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Biden's Tax Plan Calls For Massive Spying

All Financial Account Data to be an Open Book to the IRS

The Treasury Department recently released its "General Explanations of the Administration's FY 2022 Revenue Proposals." This is the so-called Treasury "Green Book." Dated May 2021, the Green Book explains exactly how various elements of the Biden Administration's tax plan will operate.

In addition to the tax increases that have been talked about at length, the Administration would set up a comprehensive financial spying operation that would impact every American. The proposal is to establish a "comprehensive financial account information reporting regime." Green Book, pg 88. The purpose is to track and report to the federal government activities in all financial accounts. The law will require an annual report to the government showing "gross inflows and outflows with a breakdown for physical cash, transactions with a foreign account, and transfers to and from another account with the same owner." Ibid.

To say that this is a system of "comprehensive" spying is not hyperbole. The Green Book states:

> This requirement would apply to all business and personal accounts from financial institutions, including bank, loan, and investment accounts, with the exception of accounts below a

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> low de minimis gross flow threshold of $600 or fair market value of $600. Ibid.

What we're talking about here is the requirement that details on every bank account in America be reported to the IRS on an annual basis. The only exceptions will be those that showed less than $600 of in-and-out transactions, or which have a total value of under $600. How many millions of bank accounts are there in the U.S.? What kind of compliance burden will this impose on America's financial sector?

The footnote to the above paragraph reads:

> Current income reporting by financial institutions would be expanded to all entities, including certain corporations. Interest payments would be included in the loan account reporting. Transferee information would be reported for all real estate transactions on Form 1099-S. Ibid, pg 88, n.2

Moreover, we are not talking about just garden variety bank accounts. The Green Book goes on to explain that the requirements would apply to "[o]ther accounts with characteristics similar to financial institution accounts." This would include the likes of PayPal and similar accounts. The rules would likewise apply to "payment settlement entities," such as credit and debit card processing companies. They will be required to report "not only gross receipts but also gross purchases, physical cash, as well as payments to and from foreign accounts, and transfer inflows and outflows." Ibid, pg 88.

This doesn't end with financial institutions or payment processing companies. The reporting requirements also extend to "crypto asset exchanges and custodians." Ibid. The crypto rules would apply on three different levels.

First, reports will be required of all crypto exchanges and custodians on the status of accounts owned by U.S. citizens. Second, reports will be required "in cases in which taxpayers buy crypto assets from one broker and then transfer the crypto assets to another broker." Finally, all businesses (whether or not they are financial institution) that receive "crypto assets in transactions with a fair market value of more than $10,000 will have to report such transactions." Ibid, pg 88-89.

Under the proposal, the IRS is to be given "broad authority" to write regulations sufficient to implement and carry out this plan. There is little doubt in my mind that the agency has the framework for such regulations already queued up and ready to go. I say that because the IRS has been working for decades to build new and far-reaching information reporting requirements into the tax code. It seems that no legislative session passes without some new reporting requirement added to the law.

For example, a little-known provision in the Affordable Care Act, passed in 2010, imposed an egregious information-reporting burden on all businesses. The requirement was that businesses had to report total payments made to any person or to any other business, if the total amount of payments over the calendar year exceeded $600. This would have caused a literal explosion in the number of information returns filed with the IRS every year, which already exceeds 3.5 billion (that's *billion*).

Because of pressure I and others put on Congress regarding that measure, it was repealed before it could take effect. But that never deterred the IRS from pressing for more reporting. The mantra of the agency is, "Where there is information, there is compliance." As such, as far as the IRS is concerned, there is no amount of data that is too much; there is no level of reporting that is too invasive; and there is no point at which the invasion of personal privacy has gone too far. The IRS will never stop its demands for more data unless and until it has real-time access to every single detail of the financial dealings of every person and business in America.

This is perhaps the single most compelling reason we must abolish the income tax in its entirety and start over with the national retail sales tax. Only a national sales tax (not a flat income tax) will stop the ubiquitous spying by the federal government through the IRS on every person and business in the country.

Can John Wick Deduct His Business Expenses?

Are Expenses Associated With a Criminal Activity Tax Deductible?

BY SCOTT MACPHERSON

My home state of Arizona decriminalized marijuana by referendum in the November 2020 election. By some counts, marijuana is now legal for recreational use in 22 States (plus D.C.), and legal with a medical prescription in another 13 States, for a total of 35 out of our 50 States (plus the nation's capital). That's 70% of the country.

