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Student Editor

Xiaoyue (Tina) Tan

Assistant Student Editor

Liubov (Luba) Shilkova

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Ken Guilfoyle

Adjunct Faculty, SJSU MST Program

William Skinner

Fenwick & West

Adjunct Faculty, SJSU MST Program

MST Student Contributors

Xiaoyue (Tina) Tan

Liubov (Luba) Shilkova

Ajmeri Zahan

Madhuri Lanka

MST Students in the Fall 2019 Tax Research Class

Special Thanks to

Mr. Robert J. Kovacev

Rachana Khandelwal, MST

AICPA

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Letter from the Editor

In our ninth year of publishing, we are honored to present the Summer 2020 issue of *The Contemporary Tax Journal*, a publication of San Jose State University's MS in Taxation (MST) Program.

This issue begins with an article about B certified benefit corporation. Emma Lloyd Best, an Attorney and Assistant Professor in the School of Business at Wake Forest University, and Marcy R Binkley, a CPA and Instructor of Accounting in the College of Business at Lipscomb University, discuss the legal and tax implications from the election of existing options of structuration for socially conscious organizations.

Next, we are pleased to present an article on robot taxes by Mr. Robert Kovacev, who is also featured as this issue's Tax Maven (see below).

Following these two articles, is an essay about a Peruvian tax lawyer's experience in a U.S. corporate tax class. Mr. Fernando J. Loayza Jordan studying at Yale Law School, explains and compares how tax law is taught in the U.S. versus Peru.

Next, we have a section dedicated to *Tax Enlightenment* which consists of articles written by SJSU MST students. Madhuri Lanka analyzes three tax treatments of business expenses. Then, Liubov Shilkova explores the consequences for taxpayers if they do not sign a tax return. Ajmeri Zahan determines the principal place of business and tax home for business deduction purpose. Lastly, I examine the *Dunlap v. Commissioner* case on the tax treatment of certain post-retirement payments.

Tax laws are changing constantly. To better understand these changes, we have MST students analyze newly proposed and enacted tax policies in each issue. In the Summer 2020 issue, MST students analyzed H.R. 4286, Virtual Apprenticeship Tax Credit of 2019, *proposing* a tax credit for virtual training programs. MST student Madhuri Lanka also explores the pros and cons of H.R. 5457, Carbon Reduction and Tax Credit Act, a proposal for an excise tax on the carbon content in various types of fuels.

It was our honor to have student assistant editor, Liubov Shilkova, conduct an interview with Mr. Robert J. Kovacev, a tax controversy partner with Norton Rose Fulbright's Washington, DC and San Francisco offices, and member of the SJSU Tax Advisory Board. His experience with tax incentives, transfer pricing controversies, as well as the economic substance and other judicial doctrines, is helpful for young people entering the tax field.

Our special section, *Fun Tax Facts*, was introduced in Winter 2019 by Rachana Khandelwal, MST. We would like to thank her for her generous contributions to our Summer 2020 journal.

The *CPA Exam Review* section includes a few multiple-choice questions provided by the AICPA. We thank the AICPA and hope you find this section helpful in preparing for the CPA exam. For

those of you who have already passed the exam, you may also find these current sample questions interesting.

Finally, I sincerely appreciate all the contributors to this issue. I would especially like to send my gratitude to Professor Annette Nellen for editing suggestions and invaluable input. I am also grateful for my student assistant editor, Liubov Shilkova; alum and dedicated supporter, Rachana Khandelwal, and our MST coordinator, Catherine Dougherty, for their contributions to this journal. Without their help, this journal would not be possible.

Please enjoy the Summer 2020 issue of *The Contemporary Tax Journal*.

Xiaoyue (Tina) Tan
Student Editor

To Be a B Certified Benefit Corporation or Not to Be

Emma Lloyd Best *

Marcy R Binkley **

I. Introduction to B Certified Corporations

A reconceptualization of firm performance is on the rise, one which includes both profit and purpose. Within this revolutionary framework sustainable enterprise is not a form of corporate social responsibility, but a better way of doing business. Despite the notion that refining processes to meet the highest standards of social and environmental performance, public transparency and legal accountability will in fact result in shareholder gain, as well as corporate profit, organizations may not be convinced. In response, this article considers the legal and tax implications from the election of existing options of structuration for socially conscious organizations.

Firms may pursue B certification through the B Lab organization, regardless of their initial legal structure. Depending on state constituency statutes, firms can elect legal structuration as a benefit corporation concurrently or subsequently after pursuance of B certification. Alternatively, socially conscious firms may elect legal structuration as a not-for-profit organization in order to maximize their tax benefits while giving back to the community. This expansion of opportunities for firms to align their mission with their legal structure benefits the firm's reputation. Most of the time, companies will display their B corporation certification under their About Us tab on their respective websites to increase awareness in the community.

Therefore, Part II of this paper will provide a history of society's perspective of socially conscious organizations. Part III of this paper will examine the traditional incorporation of businesses and related tax implications. Part IV of this paper will review the development of B certification, benefit corporations, and non-profit organizations. Part V of this paper will consider the tax, profit, and reputational benefits of each election, respectively. Part VI of this paper will compare the tax benefit from not-for-profit incorporation to the compounding profitability of benefit incorporation with a B certification. Part VII of this paper will conclude with the future for socially conscious companies.

II. History of Society's Perspective of Socially Conscious Organizations

* Emma Lloyd Best is an Attorney and Assistant Professor in the School of Business at Wake Forest University where she teaches three sections of business law. She has 17 years of experience as a transactional attorney and continues to practice law as General Counsel for Girls on the Run International on a part-time basis. Her research interests include entrepreneurship, strategic human resources, and sustainability.

** Marcy R Binkley is a Certified Public Accountant and Instructor of Accounting in the College of Business at Lipscomb University where she teaches accounting information systems and managerial accounting. Her research interests include IT governance and corporate social responsibility.

A. The Corporate Social Responsibility Evolution

It is evident that the trajectory of corporate social responsibility (CSR) owes its current position to the events of the early 1900s. It was World War I that plunged the United States into the Great Depression, causing a great cultural and economic shift within society. Unemployment rates lead to decreased consumer demand and spending as Americans struggled to earn a living wage. It was this crisis which provoked an unprecedented amount of government spending as a result of President Roosevelt's New Deal. "This increase in government spending created a multiplier effect on consumer demand, eventually producing full employment."¹ The impact of economic stimulation on behalf of the government would serve as a catalyst for the reframing of corporate America and its relationship to social responsibility.

Continuing through the evolution of the relationship between economic activity and social responsibility, it was the declaration of neutrality at the beginning of World War II which paved the way for President Roosevelt's Lease-Lend Program. To prevent full involvement in War, Roosevelt developed the Lease-Lend Act in March 1941 and allowed lent supplies to their allies to be paid back in any form after the war.² While this was more an act of defense than generosity, it was the first time in history during which corporations had shown signs of social responsibility. For example, the Hormel Company saw the "heightened demand for food that could be easily preserved and shipped abroad. In response to Congress passing the Lease-Lend program, it doubled its hours of production and sent more than 90% of their canned meat to troops."³ While there was no feast, SPAM became a mealtime staple during the 1940's.

It is no coincidence that, while wars and social unrest dominated the 1950s through the 1960s, this period of history also brought about the first cohesive shift towards CSR viewed as something other than voluntary⁴. In the past, stakeholders and owners could contribute to society only at the individual level. However, with the threat of communism on the rise, the United States government encouraged businesses to expand CSR as a means of aligning business interests with the defense of free market capitalism.

B. Friedman, Kant, and CSR

Milton Friedman and Immanuel Kant are two of the most well-known philosophers on the concept of CSR. Milton Friedman argued that "the Social Responsibility of a business is to increase its profits."⁵ Continuing in the tradition of Adam Smith, Friedman criticized suspicious businessmen running the corporations. Alternatively, Immanuel Kant's belief is centered on the following theory, that "goodwill which is not good for its effects but is good in itself; the will is

¹ Steven Horwitz et al., *The Reality of the Wartime Economy*, 17 THE INDEP. REV. 325, 326 (2013).

² History.com Editors, *Lease-Lend Act 4* (April 10, 2020, 2:14 PM), <https://www.history.com/topics/world-war-ii/lend-lease-act-1>.

³ Jill M. Sullivan, et al., *The Hormel Girls*, 25 AM. MUS. 282, 287 (2007).

⁴ John Elrick, et al., *The Social Responsibility of Business*. 31 J. OF MKTS & MORALITY, 297, 307 (2018).

⁵ Elrick, *supra* note 4 at 376.

only good when it strives to fulfil its duty”⁶ While theoretical differences are apparent, it was the synergistic effect of both men’s perspectives on the corporation’s relationship to society.

Both Friedman and Kant provide theory as to how business should be managed, while also contributing to society. Friedman argued that “the basic mission of business is to produce goods and services at a profit and in doing this, business is making its maximum contribution to society, and in fact, being socially responsible.”⁷ Friedman’s theory lies parallel with that of the Invisible Hand, as he trusts that when businesses perform for a profit, they are stimulating the economy and therefore, benefiting society. Coinciding in principle, Immanuel Kant’s philosophy is based on building an ethical code that owners can incorporate into the morals of running the business. Kant’s theory assumes an ethical code is inherently the guide force of business; if there is something positive to be gained by society or the corporation, then it is not the categorical imperative. The synthesis of these not so distant theories is that the foundation of CSR in the United States was built upon and somewhat solidified, beginning with the Cold War.

Howard Bowen, who is an author and economist, also served as a thought leader in the shift towards CSR in the 1950s. He approached CSR from a macroeconomic viewpoint, with its ultimate purpose to enhance social welfare. Bowen was determined to give a “middle ground between two extremes of socialism and pure laissez-faire capitalism, both incompatible with American ideals. One solution was the ideal social mix of individual self-determination tempered by consideration for social welfare within a mixed-economy framework.”⁸

Emerging from the New Deal and World War II, America began an attempt to once again redefine its economy considering this suggestion for a mixed-economic framework and after its prior run with the laissez faire free market. Many business owners were skeptical of CSR, and unsure of how it would impact business operations. With the concurrent global rise of communism, the concept of CSR encouraged the United States to band together and honor traditional American heritage. The United States government used this threat of communism to urge businesses towards adopting CSR measures; arguing that by treating society well and respecting individual rights was “the American, not the Communist, way.”⁹ In response, increased government regulations on corporate social responsibilities throughout the 1960s and 1970 were passed. Not only were once CSR suggestions made legal requirements, executives became more politically and ethically active as a result of the simultaneous increase in global competition, civil unrest, and inflationary pressures; each which cast blame on the revolutionary government policies.

C. The Political Problems of CSR

⁶ Krzysztof Tapek, *Corporate Social Responsibility in the Light of Kant's Categorical Imperative*. *Annales*, 21 ETHICS IN ECON. LIFE, 85, 87 (2018); Aurelien Acquier, et al., *Rediscovering Howard R. Bowen's Legacy*, *BUS. & SOC'Y*. 607, 646 (2011).

⁷ Elrick, *supra* note 4 at 300.

⁸ Acquier, *supra* note 6 at 616; Richard Marens, *The Hollowing Out of Corporate Social Responsibility*, 39 *MCGEORGE L. REV.* 851, 874 (2008).

⁹ Acquier, *supra* note 6 at 616.

With mounting pressure and legal mandates by the 1980's, businesses were ready for President Ronald Reagan to "get the government off their backs." President Reagan's disbanding of governmental policies became a driving force in shaping CSR, lending him the title "Father of CSR."¹⁰ Through the reduction of government involvement, CSR of businesses fell to pressures of civil society and a company's shareholders. Reagan's decision created an environment in which businesses are forced to respond to the problems created by their economic success by implementing CSR strategies to meet the demands of various special interest groups and communities.

An example of this evolution is that of Walmart, who in the 1980s partnered with a special interest group to enhance the sustainability of their operations and global value chain.¹¹ Walmart's low-cost, sustainable product strategy has shifted the way corporations view the process of creating sustainable products from a consumer-oriented to a supply-oriented focus. By targeting initiatives towards suppliers, Walmart has improved environmental and social performance without raising consumer prices by implementing three CSR objectives: produce zero waste, utilize 100% renewable energy, and sell products that sustain people and the environment.

Concurrently, Paul Newman, an American actor, launched his homemade salad dressing company in the early 1980s. When Newman's Own exceeded its predicted profits in the first year, Newman envisioned sharing his fortune with others. Reagan's policy implementation allowed Newman to give away all the after-tax profits.¹² This was a revolutionary concept at the time, as his for profit company was the first of its size to voluntarily forfeit earnings for the greater good. Newman's Own was a pioneer in corporate strategy which empowered consumers with a chance to partner in CSR by purchasing its products. Both Walmart and Newman's Own were on the forefront of a campaign that directly involved consumers in the social responsibility they were demanding from the companies. These campaigns helped to define CSR as it is understood today. CSR stands now on innovation, which extends to both social and environmental sustainability.

