left of the general electorate. They had rejected donor favorites Sen. Kamala Harris, D-Calif., and South Bend, Indiana, Mayor Pete Buttigieg. So the Democratic establishment and the donor class had to settle for Biden, dragging him across the line in a tiny, unrepresentative Southern state.

The former vice president is now the Democratic nominee. His financial life is characterized by a long-standing habit of living beyond his means. He was the son of a car dealer. In those days, when men made all the buying decisions, dealers sold dreams as much as they sold cars. Biden borrowed for the American dream, and recently got rescued by book deals. It's a cautionary tale.

Tax Returns

Biden's acceptance speech did not use the word inequality. Since he left the vice presidency, the Bidens have earned $15 million in speaking fees and book royalties. That's a pittance compared to Hillary Clinton's nine-figure haul, which may mean the donor class didn't see Biden as a serious presidential contender.

Formed in 2017, CelticCapri Corp. is a Delaware S corporation owned by Biden that receives his speaking fees. Giacoppa is another S corporation that receives Jill Biden's speaking fees, and which earned income in those two years and paid her a salary.

Biden exceeded expectations for his acceptance speech. (Democratic National Convention/CNP/Polaris/Newscom)

CelticCapri and Giacoppa are described on the Bidens' tax returns as S corporations in which the owners materially participate. Their earnings are described as ordinary income. Office of Government Ethics (OGE) financial disclosure forms require that the business of an entity be identified. CelticCapri and Giacoppa are described as being in the business of speaking and writing engagements.

On his 2019 financial disclosure Form OGE 278e filed with OGE, Joe Biden reported as much as $5 million in assets tied up in CelticCapri; it was valued between $1 million and $5 million. Biden reported an additional $2 million in liquid assets held in bank accounts, mutual funds, and whole life policies. Jill Biden reported slightly more than $1 million of assets mostly comprised of Giacoppa. OGE forms are idiosyncratic. They combine income and assets in a single section, and not all assets are required to have a value assigned.

The OGE form instructions ask for the value of a business owned by a candidate. The instructions don't prescribe a valuation method for a personal service business. For a solo legal practice, the instructions say to total the assets, but goodwill is an asset. OGE believes that a profits interest is valuable enough to report, but does not require a value to be ascribed to it. It's not clear how the Bidens' S corporations might have been valued, and the acceptable ranges are wide.

We don't know whether the S corporations hold the copyrights to the Bidens' books. Jill Biden's book, reported on Schedule C-EZ, earned $862 in 2017. OGE form instructions say that each book copyright has to be reported on a separate line, even if the copyright is held by an entity that is also listed. The Bidens' books appear on separate lines with no value attached.

CelticCapri collects Biden's cut from ticketed events and pays him a small salary. Biden earned between $66,000 and $234,000 for each ticketed book tour appearance. The Bidens listed the income from book tours as honoraria on their financial disclosure forms. According to the OGE form, Biden's paymasters were Creative Artists Agency, Live Nation, Bill Blumenreich, and various promoters. Biden was on the road for months at a time doing ticketed book tour events.

On his OGE form, Biden reported a share of CelticCapri's earnings, which represented less than its income reported on 2017 and 2018 tax returns. The total listed honoraria shown on the OGE form reported for the S corporation, except wages and salaries, is $6,884,894, but total distributable net income from tax returns is $9,490,857 for 2017 and $2,730,524 for 2018. The OGE form seems to be short by $5,336,630.

On his OGE form, Biden listed book tour ticket receipts identified with high specificity, but what's the source of the rest of his income from CelticCapri? OGE instructions say that payers of honoraria have to be identified.

"In comparing Mr. Biden's financial disclosure with his tax returns for 2017 and 2018, the returns indicate his actual income was over $5.5 million more than was reported on the financial disclosure," said Steven Bankler, the San Antonio CPA who helps *Tax Notes* analyze returns.

Likewise, Jill Biden's reported income from Giacoppa on the OGE forms is less than the distributive net income amount that was reported on the two tax returns. She reported slightly more than $1 million of income for Giacoppa, and on the OGE form $634,000 is reported for book tour proceeds. She also didn't disclose the $300,000 salary Giacoppa paid her on the OGE form but reported it on the two tax returns.

Book advances could account for the difference between the tax returns and the OGE forms. Biden could have received a large advance for his book and reported it in 2017. Biden is believed to have a seven-figure book contract for several books, the first of which was his 2017 book

Promise Me, Dad. That book was a *New York Times* bestseller and is available on Amazon for $6 (*Politico*, Mar. 8, 2018, and *Politico*, Apr. 5, 2017).

Book advances against future royalties are not recoverable by publishers, which often overpay for political books that flop. Advances are not loans. The publisher eats the difference if the book doesn't earn the advance. Advances are reportable as income on tax returns and OGE forms. What might have been the reason for failure to report advances on the OGE forms? Biden hadn't filed an OGE form since 2016, so the 2019 form was a catch-up.

