GEORGETOWN UNIVERSITY LAW CENTER
WASHINGTON, D.C. 20001

MARTIN D. GINSBURG
PROFESSOR OF LAW

(202) 639-7030
(202) 662-9077

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**VIA HAND DELIVERY**

The Honorable Connie Mack
100 Luna Park Drive, Apartment #380
Alexandria, Virginia 22305

Dear Connie:

I very much enjoyed our spur-of-the-moment lunch last Friday at which I mentioned a few non-governmental sources of information but, most unfairly, left you to scribble notes. Here are the correct titles for the sources I mentioned.

- *A Comprehensive Analysis of Current Consumption Tax Proposals*, a report of the ABA Section of Taxation Tax Systems Task Force that was published by the American Bar Association as a soft cover, not-too-thick book in 1997. The preliminary chapter by Greg Jenner and the transition issues chapter by Ron Pearlman, together with commentary on those issues by Dan Halperin, are particularly helpful I think.

- *Flat Taxes and Consumption Taxes: A Guide to the Debate,* published in December 1995 by the Tax Division of the American Institute of Certified Public Accountants. It runs a couple of hundred pages but is accompanied by an 8-page Executive Summary.

- *The U.S. Income Tax,* a paperback book published by W.W. Norton, was written by Yale Law Professor Michael J. Graetz and is the most current version (written in 1999) of his original book that was titled "The Decline (and Fall?) of the Income Tax." In it Mike champions the combination of (1) a generally applicable consumption tax plus (2) an income tax with a very high (e.g., $100,000) standard deduction applicable, as a result, to a fairly small percentage of taxpayers. Of course, Mike does a good deal more than that in his book which is entirely readable and, among academics at least, influential.

DIRECT MAILING ADDRESS: SUITE 800, 1001 PENNSYLVANIA AVENUE, N.W., WASHINGTON, D.C. 20004-2505
FAX: (202) 639-7008

I also enclose a copy of the mercifully much shorter National Tax Journal article I wrote to suggest ways in which tax practitioners would dismember the Nunn Domenici USA Tax proposal. You may find the opening and closing segments, if not the miserably technical middle, interesting.

If I had all this stuff in front of me and were trying to decide where to begin, I believe I would begin with Mike Graetz's book. It is certainly readable and, whether in the end you agree or disagree with his legislative proposal, the history and background should prove instructive.

I hope we will have a chance to talk again, particularly as I am committed to purchasing the next lunch.

Regards,

Martin D. Ginsburg

MDG:mlw
Enclosure

# NATIONAL TAX JOURNAL

# LIFE UNDER A PERSONAL CONSUMPTION TAX: SOME THOUGHTS ON WORKING, SAVING, AND CONSUMING IN NUNN-DOMENICI'S TAX WORLD

**MARTIN D. GINSBURG***

To tax plans old and new, I bring the certainty of a famous *New Yorker* cartoon.[1] Three staff members are reporting to their senator. The senior staffer sums up: "Sir, we've come to the conclusion that it's absolutely impossible to assemble a tax plan that *doesn't* benefit the rich."

At the threshold, I am told, I am to assume that in fall 1995, effective January 1, 1996, the 104th Congress enacts and President Clinton signs into law the USA Tax Act of 1995, S. 722, precisely in the 290-page form this grand legislation was introduced on April 25, 1995 by Senators Sam Nunn (Democratic-Georgia), Pete Domenici (Republican-New Mexico), and Bob Kerrey (Democratic-Nebraska).[2] This exorbitant assumption embraced, my task is to imagine plausible answers to the simple question, "And then what happened?"

Forecasting the tax bar's delighted response to a truly sweeping and novel legislative proposal barely off the ground is great fun. The legislation seems unlikely of enactment, surely unlikely of enactment in the form introduced, and therefore none ever will prove how wrong I was. Thus comforted, I proceed to a selective review of S. 722[3] and then hazard some tax planner responses, but preface the entire exercise with what is intended as a provoking observation. The Nunn-Domenici tax world is one in which municipal bonds pay interest in even years only, executive compensation and the yield on at least one class of each corporation's stock is paid only in odd years, and the rich with borrowed money buy raw land or works of art they admire but may not expect to keep forever.

## THE PROPOSED USA TAX SYSTEM

### *Overview*

S. 722 would do away with both the individual and the corporate income tax, and AMT as well, substituting at the individual level a broad-based, graduated (three rates) personal consumption tax—unlimited deduction for net new savings—and at the entity level (partnerships, LLCs, and

*Georgetown University Law Center, Washington, D.C. 20001.

proprietorships, as well as corporations) a flat rate (11 percent) business tax that turns out to be a subtraction-method value-added tax (VAT).[4] In addition, while the current employment tax system would persist, the individual's share of payroll taxes is a (refundable) credit against the individual tax[5] and the employer's share is a credit against the business tax.[6]

### *The Business Tax*

The business tax is imposed on "a business entity that sells or leases property or sells services in the United States."[7] Thus, all business entities—corporations, partnerships, LLCs, and sole proprietorships—are treated alike: each is a taxpayer and none is a passthrough entity.[8] The tax rate is 11 percent and the tax base is the taxable year's *gross profit,* defined as the amount by which (1) taxable receipts (which include receipts from the sale or use of property and performance of services in the United States, exclude interest on credit sales and other financial receipts,[9] but include amounts received in providing "games of chance") exceed (2) the business entity's deductible amounts for the taxable year.[10]

Deductible amounts include "the cost of business purchases in the taxable year," and business purchases expansively include the acquisition of property, the use of property (*i.e.,* rental payments), and the acquisition of services, in each case for use in a business activity in the United States.[11] However, every expenditure is not a business purchase. Some major exclusions:[12]

(1) Payments for use of money or capital, explicitly interest and dividends.[13]
(2) The acquisition of "savings assets"[14] or "financial instruments," the latter defined[15] as properties remarkably similar to savings assets.
(3) Premiums for life insurance.[16]
(4) Compensation expenses—wages, salaries, retirement plan contributions, premiums for life, health, disability, or other insurance benefiting the service provider or her family, various other fringe benefits, and the cost of property purchased to provide compensation—if the service provider is an employee of the business entity.

In sum, for the U.S. business leasing or selling goods or services, operating gross receipts—but not dividends, interest, and other "financial" income—are included in the tax base and the cost of business purchases—a term that includes rental expense and compensation paid for services furnished by independent contractors—is deductible,[17] but neither now nor ever may the business enterprise deduct dividends, interest expense, or employee compensation.