D. CSR in the Digital Age

The digital age, between 1990 and 2000, brought with it a greater awareness of global issues such as poor labor practices, human rights violations, and terrorism. This awareness fostered another shift in CSR as more people began to be invested in doing their part to help the world. The influence of social media has been substantial, as consumers have instant access and comprehensive connection worldwide. Thus, with greater access comes great responsibility. CSR has become an essential part of building a brand as it increases customer trust, customer

¹⁰ Gregory Unruh. *Ronald Reagan: The Father of CSR*. 9 (April 10, 2020, 2:17 PM), <https://www.forbes.com/sites/csr/2011/03/09/ronald-reagan-the-father-of-csr/#494ed406657f>.

¹¹ Sustainability. *Enhancing Sustainability of Operations and Global Value Chains*, (April 10, 2020 4:03 PM), <https://corporate.walmart.com/global-responsibility/sustainability/>.

¹² Unruh, *supra* note 10.

loyalty, and corporate reputation.¹³ As consumers are becoming more informed and in turn convicted about social equality around the world, corporations are pressured to show alignment in order to maintain market share.

The United Nations saw this point in history as an opportunity to define and emphasize the voluntary nature of CSR. Their efforts began with an initiative which encouraged corporations to pledge to follow ten principles covering environmental sustainability, human rights, and anti-corruption. The initiative was put in place to encourage companies to participate in CSR beyond the point of legal obligation. In the aftermath of the 2008 financial crisis, both public and regulatory bodies were questioning the largely voluntary basis of CSR. This vocal dissent led to the establishment of a connection between “the responsibility of enterprises for their impacts on society and compliance with government regulations”.¹⁴ These questions were soon answered with a mandate to report non-financial and diversity information to the public; whereas the core voluntary aspect of performing socially conscious actions was still present. However, the reporting system under new regulations placed unprecedented pressure on corporations to uphold the new standards as their actions were made public knowledge.

E. Present Conceptualization of CSR

The next decade brought a large pivot from social sustainability to environmental sustainability. As environmental issues began to garner large increasing amounts of attention, corporations responded and began an attempt to mitigate related issues within their influence. Presently, corporations are developing new innovative approaches to CSR strategies that have also proven to enhance their own performance. Consumer involvement in environmental sustainability has given corporations amplified incentive to participate as well. Consumers have discovered the voting power of their dollars, thereby from a desire to assist in promoting environmental sustainability they in turn can participate by purchasing items from companies which operate under similar values. Like Newman’s Own in the 1980s, consumers are attracted to companies that promote, and advertise, social and environmental actions. Public and verified evidence of CSR has evolved into a critical part of corporate strategy, as a result of organizations such as BLab and the Certified B Corporation seal. Through this certification, corporations can advertise on each product a third party validated seal, ensuring their actions meet the highest standards of verified social and environmental performance, public transparency, and legal accountability to balance profit and purpose.

III. Traditional Incorporation of Business and Related Tax Implications

A. Sole Proprietorship

¹³ W. Puwirat et al., *The Impact of Digital Social Responsibility on Consumer Trust and Brand Equity*, XXII EURO. RES. STUD. J. 181, 182 (2019).

¹⁴ Alvisé Favotto et. al., *Euro Crisis in the Press*, THE LONDON SCH. OF ECON. & POL. SCI. (Feb. 5, 2020), <https://blogs.lse.ac.uk/eurocrisispress/2015/03/19/corporate-social-responsibility-in-an-era-of-economic-crisis-empty-gesture-or-tool-for-corporate-learning/>.

Sole proprietorship is a form of business entity involving one person, which makes the business the same as the person. There are generally no income tax consequences upon the formation of a sole proprietorship.¹⁵ Income and losses from the business are reported on the individual's income tax return (Schedule C). The sole proprietor is fully liable for the debts and other liabilities of the proprietorship.¹⁶ All of the income and gains from the sole proprietor's business are taxed as earned on his/her individual tax return at the appropriate individual income tax rates.¹⁷ This intertwines the business and the sole proprietor, essentially creating one entity.

While sole proprietors reap the benefits of intertwining their personal lives and business endeavors, they also face challenges and complications when they choose this path. The legislators provide incentives for individuals to become entrepreneurs through tax law.¹⁸ The legislation results in rewarding successful operations of a business venture and cushioning the blow when a small business fails.¹⁹ On the other hand, there are tax code provisions that have the effect of disfavoring small businesses compared to their large corporations.²⁰ These provisions result in small businesses bearing a disproportionately higher tax burden in comparison to large businesses.²¹

The tax code stipulations cause complications and consequences for small business owners and entrepreneurs. Some studies have linked the tax burden on small business owners to lower profitability, lower rate of entrepreneurial growth, and business closures.²² While Congress has adopted a number of favorable tax provisions to help small business owners, the Internal Revenue Code is replete with tax provisions that have the effect of unfavorable treatment of small businesses.²³ While these provisions negatively impact small businesses, the corporate form of entities benefit as a result. For example, corporations are entitled to a larger deduction for charitable contributions of inventory property compared to sole proprietorships.²⁴ In addition, until recently, the tax code has limited the ability of sole proprietors to deduct health insurance costs, unlike corporate taxpayers.²⁵ The tax code effectively disfavors small businesses by offering certain tax benefits that are beneficial only to businesses that are sufficiently large enough to incur a significant initial capital expenditure.²⁶

B. Partnerships

Partnerships are a form of business entity where two or more people pool their skills, abilities, and resources to run a business. There are two forms a partnership can take: limited and

¹⁵ Craig J. Langstraat, *Choice of Business Tax Entity After the 1993 Tax Act*, 1 AKRON TAX J. 1, 2 (1995).

¹⁶ *Id.*

¹⁷ *Id.* at 3.

¹⁸ Rafael Efrat, *The Tax Debts of Small Business Owners in Bankruptcy*, 175 AKRON TAX J. 175, 176 (2009).

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.* at 177.

²³ Efrat, *supra* note 18 at 177.

²⁴ *Id.* at 176.

²⁵ *Id.*

²⁶ *Id.*

general. General partnerships follow the initial definition of a partnership, while limited partnerships are a modified form of general partnerships. The major difference between the two is that a limited partnership includes two classes of owners: general partners and limited partners. The general partners are liable for the debts and obligations of the partnership, but the limited partners are only liable up to the amount of their investment. The implication is that, unlike a limited liability corporation, a general partnership is more closely tied to its owners and, therefore, more closely approximates a true association of people.²⁷

Partnerships have multiple advantages, with the most notable being the avoidance of double taxation. As a general rule, investors seek partnership taxation because of the benefits including taxation on an entity's operations, contributions of appreciated property to the entity,²⁸ current distributions, and liquidations.²⁹ In both types of partnership arrangements, the entity is not taxed, for federal tax purposes, rather the income, gains, losses, deductions and credits are passed out to the partners equally unless otherwise provided for in the partnership arrangement.³⁰ This creates a space between the owners and the business that does not exist in a sole proprietorship.

However, there are advantages and disadvantages to partners generating their own distributions and the tax implications. Each year, partners must pay their allocated share of any applicable federal income tax on the partnership's income and gains distributed to them.³¹ Partnerships are like an S corporation since their distributions are made tax-free. Partners are taxed the same as S corporations on their share of income, gains and deductions for each tax year.³²

C. C Corporations

C corporations are separate from its owners in the eyes of the law. This separation can be beneficial about liability, with the owners being shielded from facing personal liability for the debts of the corporation. This separation can also be a burden about double taxation. The downside of creating a separate legal entity is that the corporation can be regulated as such, which means it has to pay taxes and can be subjected to criminal sanctions.³³ Corporate law thus forces individuals to live with the consequences of the organizational form they select.³⁴

Corporations are subject to double taxation, meaning the corporation is taxed on its net income, and when the same income is distributed to shareholders in the form of dividends, the income is then taxed again on the shareholders' personal tax returns. Currently, corporate

²⁷ Joshua C. Macey, *What Corporate Veil?*, 117 MICH. L. REV. 1196, 1211 (2019).

²⁸ Martha W. Jordan, *Pennsylvania's Limited Liability Company Act Raises Taxing Questions*, 703 TEMP. L. REV. 704, 711 (1996).

²⁹ *Id.*

³⁰ Langstraat, *supra* note 15 at 2.

³¹ *Id.* at 3.

³² *Id.*

³³ Macey, *supra* note 27 at 1202.

³⁴ *Id.*

income is taxed at a rate of thirty-five percent, and dividend distributions for shareholders are taxed at capital gain rates.³⁵ The tax items of the incorporated business are reported and federal tax is paid by the corporation.³⁶ A second level of tax is paid on the same income when the earnings of the corporation are passed to the shareholders in the form of dividends.³⁷ The idea of double taxation can persuade owners to find a more tax-beneficial entity; however, they could be forfeiting the limitation of liability.

D. S Corporations

S corporations combine the advantages of a partnership and a C corporation. They are like a partnership in that the income of the business is not subject to double taxation. They are like a C corporation in that the owners are not subject to personal liability for the debts or behavior of the business. An S corporation is treated as a pass-through entity for federal tax purposes.³⁸ Similar to a partnership, the tax items of the S corporation, with some exceptions, are not recognized by the corporation, but rather are passed through to the shareholders to be reflected on their individual tax returns.³⁹ The S corporation's shareholders must annually recognize the S corporation's income and gains, whether or not actually distributed to them.⁴⁰

One of the primary benefits of S corporation status over C corporation status is that there is, primarily only a single level of tax.⁴¹ For state income tax purposes, the S status may or may not be recognized.⁴² Avoiding double taxation would greatly benefit a corporation in the long-term and help establish financial stability. S corporations must meet several requirements in order to be granted this classification, and if any of these requirements are not met, the S corporation status will be terminated and the corporation will be treated as a C corporation for tax purposes.⁴³ If the S corporation does have C corporation earnings and profits, the dividend distributions are tax free and reduce the shareholder's basis to the extent of previously taxed income and the accumulated adjustments account balance.⁴⁴

E. Limited Liability Company

A limited liability company (LLC) is a form of business ownership that combines the limited liability advantages of the corporation with the tax advantages of a partnership. Since this classification is rapidly growing in the United States, the IRS is still deciding how to treat this classification for tax purposes. The IRS has the power to classify an unincorporated association

³⁵ Meredith R. Conway, *Stealth Inequity: Using Corporate Integration to Ease Unfairness in the Tax Code*, 2 WM. & MARY POL'Y REV. 53, 77 (2010) (explores the inequities inherent in the current corporate income tax structure).

³⁶ Langstraat, *supra* note 15 at 3.

³⁷ *Id.*

³⁸ *Id.* at 4.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ Langstraat, *supra* note 15 at 4.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

as either an association taxable as a corporation or as a partnership for federal tax purposes.⁴⁵ Factors which have been set out as determining whether a particular unincorporated association more closely resembles a corporation or a partnership are as follows: (1) continuity of life, (2) centralization of management, (3) limited liability, and (4) free transferability of interests.⁴⁶ An organization will be taxed as a partnership unless it has the majority of these characteristics.⁴⁷

An advantage of classifying an entity as an LLC is that members may use their distributive share of the LLC's losses to reduce their income from other sources.⁴⁸ As for the LLC's taxable income, it equals the taxable income that the LLC would have reported for federal income tax purposes if the LLC were taxed as a corporation.⁴⁹ LLC's are essentially a more cost-effective option with regard to tax implications than corporations. Because the increased cost associated with choosing an LLC is much less than the increased cost of choosing a corporation, investors in this situation, who would have chosen a corporation if LLCs did not exist, will now choose an LLC.⁵⁰ Furthermore, because the cost increase associated with choosing an LLC is substantially less than the tax cost associated with choosing a corporation, LLCs make it easier for investors to choose limited liability.⁵¹

F. Nonprofit Organizations

Some place the earliest forms of nonprofits around the late 1800's, when The Peabody Education Fund was founded. It is said to be the first foundation "created to pool the resources of a number of funders to support charitable activities".⁵² Approximately 1.56 million nonprofits were registered with the Internal Revenue Service in 2015, an increase of 10.4 percent from 2005.⁵³ The nonprofit sector contributed an estimated \$985.4 billion to the US economy in 2015, composing 5.4 percent of the country's gross domestic product (GDP).⁵⁴ Nonprofits are most numerous in these two sectors: Human Services (35.2%), Education (17.2%).⁵⁵ However, in terms of revenues and expenses, the Health sector accounts for more than 50%.⁵⁶

⁴⁵ Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race Between the States, but Heading Where?* 45 SYRACUSE L. REV. 1193, 1210 (1995).

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ Jordan, *supra* note 28 at 724.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *6 Important Moments in the History of the Non-Profit Sector*, OHIO UNIVERSITY BLOG (Mar. 29, 2020, 9:04 AM), <https://onlinemasters.ohio.edu/blog/six-important-moments-in-the-history-of-the-nonprofit-sector/>.

⁵³ Brice S. McKeever, *The Non-Profit Sector in Brief 2018: Public Charities, Giving, and Volunteering*, THE URBAN INST. (Mar. 29, 2020, 9:12 AM), <https://nccs.urban.org/publication/nonprofit-sector-brief-2018#the-nonprofit-sector-in-brief-2018-public-charities-giving-and-volunteering>.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ McKeever, *supra* note 53.