The Arizona laws took effect January 21, 2021. In just the first three months, two-dozen new dispensaries opened for business (an average of two a week). While this may be great for Arizona's internal economy, marijuana is still categorized as a "Schedule I controlled substance." As I wrote in the June 2019 issue of *Pilla Talks Taxes*, this means that under 12 U.S.C. § 812, it "has no currently accepted medical use in treatment" according to Uncle Sam, never mind what 70% of the States have said.

As a consequence of that federal categorization, 12 U.S.C. § 841(a) criminalizes the manufacture, distribution, dispensation, or possession of marijuana, again without regard to what 70% of the States have said.

This inconsistency between jurisdictions creates confusion and conflict for purposes of the federal tax laws. In the June 2019 issue of *PTT* I reported on the case of *Patients Mutual Assistance Collective Corp. v. Commissioner,* 151 T.C. 176. There the court held that a business that is illegal under 12 U.S.C. § 841 cannot claim expense deductions under Internal Revenue Code § 162 for purposes of its federal tax return.

That holding is based on tax code § 280E. That provision removes all tax deductions and tax credits for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) that are prohibited by Federal law.

In October 2019, the Tax Court repeated itself in the case of *Northern California Small Business Assistants Inc. v. Commissioner,* 153 T.C. 65. There, the petitioner was a medical marijuana dispensary legally operating in California under California law. The dispensary sued to challenge the denial of § 162 business expenses. The court held that § 280E does not violate the 8th Amendment (because it's not a penalty), and that it was enacted under Congress's "unquestionable authority to tax gross income pursuant to the Sixteenth Amendment." *Id.* at 70. As the court explained:

> Our precedent is unambiguous. Congress, rather than this Court, is the proper body to redress petitioner's grievances. We are constrained by the law, and Congress has not carved out an exception in section 280E for businesses that operate lawfully under State law. Until then, petitioner is not entitled to deduct expenses incurred in the operation of its drug-related business. *Id.* at 74.

So, despite Arizona's vote last November, all of the dozens of new dispensaries face the same reality: their business expenses are not deductible for purposes of federal taxes.

But, what if your client's business is to violate a different federal law? Let's say that your client is in the business of doing something criminal other than marijuana distribution. Let's go extreme: could John Wick, the fictional movie hit man played by Keanu Reeves, deduct his business costs under § 162?

According to the courts, yes, John Wick could, by either of two different ways.

The first is under § 162. In *Commissioner v. Heininger*, 320 U.S. 467 (1943), the Supreme Court allowed a dentist a business deduction for the cost of his fraud lawsuit. Heininger sold false teeth through the mail. The Postmaster General alleged that some of his advertised claims were false, and stopped his mail. That put him out of business, so Heininger sued for an injunction to reverse the stop order. He won at trial but was reversed on appeal (meaning, he was guilty of fraud).

He claimed a business deduction for the cost of the litigation. The Commissioner argued that the expense was not "ordinary and necessary" because committing fraud is not "ordinary and necessary." *Id.* at 471-72. The Supreme Court in contrast held that "ordinary and necessary" refers to what is normal and helpful for a business to do, and defending its operation from destruction certainly is normal and helpful. *Id.* at 471.

Further, "The language of Section 23(a) [the predecessor to § 162] contains no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible." *Id.* at 474. The court said it is not the purpose of tax laws to penalize an illegal business by taxing gross instead of net income. Consequently, hit man John Wick could deduct his expenses the same as Heininger.

The Court affirmed that holding in *Commissioner v. Sullivan,* 356 U.S. 27 (1958), where it held that rent and wages paid in the operation of an illegal (under Illinois law) bookmaking establishment were deductible as "ordinary and necessary business expenses."

The Sullivan Court explained:

> We said in *Commissioner of Internal Revenue v. Heininger,* 320 U.S. 467, 474, 64 S.Ct. 249, 254, 88 L.Ed. 171, that the 'fact that an expenditure bears a remote relation to an illegal act' does not make it nondeductible. And see *Lilly v. Commissioner,* 343 U.S. 90, 72 S.Ct. 497, 96 L.Ed. 769. If we enforce as federal policy the rule espoused by the Commissioner in this case, we would come close to making this type of business taxable on the basis of its gross receipts, while all other business would be taxable on the basis of net income. If that choice is to be made, Congress should do it. *Id.* at 29.

As noted above, Congress made exactly that choice with respect to Schedule I drugs. However, it has not done so with respect to criminal matters generally (and not as to John Wick's career choice as a hit man).