Now, not *every* purchase by a business entity is a "business purchase." In particular, the acquisition of unimproved land will qualify if the business entity rents out the real estate (at full value),[18] but will not qualify as a business purchase if the land will be held for speculation, subdivision or other development, leasing on a temporary basis, use not commensurate with underlying value (*e.g.,* a temporary parking lot pending construction of an office building), or simply an indefinite future use in a business activity.[19] In any of these circumstances the business entity, denied a purchase deduction, will hold the land at a basis equal to its undeducted purchase price. If in a subsequent year the land is put to full current business use (*e.g.,* when improvements on the land are placed in service), cost is deductible as a business purchase at that time.[20] Also, to take the polar case, if the business entity acquired land as rental property and thus took an immediate de-

duction for the entire cost, and in a subsequent taxable year the realty ceases to qualify as rental property (because put to a nonbusiness use by, *e.g.*, having been leased at a below-market rent),[21] the realty (and any associated debt) "shall be treated as distributed by the business entity to its owners."[22]

An individual in her human-being capacity is not a business entity conducting a business activity, but an individual engaged in business activity is, with respect to that, a business entity subject to the business tax.[23] An individual proprietorship running the corner newsstand is an example; an independent contractor is another; individually owned property leased full-time for full and fair rent is yet another. The need for an exception is patent. If an employee were deemed a business entity and her employment its business activity, wages could be taxed three times: first to the employer (no deduction for wages paid employees in computing the business tax base); a second business tax, this time on the employee's business entity; and third, the individual tax that is imposed on the employee herself.[24] S. 722 avoids the employee's second tax, announcing that the performance of services by an employee for a business entity employer is not a business activity for purposes of the business tax.[25] Additionally, and sensibly, "business activity" does not include casual or occasional sales of property used by an individual (other than in a business activity).[26]

A successful business entity in the throes of expansion, new factory, new offices, new equipment, materials, and inventory, in a given year will have aggregate business purchases far in excess of its taxable receipts. The difference is a loss,[27] and while the loss cannot be carried back to obtain an immediate refund of business tax previously paid, under the business tax it is a loss carryover good for 15 years.[28] Of course, if a number of taxable years of expansion are anticipated, the present value of that 15-year loss carryover will not be great unless it can be put to more immediate use.

The business tax's treatment of losses incurred after 1995 contrasts sharply with the treatment the business tax accords losses incurred, pre-1996, under the old regime. S. 722 announces that no deduction is allowed under the business tax for net operating loss carryovers, capital loss carryovers, or "any other loss carryovers" from the days of the income tax, and no credit carryovers are allowed either.[29] They simply go "poof."

A very different transition rule applies to embedded asset basis, the unrecovered basis as of January 1, 1996 of business assets acquired, created, or placed in service under the old regime. The business tax accords a transition basis adjustment or deduction—no poof here—by establishing four categories of business assets and allowing the aggregate basis in each category to be amortized over a set period. Unrecovered inventory costs, for example, are amortized over 3 years; depreciable property that enjoys on January 1, 1996 a remaining recovery period of less than 15 years is amortizable over 10 years.[30]

Under the pre-1996 Internal Revenue Code, whole law school courses were taught and grand careers in tax practice were made concentrating on transactions among business entities and their owners. It is too much to hope that all of the Byzantine rules and requirements of historic corporate tax law retain vitality in Nunn-Domenici's tax world. They do not. However, the new tax world presents its own challenges. To appreciate them, it is first necessary to review the proposed USA tax for individuals because contribution and distribution transactions and business

combinations implicate both entity-level business tax considerations and individual tax considerations.

### *The USA Tax for Individuals*

The individual tax component of the new system imposes a tax on personal consumption at graduated rates (up to 40 percent). For those who prefer a tie to the familiar, the new individual tax has been described as "a broader-based individual tax with an unlimited deduction for net new saving . . . imposed using a three-tier graduated rate schedule."[31] The individual tax proposal departs from recognized cash flow consumption tax design, and attracts the description of an "income tax with an unlimited deduction for net new saving," by excluding borrowed money from the tax base (and concomitantly allowing no deduction for interest payments and debt repayments) while allowing, some of the time and perhaps a lot of the time, a deduction for savings generated with borrowed money.[32]

Gross income for the taxable year is all income from almost every source derived—wages, salary, and other compensation for services; most fringe benefits including the cost of employer-financed health insurance; distributions from business entities including dividends, interest, rents, and other compensation for use of capital; life insurance proceeds; and gains on asset sales[33]—but does not include gifts and bequests,[34] amounts that are treated as taxable receipts of a business entity under the business tax,[35] and tax-exempt bond interest.[36]

The important changes are on the deduction side. Child support payments are now deductible (like alimony)[37]; the individual tax law continues to afford a personal exemption ("personal and dependency deduction" in the new world) for each exemption reflected in the tax return[38]; and an enlarged standard deduction, redesignated the Family Living Allowance, now is available to taxpayers whether or not they itemize deductions.[39] On the other hand, few itemized deductions persist; reidentified "USA deductions,"[40] they are a homeowner deduction (old law's home mortgage interest deduction but without the home equity line),[41] a philanthropic transfer deduction (old law's charitable contribution deduction, modestly modified),[42] and a new education deduction of up to $2,000 of qualified higher-education expenses of each eligible student (the taxpayer, the taxpayer's spouse, and the taxpayer's dependents), but limited to a maximum annual education deduction of $8,000.[43]

However, among post-1995 deductions the Big Pineapple is the unlimited deduction for net new saving. In S. 722 it is called, in search of the perfect acronym, the Unlimited Savings Allowance, and is announced to be "intended to reflect the amount of net new savings other than new savings attributable to borrowings or tax-exempt interest."[44] As Professor Warren has demonstrated with great care, some algebra, and a dozen simple examples,[45] S. 722 is rather more complicated and, as Professor Kaplow convincingly argues, will attract a full measure of responsive taxpayer manipulation.[46]

More than a century ago, Private Willis assured us that in Great Britain everyone born into the world alive is either a little Liberal or a little Conservative.[47] Stability there. In the United States after 1995, on the contrary, without regard to political persuasion everyone decently wealthy will be a net saver in some (perhaps odd-numbered) years and a net dissaver in other years. Transition, from old tax to new, is the first reason but by no means the only reason.

Net saving in any year equals what you put into savings in excess of what you

withdraw (above any available basis you may have in the withdrawn asset or account).[48] Net withdrawal is the reverse.[49] The savings deduction is not simply for the year's "net savings," however, and a net withdrawal in any year does not inevitably attract individual tax liability. There is more to it.

"Deductible net savings,"[50] which does reduce individual tax, is (1) the year's net savings minus (2) a number you get by adding up these three so-called nontaxable sources of funds—(a) your nonexempt debt as of the end of the taxable year over your nonexempt debt at the beginning of the taxable year,[51] plus (b) any interest you receive during the year on tax-exempt bonds,[52] plus (c) the basis (normally from pre-1996 investments) of savings withdrawn this year.