Whereas from 2005 to 2015, the number of nonprofits remained constant despite some fluctuations, the revenues, expenses, and assets of nonprofit rose by around 40%.⁵⁷

IV. Tax, Profit, and Reputational Benefits of Nonprofits, Certified B Corporations, and Benefit Corporations

A. Nonprofits

A non-profit organization is defined by Cornell Law as a group organized for purposes other than generating profit and in which no part of the organization's income is distributed to its members, directors, or officers.⁵⁸ These organizations focus on bringing awareness and generating money to support social causes. As for their taxes, American nonprofit organizations receive favorable tax treatment, including tax exemptions and tax-deductibility of contributions, in return for their devotion to charitable purposes and restrictions not to distribute profits.⁵⁹ Nonprofits are able to generate an admirable amount of revenue for this specific cause through donations and fundraising events. Charitable nonprofits reported \$1.4 trillion in revenue in 2006.⁶⁰

While this seems appealing to many businesses, it is not simple to gain non-profit status. Broadly, state law governs how charitable organizations may be created, the form they may take, the fiduciary duties of their leaders, and the regulation of their continued operation.⁶¹ State regulation was created to support the role of charities in society without allowing for abuse of the system.⁶² First, charitable corporations require authorization from the state in order to be created.⁶³ This supports the ideal that only those corporations with the intent to support a specific cause are allowed to benefit from non-profit operations. The Internal Revenue Code lists the permissible purposes for nonprofit organizations, limits the private benefits of transactions in which nonprofits engage, and restricts the activities and investment of various types of nonprofit organizations.⁶⁴

B. B Law Certification

B Lab was founded in 2006, in Berwyn, Pennsylvania. To be B certified, a company must undertake the B impact assessment, a social impact assessment that will evaluate the effects of both day-to-day operations as well as the company's business model on workers, communities,

⁵⁷ *Id.*

⁵⁸ Alyssa A. Dirusso, *American Nonprofit Law in Comparative Perspective*, 10 WASH. U. GLOBAL STUD. L. REV. 39, 41 (2011).

⁵⁹ James R. Hines Jr., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179, 1214 (2010).

⁶⁰ Dirusso, *supra* note 58 at 60.

⁶¹ *Id.*

⁶² Dirusso, *supra* note 58 at 60.

⁶³ *Id.*

⁶⁴ *Id.*

customers and environment.⁶⁵ The questions, and the annual fee are both dependent on the size of the company evaluated. B certified companies have increased by 75% in the last 4 years as 1789 companies were B certified by 2016 while the B Lab website references 3,128 companies in 2020.⁶⁶ The amount of B certified companies is growing exponentially across all sectors, but the top three are the service, manufacturing, and finance sectors.

Certified B corporations are businesses that meet the highest standards of verified social and environmental performance, public transparency, and legal accountability to balance profit and purpose.⁶⁷ These companies strive to be conscious of elements of business that are not expressly stated. B Corps are accelerating a global culture shift to redefine success in business and build a more inclusive and sustainable economy.⁶⁸ By harnessing the power of business, B Corps use profits and growth as a means to a greater end: positive impact for their employees, communities, and the environment.⁶⁹ These companies are attempting to positively impact the business community by focusing on their social consciousness. The B Corp community works toward reduced inequality, lower levels of poverty, a healthier environment, stronger communities, and the creation of more high-quality jobs with dignity and purpose.⁷⁰

There are many steps required for a company to complete before they are granted the B Certification. They must first complete a B Impact Assessment, which is a free confidential platform designed to help measure and manage the company's positive impact on their workers, community, customer and environment.⁷¹ A company must obtain a minimum total score of 80, which is totaled from all impact areas.⁷² The B Certification assessment measures performance over the past twelve months.⁷³ The 200 questions asked on the B Assessment are determined by company size, sector, and market.⁷⁴

There are many legal requirements that B Certified Companies must comply with, in order to be granted B certificates. The B Corp legal framework helps companies protect their mission through capital raises and leadership changes and give entrepreneurs and directors more flexibility when evaluating potential sale and liquidity options.⁷⁵ While the legal framework is outlined in a specific way, it does allow for flexibility in how to decide to organize the company. The legal requirement can be fulfilled through a variety of structures, from LLC's and traditional corporations to benefit corporations and cooperatives.⁷⁶ The best way for corporations to meet

⁶⁵ Certification Requirements, CERTIFIED B CORP. (2020) <https://bcorporation.net/certification/meet-the-requirements>.

⁶⁶ Cao, Ke, Joel Gehman, & Matthew G. Grimes, *Standing out and fitting in: Charting the emergence of Certified B Corporations by industry and region*, 19 FIRM EMERGENCE AND GROWTH, 1, 23 (2017).

⁶⁷ *What is a Benefit Corporation?* BENEFIT CORP. (2020) <https://benefitcorp.net/>.

⁶⁸ *What is a Benefit Corporation?* BENEFIT CORP. (2020) <https://benefitcorp.net/>.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *What is a Benefit Corporation?* BENEFIT CORP. (2020) <https://benefitcorp.net/>.

the legal requirement for B Corp certification is to use the benefit corporation legal structure. For corporations in some states, notably Delaware, using the benefit corporate structure is the only way to meet the legal requirement for B Corp certification.

C. Benefit Corporations

In April 2010, Maryland became the first U.S. state to pass benefit corporation legislation.⁷⁷ Since then, 40 states as well as the District of Columbia have enacted such statutes. The main singularity of such a legal structure is that it adds to the directors' duties to consider the impact business decisions might have on non-financial stakeholders. Benefit corporation statutes have been adopted in several states to address the general perception that a business corporation cannot be operated as a charity or philanthropic organization.⁷⁸ The benefit corporation form has emerged as the most popular social enterprise statute type.⁷⁹ The benefit corporation can also lead to more complex operations for upper level management. The duties of directors and officers of a benefit corporation can be expected to be more complex than those of a non-benefit corporation because public benefit fiduciary duties are now added to the duty to maximize shareholder value.⁸⁰

V. Comparison of Reputational Benefits

As predicted, the integration of sustainability initiatives into corporate strategy is no longer optional.⁸¹ The assumption that CSR is a burden to the organization has also been discounted. Porter and Kramer introduced the shared value model in which the value of CSR is measured in profit for the corporation and in reduction of harms for society.⁸² This approach has been revolutionary in reconnecting company success with social progress. Furthermore, corporate reputational benefits can unlock billions of dollars in potential investments for companies that pursue a positive impact on society and the environment. Evidence has shown CSR provides shareholders with numerous benefits, functional, psychosocial and values, which in turn influence the quality of the relationship between the shareholder and the company.⁸³ As such, it is evident that benefits of CSR are highly influenced by social perceptions; each which can differ according to legal structure of the socially responsible entity. Some of these benefits follow.

A. Nonprofit Industry

⁷⁷ Baudot, Lisa, Jesse Dillard, & Nadra Pencle, *The emergence of benefit corporations: A cautionary tale*, CRITICAL PERSP. ON ACCT. (2019).

⁷⁸ William D. Harrington, *Business Associations*, 44 SYRACUSE L. REV. 27, 49 (2001).

⁷⁹ J. Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. 25, 27 (2015).

⁸⁰ Harrington, *supra* note 78 at 50.

⁸¹ Kathleen Wilburn & Ralph Wilburn, *The double bottom line: Profit and social benefit*, 57 BUS. HORIZONS, 11, 12 (2014).

⁸² Michael E. Porter & Mark R. Kramer, *Creating shared value*, MANAGING SUSTAINABLE BUS. 323, 326 (2019).

⁸³ C.B. Bhattacharya et al. *Strengthening stakeholder–company relationships through mutually beneficial corporate social responsibility initiatives*, 85 J. OF BUS. ETHICS 257, 257 (2009).

A positive reputation is important for nonprofits to attract more donations and increase their donors' loyalty.⁸⁴ Other data shows that a positive reputation will “draw passionate volunteers and high-quality staff,” and help the nonprofit gain access to government contracts.⁸⁵ Furthermore, organizations would be more likely to both grow and establish stronger performance if they allocate more resources to their image and reputation or “influential intangible assets.”⁸⁶ A firm having already established a reputation will not need to divert excessive assets to convince its stakeholders it is trustful and credible.⁸⁷ Thus, reputation is a key asset of nonprofit and its management can be of significant importance to the future performance of the company.

B. For-Profit Corporation with B Certification

The shareholder wealth maximization norm has infiltrated corporate America.⁸⁸ Even so, businesses under traditional forms of incorporation have always had the ability to meet the needs of social entrepreneurs through affiliated foundations or nonprofit entities.⁸⁹ It is now that CSR is an important component of dialogue between companies and their stakeholders⁹⁰ that marketing of these CSR efforts has become a key component in maximizing a multifaceted return on CSR investment. As such, the need for socially conscious for-profit corporations to delineate from the norm is of increasing importance. In these instances, it is the CSR initiatives that have the greatest influence on the societal reputation of the firm.

Research suggests consumers tend to form relationships with brands in a similar way as they form relationships with people.⁹¹ There are two key assumptions underlying the reasoning for a for-profit corporation to pursue CSR initiatives. First, the more a firm can benefit from CSR the more it will be inclined to integrate CSR on a strategic level. Second, if companies do not inform consumers adequately about CSR initiatives, they will not reap the full benefits of their CSR investments.⁹² In this light, companies can elect to focus the strategic management of CSR investment on either reputation management or building of a virtuous brand.

Bhattacharya argues that in order for CSR initiatives to provide a return to company, they must first provide a return to individual stakeholders, highlighting the reputational or relational

⁸⁴ Schultz, Christian, Sabine Einwiller, Jens Seiffert-Brockmann, & Wolfgang Weitzl, *When Reputation Influences Trust in Nonprofit Organizations: The Role of Value Attachment as Moderator*, 22 CORP. REPUTATION REV. 159, 170 (2019).

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ Kong, Eric, and Mark Farrell, *The role of image and reputation as intangible resources in non-profit organizations: a relationship management perspective*, In Proceedings of the 7th Int'l Conference on Intellectual Capital, Knowledge Management & Org. Learning, 245, 252 (2010).

⁸⁸ J. Haskell Murray, *Choose your own master: Social enterprise, certifications, and benefit corporation statutes*, 2 AM. U. BUS. L. REV. 1, 18 (2012).

⁸⁹ *Id.*

⁹⁰ Bhattacharya, *supra* note 83 at 257.

⁹¹ Jennifer Aaker et al., *When good brands do bad*, 31 J. OF CONSUMER RES. 1, 16 (2004).

⁹² Bert Van de Ven, *An ethical framework for the marketing of corporate social responsibility*, 82 J. OF BUS. ETHICS 339, 341 (2008).

significance of CSR strategy.⁹³ Relationship marketing is defined as all marketing activities directed toward establishing, developing and maintaining successful relational exchanges.⁹⁴ As such, further findings suggest that stakeholders respond to CSR activity based on their perceptions of the company's CSR initiatives.⁹⁵

Hanson, et. al (2019) focus on the people and planet aspects of the triple bottom line to offer theoretical insights that are specific to understanding consumers' attitudes toward brands' CSR activities. It is known that CSR activities, which focus on either environmental or social dimensions, trigger different consumer preferences.⁹⁶ Extant literature has found CSR investments should be "on-brand"⁹⁷ and furthermore, are dependent on the tangibility characteristics of the brand and the primary focus of operations, either service or merchandising driven.⁹⁸

Reputational benefits of CSR activity at for profit corporations must be evaluated by both the relational significance and the branding communication. The synergistic effect of the B Certification to solidify both signals sent to consumers is significant. B Lab has positioned itself as an independently trusted, compliance officer evidencing enough CSR activity encompassing environmental and social activities. Additionally, obtaining and branding corporate communication and products with the B Certification seal, a recognized trademark across all industries, is an ideal solution for maintaining successful relational exchanges, as well as generalizable operations and tangibility characteristics.

C. Benefit Corporation with Mandatory CSR Certification

In terms of societal perception and related benefits, it is the legal benefit corporation which is obligated to report on its overall social and environmental performance using third party standards.⁹⁹ As such, unique to the benefit corporation is the mandatory obligation to what was initially an elective choice, CSR. Despite the obligation, legally the benefit corporation must only demonstrate "general public benefit" which allows for broad discretion in determining the type of societal and/or environmental impact to pursue.¹⁰⁰ Lastly, in order to provide corporate transparency and accountability, most states require benefit corporations to annually

⁹³ Bhattacharya, *supra* note 83 at 259.

⁹⁴ Robert M. Morgan & Shelby D. Hunt, *The commitment-trust theory of relationship marketing*, 58 J. OF MKT'G. 20, 20 (1994).

⁹⁵ Bhattacharya, *supra* note 83 at 267.

⁹⁶ John Peloza & Jingzhi Shang, *How can corporate social responsibility activities create value for stakeholders? A systematic review*, 39 J. OF THE ACAD. OF MKT'G. SCI. 117, 135 (2011).

⁹⁷ Danielle Blumenthal and Alan Bergstrom, *Brand councils that care: Towards the convergence of branding and corporate social responsibility*, 10 J. OF BRAND MGMT. 327, 341 (2003).

⁹⁸ Sara Hanson et al., *Society or the environment? Understanding how consumers evaluate brand messages about corporate social responsibility activities* J. OF BRAND MGMT. 21, 29 (2019).