CelticCapri and Giacoppa would be filing Form 1120S that wouldn't be disclosed. Those corporate returns would provide information about salaries and expenses. Actual receipts should be higher than reported on the tax returns. The Bidens would have to pay agents, managers, and travel expenses. Chartered jets and hotel suites would add up.

Biden appears to have been paying his own travel expenses. Usually on a promoted tour, the artist would be paying his own expenses. A Creative Artists Agency contract for Biden's 2018 appearance at the Broward Center in Fort Lauderdale had a rider asking for Coke Zero and a plate of angel hair pasta. Ticket prices ranged between $50 and $300; Biden got a flat $150,000 fee instead of being paid 85 percent of the gross ticket receipts. For this event, Biden reported $135,000 income on his OGE form, indicating that CelticCapri absorbed travel expenses (*New York Post*, Feb. 26, 2019).

> ***Many politicians have arranged for their speaking fees and book royalties to flow through S corporations, which is kosher as long as the entity pays its owner reasonable compensation.***

Jill Biden files a Schedule C-EZ for her book. If the taxpayer uses a Schedule C instead of an S corporation, then he or she would be paying SECA taxes and the expenses would be visible on political disclosure of personal returns. Insofar as audit potential is concerned, any Schedule C with more than $50,000 of total positive income is an audit candidate, whereas an S corporation with millions of dollars of income wouldn't be an audit candidate. And as a corporation, an S corporation's expenses would not be an audit target. "You can bury a lot of sins in that 1120S," said Bankler.

Biden was accused of using the S corporations to dodge payroll taxes the first time he griped about the president's payroll tax collection holiday. He reiterated that criticism in his acceptance speech. If all the Bidens' book royalties and speaking fees were reported as self-employment income, nearly $500,000 more in payroll taxes would have been payable (*The Wall Street Journal*, Aug. 10, 2019).

Many politicians have arranged for their speaking fees and book royalties to flow through S corporations, which is kosher as long as the entity pays its owner reasonable compensation. CelticCapri paid Biden $146,000 in salary in 2017, when it earned $9.5 million, and $300,000 in 2018, when it earned $3 million. Biden's CelticCapri salary reported on the OGE form is $425,000, which doesn't match either year reported on tax returns, $145,833 for 2017 and $300,000 for 2018, or the total.

Biden's salary from his S corporation was less than 10 percent of his distributive net income in his highest-earning year. "The IRS could make a legitimate argument that reasonable compensation to the shareholder for the performance of services would surely exceed the compensation he was paid," said Bankler.

But in some circles this arrangement is seen as a loophole because the entity would have zero earnings if the owner didn't show up. The Obama administration proposed subjecting all such personal services earnings to payroll tax in Treasury's fiscal 2016 budget proposals. The proposal would have equalized self-employment taxes for professional services corporations, subjecting them to self-employment taxes.

The Treasury green book groused that "the taxation of employment income earned by owners of pass-through entities is outdated, unfair, and inefficient. It treats business owners differently according to the legal form of their ownership and the legal form of the payment that they receive." Treasury argued that the income in question is equivalent to self-employment earnings, which would be subject to employment taxes.

Moreover, the "reasonable compensation" determination for S corporation owners depends on facts and circumstances and requires a valuation analysis, making it difficult for the IRS to enforce. Instead, Treasury proposed to move the argument to whether the owner providing services materially participated in the business under the passive activity loss rules and associated regulations without the limited partner exception (section 469). If so, the owners would be subject to SECA taxes on their distributive shares of S corporation income, including amounts paid as compensation.

As a former vice president, Biden earns a large pension, which is reported on tax forms but not reportable on OGE forms. He earns quite a bit from the University of Pennsylvania, where he holds a professorship from which he is on leave. His university salary reported on the OGE form is $540,484, which doesn't match either year reported on tax returns, $371,159 for 2017 and $405,368 for 2018, or the total.

Politicians are supposed to make a show of giving to charity, and over the years, the usually cash-strapped Bidens haven't given much. The recipients were churches, civic organizations, and his own foundations.

After it became clear he was running in 2020, one would have thought that the pair would have ramped up their giving. They did, but as of 2018 it still didn't hit 10 percent of their adjusted gross income. They raised their giving from 2 percent or less in previous years to 9 percent in 2017, their biggest-earning year, and almost 5 percent in 2018.

Biden's total charitable contributions from 2004 through 2018 represent a small percentage of his income from those years. "During his tenure as both a senator and VP, his charitable donations shown on his tax returns from 2004 through 2016 averaged 1.52 percent of his gross income. After leaving office, his charitable deductions on his 2017 and 2018 tax returns averaged 8.26 percent," Bankler explained.

Real Estate

Biden, by his own admission, is seduced by real estate. On his Amtrak runs, he read *Architectural Digest*. Most members of the Senate are rich, and Biden emulated their lifestyles, for which he borrowed heavily and often reported negative net worth. He parlayed his financial straits into an average-guy image (*The Wall Street Journal*, Feb. 28, 2020).