Thus, if in 1996 you (1) enjoy gross income of $500,000 and save $400,000 more than you withdraw from savings, but during the year you foolishly (a) borrow $135,000 to buy cars for the family, (b) receive $250,000 of municipal bond interest, and (c) discover that incident to this year's modest savings withdrawals you also "withdrew"—forget for the moment how—$40,000 of historic basis, your deductible net savings are limited to $10,000.[53]

What happens to the other $390,000 of net savings, on which you have just been taxed? Obviously you should not be taxed on this same amount later, when you withdraw funds from savings to repay debt, live riotously, or whatever. The USA Tax mechanism to allow later tax-free withdrawal of the previously taxed $390,000 is a general basis account[54] to which is added at the end of 1996 $390,000—the lesser of (1) your net savings ($400,000) or (2) your "nontaxable sources of funds" ($390,000). Well and good, but there is another way to see it: Neither borrowing nor receiving tax-exempt interest nor recovering historic basis is a smart idea in a year in which you are a net saver.[55]

Is there no way quickly to free up the basis you amassed in savings during the days of the income tax? Indeed there is, provided you did not amass much: Not more than $50,000 in "qualified savings assets," which are all the savings assets you have on January 1, 1996, excluding only (1) your ownership interest in a nonpublic business entity to which you regularly provide services and (2) if you so elect, your retirement accounts.[56] If you are a small fish, so described, say $45,000 in aggregate basis, this $45,000 of "transition basis" electively is deductible one-third ($15,000) each year in 1996, 1997, and 1998, with a year-to-year carryover of any unused deduction,[57] and your asset basis is properly and promptly reduced to zero. However, if you (together with your spouse) are a more than $50,000 savings basis fish, it is transition basis that is zero[58] and your asset basis remains what it was, doing you no good so long as you continue to qualify as a net saver.

Suppose in 1996 your gross income was small and, choosing not to invest this year, you instead withdraw $40,000 from savings and expend it along with your $135,000 of borrowed money and $250,000 of municipal bond interest. You are a 1996 net dissaver. Neither tax-exempt income nor borrowings, whether exempt or nonexempt, go into the tax base of a net dissaver, and your "net includable withdrawal income" —the amount that is to be added to your 1996 tax base—is limited to that $40,000 withdrawal from savings, less your basis if any allocated to the savings asset you disposed of, and in all events less the balance in your general basis account (which is thereby reduced dollar-for-dollar).[59]

For potential net dissavers, as you can see, it pays to have a sizable general basis account.

In sum, in 1996 you borrow or otherwise obtain and consume all sorts of money, but you are taxed on little if any of it. In all likelihood, you will not concern yourself about the tax until the future year in which you repay your debt. A strange sort of consumption tax, is it not?

A few miscellaneous notations will wrap up this brief introduction to the USA individual tax and its centerpiece, the Unlimited Savings Allowance. While a great many purchases give rise to additions to savings—payment of a life insurance premium, even a term life insurance premium, is a somewhat unexpected example[60]—some do not. Savings assets do not include investments in land whether made directly or through investments in business entities whose "primary purpose" is investment in land.[61] Thus, the investor in undeveloped land or in a land company obtains no current deduction and holds the property at a basis reflecting her investment.

Savings assets also do not include "cash on hand,"[62] a collectible[63]—a Picasso painting, a Rodin sculpture, the Hope Diamond—or "the investment in any business entity, the purpose of which is to hold collectibles for appreciation."[64] Amounts contributed to a hobby activity—pleasurable, revenue generating, but not intended to earn a profit—are not additions to savings.[65]

The receipt of a gift or bequest is not gross income.[66] An in-kind transfer of a savings asset is not a taxable withdrawal from savings by the donor.[67] Transfer of cash or a bank account is a withdrawal by the donor and (if the cash is then invested) an addition to savings by the donee.[68]

As noted earlier, amounts that are treated as taxable receipts of a business entity under the business tax—for example, my proprietorship supplies to third parties my "independent contractor" professional services as a chef for the occasional great family dinner—are not gross income to me under the individual tax.[69] My individual tax liability will mature when I receive a payment or distribution from my proprietorship.

Finally, sprinkled about the USA Tax statute are antiabuse provisions, sad testimonials to the drafters' quite reasonable fear that the tax bar is poised to do them in. In paranoid focus, for example, are (1) an *inter vivos* gift "made primarily to effect a transfer of tax liability to a taxpayer in a lower tax bracket,"[70] which I would have accounted a fairly trivial concern at this late date in our tax history; (2) acquiring a savings asset "with funds borrowed for the purpose of increasing the taxpayer's Unlimited Savings Allowance";[71] and (3) taxpayers "borrowing against their savings to consume rather than withdrawing their savings."[72] The last two concerns are not trivial, but antiabuse rules of this sort suggest, not that the problems are thereby solved, but rather that there are basic flaws in the Unlimited Savings Allowance.

### *Transactions Among Business Entities and Their Owners*

#### Contributions

A cash contribution to business entity B by individual A is a saving by her (but not a net saving if the cash is withdrawn from a different investment) under the individual tax, and is not a taxable receipt by B under the business tax.[73] If A contributes to B property that A has just bought from Z for the purpose, it is as if B bought from Z with cash furnished by A.[74] If A contributes to B personal use property—property used by A at any time other than in a business activity[75]—B has no income or deduction and enjoys a carryover basis in the property[76] and A is given no addition to savings[77] but is awarded basis

in her interest in B equal to the lesser of her basis in the p.u. property or its fair market value.[78] A's contribution to B of a financial asset is, I would guess, a carryover basis transaction in which neither A nor B has any income or deduction under, respectively, the individual tax and the business tax.[79] Finally, if A contributes services to B for an ownership interest, B is awarded no deduction[80] and A, having received a savings asset, has no net income.

A's contribution to B of an asset used by A in a business activity is a transfer, not by A the human, but by a business entity to a business entity. That transaction implicates only the business tax and under it neither entity has a deduction or a taxable receipt. If the transfer were in cash, the results would be the same.[81]

### Distributions

For both liquidating and nonliquidating distributions, General Utilities stays repealed. Indeed, repeal is extended to all business entities and is not limited solely to corporations. B's initial distribution to A is a sale to A at fair market value as reasonably determined by B.[82] Under the individual tax, it is a savings withdrawal by A, but if the property is a savings asset or is converted to business use, for A this much of it is a wash.[83] Additionally, under the business tax, real property will be treated as distributed if used by B for a nonbusiness purpose for more than an insubstantial period of time during the taxable year.[84]

There are two exceptions to the rule that in-kind distributions are fully taxable to B. First, if the distributee is a controlling business entity—the direct or indirect owner of more than 50 percent of the capital or profits interest in B—it is nonrecognition and tax attribute carryover for both parties.[85] Second, if p.u. property is distributed by B to A and A originally contributed that property to B, then (1) in computing B's gain on its deemed sale to A fair market value equals the p.u. property's basis plus any enhancements in value attributable to business purchases with respect to the property,[86] and (2) A's basis in the p.u. property is equal to her basis in that property at the time of contribution (but not more than her predistribution basis in B) and her basis in B is concomitantly reduced.[87]

If the distribution is not just p.u. property back to the contributor, there is one point on which it matters if B's transfer to A is or is not a distribution in "complete liquidation" of B: If A has basis in her interest in B, under the USA individual tax she can offset that basis (allocating to cash, savings assets, and other property received) only if B's distribution is in complete liquidation.[88]