⁹⁹ BENEFIT CORP. INFO. CTR. (2020) <https://benefitcorp.net/businesses/benefit-corporation-reporting-requirements>.

¹⁰⁰ Elisabeth J. Teal & A. Rebekah Teal, *Benefit Corporations: A Newer Legal Option for Structuring Socially Responsible For-Profit Enterprises in the US*, J. OF LEGAL, ETHICAL & REG. ISSUES 1, 3 (2019).

disseminate a report to shareholders, stakeholders, and the entire world evidencing their adherence to benefit corporation standards.¹⁰¹

The concept of private branding versus public branding is a driving factor to consider in the analysis of CSR on reputational benefit. Private branding includes independent, third party certification of CSR activity such as the B Certification, while public branding is evidenced by public incorporation designation under the benefit corporation.¹⁰² While ample evidence exists highlighting the positive impact on firm growth of private CSR branding,¹⁰³ there exists only concern for the complexity of public branding as the obligation to serve a dual purpose can be quite taxing.¹⁰⁴

It is vital to understand that the legislative formation of the benefit corporation set to create a hybrid organization which allows entities endeavoring to act in the public interest access to markets and investment capital alongside compatible governance processes.¹⁰⁵ However, the blending of public and private business objectives is yet to be determined as desirable. There is little empirical evidence to support quantification of reputational benefits of benefit incorporation, while studies do express concern that benefit corporations acting in the public interest do not become another avenue for transferring public resources into the private sector.¹⁰⁶

VI. Making Dollars and Sense of Certified B Benefit Corporations

The largest financial benefit to not-for-profit elections is the exemption of federal tax liability imposed on the revenues of the organization, which is known as 501(c) (3). The compounding effect of this tax savings and the ability of the organization to reinvest those reserved funds back into its operations is of extreme significance. However, the impact of the “not-for-profit” mindset of a governance and executive team at a not-for-profit organization is one ripe for empirical research to evaluate the ability of this mindset to negate the potential profitability of the organization, as compared to a traditional for-profit enterprise of the same nature.

Traditional corporations who obtain the B Certification are subject to Federal corporate taxation obligations. In order to achieve the B Certification, corporations must pay an annual fee which ranges from \$1,000 to \$50,000+ on a scale based on company annual revenues, as well as principles of inclusivity, transparency and fairness.¹⁰⁷ This fee covers verification and

¹⁰¹ Brett H. McDonnell, *Committing to doing good and doing well: Fiduciary duty in benefit corporations*, 20 FORDHAM J. CORP. & FIN. L. 19, 32 (2014).

¹⁰² Murray, *supra* note 88 at 45.

¹⁰³ Simon C. Parker et al., *The impact of B lab certification on firm growth*, 5 ACAD. OF MGMT. DISCOVERIES 57, 77 (2019).

¹⁰⁴ Teal, *supra* note 100 at 5.

¹⁰⁵ Lisa Baudot et al. *The emergence of benefit corporations: A cautionary tale*, CRITICAL PERSP. ON ACCT. 1, 1 (2019).

¹⁰⁶ Robert Jupe & Warwick Funnell., *Neoliberalism, consultants and the privatization of public policy formulation: The case of Britain's rail industry*, 29 CRITICAL PERSP. ON ACCT. 65, 66 (2015).

¹⁰⁷ BENEFIT CORP. INFO. CTR. (2020) <https://benefitcorp.net/businesses/benefit-corporation-reporting-requirements>.

standards, technology platforms, licensing fees and local and global movement building.¹⁰⁸ While this fee may be quite negligible to many large public or privately held organizations, the efforts which would be necessary to obtain B Certification could be quite costly. There may be as many as 130 to 180 factors a company must address in the certification process, including a direct assessment of the following five impact areas: governance, workers, community, environment and customers. Revisions to supply chain, internal processes and controls and external network engagement necessary to comply with B Lab certification standards and result in earning at least 80 out of 200 total points necessary to qualify for B Certification could result in exponential additional expenses or opportunity costs, depending on the size of the organization.¹⁰⁹

Benefit corporations must also pay the same fees under the same adjusted scale as traditional corporations to maintain B Certification. However, as the benefit corporation is theoretically designed from the beginning to fit the requirements of the five impact areas, the additional remediation expenses and opportunity costs of sustainable business practices would not apply to these benefit organizations. Additionally, there is no reduction in tax liability for benefit corporations who maintain a B Certification.

One suggested primary financial benefit for traditional corporations who obtain the B Certification is brand and marketing driven. Publicly held, for profit firms can obtain the B Certification at the division level while holding other divisions separate from the sustainable practices required for B Certification. This can allow the brand to enter markets where consumers value social responsibility to a stronger degree.

Secondly, sustainable practices necessary for earning B Certification include improvements to internal processes of a wide range in nature. It is proposed that the implementation of these processes is predictive of future increase in earnings as these practices over time result in process efficiencies, better supply chain management, stronger employee retention, etc., each resulting in increased profitability.

While these potential monetary influences are positive in nature for traditional corporations who hold a B Certification, they may not have the same degree of positive impact on the benefit corporations' bottom line. Instead, the benefit corporation is likely to reap negative consequences if these actions were not taken or circumstances not observed. There is an unprecedented level of board accountability mandated within the benefit corporation statute. As such, what serves as a differentiator for traditional corporations becomes a liability for the benefit corporation.

The primary differentiating factor for social enterprises that have elected traditional incorporation or benefit incorporation, and hold the B Certification, is the organization's ability to enter certain capital markets. Foundations and impact investors are those which are willing

¹⁰⁸ *Id.*

¹⁰⁹ Wilburn, *supra* note 81 at 17.

to sacrifice some profit if a company can further social and environmental goals.¹¹⁰ Crowdfunding has recently been opened to the general public and is an excellent way to obtain capital for social enterprises. In these two areas, the primary election of an organization as a benefit corporation is likely to serve as an advantage, as opposed to traditional corporations which hold the B Certification and may appear to be “greenwashing”.

VII. Conclusion

It is imperative for organizations to continue their focus on the bottom line; however, we see that is no longer their only focus. Companies are forced to consider social values, fiduciary responsibility and going concern. Due to the shifting awareness of global sustainability concerns, as well as a societal shift towards communitarianism, corporations must find a way to adapt without substantial sacrifice. Moreover, evidence is building that the principles of sustainability can be the source of corporate and product differentiation and competitive advantages.¹¹¹ Fortunately, the option of legal structuration as a Benefit corporation and the measures to obtain the Certified B Corporation status add another layer of prosperity for organizations, enabling entrance into certain markets, as well as signaling positive messages to customers and economically linked organizations. CSR efforts, particularly the defined and measured impact factors necessary to maintain the related titles of Benefit Corporation and Certified B Corporation, are poised to raise the prosperity tide in which all ships will sail. Entrepreneurs and organization management need to understand the demands, benefits, and ripple effects from these systemic investments in social responsibility culture.

¹¹⁰ J. Haskell Murray, *Choose your own master: Social enterprise, certifications, and benefit corporation statutes*, 2 AM. BUS. L. REV. 1, 47 (2012).

¹¹¹ Robert B. Bennett, *A Sustainability Manifesto*, 27 MIDWEST L.J. 1, 39 (2017).

A Taxing Dilemma: Robot Taxes and the Challenges of Effective Taxation of AI, Automation and Robotics in the Fourth Industrial Revolution

Robert J. Kovacev¹

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I. Introduction

Michele Wucker coined the phrase “gray rhino” to describe a “highly probable, high impact threat” that leaders “ought to see coming but nevertheless fail to recognize and react to in time.”² The impact of the rise of artificial intelligence (“AI”), robotics, and automation on the tax system falls squarely within the definition of a gray rhino. Technological change promises major dislocations in the economy, including potentially massive displacement of human workers. At the same time, government revenues dependent on the taxation of human employment will diminish at the very time displaced workers will increasingly demand social services. It is undeniable that drastic changes will have to be made, but until recently there has been little appetite among policymakers for addressing the situation.

One potential solution to this dilemma has emerged in the public discourse over the past few years: the ‘robot tax.’³ This proposal is driven by the idea that if robots (and AI and automation) are displacing human workers, and thereby reducing tax revenues from labor-based taxes, then the robots themselves should be taxed. In theory, this kills two birds with one stone: the robot taxes make up the shortfall caused by reductions in income and payroll taxes, and the revenues raised are used to support and retrain the displaced workers. To supporters of a robot tax, “a taxation of robots, or the use of robots, represents a powerful and interesting alternative solution to a potential crucial issue: the decline, or at least the complete change, of labor market and the distributional implications on persons of the growing use of automation.”⁴

¹ Robert Kovacev is a Partner in the San Francisco and Washington, D.C. offices of Norton Rose Fulbright US LLP. This article arises from my presentation at The Ohio State University Moritz College of Law’s symposium on Artificial Intelligence and the Future of Tax Law and Policy on March 22, 2019. I am grateful to Professor Stephanie Hoffer for inviting me to participate in the symposium, to Professor Orly Mazur, at Southern Methodist University, for her thoughtful comments on an earlier draft of this article, and to the participants in the symposium for their insights and suggestions.

² MICHELE WUCKER, *THE GRAY RHINO* 7 (2016).

³ While the term “robot tax” has gained the widest currency, many of the proposals embrace AI, robotics, and other types of automation. The common thread between these proposals being the advancement of technology that threatens to displace human workers. See generally XAVIER OBERSON, *TAXING ROBOTS: HELPING THE ECONOMY TO ADAPT TO THE USE OF ARTIFICIAL INTELLIGENCE* 1-4 (2019) [hereinafter OBERSON I] (describing proposals to tax AI and robotics as a ‘robot tax’). Accordingly, while I will refer to ‘robot tax’ herein, my analysis applies with equal force to taxes directed specifically at AI, robotics, and automation.

⁴ *Id.* at 3-4.

Robot tax proposals have attracted academic interest among economists,⁵ legal scholars in the technology and employment fields⁶ and, increasingly, tax law scholars.⁷ Much of the focus has been on economic and policy arguments for and against robot taxes. There has been far less analysis of the practical difficulties of drafting and administering such a tax. This is hardly surprising, given that the field is so new, and few proposals have actually been boiled down to statutory language. From the perspective of a tax lawyer, however, the statutory language is vitally important to the administrability and feasibility of a robot tax proposal. Therefore, this

⁵ See, e.g., Joao Guerriero, Sergio Rebelo, & Pedro Teles, *Should Robots Be Taxed?* (Nat'l Bureau of Econ. Research, Working Paper No. 23806, 2019), <https://www.kellogg.northwestern.edu/faculty/rebelo/htm/robots.pdf>; Vincent Ooi & Glendon Goh, *Taxation of Automation and Artificial Intelligence as a Tool of Labour Policy* (SMU Ctr. for AI & Data Governance, Research Paper No. 2019/01, 2019),

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3322306; Pengqing Zhang, *Automation, wage inequality and implications of a robot tax*, 59 INT'L REV. OF ECON. & FIN. 500 (Oct. 13, 2019),

<https://www.sciencedirect.com/science/article/pii/S1059056018307251>; Arnaud Costinot & Ivan Werning, *Robots, Trade, and Luddism: A Sufficient Statistic Approach to Optimal Technology Regulation*, (Nat'l Bureau of Econ. Research Working Paper No. 25103, 2018), <https://economics.mit.edu/files/15811>;

Germana Bottone, *A Tax on Robots? Some food for thought*, (Ministro dell'Economica e delle Finanze DF Working Paper No. 3 (Sept. 2018),

https://www.finanze.it/export/sites/finanze/it/.content/Documenti/Varie/dfwp3_2018.pdf;

Uwe Thuemmel, *Optimal Taxation of Robots* (CESifo, Working Paper No. 7317, 2018),

http://uwethuemmel.com/wp-content/uploads/2017/02/Thuemmel2018_OptimalTaxationOfRobots_August.pdf;

see also Anton Korinek & Joseph E. Stiglitz, *Artificial Intelligence and its Implications for Income Distribution and Unemployment* (Nat'l Bureau of Econ. Research, Working Paper No. 24174, 2017),

<https://www.nber.org/papers/w24174>.

⁶ See, e.g., Ryan Abbott & Bret Bogenschneider, *Should Robots Pay Taxes? Tax Policy in the Age of Automation* 12 HARV. L. & POL'Y REV. 145 (2018); Cynthia Estund, *What Should We Do After Work? Automation and Employment Law*, 128 YALE L.J. 254, 315-18 (2018); Ryan Calo, *Artificial Intelligence Policy: A Primer and Roadmap*, 51 U.C. DAVIS L. REV. 399, 426-27 (2017); Ana Čulo, *Oporezivanje Robota: Utjecaj Automatizacije Na Radna Mjesta I Održivost Postojećeg Fiskalnog Sustava*, 7 ZAGREB L. REV. 71 (2018); A. Michael Froomkin et al., *When AIs Outperform Doctors: Confronting the Challenges of a Tort-Induced Over-Reliance on Machine Learning*, 61 ARIZ. L. REV. 33, 92-93 (2019).