In 1966, in the case of *Commissioner v. Tellier,* 383 U.S. 687, the Court held that the taxpayer could deduct under § 162 his attorney's fees incurred in his unsuccessful criminal defense—emphasis on "*unsuccessful* criminal defense." As a threshold matter, the Court established that these were business expenses ("There can be no serious question that the payments deducted by the respondent were expenses of his securities business under the decisions of this Court, and the Commissioner does not contend otherwise.") and that this type of expense is "ordinary and necessary." Thus, they are generally deductible (the IRS actually conceded that fact). *Id.* at 689. But, the Commissioner and the Tax Court determined that even though the expenditures meet the literal requirements of § 162(a), their deduction must nevertheless be disallowed on the ground of public policy, because the taxpayer was found guilty of a crime.

The Supreme Court did not care about the crime, saying:

> [That view] finds no support, however, in any regulation or statute or in any decision of this Court, and we believe no such 'public policy' exception to the plain provisions of § 162(a) is warranted in the circumstances presented by this case." *Id.*

> at 690-91. "Income from a criminal enterprise is taxed at a rate no higher and no lower than income from more conventional sources." And the statutes for deductions make no distinction. *Id.* at 691. Congress would have to pass a law specifically disallowing this deduction, for the Court to countenance it. *Id.* at 693.

And scheduled drugs aside, Congress has not done that.

The Tax Court recognizes these holdings. In *Brizell v. Commissioner,* 93 T.C. 151, 165 (1989), the court quoted *Tellier* for the point that, "We start with the proposition that the Federal income tax is a tax on net income, not a sanction against wrongdoing." A decade later, in *DiFronzo v. Commissioner,* T.C. Memo. 1998-41 (1998), the court held that a taxpayer was entitled to § 162 business deductions in connection with criminal activity.

DiFronzo was found guilty of conspiracy, mail fraud, and wire fraud, in connection with "his business activities as a member of the Chicago organized crime family." *Id.* at *3. He sought to deduct the legal fees incurred in his unsuccessful trial. As a stepping stone the court found that he was engaged in gambling operations, which is a business operation, and thus § 162 was applicable. The court then applied *Tellier* and *Sullivan* to conclude:

> Although it would seem contrary to public policy to allow a deduction in the conduct of an illegal and highly reprehensible criminal activity, it has been established that such is not sufficient to deny a deduction otherwise allowable. … [T]he payment here of legal expenses is no more illegal than the payment of rent or utility charges. *Id.* at *4.

John Wick's business expenses are no more illegal than the payment of rent or utility charges, either. His airplane tickets, new suits and shoes so that he blends in, a hotel room and meals, pistols and shotguns, ammo, knives, and body armor are all legal. It is true, however, that the pistols, shotguns, knives and body armor would have to be capitalized and depreciated since they have a useful life of more than one year, unless an election is made on the return to 179 the expenses in the year they are put into service, or unless he discards them at the scene, but that does not change the point.

The nature of Wick's work requires that most of his supplies are used once and then discarded, and that creates a great deal of front-end business expenses deductible under § 162. Pencils, too, are legal, so for purposes of his federal tax computation, John Wick can deduct the cost of any pencils with which he kills a target in violation of the law in all 50 States. However, the guy running a marijuana dispensary in Arizona cannot deduct anything to do with the cost of running his legal business (other than the cost of goods sold).

Really? Yes, really. In *Blanning v. Commissioner,* T.C. Memo. 2004-201 (2004), the court again followed *Tellier* and *Sullivan* to hold that the taxpayer was entitled to § 162 business deductions in connection with criminal activity concerning "illicit property transactions." He was prosecuted and found guilty under state law, and imprisoned for an unspecified amount of time. Still, according to the court, he was entitled to his § 162 deductions.

In my June 2019 article I reported that the Tax Court's solution to this inconsistency was to split the business into a trafficking side and a non-trafficking side. Section 280E does not block deductions for, e.g., caregiving services that complement marijuana purchases. So, one potential solution for dispensary clients is to educate and encourage them to increase the deductions that courts will allow.

But in the movies John Wick maintained that he was retired, that he was not in the assassination business any longer. That raises a second possible alternative: § 212. In *Johnson v. Commissioner,* 72 T.C. 340 (1979), the Tax Court followed *Tellier* to hold that a deduction under either § 162 or § 212 for the legal expenses of a criminal defense would be deductible. Mr. Johnson was part of a criminal operation to defraud the government with false income tax refund claims. The court said:

> Moreover, while we recognize that since the Supreme Court's decision in *Commissioner v. Tellier, supra*, there is no longer any public policy objection to the deduction of legal expenses incurred in the unsuccessful defense of criminal charges,

> such expenses to be deductible must still meet the requirements of either section 162 or section 212. *Id*. at 347.