Finally, the dividing up of a business entity—a spin-off, split-off, or split-up—triggers no immediate business tax consequence.[89] At the individual investor level no income is realized (one savings asset has become two) and her basis, if she has any, will be allocated among her new and old entity holdings proportionate to relative values.[90]

### Sale of Business Assets

We consider here the class of transactions in which one business entity (T) transfers some or all of its assets to another business entity (P) for consideration that does *not* include equity (*e.g.*, "corporate stock") in P or in a P subsidiary.[91] Under the business tax, T has sold assets and the consideration received is allocated among those assets applying the rules of current Code § 1060, subject to the ability of T and P to reach a mutually binding and reasonable allocation agreement.[92] Alternatively, if P acquires from T substantially all of either T's assets or a line of business of T or "a separately standing

business" of T, P and T may jointly elect to treat the acquisition as if it were the acquisition of stock of a business entity holding the assets transferred, a transaction that is subject to the merger and stock acquisition rules of § 213 and not to the asset acquisition rules.[93]

If the "treat as a stock sale" election is not made, or indeed cannot be made because P has not acquired substantially all of the relevant T assets, there is one rule left to consult. If T's business predated 1996, T almost certainly holds transition basis assets and is amortizing transition basis in up to four categories.[94] Because all transition basis has been reallocated to amortization accounts, the respective transition basis assets have no basis.[95]

What happens to T's transition basis property amortization accounts when T makes a big sale of assets to P but there is no election to treat the transaction as a sale of stock? The answer is, nothing—T keeps the accounts—*unless* P and T jointly elect to have P assume the amortization deductions attributable to the assets sold.[96] The election is available only for a "substantial sale"[97] and, if it is made, T's taxable receipts on the asset sale are reduced by the unamortized accounts' balance and P's cost of the business purchase is reduced by the same amount.

## Mergers and Stock Acquisitions

Tax simplification is on the horizon. Under the business tax, nothing happens. At the entity level, T and P, no income, no deduction, and T's loss carryovers and other tax attributes (*e.g.*, transition basis amortization accounts) are inherited by P. In the USA business tax there are no "don't traffic in NOLs" rules similar to current Code §§ 382 through 384, or even to § 269. In the business tax no one has heard of the continuity of interest doctrine, and that seems a very good thing.[98]

At the individual investor level, A's exchange of T stock or other T ownership interest for P stock or other P ownership interest is a nontaxable exchange of savings assets, with substituted basis if A has basis in T. If in the exchange A receives cash "boot" in addition to P stock, the boot is a withdrawal from savings under the USA individual tax.

A final observation on asset transfers to and from business entities. If T owns as one of many assets an operating factory building worth $1 million and transfers the building to P for $1 million cash, T has a $1 million taxable receipt and P a $1 million deduction. The results are the same if P pays T with a P debt obligation or with stock of X, a corporation unrelated to P. The latter arrangement should be disaggregated, viewed as if P paid T $1 million in cash and T then used the cash to purchase the X stock from P (on which deemed sale of a financial asset P would not be subject to USA business tax).

But if P pays T by delivering to T $1 million of P stock, as I read the proposed statute[99]—a reading that may be faulty to be sure—T does not have a taxable receipt and P has no deduction, just a carryover of T's (presumably zero) basis. Restated in pre-1996 terms, Code § 351 is shorn of its 80 percent control requirement and now applies all over the place.

One may view in a similar way the rule for contributions of p.u. property by individual A to widely-held business entity P in exchange for P stock.[100] A has no income and gets no deduction, and instead holds the P stock at a basis equal to her basis in the p.u. property, reduced by any encumbrance on the property to which P succeeds. P has no income and gets no deduction, and inherits A's basis in the p.u. property. These would be the tax results under current Code §§ 351, 357, 358, and 361, if § 351 did not contain an 80 percent control requirement.

## AND THEN WHAT HAPPENED?

The proffered review of S. 722 is selective in attempting to suggest some of the provisions and positions that seem likely to confuse the tax advisor, or attract her responsive tax plan, or some of each. In what follows, I will try to put a measure of flesh on the collection of bones.[101]

### *Before the January 1, 1996 Effective Date*

#### NOLs and Other Carryovers

Because carryovers will go poof on January 1, 1996, they should if possible be promptly converted to a tax attribute that will survive the changeover. Basis will survive, under both the USA individual tax and (usefully converted to transition basis amortization) the USA business tax.

Sell the right amount and sort of appreciated property (*i.e.,* capital gain property with appreciation sufficient to match the capital loss carryover).

If you are an individual selling investment assets, put the proceeds (cash, which is basis on the hoof) in your bank account *not* in your brokerage account.

If you are a corporation with an NOL and the appreciated assets you would sell are difficult to transfer to a third-party, even with a leaseback, do not despair. Organize a 99-percent owned partnership (see to it that the other 1 percent is in friendly hands) and contribute the appreciated assets to the partnership. Just before you do this, be sure that you have filed a consent under Code § 341(f)(2) and that one of your more-than-5-percent shareholders promptly thereafter sold at least one of her shares to anyone other than her spouse.[102]

#### Corporate Debt Restructure

After 1995 a business entity will not be allowed an interest deduction. Retire corporate debt in 1995. Substitute lease financing. A nice thought: If you have assets eligible for installment sale, sell for a buyer's note that will come due in 1996 and leaseback. It would appear that the 1996 gain will be taxed under the USA business tax, which may mean, if the buyer's note is viewed as a financial asset, no business tax at all.

#### Individual Debt Restructure

Money borrowed before 1996 for consumption or to purchase a savings asset will, if not repaid until after 1995, attract disadvantageous tax consequences under the USA individual tax. This is because post-1995 interest on pre-1996 debt is not deductible (unless the debt is a home mortgage), while the earnings used to pay the interest are includable in the individual's gross income. The individual is well advised to pay, before the end of 1995, all 1995 interest that is deductible under Code § 163, and to repay the debt before the end of 1995 if the necessary funds can be raised without attracting significant income tax liability.[103]

#### Postpone Excess Investment Gains

Other than to offset losses that will otherwise go poof, see "NOLs and Other Carryovers" above, gains on investment assets are best deferred to 1996 when they will be exempt from USA business tax and deferrable under the USA individual tax through the Unlimited Savings Allowance. Those who appreciate tax deferral (or tax elimination) but wish to lock up an economic profit will consider the acquisition of a put option, a short sale against the box, or an equity swap. It is unclear, at least to me, how the USA Tax reacts to each of these strategies.

#### Fattening Individual Bank Accounts

Under the USA individual tax asset basis survives transition, but all asset basis is not equally available for use. Basis in an

individual's adjusted general basis account is best because it is most available. Basis in investment securities held in a brokerage account is poor because it is stacked last on withdrawals. Basis in a bank account is good because it will promptly become part of the general basis account. It is good planning to fatten the bank account and slim down the brokerage account, prior to 1996, provided it is done in a way that does not trigger undesired 1995 gains.