⁷ See, e.g., OBERSON I, *supra* note 3; Sami Ahmed, *Cryptocurrency & Robots: How to Tax and Pay Tax on Them*, 69 S. C. L. REV. 697 (2018); Orly Mazur, *Taxing the Robots*, 46 PEPP. L. REV. 27 (2019); Xavier Oberson, *Taxing Robots? From the Emergence of an Electronic Ability to Pay to a Tax on Robots or the Use of Robots*, 1 WORLD TAX J. 247 (2017) [hereinafter Oberson II],

https://www.ibfd.org/sites/ibfd.org/files/content/pdf/wtj_2017_02_int_3_SeptNewsletter.pdf; Joachim Englisch, *Digitalisation and the Future of National Tax Systems: Taxing Robots?* (Sept. 5, 2018) (unpublished manuscript),

<https://ssrn.com/abstract=3244670>; Christina Dimitropoulou, *Robot Taxes: Where Do We stand?*, in CFE TAX

ADVISERS EUROPE – 60TH ANNIVERSARY LIBER AMICORUM 55 (2019); Vasiliki Koukouliti, *What Are You Taxing About? Balancing Out the Tax System to Avoid the Consequences of Automation in the Welfare System*, CTR. FOR LEGAL & CT. TECH. (April 24, 2019), [https://legaltechcenter.openum.ca/files/sites/159/2019/04/Koukouliti-What-Are-You-Taxing-About-Balancing-Out-the-Tax-System-to-Avoid-Consequences-of-Automation-in-the-Welfare-System.docx .pdf](https://legaltechcenter.openum.ca/files/sites/159/2019/04/Koukouliti-What-Are-You-Taxing-About-Balancing-Out-the-Tax-System-to-Avoid-Consequences-of-Automation-in-the-Welfare-System.docx.pdf);

Shu-Yi Oei, *So about that Robot Tax...*, THE SURLY SUBGROUP (Aug. 16, 2017),

<https://surlysubgroup.com/2017/08/16/so-about-that-robot-tax/>;

Kerry Ryan, *Taxing R2-D2? ABA Tax Section Panel on Automation and AI*, THE SURLY SUBGROUP (Feb. 16, 2018), <https://surlysubgroup.com/2018/02/16/taxing-r2-d2/>;

Stefano Dorigo, *Robots and Taxes: Turning an Apparent Threat Into an Opportunity*, 92 TAX NOTES INT'L 1079 (2018). This is by no means an exhaustive list. For a U.S. tax practitioner's perspective, see Robert J. Kovacev, *The Challenges of Administering a Robot Tax*, LAW360 (Sept. 25, 2017), <https://www.law360.com/articles/967115/the-challenges-of-administering-a-robot-tax>.

article examines the practical aspects of a robot tax, including ways in which such a tax could be drafted and implemented.

Part II of this article sets forth the current tax regime’s inherent preference for capital over labor. Part III discusses the effect of AI, robotics and automation both on employment and on tax revenues. Part IV outlines the emergence of robot tax proposals as a potential remedy for those effects. Part V addresses the challenges arising from these proposals. Part VI analyzes specific legislative robot tax proposals from the United States and internationally. Part VII considers whether a robot tax could be designed that would address the challenges discussed in Part V. Part VIII concludes.

II. The Current Tax Regime Favors Capital Over Labor

Taxes on labor income form the backbone of the tax regimes of the United States and other developed nations. Across the member states of the Organization for Economic Co-operation and Development (“OECD”),⁸ approximately 50% of all tax revenues in 2015 came from either individual income taxes or social insurance taxes.⁹ In the United States, this reliance on tax revenue from human effort is even more pronounced. In 2015, 64.2% of all tax revenue came either from individual income taxes or payroll taxes.¹⁰

In the United States in particular, the tax code favors capital over labor income.¹¹ Employers and employees must pay payroll taxes that are, in effect, excise taxes for the privilege of employing human workers.¹² No such taxes apply to capital investments in AI, robotics, or automation. Instead, businesses receive substantial tax benefits from developing, purchasing, and deploying AI, robotics, and automation equipment.¹³

This effect was amplified by the recent tax reform legislation. On December 22, 2017, President Trump signed into law sweeping tax legislation commonly known as the Tax Cuts and Jobs Act (“TCJA”).¹⁴ Supporters of the TCJA emphasized the legislation’s reduction of income tax rates,

⁸ *Where: Global Reach*, OECD, <http://www.oecd.org/about/members-and-partners/> (last visited July 8, 2019) (the OECD is an international intergovernmental organization with 36 nations as members, including the United States).

⁹ Amir El-Sibaie, *Sources of Government Revenue in the OECD, 2018*, TAX FOUNDATION FISCAL FACT NO. 581, 2 (Mar. 2018), <https://files.taxfoundation.org/20180322141501/Tax-Foundation-FF581.pdf>.

¹⁰ *Id.* at 3.

¹¹ Abbott, *supra* note 6, at 150-51; Mazur, *supra* note 7, at 292-93.

¹² I.R.C. §§ 3101, 3111; *see generally* I.R.C. §§ 3101-3512 (“Employment Taxes”); *see Estlund, supra* note 6, at 309 n.210 (“Payroll taxes in general are the most regressive large category of taxes (in Europe as well as in the United States”).

¹³ *See, e.g.*, I.R.C. §§ 41, 162, 167, 174, 179, 197. Sometimes seemingly neutral tax incentives can have the effect of encouraging deployment of robots. *See, e.g.*, Carrie Healy, *To Keep Operating, New England Dairy Farm Looks To 'Milking Robots,' Tax Credits*, NEW ENGLAND PUBLIC RADIO (Nov. 20, 2017), <https://www.nepr.net/post/keep-operating-new-england-dairy-farm-looks-milking-robots-tax-credits> (explaining dairy tax credits used to subsidize installation of milking robots).

¹⁴ Pub. L. No. 115-97, Title I, § 13305(a), 131 Stat. 2126 (2017).

particularly on corporations, which it was asserted would create jobs. One of the most significant features of the TCJA was the so-called 100% expensing provision, which allowed businesses to deduct the entire expense of certain capital investments in the year of acquisition, rather than having to take depreciation deductions over time.¹⁵ The TCJA contained no corresponding tax benefit for hiring more employees.

Given the structure of the U.S. tax code, many commentators have come to the conclusion that “many businesses are investing in automation simply because the tax code is urging them to do so.”¹⁶ Certainly, the current tax structure does little to preserve employment in the face of growing pressure from AI, robotics and automation.

III. Effect of AI and Robotics

The effect of technological improvements on the economy and society has been widely debated for centuries.¹⁷ The rise of AI, robotics, and automation may bring about change of a different order than past innovations, however.¹⁸ The effect of the rise of AI and robotics has been described as a “fourth industrial revolution,” reflecting the significant impact on the economy and society that is widely anticipated.¹⁹ While “it was previously possible to automate a large number of work processes, it has now become practicable.”²⁰ And automation of tasks may lead to the elimination of the jobs and livelihoods of those humans currently employed in

¹⁵ Pub. L. No. 115-97 Title I, § 13201 (2017) (codified at I.R.C. § 168(k)); see Mazur, *supra* note 7, at 295; see also Andrew Tangel & Patrick McGroarty, *Tax Incentive Puts More Robots on Factory Floors*, WALL ST. J. (Jan. 26, 2018), <https://www.wsj.com/articles/tax-incentive-puts-more-robots-on-factory-floors-1516962600>.

¹⁶ Eduardo Porter, *Don't Fight the Robots, Tax Them*, N.Y. TIMES (Feb. 23, 2019), <https://www.nytimes.com/2019/02/23/sunday-review/tax-artificial-intelligence.html>; see also Chris Arnold, *Tax Bill Favors Adding Robots Over Workers, Critics Say*, NPR (Dec. 8, 2017), <https://www.npr.org/2017/12/08/569118310/tax-bill-favors-adding-robots-over-workers-critics-say>.

¹⁷ See, e.g., Abbott, *supra* note 6, at 156-58; see also Bruno Colmant, *Faut-il taxer les robots? L'ECHO* (Sept. 26, 2017), <https://bruxselsfuture.files.wordpress.com/2019/04/taxer-les-robots-colmant.pdf> (citing the work of nineteenth-century Swiss economist Jean de Sismondi, who proposed a tax on the owners of machines).

¹⁸ MARTIN FORD, *RISE OF THE ROBOTS: TECHNOLOGY AND THE THREAT OF A JOBLESS FUTURE* 29-61 (2016); James Manyika et al., *A Future That Works: Automation, Employment and Productivity*, MCKINSEY GLOB. INST. (2017), <https://www.mckinsey.com/~media/McKinsey/Featured%20Insights/Digital%20Disruption/Harnessing%20automation%20for%20a%20future%20that%20works/MGI-A-future-that-works-Full-report.ashx>; see also MICROSOFT, *THE FUTURE COMPUTED: ARTIFICIAL INTELLIGENCE AND ITS ROLE IN SOCIETY* 87-136 (2018).

¹⁹ Klaus Schwab, *The Fourth Industrial Revolution: what it means, how to respond*, WORLD ECON. F. (Jan. 14, 2016), <https://www.weforum.org/agenda/2016/01/the-fourth-industrial-revolution-what-it-means-and-how-to-respond/> [<https://perma.cc/D4NZ-DHUU>].

²⁰ Abbott, *supra* note 6, at 153.

those tasks.²¹ While estimates vary, some studies place the estimate of lost jobs as high as 57% among OECD countries, and even higher in India and China.²²

The rise of AI, robotics, and automation will have a concomitant effect on government tax revenues. As noted in Part II above, the tax base in the OECD, particularly in the United States, is heavily dependent on labor (through individual income taxes or payroll taxes). In a vicious circle, at the same time that automation increases the need for government spending to support displaced workers, it will also decrease tax receipts.²³ It is not at all clear that other forms of taxation, such as corporate taxes, would be sufficient to pick up the slack.²⁴

IV. The Rise of Robot Tax Proposals

The first prominent robot tax proposal came from the European Union. In 2017, Mady Delvaux, Member of the European Parliament from Luxembourg, prepared a report with recommendations to the European Parliament for the regulation of robotics.²⁵ The recommendation included an explicit statement in favor of considering a robot tax.²⁶ The

²¹ *Id.* at 159. *But see* Jeff Spross, *How Robots Became a Scapegoat for the Destruction of the Working Class*, THE WEEK (Apr. 29, 2019), <https://theweek.com/articles/837759/how-robots-became-scapegoat-destruction-working-class> (arguing that “the automation we’re seeing now is little different from the technological advances we’ve seen in every other era”) [<https://perma.cc/5MUA-FQX8>].

²² Carl B. Frey et al., *Technology at Work v. 2.0: The Future Is Not What It Used To Be*. Citi GPS 7 (Jan. 2016), https://www.oxfordmartin.ox.ac.uk/downloads/reports/Citi_GPS_Technology_Work_2.pdf; Carl Benedikt Frey & Michael A. Osborne, *The Future of Employment: How Susceptible are Jobs to Computerization?* 44 (Oxford Martin Programme on Tech. and Emp., Working Paper, 2013), https://www.oxfordmartin.ox.ac.uk/downloads/academic/The_Future_of_Employment.pdf (predicting that 47 percent of total US employment is in the high risk category, meaning that associated occupations are potentially automatable over some unspecified number of years, perhaps a decade or two.”); *see also* Ed Husic & Mike Priddis, *Australia unprepared for automation of its workforce*, FIN. REV. (Jul. 31, 2017, 11:00 PM), <https://www.afr.com/technology/australia-unprepared-for-automation-of-its-workforce-20170730-gxlw5>. *But see* Michael Koch, Ilya Manuylov, & Marcel Smolka, *Robots and Firms*, (CESifo Working Paper No. 7608, 2019), https://www.econstor.eu/bitstream/10419/198968/1/cesifo1_wp7608.pdf (finding that robot adoption leads to net job creation); *But see* Melanie Arntz, Terry Gregory, Ulrich Zierahn, *The Risk of Automation for Jobs in OECD Countries: A Comparative Analysis*, (OECD Soc., Working Paper No. 189, 2017), http://www.oecd-ilibrary.org/social-issues-migration-health/the-risk-of-automation-for-jobs-in-oecd-countries_5jlz9h56dvq7 (arguing that estimates of job losses are exaggerated); CTR. FOR THE NEW ECON. & SOC’Y, WORLD ECON. FORUM, THE FUTURE OF JOBS REPORT 2018, viii (2018), http://www3.weforum.org/docs/WEF_Future_of_Jobs_2018.pdf (estimating that AI, automation and robotics will create 58 million net jobs between 2018 and 2022).

²³ Abbott, *supra* note 6, at 156.

²⁴ *See, e.g.*, Sam Mitha, *Robots, Technological Change and Taxation*, TAX J. (Sept. 14, 2017), <https://www.taxjournal.com/articles/robots-technological-change-and-taxation-14092017> (former head of Central Tax Policy Group at Her Majesty’s Revenue & Customs; “Unless corporate profits were to increase very substantially indeed, it would be necessary for the government to increase the corporation tax rate by a significant amount to recoup the personal tax revenues lost through automation.”).

²⁵ Report with Recommendations to the Commission on Civil Law Rules on Robotics, PARL. EUR. DOC. A8-0005/2017 (2017), http://www.europarl.europa.eu/doceo/document/A-8-2017-0005_EN.pdf.