The Tax Court then discussed the elements of those two statutes, and found "that [Mr. Johnson's] legal expenses arose in connection with the production of income within the meaning of section 212(1)." The key is "production of income," and the case of *Peters, Gamm, West & Vincent, Inc. v. Commissioner,* T.C. Memo. 1996-186 (1996) expands on that point.

There, the court found that the underlying expenses did not arise out of business activity, and therefore it did not allow a deduction under § 162. But, because the expense did arise out of a personal profit-seeking venture, the taxpayer could deduct it under § 212 instead. "The origin of the claim herein," the court said, "was not in the trade or business of PGWV, but rather in Peters' separate activities. The legal expenses were incurred defending a claim which had its origin in a transaction that was not part of PGWV's business and which benefited Peters personally." *Id*. at *6. But, the expenses arose from a profit-seeking activity. ("The final element will be met where the activity proximately results from the taxpayer's profit-seeking activity." *Id*. at *9.) Therefore, the expenses were deductible under § 212.

In the movies John Wick is not exactly doing his thing for profit, so maybe § 212 would not apply to him. However, the point is that there is a court-recognized alternative for what amounts to business deductions that one can claim without having a separate business. That statute also applies to expenses for "the determination, collection, or refund of any tax." The key difference between § 162 and § 212 is that business expenses under § 162 are reported on Schedule C (for self-employed persons) and therefore reduce one's Social Security tax liability. Section 212 expenses do not.

In short, our wise and honorable politicians determined that it is in our best interest to allow business deductions for fraud, criminal mobs, and even for professional assassinations, but not for the business of selling pot. At the same time, though, they wrote a couple of potential alternatives that we should keep in mind now that 70% of the state governments disagree with Uncle Sam's policy.

Editor's Note: ***Dan Pilla's Small Business Tax Guide*** presents detailed analysis of what constitutes a business activity engaged in for profit, and what constitutes an ordinary and necessary business expense. The lessons in the book are essential for all business owners and tax pros representing businesses.

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Renewed Push to Regulate Paid Preparers

Plan Would Establish "Minimum Competency Standards"

About 60% of all tax returns filed are prepared by paid tax pros. Another 20% are self-prepared using some kind of tax prep software, such as Turbo Tax. Most professional preparers are CPAs or Enrolled Agents (those admitted to practice before the IRS). However, the law is such that no license or permit—or even minimum training—is required to declare oneself a professional tax preparer. All one need do is hang out a shingle, prepare a tax return and charge a fee. Presto! You're in business as a "tax pro." Those who prepare returns under such conditions are referred to as "unenrolled paid preparers."

In speaking out against encroachment on liberty by the state, my late father used to say, "Name three things you can legally do without a license or permit from the state." Even dogs and bicycles have to be licensed in most jurisdictions. But not tax preparers. And that seems quite odd given that the tax code consists of more than 4 millions words and is changed with monotonous regularity, and also considering the fact that the preparation of a tax return necessarily requires the knowledge and interpretation of complex legal concepts. Yet, any 18-year old fresh out of high school can call himself a tax pro and prepare tax returns professionally. And while I'm thinking about it, why does one have to be 18 years old to prepare returns?

For over a decade, the IRS has been pushing to create licensing requirements for unenrolled preparers. In 2009, the IRS conducted a formal review of its regulatory scheme. Shortly thereafter, the IRS amended Circular 230 (the regulations governing enrolled preparers) to regulate the practice of all paid preparers, including unenrolled preparers. The regulations were quickly challenged, and in *Loving v. Commissioner*, 917 F.Supp.2d 67 (2013), a federal court determined that the IRS lacked the legal authority to create such regulations. Any such authority had to come from Congress.

Congress has been dancing around the issue since the *Loving* case was decided in 2013. The Biden Administration is bringing this to the fore with a proposal to rewrite Title 31 of the U.S. Code, the body of law that contains all Treasury statutes. The proposal will give the Treasury Secretary (and by delegation, the IRS) explicit authority to regulate all paid preparers of federal tax returns, including establishing mandatory minimum competency standards.

My expectation is that the IRS will quickly roll out a required examination much like that required of candidates to become Enrolled Agents. Two of the three parts of the EA test administered by the IRS are pointed at income tax matters and tax return preparation. The third part is pointed at representation issues.

Currently, unenrolled preparers are not authorized to represent anyone, including their own tax prep clients, before the IRS. An unenrolled preparer may simply attend an audit of a return he prepared, but only for the purposes of answering questions about *how* the return was prepared. Such person may not advocate on behalf of the client.