### Consider Combining Business Activities

Under the USA business tax, a business entity that has business purchases in excess of taxable receipts in any year has generated a loss that cannot be carried back and can be carried forward 15 years. If Ms. A owns two business entities, the one just described and another that every year generates substantial taxable receipts in excess of business purchases, she will be grumpy, and rightly so, if she cannot offset the losses in business 1 against the profits in business 2 each year.

Under the USA Tax Act it is wonderfully unclear if and when the results of operations of two business activities can be combined.[104]

Postponing a restructure until after 1995 is possible, but prudence argues for restructuring now so that the business activities are properly configured at all times commencing the January 1, 1996 effective date of the USA business tax. Thus, Ms. A might now transfer both businesses to a single corporation, or one business to a parent corporation and the other business to its wholly owned subsidiary. If each business is currently in a separate partnership, the two partnerships might be combined into one or might be incorporated into a single entity or into a parent-subsidiary corporate configuration.

### Consider Postponing the Sale of Your Home

If you have lived in your home at least 3 years out of the last 5, are 55 years of age, and contemplate a sale gain that will not exceed $125,000, you should sell before the close of 1995.[105] Otherwise, for reasons explored hereafter, you should consider waiting until next year or the year after.

### Fund Your Issue

If you can afford it—and what tax planner would wish to represent a taxpayer of only slender means?—be sure that on January 1, 1996 each of your children and grandchildren owns qualified savings assets (cash in the bank, publicly traded securities) that have an aggregate basis of $50,000 or a little bit less, but in no event even a penny more.[106]

### Consider Divorce

The USA individual tax presents its unfair share of marriage penalties. If on January 1, 1996 your son and daughter-in-law own qualified savings assets with an aggregate basis of just under $100,000, no transition basis adjustment for them.[107] If they divorce the week before and divide their qualified savings assets equally, on January 1, 1996 each will be under the $50,000 Plimsoll Line and each will enjoy happy years of transition basis deductions. Should only one of them have outside income, payments to the other of alimony and child support[108] will take care of that.

Divorce may be in your interests, as well as in the interests of your kids. The new deduction for qualified higher-education expenses is up to $2,000 for each eligible student, but the maximum annual deduction is limited to $8,000.[109] If you have

eight children you currently are higher educating at $2,000 per year each,[110] marriage is imposing a significant penalty. Divorce, split the children four a piece, and equalize incomes by paying and receiving alimony. You will double the annual education deduction, from $8,000 to $16,000.

Does it matter what sort of school the kids attend? A so-called "white flight" institution, I believe, would not qualify as an eligible education institution under new § 10(b)(2)(B).[111] Now, how about a parochial school?

By the way, maintaining two households rather than one joint return, your aggregate family living allowance will increase from $7,400 to $10,800.[112]

### *After 1995: Some Planner's Tools*

Facing the USA individual and business taxes, the planner will think about the tools the statute places at hand.

(1) Investments are immediately deductible, but with exceptions. One exception is the purchase of a collectible, the Hope Diamond or a Picasso painting, or something a bit cheaper. A second exception is land if the land is not currently leased for a full and fair rental. Simply holding cash in hand (rather than in the bank) generates no deduction. Thus, by the investment she makes or does not make, the taxpayer can elect for the current year saving/deduction or no saving/no deduction.

(2) In any year, a savings deduction, otherwise available, is reduced by the amount of net nonexempt borrowing in that taxable year. Net nonexempt borrowing is the excess, if any, of nonexempt debt at year-end over nonexempt debt at the beginning of the year. Thus, if the taxpayer incurs $1 million of nonexempt debt in year 1 and, paying interest currently, maintains the debt balance through the close of year 2, the taxpayer has no "net nonexempt borrowing" in year 2, and on down the years so long as the taxpayer maintains the debt position.[113]

(3) In applying the Unlimited Savings Allowance and the deferred-income adjustment,[114] each taxable year stands on its own. The USA individual tax contains no rule of the sort found in Code § 1231(c) under which a later year's tax reporting changes in consequence of an earlier year's reporting of a different transaction. Thus, it is entirely possible to arrange an individual's financial affairs to alternate years of net saving and years of net dissaving.

(4) Ms. A, an individual service provider to P, a business entity, may be P's employee, in which event the compensation paid by P for her services is not deductible in computing P's business tax liability. However, the relationship can be established as a "loaned employee" arrangement in which Q, a different business entity (Ms. A may or may not have an ownership interest in Q), employs A and seconds her services to P for a fee paid by P to Q.[115] In this configuration, P's fee payment is deductible by P and is income to Q; for its compensation payments to A no deduction is awarded Q. If P is currently profitable while Q enjoys a sizable post-1995 business tax loss, the arrangement will be attractive to all parties and the pricing will reflect the tax benefit Q through its intermediation has conferred on P.[116]

(5) The USA business tax bifurcates sale proceeds, when goods or services are sold on credit, into a (taxable) payment for the product or service and a payment for delay that is not income to the seller and is not de-

ductible by a business entity buyer. If, however, the customer is an individual, not a business entity, she can deduct neither component of the price and presumably is indifferent to the relative size of its segments.

### *Some Illustrations of Life and Work Under the USA Tax Act*

### A Basic Strategy for the Truly Rich

Here is the basic strategy, in a few simple steps.

*Withdraw Opening Basis in 1996.* The USA business tax converts a business entity's 1996 opening basis to deduction streams that are essentially unaffected by subsequent taxpayer actions. The USA individual tax does not follow that sensible course when the aggregate basis of savings assets exceeds $50,000. The individual taxpayer is obliged to plan for it, and if she is rich—ample pre-1996 savings—she should do just fine.

(1) Early in 1996 shift investment basis to the general basis account by (a) a simple election in the case of bank accounts[117] and (b) selling all marketable securities and closing all brokerage accounts.[118] (It is okay for the moment to open a new brokerage account with a new broker and reestablish investment positions.) Selling a savings asset at a loss is fine for this purpose: the loss goes directly to the general basis account.[119]

(2) Shift a reasonable part of the investment portfolio into tax-exempt bonds that pay interest only in even years (of which the first is 1996).[120] It is safe to predict that once the USA Tax becomes law, there will be lots of product like this available for acquisition.

(3) Shift a reasonable part of the investment portfolio to stocks and bonds that pay cash dividends and cash interest only in odd years (1997 will be the first). Once again, after 1995 there should be lots of product available.

(4) Renegotiate the compensation package so that the bulk of cash compensation is payable only in odd years (1997 will be the first).

(5) Before the end of 1996, withdraw in cash from savings an amount equal to a fair part of the total general basis account. This is a net withdrawal year, obviously, and hence this recapture of historic savings basis will not be taxable.

(6) Take the largest part of 1996's tax-free money—historic savings basis plus tax-exempt interest—and before the close of 1996 buy either (a) the Hope Diamond (or other collectibles of ensured value)[121] or (b) land that is *not* leased for a full rental appropriate to its underlying value.