²⁶ *Id.* at 4.

recommendation noted that the development of robotics and AI raised “concerns about the future of employment, the viability of social welfare and security systems and the continued lag in pension contributions, if the current basis of taxation is maintained, creating the potential for increased inequality in the distribution of wealth and influence.”²⁷ The corrective for these risks was identified as “the likelihood of levying tax on the work performed by a robot or a fee for using and maintaining a robot should be examined in the context of funding the support and retraining of unemployed workers whose jobs have been reduced or eliminated.”²⁸

The EU robot tax proposal gained early support from a high-profile source. In a controversial interview with Quartz magazine shortly after the proposal was publicized, Bill Gates endorsed a proposal for a tax on robots.²⁹ Other prominent figures soon announced their support for the Gates robot tax idea. For example, Robert Shiller, Nobel laureate in economics known for predicting the 2008 financial crisis,³⁰ endorsed a “moderate tax on robots” as a “natural component of a policy to address rising inequality.”³¹ Elon Musk³² and Stephen Hawking³³ also joined the fray.

Others were decidedly less keen. The International Federation of Robotics took a strong stand against robot taxes, noting that such a tax would “have a negative impact on competitiveness and employment.”³⁴ So did European politicians like former Greek finance minister Yanis

²⁷ *Id.*

²⁸ *Id.*

²⁹ Kevin J. Delaney, *The Robot That Takes Your Job Should Pay Taxes, Says Bill Gates*, QUARTZ (Feb. 17, 2017), <https://qz.com/911968/bill-gates-the-robot-that-takes-your-job-should-pay-taxes/> [<https://perma.cc/H8RR-UCN5>].

³⁰ Robert J. Shiller, *Bubble Trouble*, PROJECT SYNDICATE (Sept. 17, 2007), <https://www.project-syndicate.org/commentary/bubble-trouble?barrier=accesspaylog> [<https://perma.cc/72U9-TRGQ>].

³¹ Robert J. Shiller, *Robotization Without Taxation?*, PROJECT SYNDICATE (Mar. 22, 2017), <https://www.project-syndicate.org/commentary/temporary-robot-tax-finances-adjustment-by-robert-j--shiller-2017-03?barrier=accesspaylog> [<https://perma.cc/479B-BHRG>].

³² Catherine Clifford, *Elon Musk: Robots Will Take Your Jobs, Government Will Have to Pay Your Wage*, CNBC (Nov. 4, 2016, 2:19 PM), <https://www.cnn.com/2016/11/04/elon-musk-robots-will-take-your-jobs-government-will-have-to-pay-your-wage.html> [<https://perma.cc/3YA6-9VMK?type=image>].

³³ Doug Bolton, *Stephen Hawking Says Robots Could Make Us All Rich and Free - but We're More Likely to End Up Poor and Unemployed*, THE INDEPENDENT (Oct. 9, 2015, 6:35 PM), <https://www.independent.co.uk/life-style/gadgets-and-tech/stephen-hawking-says-robots-could-make-us-all-rich-and-free-but-were-more-likely-to-end-up-poor-and-a6688431.html> [<https://perma.cc/NSKM-PAED>].

³⁴ Press Release, Int'l Fed'n Robotics, World Robotics Federation IFR: Why Bill Gates' Robot Tax Is Wrong (Feb. 27, 2017), <https://ifr.org/ifr-press-releases/news/world-robotics-federation-ifr-why-bill-gates-robot-tax-is-wrong> [<https://perma.cc/AM7B-AATEP?type=image>]; see also Steve Cousins, *Is a 'Robot Tax' Really an 'Innovation Penalty'?*, TECHCRUNCH (Apr. 22, 2017, 12:30 PM), <https://techcrunch.com/2017/04/22/save-the-robots-from-taxes/> [<https://perma.cc/2ZV2-RDLY>]; cf. Tshilidzi Marwala, *On Robot Revolution and Taxation* (Aug. 5, 2018) (unpublished manuscript), <https://arxiv.org/abs/1808.01666>.

Varoufakis³⁵ and EU Commissioner Andrus Ansip,³⁶ as well as former U.S. Treasury Secretary Lawrence Summers.³⁷ After considerable debate, the final version of the motion proposed by MEP Delvaux and adopted by the European Parliament contained no reference to a potential robot tax.³⁸

Despite this setback, support for robot tax proposals has increased globally.³⁹ While most of these endorsements have come from the political left of the political spectrum,⁴⁰ some in the political right have also favorably discussed robot tax proposals.⁴¹

Proposals have also surfaced in the United States. In 2018, Jane Kim, a candidate for mayor of San Francisco, ran on a platform that included a tax on AI, robots, and algorithms displacing human workers.⁴² A political candidate in Chicago, Ameya Pawar, has proposed ordinances clawing back relocation subsidies given to companies who fail to create the promised number

³⁵ Yanis Varoufakis, *A Tax on Robots?*, PROJECT SYNDICATE (Feb. 26, 2017), <https://www.project-syndicate.org/commentary/bill-gates-tax-on-robots-by-yanis-varoufakis-2017-02?barrier=accesspaylog> [<https://perma.cc/2CX2-F3NT>].

³⁶ Kate Samuelson, *EU Commissioner Says No to Bill Gates' Robot Tax Idea*, FORTUNE (June 2, 2017), <http://fortune.com/2017/06/02/andrus-ansip-bill-gates-robot-tax/> [<https://perma.cc/8LHG-M4NZ>].

³⁷ Sarah Kessler, *Lawrence Summers Says Bill Gates' Idea for a Robot Tax is 'Profoundly Misguided'*, QUARTZ (Mar. 6, 2017), <https://qz.com/925412/lawrence-summers-says-bill-gates-idea-for-a-robot-tax-is-profoundly-misguided/> [<https://perma.cc/UTM4-MP9Z>].

³⁸ Civil Law Rules on Robotics, PARL. EUR. DOC. P8_TA(2017)0051 (2017), https://www.europarl.europa.eu/doceo/document/TA-8-2017-0051_EN.pdf; Geordina Prodhon, *European Parliament Calls for Robot Law, Rejects Robot Tax*, THOMAS REUTERS (Feb. 16, 2017), <https://www.reuters.com/article/us-europe-robots-lawmaking/european-parliament-calls-for-robot-law-rejects-robot-tax-idUSKBN15V2KM> [<https://perma.cc/G6G2-CPDY>].

³⁹ Mazur, *supra* note 7, at 297.

⁴⁰ See, e.g., Gordon Rayner, *Jeremy Corbyn Plans to 'Tax Robots' Because Automation is a 'Threat' to Workers*, THE TELEGRAPH (Sept. 26, 2017, 10:00 PM), <https://www.telegraph.co.uk/news/2017/09/26/jeremy-corbyn-plans-tax-robots-automation-threat-workers/> [<https://perma.cc/M5BT-ZGMK>]; Ewin Hannah, *'Robot Tax' to Help Retrain Displaced Workers*, THE AUSTRALIAN (Dec. 13, 2018, 12:09 AM), <https://www.theaustralian.com.au/nation/labor-plans-robot-tax-to-help-retrain-displaced-workers/news-story/966b5534e8a68239a727a783a66e731a>; Marie Théobald, *Taxe sur les Robots, Revenu Universel, Énergie . . . Benoît Hamon Détaille son Programme Économique* [*Tax on Robots, Universal Income, Energy . . . Benoît Hamon Details his Economic Program*], LE FIGARO ÉCONOMIQUE (Mar. 3, 2017, 8:39 AM), <http://www.lefigaro.fr/conjoncture/2017/03/03/20002-20170303ARTFIG00144-taxe-sur-les-robots-revenu-universel-energie8230-benoit-hamon-detaille-son-programme-economique.php> [<https://perma.cc/G5U4-DW5W>]; Cheryl Chan, *Green Party's Elizabeth May Proposes 'Robot Tax' to Prepare for Future of Automation*, VANCOUVER SUN (Sept. 30, 2019), <https://vancouversun.com/news/local-news/green-partys-elizabeth-may-proposes-robot-tax-to-prepare-for-future-of-automation> [<https://perma.cc/M37Q-UNHT>].

⁴¹ See, e.g., Federica Meta, *Tassa sui Robot, si Riapre il Dibattito, Salvini: 'Imposta a Tutela del Lavoro:'* [*Tax on the Robots, the Debate Reopens, Salvini: 'Tax to Protect Labor'*], CORCOM (Feb. 8, 2018), <https://www.corrierecomunicazioni.it/elezioni-2018/tassa-sui-robot-si-riapre-dibattito-salvini-imposta-tutela-del-lavoro/> [<https://perma.cc/X46F-SHG4>] (discussing independent robot tax proposals made by Deputy and Italian Socialist Party member Oreste Pastorelli and Deputy Prime Minister and Lega party member Matteo Salvini).

⁴² See also *About Us*, JOBS FOR THE FUTURE FUND, <https://www.jobsofthefuturefund.com/about/> [<https://perma.cc/BQ4U-WUNV>]; Emily Price, *Bill Gates' Plan to Tax Robots Could Become a Reality in San Francisco*, FORTUNE (Sept. 5, 2017), <http://fortune.com/2017/09/05/san-francisco-robot-tax/> [<https://perma.cc/3V9H-KF9Z?type=image>].

of jobs due to automation and imposing a tax on companies who replace human employees with automation, in the amount of the annual salary of the displaced workers.⁴³

The most recent high-profile endorsement of the concept of a robot tax came from U.S. Representative Alexandria Ocasio-Cortez.⁴⁴ Rep. Ocasio-Cortez suggested in a speech at SXSW that a tax rate of 90% on businesses using robots may be necessary, referencing Mr. Gates' robot tax proposal.⁴⁵ At least two U.S. presidential candidates in the 2020 Democratic primary have explicitly adopted a robot tax proposal.⁴⁶

V. Challenges with Robot Tax Proposals

While there have been many proposals for a robot tax, few of those proposals include any specifics about how such a tax would be implemented or administered. Put bluntly, “[t]he enthusiasm of robot tax proponents is matched by the lack of detail on how such a tax would work.”⁴⁷ There is good reason for this omission: while broad policy statements about taxing robots is easy, addressing the many practical challenges of such taxes is much more difficult. As Professor Mazur has put it, “these proposals involve substantial elements of arbitrariness and complexity in implementation, likely increasing compliance and administrative burdens on companies and tax authorities.”⁴⁸ The most significant hurdles are discussed below.

A. What is a Robot?

There is a fundamental definitional problem plaguing robot tax proposals: what is a taxable robot?⁴⁹ “Few complex technologies have a single, stable, uncontested definition. Robots are

⁴³ Fran Spielman, *Pawar Proposes Claw-back Clause, Robot Tax to Guard Against Amazon Automation*, CHI. SUN-TIMES (Feb 12, 2019, 2:25 PM), <https://chicago.suntimes.com/2019/2/12/18314110/pawar-proposes-claw-back-clause-robot-tax-to-guard-against-amazon-automation> [<https://perma.cc/2XZ6-M48U>].

⁴⁴ Jeffry Bartash, *Bill Gates Finds an Ally in Washington for his Idea to Tax Robots: Alexandria Ocasio-Cortez*, MARKETWATCH (Mar. 11, 2019, 1:59 PM), <https://www.marketwatch.com/story/bill-gates-finds-an-ally-in-washington-for-his-idea-to-tax-robots-alexandria-ocasio-cortez-2019-03-11> [<https://perma.cc/X9KX-S2P5>]; SXSW, *Alexandria Ocasio-Cortez | SXSW 2019*, YOUTUBE (Mar. 10, 2019), <https://www.youtube.com/watch?v=JU-SE5eNt04> (The robot tax discussion begins at 57:40) [<https://perma.cc/RNQ3-233W>].

⁴⁵ SXSW, *supra* note 44, at 57:40.

⁴⁶ Team Delaney, *Delaney Releases Living Wage Plan to Increase Take Home Pay, Create Universal Paid Family Leave*, DELANEY FOR PRESIDENT 2020 (June 21, 2019), <https://www.johndelaney.com/2019/06/21/delaney-releases-living-wage-plan-to-increase-take-home-pay-create-universal-paid-family-leave/> [<https://perma.cc/KXS5-UE7H>]; Bill De Blasio, *Why American Workers Need to be Protected from Automation*, WIRED (Sept. 5, 2019, 3:16 PM), <https://www.wired.com/story/why-american-workers-need-to-be-protected-from-automation/> [<https://perma.cc/2EBH-L9DZ>].

⁴⁷ Robert J. Kovacev, *Don't Tax the Robots*, S. F. CHRONICLE (Jan. 21, 2018, 5:21 PM), <https://www.sfchronicle.com/opinion/openforum/article/Don-t-tax-the-robots-12511631.php> [<https://perma.cc/TQJ6-HSEV>]. For a rare example of a robot tax proponent willing to grapple with such details, see OBERSON I, *supra* note 3, at 112-137.

⁴⁸ Mazur, *supra* note 7, at 303.