Within three years of being elected to the Senate, he bought an abandoned DuPont mansion. The property was a hole in the ground he threw money into — all his money went to maintenance. He sold it for $1.2 million, six times the purchase price, a decade later, and put the proceeds into his current house, the basement of which he's using as a campaign headquarters. Last time we visited Biden, he had two mortgages on this 6,800-square-foot, custom-built, colonial-style house on a 4-acre lakefront property in the Greenville section of Wilmington, Delaware. It is currently worth roughly $2 million. (Prior coverage: *Tax Notes*, Apr. 26, 2010, p. 366.)

In 2017, shortly after signing the book deal, the couple added a $3 million six-bedroom Rehoboth Beach house to their real estate holdings. Personal residences do not need to be disclosed in candidate financial disclosure, nor do associated mortgages. According to his OGE form, Biden reports his net worth as between $2 million and $8 million, without the houses, which would add approximately $5 million. Biden also rents a large house in McLean, Virginia, for visits to Washington (*The Wall Street Journal*, Feb. 6, 2020).

Biden, by his own admission, is seduced by real estate. He parlayed his financial straits into an average-guy image.

On OGE forms, residences and mortgages do not have to be reported unless they are earning income. (Oddly, Senate-confirmed nominees must report all residential mortgages.) Reportable liabilities are those exceeding $10,000 and include boat loans, capital commitments, credit card debt, exercised lines of credit, margin accounts, residential mortgages, student loans, noncommercial loans, and loans for which the candidate cosigned and has a current legal obligation to repay. Alimony, trade or business debt, loans from relatives, car loans, and credit card debt do not have to be reported.

Did the Bidens finally pay their mortgages, which still showed up on their tax returns as late as 2018? We don't know. The pair took out two mortgages totaling $1.3 million in 1995 when they built the Wilmington house. As of 2018, he was still paying and deducting nearly $30,000 annually in mortgage interest on the main house.

While vice president, Biden rented the Wilmington guesthouse to the Secret Service. He reported nearly $1 million in liabilities on his 2016 OGE form, which would include the mortgages. Rental income was reported on tax returns through 2017. But there is no rental income on his 2018 return or his 2019 OGE form. So technically, any remaining mortgage would not be reportable on his OGE form. On the 2019 OGE form, the Bidens reported only $150,000 of debt, part of which was as cosigner on a loan for his late son, Joseph "Beau" Biden III.

What About?

But what about President Trump's tax returns? We're not likely to see them before the election. As this article was being written, the Southern District of New York dismissed the Trump challenge to a Manhattan grand jury subpoena for financial records and tax returns in a criminal investigation of nondisclosure payments to strippers. The president will appeal the court's rejection of his argument that he is absolutely immune from criminal investigation while president (*Trump v. Vance*, No. 1:19-cv-08694-VM (S.D.N.Y. Aug. 20, 2020)).

Why are we dissecting Biden's relatively primitive financial life when Trump's finances are so complicated? The president's latest OGE Form 278e, filed in 2019, reported a net worth of $1.7 billion, indicating that his image rights have diminished in value. Tax returns are not financial disclosure forms, and they do not tell the whole story. ■

ECONOMIC ANALYSIS

CARES Act Second-Quarter Effects: S&P 500 Companies Report to SEC

by Martin A. Sullivan

The tax provisions of the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136) are intended to provide liquidity and maintain employment. According to official estimates, nearly $700 billion should be available to American businesses during the first 18 months after enactment, three-quarters of that in fiscal 2020 (ending September 30). But with notable exceptions — like Marathon Petroleum Corp., which is expecting a $1.1 billion refund — the tax benefits of the CARES Act don't seem like a big deal for most of the companies comprising the S&P 500.

In the 90-day period ending August 17, 10-Q reports were filed with the SEC by 463 of the companies comprising the S&P 500. Of those 463 companies, only 257 even mentioned the CARES Act. And of those 257, less than half indicated that CARES Act tax provisions had a noticeable effect. By "noticeable" we mean the company reported that one or more of the CARES Act provisions had an impact — whether quantified or not — on its tax expense or cash flow. (In this analysis, mere mention or recitation of the provisions in the CARES Act is not considered to indicate there was an impact.)

Net Operating Losses

The Tax Cuts and Jobs Act ended carrybacks of net operating losses. The CARES Act reinstated them, and more. Instead of the prior-law carryback period of two years, the CARES Act allowed losses generated in 2018, 2019, and 2020 to be carried back five years. Because the corporate tax rate was 35 percent before 2018 and is now 21 percent, these carrybacks are especially lucrative.

We identified 32 companies that reported they were benefiting from the CARES Act NOL provision. Of those, 16 provided quantifiable amounts. Sometimes those were the amount of refunds (or accounts receivable) attributable to a carryback. Sometimes the amounts represented the effect of the income tax provisions (that is, the