(7) Consume the rest of the tax-free money in 1996. Prepay some 1997 consumption if you can (buy the 1997 vacation package now).

*Save in 1997.* In 1997 the taxpayer will receive large amounts of gross income in the form of dividends, interest, and compensation. She should invest as much of the funds as possible in taxable securities that yield only in odd years, and in tax-exempt securities that yield only in even years. These investments are 1997 deductions against 1997 gross income.

The taxpayer needs money for consumption in 1997. Her sale of the Hope Diamond, or the real estate, or an appropriate part of either, will generate consumable funds but not gross income.

*And on Down the Line.* In 1998 the taxpayer again has low gross income and again will be a net dissaver, recapturing another part of the general basis account. These funds plus tax-exempt interest finance 1998 consumption, the purchase

of collectibles and land, and even some prepayment of 1999 consumption.

In 1999 it is back to saving, coupled with any necessary consumption withdrawals, not from savings, but from land and collectibles.

### Sell Your Fine Home

Mr. H owns Tara, a fine home. His basis is $5 million and the property is worth $15 million. Mr. H is happy at Tara, but willing to move to equivalent housing.

In 1996 Mr. H sells Tara for $15 million cash. He promptly purchases a new principal residence, Boutwell. He pays the $15 million purchase price $3 million in cash and $12 million by executing a long-term note secured by a mortgage on Boutwell.[122] Mr. H invests his surplus $12 million cash in collectibles, land, consumption, and anything but savings assets.

In subsequent years Mr. H saves much gross income as it is received, and never acquires savings assets with any of the $12 million. Over time the collectibles and land are turned back into cash and the cash consumed. Mr. H never borrows against his savings.

This example is to be tested against the § 58 antiabuse rules none of which, I believe, hits the mark.

### Long-Term Nonexempt Borrowing

In 1996 wealthy Ms. K borrows long-term $2 million on her spotless personal credit. With the funds she purchases a tract of undeveloped land for a long-term investment. The property is operated temporarily as a parking lot and throws off only enough earnings to defray part of the carrying costs.

Property values go up and in 1999 Ms. K, revising her original investment plan, sells the land for $3 million cash. Her 1999 gross income from other sources is $1 million. Ms. K decides not to repay the $2 million personal loan—interest rates have gone up and the loan is advantageous from the viewpoint of the borrower—and, while considering her options, Ms. K invests her $3 million land sale proceeds in a money market fund at the end of 1999.

I suggest Ms. K has beaten the system, and that her 1999 USA individual tax liability is zero.

### *Summing Up*

Many questions might be added. For example, may Mr. Rich consume in odd years and save in even years, while Mrs. Rich, filing a separate return, does the reverse? Or is it necessary to the plan that Mr. and Mrs. Rich divorce and live together in wealthy sin?

If in 1996 a corporation acquires land for business use and in 1999 that land turns into a nonbusiness asset, the USA Tax finds a deemed corporate distribution. If in 1999 a corporation acquires, with business intent, an asset that turns out to be a collectible, is there a deemed distribution?[123] Whether of land or collectibles, precisely who are the deemed distributees if the corporation is capitalized with various classes of common stock, convertible and nonconvertible preferred stock, convertible and nonconvertible debt, and warrants that are in-the-money?

Corporate stock that has a basis (from income tax days) less than current value can, after 1995, be reconfigured tax-free into (1) corporate stock with a value equal to its basis and (2) other corporate capital instruments that have value but no basis. Are the benefits to be derived from manipulating this isolated basis structure superior to the benefits to be obtained through manipulation of the general basis account?

- How comfortable should the creators really be in their tax world in which NOLs are freely transferable in corporate acquisitions, and readily exportable through loaned employee and equivalent arrangements?

All of these questions and concerns, all of the suggestions for manipulation set out earlier, and the many others that time and experience would bring forth, urge that Professor Warren's "tentative conclusions" [124] concerning the superiority of a standard consumption tax model over the USA Tax's Unlimited Savings Allowance, and Professor Kaplow's determinations with regard to the recovery of preenactment basis,[125] are absolutely correct. I would only add that conjoining tax-exempt bond interest with a savings deduction for the purchase of those bonds, as the USA Tax would do, seems to me genuinely flaky. In any event, a cash flow consumption tax that (1) includes borrowed amounts in the tax base and (2) does not hold the recovery of preenactment basis hostage to taxpayers' postenactment conduct, may not solve all of the problems and eliminate all of the opportunities real life and the tax bar can produce—the rich will persevere—but it will perform measurably better the task to which the Nunn-Domenici proposals are addressed.

## Conclusion

*The New Yorker* got it right.

### ENDNOTES

1 *The New Yorker Magazine,* January 14, 1985, p. 35.

2 The April 25 introduction of S. 722 was preceded by the wide circulation (as a Special Report Supplement to the March 13, 1995 issue of *Tax Notes)* of a lengthy paper entitled "Description and Explanation of the Unlimited Savings Allowance Tax System," prepared for Alliance, USA by Ernest S. Christian and George J. Schutzer (hereafter, the "USA Explanation"). The USA Explanation is helpful in analyzing S. 722 but the two do not inevitably match, *e.g.,* S. 722 embraces the accrual method for its business tax although the USA Explanation announced that all businesses will report on the cash method.

3 In attempting to understand just what S. 722 is attempting to do and how, I have been greatly aided by, in addition to the USA Explanation, the following more recent papers. *Description and Analysis of Proposals to Replace the Federal Income Tax* (JCS-18–95), prepared by the Staff of the Joint Committee on Taxation (June 5, 1995), hereafter "Joint Committee Pamphlet"; Alvin C. Warren, Jr., The Proposal for an "Unlimited Savings Allowance," *Tax Notes 68* (August 28, 1995): 1103, hereafter "Warren Paper"; Louis Kaplow, "Recovery of Pre-Enactment Basis Under a Consumption Tax: The USA Tax System," *Tax Notes 68* (August 28, 1995): 1109, hereafter "Kaplow Paper"; Alan L. Feld, "Nunn-Domenici and Non Profits," *Tax Notes 68* (August 28, 1995): 1119, hereafter "Feld Paper"; Bernard Wolfman, "Corporate Tax Issues Under the Nunn-Domenici Consumption Tax," *Tax Notes 68* (August 28, 1995): 1121, hereafter "Wolfman Paper." I have cribbed shamelessly from all of them.

4 Joint Committee Pamphlet 38. Thus, export sales are not taxed and imports are subject to an 11 percent import tax. S. 722 §§ 286-288.

5 S. 722 § 21.

6 S. 722 §§ 281-282. Under the business tax, excess credit is not refundable and instead carries forward a maximum of 15 years. S. 722 § 283.

7 S. 722 § 201(b).

8 While subchapters K and S of present law thus disappear, subchapter T (Code § 1381-1388 relating to cooperatives and their patrons) in large measure persists, see S. 722 § 260 (qualified patronage dividend).