⁴⁹ *Id.* at 299. Even scholars who are generally favorably disposed to the concept of the robot tax concede the challenge posed by this basic definitional problem. See, e.g., Xavier Oberson, *How Taxing Robots Could Help Bridge Future Revenue Gaps*, OECD (2017), <http://www.oecd.org/employment/how-taxing-robots-could-help-bridge->

no exception.”⁵⁰ This is a significant problem for dealing with robots in a legal context and not unique to tax.⁵¹ To be sure, there are various technical definitions that attempt to define what a robot is.⁵² While the details vary, the “common thread is that they tend to focus on the autonomy and decision-making process of robots.”⁵³ These technical definitions, while they may be useful in a scientific context, would do little to assist a lay judge or tax administrator without a technical background. The European Union tried its hand at determining a “common definition of smart autonomous robots” to include the following characteristics: “acquires autonomy through sensors and/or by exchanging data with its environment (inter-connectivity) and trades and analyses data; is self-learning (optional criterion); has a physical support; [and] adapts its behaviours and actions to its environment.”⁵⁴ Despite this attempt, the EU recognized that “defining robots is no easy task in the absence of any real consensus within the global scientific community.”⁵⁵ In sum, there simply is no commonly-accepted legal definition of a “robot.”⁵⁶

The definitional problem is simply one manifestation of the difficulty judges (and by extension, tax authorities, taxpayers, and tax professionals) have in dealing with inanimate objects that exhibit features of autonomy that we commonly associate with robots. A bizarre example of the gymnastics required to address the tax implications of robots comes from, of all places, Chuck E. Cheese.⁵⁷ At the time, Maryland gave its counties the authority to impose an admissions and amusement tax on the gross receipts of entities providing “refreshment, service or merchandise at any roof garden, cabaret or similar place where there is furnished a performance.”⁵⁸ Chuck E. Cheese is a “family dining and entertainment center” including, among other amusements, an animatronic Chuck E. Cheese, an “iconic, energetic mouse mascot, performs music and entertainment shows along with his friends, providing free

future-revenue-gaps.htm [https://perma.cc/3FMH-SZQH] (“clear and agreed definition of robots would be required”).

⁵⁰ Ryan Calo, *Robotics and the Lessons of Cyberlaw*, 103 CAL. L. REV. 513, 529 (2015).

⁵¹ See, e.g., Mohammad Iqbal, *Defining Cyberterrorism*, 22 Marshall J. Computer & Info. L. 397 (2004); Raymond Nimmer & Patricia A. Krauthaus, *Copyright and Software Technology Infringement: Defining Third Party Development Rights*, 62 Ind. L.J. 13 (1986).

⁵² See Oberson II, *supra* note 7, at 249-250.

⁵³ *Id.* at 250.

⁵⁴ European Civil Law Rules in Robotics: Study of the Legal Affairs Committee, Parl. EUR. Doc. PE 571.379, 8 (2016), [https://www.europarl.europa.eu/RegData/etudes/STUD/2016/571379/IPOL_STU\(2016\)571379_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2016/571379/IPOL_STU(2016)571379_EN.pdf).

⁵⁵ *Id.*

⁵⁶ Mazur, *supra* note 7, at 298-99; Oberson II, *supra* note 7, at 249-250; Ryan Calo, *Robots in American Law* (Univ. Wash. Sch. L., Research. Paper No. 2016-04 (Feb. 24, 2016), <https://ssrn.com/abstract=2737598>; Kovacev, *supra* note 7.

⁵⁷ *Comptroller of the Treasury v. Family Entm’t Ctrs.*, 519 A.2d 1337 (Md. 1987), *overruled on other grounds by* 318 N. Market St., Inc. v. *Comptroller of the Treasury*, 554 A.2d 453 (Md. 1989). Thanks to Professor Calo for suggesting this example.

⁵⁸ MD. CODE ANN., ART. 81, §§ 402, 402(A) (1957). The current successor statute uses the term “entertainment” instead of “performance.” MD. CODE ANN., TAX-GEN. § 4-101 (2017). There are no subsequent judicial decisions analyzing whether this statutory change would change the result for Chuck E. Cheese.

entertainment to our guests and driving strong brand recognition.”⁵⁹ The Maryland Comptroller of Treasury assessed this tax against the owner of three Chuck E. Cheese restaurants in the state, alleging that the performance of Chuck E. Cheese and his animatronic friends constituted a performance for purposes of the admissions and amusement tax statute. The Maryland Court of Special Appeals disagreed, based on its interpretation of the term “performance:”

According to Webster's New Universal Unabridged Dictionary (2d edition, 1983), one definition of the word “performance,” among others clearly less applicable, is “(4) a formal exhibition of skill or talent as a play, musical program, etc.; a show.” We recognize that “performance,” as used in § 402(a), has connotations of inherent human input that leaves room for spontaneous imperfections during the exhibition of skill or talent. A “performance” is a method to measure human skill or talent. In other words, a pre-programmed robot can perform a menial task but, because a pre-programmed robot has no “skill” and therefore leaves no room for spontaneous human flaw in an exhibition, it cannot “perform” a piece of music anymore than can a jukebox. Just as a wind-up toy does not perform for purposes of § 402(a), neither does a pre-programmed mechanical robot.

Appellees' mechanical puppets are designed to give the impression that they are performing; however, because there is no human skill necessary in their control, there is no “performance.”⁶⁰

If you accept that Chuck E. Cheese and friends are little more than glorified jukeboxes, then this decision seems reasonable. Yet, robots and AI are capable of much more sophisticated tasks than replaying canned tunes for pizza-fueled children’s birthday parties. As Professor Calo points out, robots increasingly engage in emergent behavior that displays the “ability or tendency of a system to behave in complex, unanticipated ways.”⁶¹ Would the result be different if the cybernetic mouse could compose its own music, choose what songs to perform and reflect a unique style in performing it? It is not at all clear that judges will have the technical knowledge to make the distinction between a simple machine and an emergent-behavior robot.⁶² Even if they did, it is unlikely that a bright-line rule could separate robots from mere machines. Resolving that question would therefore revolve around the facts and circumstances of each particular case. There is no reason to expect tax authorities, taxpayers, or tax professionals to have better luck managing that difficult task.⁶³

⁵⁹ CEC ENTERTAINMENT, INC., FISCAL 2018 FORM 10-K 5 (2018). To parents who have raised children in the United States over the past 40 years, this particular iconic, energetic mouse mascot needs no introduction, for better or worse.

⁶⁰ Family Entm’t Ctrs, 519 A.2d at 1339; *cf.* Louis Marx & Co. v. United States, 66 Cust. Ct. 139, 142 (1971) (mechanical robots are not “figures or images of animate objects” for purposes of the Tariff Act of 1930).

⁶¹ Ryan Calo, *Robots as Legal Metaphors*, 30 HARV. J.L. & TECH. 209, 227 (2016).

⁶² *Id.* at 229-31.

⁶³ Consider, for example, the distinction between an employee and an independent contractor for employment tax purposes has been “riven with controversy and ambiguity” for decades and promises to remain so. Kovacev, *supra* note 7. If a tax authority has difficulty sorting that out after repeated iterations and disputes, it is difficult to imagine a smooth interpretation and implementation of the definition of an emerging and evolving technology.

So, when discussing a robot tax, does a “robot” refer to any labor-saving machine (say, an ATM), or something more complex? What degree of autonomy (or emergent behavior, if you prefer) must it exhibit? Does it include an intangible algorithm embedded in code, or must it be a physical actor? Does it include a machine that enhances rather than replaces human activity?⁶⁴ Any robot tax must answer these questions, and reduce that language to statutory text. From a practitioner’s standpoint, the difficulty in nailing down such a basic element creates compliance nightmares and planning opportunities, and is not a sound basis for an administrable tax.

B. Who Actually Pays the Tax?

There is an even more fundamental problem with robot taxes: robots do not pay taxes, rather, humans (or entities formed and controlled by humans) do. Robots do not own property, nor do they earn wages. Should a robot collect money, it does so on behalf of its human owner, and legally must do so in the name of that human agent.⁶⁵ The Internal Revenue Code defines a taxpayer as “an individual, a trust, estate, partnership, association, company or corporation.”⁶⁶ A robot is none of those things, at least under present law. A ‘robot tax’ is really a tax on humans (or entities formed and run by humans) who own, use, or benefit from the use of robots.⁶⁷

It has been proposed that robots be granted a separate legal personality, akin to a corporate entity, that would be charged with paying taxes.⁶⁸ In reality, this would not change the analysis of who pays the tax, however. Calling a robot a person via a legal fiction does not change the fact that the money paying the tax must, in substance, come from and be controlled by human

⁶⁴ See, e.g., Signe Brewster, *This \$40,000 Robotic Exoskeleton Lets the Paralyzed Walk*, MIT TECH. REV. (Feb. 1, 2016), <https://www.technologyreview.com/s/546276/this-40000-robotic-exoskeleton-lets-the-paralyzed-walk/> [https://perma.cc/Q7V7-GAKS].

⁶⁵ *Oberson II*, *supra* note 7, at 260.

⁶⁶ I.R.C. § 7701(a)(1), (14) (1992).

⁶⁷ At common law, an inanimate object could be held responsible for the death of a human, and the object “forfeited to the Crown as a deodand.” *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 681 (1973) (citation omitted). There does not appear to be a common-law equivalent to holding an inanimate object independently liable for taxes, however, even if taxes are sometimes erroneously described that way. For example, a real property tax may be described as a “tax on land,” see, e.g., JOAN M. YOUNGMAN, *CHAPTER 9: TAX ON LAND AND BUILDINGS*, in 1 *TAX LAW DESIGN AND DRAFTING* 264 (Victor Thuronyi ed., 1996), but the tax is actually paid by the owners of the land, not the land itself. *Cf. Automatic Vending Sales Co. v. City of Johnstown*, 19 Pa. D. & C. 474 (Pa. Ct. Comm. Pleas 1933) (invalidating ordinance that purported to impose a license tax upon vending machines; “literally construed [the ordinance] would subject these robots to fine and imprisonment upon noncompliance with its terms.”)

⁶⁸ *OBERSON I*, *supra* note 3, at 17-24.

actors.⁶⁹ Further, there are considerable difficulties in holding such an artificial legal ‘person’ accountable for its actions, leading to potential moral and ethical objections.⁷⁰

There are important policy ramifications to choosing which humans would pay the tax. Either the tax is imposed on: (1) the manufacturers of robots, (2) the businesses purchasing the robots, or (3) on consumers of goods or services provided by robots. The incidence of a robot tax varies with the type of tax employed and it is not always clear who ultimately bears the incidence of taxation. Most obvious is a sales tax, value-added tax, excise tax or use tax imposed at the retail level on products produced or services provided by AI, robotics, or automation.⁷¹ Clearly, the consumer pays those taxes. For other taxes, the ultimate bearer of the tax burden is less clear.⁷²

A popular proposal involves taxing robots in the equivalent amount to the foregone taxes of displaced employees.⁷³ This assumes, of course, that there is a demonstrable correspondence between acquiring a particular robot and lost human jobs. What if a business acquires a robot without firing any existing employees? Or lays off a number of low-skill employees but hires

⁶⁹ An *in rem* action may be maintained nominally against an item of property (such as a ship under admiralty law or property subject to forfeiture). See FED. RS. CIV. P. A-G. This is properly understood as a device allowing the determination of rights of persons to the property, however, not a vesting of legal personhood on the property itself. See, e.g., *Tyler v. Judges of the Court of Registration*, 175 Mass. 71, 76-77 (Mass. 1900) (Holmes, C.J.) (“All proceedings, like all rights, are really against persons. . . . Personification and naming the res as defendant are mere symbols, not the essential matter. They are fictions, conveniently expressing the nature of the process and the result; nothing more.”)

⁷⁰ See Joanna J. Bryson, Mihailis E. Diamantis, & Thomas D. Grant, *Of, for, and by the People: The Legal Lacuna of Synthetic Persons*, 25 ARTIFICIAL INTELLIGENCE & L. 273 (2017), <https://link.springer.com/article/10.1007/s10506-017-9214-9>.

⁷¹ See, e.g., Alexis Carey, *MPs Want Shoppers to be Charged a Self-checkout Machine Tax*, NEWS.COM.AU (May 21, 2019, 9:20 PM), <https://www.news.com.au/finance/business/retail/mps-want-shoppers-to-be-charged-a-selfcheckout-machine-tax/news-story/78e9353a938bb9cf117f5935ce1521ed> [<https://perma.cc/CZ3P-C7Q3>].

⁷² An analogy can be drawn to the question of who bears the burden of corporate taxes. The incidence of corporate taxation is a highly controversial subject. See, e.g., Clemens Fuest, Andreas Peichl & Sebastian Sieglöckh, *The Incidence of Corporate Taxation and its Implications for Tax Progressivity*, VOX: CEPR POLICY PORTAL (Oct. 10, 2017), <https://voxeu.org/article/incidence-corporate-taxation-and-implications-tax-progressivity> [<https://perma.cc/HG2H-X8SP>].