Once the IRS is successful in establishing its regulatory scheme for unenrolled preparers, I expect that the representation rules will not change. That is, unenrolled preparers, even though licensed and regulated by the IRS for return preparation purposes, will still be unable to represent clients before the IRS in any phase of the enforcement process.

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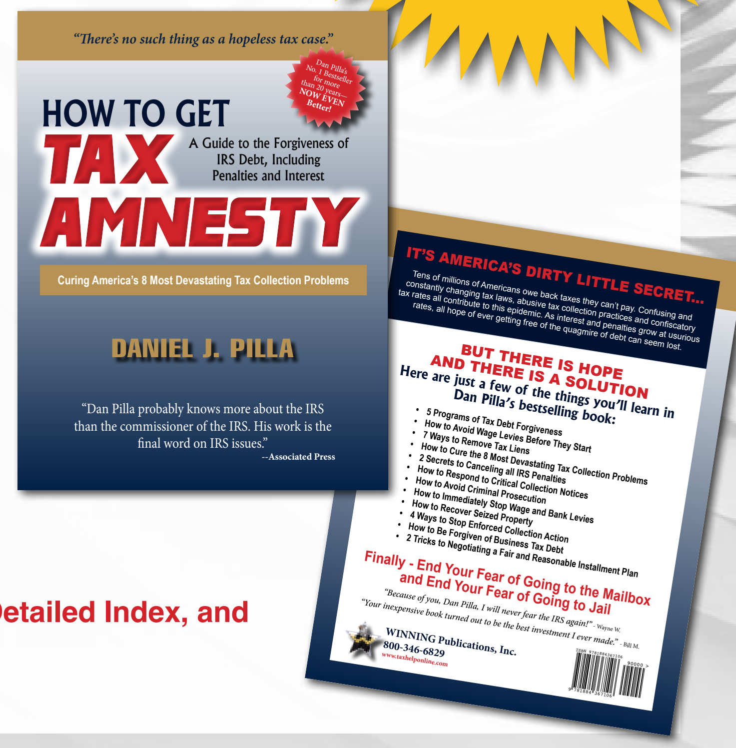

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All This for 1.8 Percent Growth?

The U.S. Economy Will Likely Go Backwards

BY TOM GIOVANETTI

In late May, President Joe Biden released his long awaited, "go big or go home" $6 trillion federal budget proposal.

Obviously there is much to say about this budget proposal, and we'll have much to say about it in coming weeks. But there are a couple of major assumptions in the budget that are just so jaw-dropping, so untethered to reality, that we're going to lead off our budget discussions by pointing them out.

And we're not talking about the sheer unimaginable size of the budget proposal or the harmful tax increases. We'll get to them.

The first absurdity is the Biden budget's projection of inflation remaining at 2.1 percent for the next several years. While that may be defensible considering the last few decades, the sad fact is that inflation this past April alone was 3.6 percent—the highest level in 29 years.

And, unfortunately, that was NOT a one-month, post-COVID aberration. Inflation in February doubled over that of January, and inflation in March doubled over that of February. That's a trend, not an aberration. And while it's possible that this is a unique, temporary inflation driven by the economic disruptions from the COVID pandemic, it's economic malpractice to assume that rate years in the future—especially when it's done just to make the budget more politically palatable.

But the second absurdity is much worse.

Remember the Biden campaign slogan "Build Back Better"? The Biden agenda, which seems to be pretty much the standard radical progressive agenda fronted by a genial spokesman, is based on the idea that enormous "investment" (i.e., spending) on education, green energy transformation, infrastructure, child care, and other Big Government goodies will result in a stronger economy.

So it's beyond amazing that the Biden budget proposal projects an economic growth rate as a result of his policies of—brace yourself—1.8 percent.

In every one of Donald Trump's first three years in office, the rate of economic growth was *higher* than that. It's unreasonable to consider Trump's fourth year, since that was the year of the COVID pandemic.

So what the Biden administration is proposing is a gargantuan expansion of federal spending and borrowing, which will explode the deficit, further bloat the national debt, and run the risk of monetary inflation, all in order to achieve a rate of economic growth that is *lower* than that of the previous administration.

All this for 1.8 percent economic growth?

If inflation is 2.1 percent, as Biden predicts, but economic growth is 1.8 percent, we're actually losing ground economically. While GDP is an inflation-adjusted statistic, Americans will still be worse off if inflation exceeds economic growth.

And since there is every reason to believe inflation will be higher than the Biden budget assumptions, it seems the Biden budget is going to result in stagnant economic growth, higher inflation, bigger deficits and more national debt. Stagflation, anyone? Misery Index, anyone?

Is that what Americans voted for last November?

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How You Can Ask Dan Pilla a Question

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