9 S. 722 § 203(e) defines *financial receipts* to include interest, dividends, and other distributions by a business entity, proceeds from the sale of financial instruments including corporate stock and other ownership interests in business entities, and proceeds from annuities and life insurance policies, currency hedging and exchanges, and other financial transactions.

10 S. 722 §§ 202, 203.

11 S. 722 §§ 204, 205(a).

12 *See* S. 722 § 205(a)(3).

13 The proposed statute, S. 722 § 205(a)(3)(A),

announces an exception to nondeductibility "to the extent that a portion so paid is a fee for financial intermediation services." The proposed treatment of financial intermediation services and businesses, §§ 235-246, turns the mind to mush. Section 246, dealing with a business entity which, although not "regularly" in the business of providing financial intermediation services, engages in "significant" financial intermediation activity anyway—no doubt out of sheer perversity—strikes a ringing blow for tax simplification. I shall write no more on this perfidious subject.

[14] *Savings assets* is defined in S. 722 § 53(b) to include stocks, bonds, securities, certificates of deposit, investments in partnerships and proprietorships, shares of mutual funds, life insurance policies, annuities, and "other similar savings or investment assets."

[15] In S. 722 § 242(b)(3).

[16] S. 722 § 238.

[17] One cannot safely say immediately deductible, because the business taxpayer is ordinarily on the accrual method of accounting and the economic performance rules, Code § 461(h), apply. S. 722 § 220.

[18] S. 722 § 232.

[19] S. 722 § 230.

[20] S. 722 § 230(d).

[21] See S. 722 § 232(b)(2)(A).

[22] S. 722 § 232(c). That deemed distribution, in turn, under S. 722 § 211(a) is treated as if the business entity sold the property "to its owners at fair market value." Because the business entity would have deducted the property's cost in a prior year, the property's full value is part of the entity's gross receipts for business tax purposes.

[23] S. 722 § 206.

[24] Alternatively, only two taxes might be imposed but, inappropriately, both would be borne directly by the employee (business tax on her business entity and personal tax on her wages) and the "true employer" would be awarded a deduction for compensation paid the employee's business entity.

[25] S. 722 § 206(c)(1). The same provision announces that "business activity" does not include the performance of regular domestic household services (baby-sitting, housecleaning, lawn cutting, etc.) by an employee of "an employer that is an individual or family."

[26] S. 722 § 206(b). The illustration given is the sale by an individual of her used car.

[27] In fact, the loss will be greater than the described difference, by the amount of the "transition basis adjustment" for the taxable year. See S. 722 § 290 (amortization of transition basis), described below.

[28] S. 722 § 207(b)(1).

[29] S. 722 § 292.

[30] S. 722 § 290. Depreciable property with a remaining recovery period of 15 years or more is awarded a 30-year amortization period, and nondepreciable property used in a business activity in 1996 and previously placed in service is awarded 40-year amortization provided that property, were it initially acquired by the business entity in 1996, would have been immediately deductible under the business tax.

[31] Joint Committee Pamphlet 38.

[32] In the standard cash flow consumption tax model, a dollar borrowed goes into the tax base and a dollar committed to saving is deducted in computing the tax base. Under that arrangement, borrowed money can increase but can never decrease the net amount that otherwise would have been subject to consumption tax, in the year of borrowing, had the borrowing not occurred.

[33] S. 722 § 3.

[34] S. 722 § 4(a)(3).

[35] S. 722 § 4(a)(12).

[36] S. 722 §§ 4(a)(4), 91. Section 4 catalogs a miscellany of other exclusions mainly derived from current law, *e.g.*, Code §§ 104(a)(2) (compensation for injury and sickness), 107 (parsonage allowance), and 119 (meals and lodging furnished for the convenience of the employer).

[37] S. 722 § 5.

[38] S. 722 § 6.

[39] S. 722 § 7.

[40] S. 722 § 8.

[41] S. 722 § 9.

[42] S. 722 § 11. See Feld Paper 1119–20.

[43] S. 722 § 10. The maximum annual deduction is limited to $4,000 in the case of married individuals filing separate returns, and all dollar amounts are adjusted for inflation commencing 1997. See S. 722 §§ 10(d), 24.

[44] S. 722 § 50(a).

[45] Warren Paper 1104–8.

[46] Kaplow Paper 1109–18.

[47] W.S. Gilbert, *Iolanthe*, Act II (1882).

[48] S. 722 §§ 52(a)(1), 53(a), (b), 54.

[49] S. 722 § 52(b)(1).

[50] S. 722 § 52(a)(2).

[51] S. 722 § 55. Nonexempt debt is the principal amount of plus accrued interest on indebtedness that is not exempt debt. Exempt debt is limited to (1) principal residence debt (home mortgage), *see* § 9, but without regard to the $1 million limitation that relates to the interest deduction in § 9; (2) debt to acquire a consumer durable, up to $25,000; and (3) an additional $10,000.

[52] S. 722 § 91.

[53] Savings of $400,000 less $390,000, which is the sum of nonexempt borrowing $100,000 [equal to $135,000 less (a) $25,000 and (b) $10,000], tax-exempt interest $250,000, and $40,000 basis of savings withdrawn during the taxable year.

[54] S. 722 § 57.

[55] See Warren Paper 1105.

[56] S. 722 § 12(d).

[57] S. 722 § 12.

[58] S. 722 § 12(c)(1).

[59] See S. 722 § 52(b), defining net includable withdrawal income, and § 57 defining general basis account (GBA) to reflect for each year: (1) if the taxpayer is a net saver, a GBA increase equal to the lesser of (a) net savings or (b) nontaxable sources of funds; (2) if the taxpayer is a net dissaver, a GBA decrease equal to the net withdrawal; (3) if a savings asset having a basis is disposed of for less than that basis, an increase equal to the "loss"; and (4) an elective addition to GBA under § 57(c) when sale of a principal residence and investment of the proceeds produces a savings deduction in excess of the year's income. In addition, § 57(d) affords a one-time election in the 1996 tax return to increase the GBA by the January 1, 1996 balance of the taxpayer's bank accounts (which thereafter have no basis). It is unclear why the USA Tax does not award a similar election with respect to historic brokerage accounts; historic brokerage accounts in fact are treated far worse (a "recover basis last" approach) by § 56(a)(3).

[60] See S. 722 § 53(a)(3), USA Explanation 1559. On the other hand, proceeds of life insurance are not exempt from USA individual tax, *cf.* § 238(c) (business tax exemption), which requires the individual beneficiary to invest rather than consume the proceeds in order to postpone the tax.

[61] S. 722 §§ 53(c)(1), 1114 (land companies). However, "the activity of rental of real estate is a business activity," § 112(a), and hence the acquisition of rental real estate (fully leased for fair rent) should qualify as a deductible investment in a business entity, *i.e.*, a real estate rental proprietorship that is separately subject to the business tax, and not as a nondeductible investment in land.

[62] S. 722 § 53(c)(2).

[63] S. 722 § 53(c)(3).

[64] S. 722 § 53(c)(4).

[65] S. 722 § 113. *Cf.* Code § 183.

[66] S. 722 § 4(a)(3). Basis, if there is any, limited to fair value if lower, carries over from the donor or testator (no stepped-up basis at death). § 74.

[67] S. 722 § 56(c)(1).

[68] S. 722 § 56(c)(3).

[69] S. 722 § 4(a)(12).

[70] S. 722 § 56(c)(2).

[71] S. 722 § 58(a)(1).

[72] S. 722 § 58(c).

[73] S. 722 § 210(b)(1).

[74] S. 722 § 210(b)(2).

[75] S. 722 § 210(b)(3)(B). In the individual tax personal use property ("p.u. property") is defined with respect to personal use by A, anyone related to A, and anyone from whom A acquired the property at other than an arm's-length price. § 111(c).

[76] S. 722 § 210(b)(3)(A).

[77] S. 722 § 111(a).

[78] S. 722 § 74(b).

[79] For some reason S. 722 § 210, entitled Contribution to a Business Entity, does not appear to advert to this case.

[80] S. 722 § 210(b)(4).

[81] S. 722 § 210(a).

[82] S. 722 § 211(a).

[83] S. 722 § 75(d).

[84] S. 722 § 211(e). *Nonbusiness use* is defined in § 232(b)(2) to mean, *inter alia,* a use for which a fair rent is not paid. It is barely conceivable that the deemed distribution provision, § 211(e), is intended to apply to personal property (*e.g.*, collectibles) as well as real property, but the definitional reference in § 211(e) is solely to § 232, a provision that deals only with real property.

[85] S. 722 § 211(b)(d).

[86] S. 722 § 211(c).

[87] S. 722 § 75(d)(4).

[88] S. 722 § 75(d)(3). For an excellent discussion of the concerns focused by this differential individual tax treatment of liquidating and

nonliquidating distributions, see Wolfman Paper 1122–1123.

[89] S. 722 § 214. Allocation of tax attributes, carryovers and the like, between the entities is to be prescribed by regulations. Section 215.

[90] S. 722 § 75(c).

[91] S. 722 § 212(e). If P equity is exchanged as part or all of the acquisition consideration, the merger rules of § 213, reviewed below, govern the transaction.

[92] S. 722 § 212(a).

[93] S. 722 § 212(c). When a business entity sells stock, a financial asset, under the business tax the entity is not taxed. This election, to treat an asset sale as a stock acquisition, is current Code § 338(h)(10) in reverse. The proposed USA business tax contains nothing equivalent to current law's § 338(h)(10) election to treat a stock sale as a sale of underlying assets.

[94] See S. 722 § 290, reviewed earlier in this paper.

[95] S. 722 § 291(a).

[96] S. 722 § 291(b).

[97] More than 20 percent (in value or original cost) of T's assets are sold for total consideration that exceeds $1 million or 20 percent of T's taxable receipts of the immediately preceding taxable year.

[98] S. 722 § 213(a). The same business tax nonrecognition results obtain if P acquires, whether for cash or P stock, all or substantially all of the stock of (or other form of ownership interest in) T. Section 213(b).

[99] See S. 722 §§ 210(a)(2), 212(e)(2). See also USA Explanation 1571, which is supportive.

[100] See S. 722 § 210(b)(3), reviewed earlier in this paper.

[101] After this Nunn-Domenici paper was drafted I received from Professor Alan Feld his paper, "Living With the Flat Tax," which I promptly read with a view to stealing the flat tax concerns identified in the paper and presenting them as Nunn-Domenici concerns. But I failed. Not out of a sudden concern over propriety, but because a high percentage of the unanswered or misanswered questions identified under the flat tax are decently responded to in the proposed USA Tax Act (which presents a set of its own problems).

[102] The contribution to the partnership is a taxable exchange. See Reg. § 1.341–7(e)(2). It is irrelevant that the corporation is not in fact collapsible. Reg. § 1.341–7(a)(2)(ii).

[103] For a further discussion on preenactment individual debt, see Warren Paper 1107–8 (examples 10–12).

[104] See S. 722 §§ 301(b) (referring to proprietorships and calling for regulations), 302(a) (contemplating the filing of consolidated returns by business entities but written in a way that appears to prevent consolidation in the case of Ms. A's two businesses because she and not a business entity would be the "common parent").

[105] See Code § 121.

[106] See S. 722 § 12 (transition basis deduction).

[107] See S. 722 § 12(c)(2).

[108] Under S. 722 §§ 3(a)(7) and 5, child support and alimony are treated alike, deductible by the payor and income to the recipient.

[109] S. 722 § 10(c).

[110] This can happen. We have friends with nine children, each of whom has been educated both highly and costly.

[111] *Cf. Bob Jones University v. United States*, 461 U.S. 574 (1983).

[112] S. 722 § 7. The numbers will be adjusted for inflation beginning in 1997.

[113] S. 722 § 58 contains antiabuse rules, *e.g.*, "Borrowing to Generate Deduction," which the tax planner would consult and, employing adequate care and patience, almost certainly subdue. Decades of experience with Code § 269 lends comfort.

[114] Deferred income is defined in S. 722 § 51 as the amount of gross income that was previously deferred though the Unlimited Savings Allowance and that is treated as withdrawn from savings in a subsequent taxable year; the amount of deferred income for a taxable year is equal to the net includable withdrawal income (net withdrawal in excess of the balance in the taxpayer's general basis account) computed under § 52(b).

[115] See, *e.g.*, *Rubin v. Commissioner*, 429 F.2d 650 (2d Cir. 1970), rev'g 51 T.C. 251 (1968); *Robert E. Wilgus*, 20 T.C.M. 752 (1961); *Fontaine Fox*, 37 B.T.A. 271 (1938).

[116] A similar strategy on the asset side: Q purchases equipment on credit and leases to P; Q uses part of the rent to pay carrying costs.

[117] S. 722 § 57(d).

[118] S. 722 § 56(a)(2)(D).

[119] S. 722 § 57(b)(3).

[120] S. 722 § 122(b) makes it clear that OID accrual notions do not apply under the USA individual tax. Absent constructive receipt, it is "follow the cash."

[121] It is reasonable to anticipate that an industry will spring up to sell and to "guarantee" resale prices for collectibles so employed.

[122] Under S. 722 § 76, Mr. H would not recognize gain on his residence rollover.

[123] As pointed out in the Wolfman Paper 1121, neither the USA Tax Act as introduced nor the USA Explanation offers a clue.

[124] Warren Paper 1108.

[125] Kaplow Paper 1117–18.

SENATOR CONNIE MACK

2-10-05

Dear Marty,

I enjoyed our lunch together. Very informative. Thanks for your letter with the titles of the sources you + I spoke about.

We are about to start our hearings and I will be glad to get started.

Sincerely,

Connie