⁷³ FAQs, JOBS OF THE FUTURE FUND, <https://www.jobsofthefuturefund.com/faq/> [<https://perma.cc/W9KG-7X3R>]; see also OBERSON I, *supra* note 3, at 114 (proposing a tax based on an “imputed salary” allocated to robots, based on the equivalent salary paid to human workers for similar activities, analogous to the Swiss tax on “imputed rent” imposed on homeowners). “Imputed rent” is the theoretical income that homeowners enjoy as a result of not having to pay rent in order to live in their own homes. William Gale, Jonathan Gruber, & Seth Stephens-Davidowitz, *Encouraging Homeownership Through the Tax Code*, 155 TAX NOTES 1171, 1173 (2007). While the concept of imputed rent is mercifully absent from the United States’ tax code, see *id.* at 1173 n.3, a handful of European jurisdictions including Switzerland do tax imputed rent, notionally based on a valuation of market rent for similar properties minus associated expenses. *Id.*; see also Dan Andrews, Aida Caldera Sánchez, & Åsa Johansson, *Housing Markets and Structural Policies in OECD Countries* 39, 43 (OECD Econ. Dep’t, Working Paper No. 836, 2011), <https://www.oecd-ilibrary.org/docserver/5kgk8t2k9vf3-en.pdf?expires=1573961403&id=id&accname=guest&checksum=DD6B082EA945A1C15299D620D57B7BA0>.

new skilled employees to work with the robot?⁷⁴ Answering these questions would necessarily involve subjective judgment calls, inviting complexity and uncertainty from a tax administration perspective. This complexity and uncertainty would increase compliance costs for taxpayers, while creating opportunities for tax avoidance designed to exploit the ambiguities inherent in this proposal.⁷⁵

Another type of proposal calls for a tax based on income derived from AI, robots, or automation. Unless a business derives all its income from using robots, however, this would require some sort of allocation of income in order to calculate the tax. This would necessarily be a fact-driven case-by-case analysis, analogous to the analysis required in the context of transfer pricing.⁷⁶ Transfer pricing is famously driven by complexity and costly disputes,⁷⁷ and the same pattern would likely emerge if a robot tax required allocation of income between robot-sourced and non-robot-sourced income.⁷⁸

An excise tax charged against the manufacturers or purchasers of robots is another possible approach. But there are also distributional effects to be considered. For example, such excise taxes would be regressive, because a business would pay the same amount of tax per robot no matter how large or profitable the business is.⁷⁹ A small family business would likely be less able to absorb the cost of a per-robot tax than a Fortune 500 company.

⁷⁴ Kovacev, *supra* note 7; Mazur, *supra* note 7, at 302.

⁷⁵ See, e.g., Leigh Osofsky, *The Case Against Strategic Tax Law Uncertainty*, 64 TAX L. REV. 489, 536-37 (2011). Regarding the analogy to “imputed rent,” see *supra* note 72, the experience with taxation of imputed rent in Switzerland is not encouraging. The tax on imputed rents incentivizes homeowners to hold large mortgages, inflate expenses, and undervalue the hypothetical imputed rent. As a result, the Swiss tax on imputed rents actually generates negative net tax revenues. Petar Vujanovic, *Policies to Tame the Housing Cycle in Switzerland* 22-23 (OECD Econ. Dep’t, Working Paper No. 1279, 2016), <https://www.oecd-ilibrary.org/docserver/5jm3scgb48d4-en.pdf?expires=1573961791&id=id&accname=guest&checksum=CB8A44AF4568F8D3450C19F3F7232ADD>. An “imputed salary” would create similar opportunities for tax gamesmanship.

⁷⁶ “Whenever business transactions take place across the boundaries of two or more jurisdictions, there is a need to determine what portion of the income is subject to tax by each jurisdiction.” Masahiro Max Yoshimura, *The ‘Tax War’ Between the United States and Japan under Internal Revenue Code § 482: Is There a Solution?*, 12 WISC. INT’L L.J. 401, 401-02 (1994). Transfer pricing is the term for the process by which that allocation is made. In the United States, transfer pricing is governed by I.R.C. § 482 and attendant Treasury Regulations.

⁷⁷ See, e.g., *Eaton Corp. v. Comm’r*, T.C.M. 2017-147 (2017); *Medtronic, Inc. v. Comm’r*, T.C. M. 2016-122 (2016), *vacated and remanded*, 900 F.3d 610 (8th Cir. 2018); *Amazon.com, Inc. v. Comm’r*, 158 T.C. 108 (2017); *Altera Corp. v. Comm’r*, 145 T.C. 91 (2015), *rev’d*, 2018 WL 3542989 (9th Cir. 2018), *op. withdrawn*, 898 F.3d 1266 (9th Cir. 2018), *rev’d by superseding op.*, 926 F.3d 1061 (9th Cir. 2019); *Xilinx Inc. v. Comm’r*, 125 T.C. 37 (2005), *rev’d*, 567 F.3d 482 (9th Cir. 2009), *op. withdrawn*, 592 F.3d 1017 (9th Cir. 2010), *aff’d by superseding op.*, 598 F.3d 1191 (9th Cir. 2010); see generally Reuven S. Avi-Yonah et. al., *Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split*, 9 FLA. TAX REV. 497 (2009).

⁷⁸ An analogous proposal involves defining robots as separate “taxable persons” for purposes of a value-added tax (“VAT”), rather than as part of an enterprise, thereby adding an additional layer of VAT tax liability on any products and services involving a robot. OBERSON I, *supra* note 3, at 87-111. This creates similar difficulties in allocating the value attributable to the robot, as opposed to the enterprise as a whole.

⁷⁹ A study by the Tax Policy Center concluded that excise taxes in general are regressive, “because both the share of income burdened by excises and the share of consumption spending on taxed goods and services is higher, on average, for lower income households.” JOSEPH ROSENBERG, TAX POLICY CENTER, THE DISTRIBUTIONAL BURDEN OF FEDERAL

C. Effects on Innovation

Robot tax proponents generally assume that the rise of AI, robotics, and automation will be a net negative for society, at least in the short run. The negative effects of robotization, particularly job displacement and increased economic inequality, have been characterized as negative externalities, like pollution or alcoholism.⁸⁰ The assumption, therefore, is that a robot tax would be a Pigouvian tax,⁸¹ designed to disincentivize activities giving rise to the negative externalities.⁸²

What if that assumption is wrong? AI, robotics, and automation provide benefits to society, as even some robot tax proponents admit.⁸³ Indeed, as a general rule, technological advancement has led to increases in both employment and living standards, at least over the long term.⁸⁴ Increasing the tax burden on the still-budding fields of AI and robotics could slow down the course of automation considerably, by increasing the cost of developing and deploying such technologies.⁸⁵ As UK Business Minister Andrew Stephenson recently testified before a Parliamentary committee, robot taxes are “perverse,” precisely because they would disincentivize innovation.⁸⁶

D. Tax Competition

EXCISE TAXES 15 (2015), <https://www.taxpolicycenter.org/publications/distributional-burden-federal-excise-taxes/full>.

⁸⁰ *Why Taxing Robots is Not a Good Idea*, THE ECONOMIST (Feb. 25, 2017), <https://www.economist.com/finance-and-economics/2017/02/25/why-taxing-robots-is-not-a-good-idea> [<https://perma.cc/REG2-KMUQ>]; Abbott, *supra* note 6, at 152.

⁸¹ The term “Pigouvian tax” refers to a tax designed to impose costs on private actors who, in maximizing their own private gain, produce effects that are deleterious to society as a whole. A tax on the distribution of alcoholic beverages, which increases the cost of such beverages and therefore reduces consumption, is an example of such a tax. ARTHUR C. PIGOU, THE ECONOMICS OF WELFARE 98-105 (4th prt. 2010). The economic basis for the concept was first discussed by the economist Arthur C. Pigou, hence the term “Pigouvian tax.”

⁸² See Ooi & Goh, *supra* note 5; Abbott, *supra* note 6, at 152; see also Englisch, *supra* note 7, at 19. The recent proposal in the United Kingdom for a tax on shoppers using automated checkouts is premised in part on supposed loss of “valuable everyday human contact” arising from use of those machines. SAM DALTON, ALL PARTY PARLIAMENTARY GROUP ON SOCIAL INTEGRATION, HEALING THE GENERATIONAL DIVIDE: INTERIM REPORT ON INTERGENERATIONAL CONNECTION 30 (2019), <https://socialintegrationappg.org.uk/wp-content/uploads/sites/2/2019/05/Healing-the-Generational-Divide.pdf>.

⁸³ See, e.g., Abbott, *supra* note 6, at 147 (“Automation has the potential to create widespread benefits. Not only will automation increase productivity, it will also improve safety and lead to new scientific breakthroughs.”).

⁸⁴ Ooi & Goh, *supra* note 5.

⁸⁵ Mazur, *supra* note 7, at 299-300.

⁸⁶ BUSINESS, ENERGY, AND INDUSTRIAL STRATEGY COMMITTEE, ORAL EVIDENCE: AUTOMATION AND THE FUTURE OF WORK, 2019, HC 1093, at Q303 (UK), <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/business-energy-and-industrial-strategy-committee/automation-and-the-future-of-work/oral/102291.pdf>.

Robot taxes, imposed at any level short of universal global acceptance, gives rise to the potential for tax competition.⁸⁷ A tax imposed on businesses in San Francisco may simply cause businesses to relocate their robots across the bay; a tax in California may cause moves to Nevada; a tax in the United States may cause moves to Mexico or China.⁸⁸ This suggests that a global, multilateral solution would ultimately have to be found in order to impose an administrable robot tax. Easier said than done.

The recent ‘digital tax’ debate provides a useful illustration of this problem. One of the hallmarks of the modern economy is the prevalence of multinational corporations whose economic reach extends far beyond their country of origin, or even those countries where they have a physical presence.⁸⁹ Many goods are tradeable across borders, and many services even more so due to the internet.⁹⁰ Historically, the lynchpin of international taxation has been that businesses may be taxed in a country only if they have a permanent establishment in that country.⁹¹ In the internet era, where goods and services can be ordered online from a company without any presence in the country, many businesses pay little or no tax in countries from which they derive considerable profits.⁹² Accordingly, the EU and several nations have proposed ‘digital tax’ regimes that would tax the gross receipts or profits earned in jurisdictions where the business has no traditional permanent establishment.⁹³ Discussions at the OECD-level toward a consensus approach have continued for several years, but agreement seems elusive.⁹⁴ A cross-border robot tax, imposing a tax related to the use of AI, robotics, and

⁸⁷ See Mazur, *supra* note 7, at 300-01; see generally, e.g., Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1574 (2000) (discussing tax competition).

⁸⁸ Kovacev, *supra* note 7.

⁸⁹ OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT, OECD, ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY, ACTION 1 – 2015 FINAL REPORT, 65-67 (2015). https://www.oecd-ilibrary.org/taxation/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report_9789264241046-en.

⁹⁰ *Id.* at 66-67.

⁹¹ See OECD, *Commentary on Article 5: Concerning the Definition of Permanent Establishment*, in MODEL TAX CONVENTION ON INCOME AND ON CAPITAL: CONDENSED VERSION 116, 116 (10th ed. 2017); OECD, *Commentary on Article 7: Concerning the Attribution of Business Profits*, in MODEL TAX CONVENTION ON INCOME AND ON CAPITAL: CONDENSED VERSION 173, 173 (10th ed. 2017)..

⁹² OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT, *supra* note 89, at 79.

⁹³ A *Fair and Efficient Tax System in the European Union for the Digital Single Market*, at 8-10, COM (2017) 547 final (Sept. 21, 2017), https://ec.europa.eu/taxation_customs/sites/taxation/files/1_en_act_part1_v10_en.pdf.

⁹⁴ See, e.g., OECD Livestream, *BEPS Public Consultation on the Tax Challenges of Digitalization*, OECD (Nov. 1, 2017), <http://www.oecd.org/tax/beps/public-consultation-on-tax-challenges-of-digitalisation-1-november-2017.htm>; Econ. and Soc. Council, Comm. of Experts on Int'l Cooperation in Tax Matters, *The Digitalized Economy: Selected Issues of Potential Relevance to Developing Countries*, U.N. Doc. E/C.18/2017/6 (Aug. 8, 2017); Comm. of Experts on Int'l Cooperation in Tax Matters, *Tax Challenges in the Digitalized Economy: Selected Issues for Possible Committee Consideration*, U.N. Doc. E/C.18/2017/CPR.22 (Oct. 11, 2017); U.S. DEP'T OF THE TREASURY, PRESS RELEASE, SECRETARY MNUCHIN STATEMENT ON DIGITAL ECONOMY TAXATION REPORT (2018), <https://home.treasury.gov/news/press-releases/sm0316>; Stephanie Soong Johnston, *Saint-Amans Warns Against Unilateral Moves to Tax Digital Economy*, 87 TAX NOTES INT'L 1157 (2017); Tom O'Shea, *The EU's Proposed "Significant Digital Presence" Framework*, 90 TAX NOTES INT'L 1295 (2018); Monica Gianni, *OECD BEPS (In)Action 1: Factor Presence as a Solution to Tax Issues of the Digital Economy*, 72 TAX LAW. 255 (2018). The details of the various proposals for a digital tax regime, and the numerous challenges to implementing such a regime on a global basis, are beyond the scope of this article.

automation outside the taxing jurisdiction, poses the same challenges of lack of international consensus and difficulty of administration and enforcement.

VI. Statutory Attempts at Robot Taxes

While there are many advocates of robot tax proposals, actual legislative proposals are few and far between. To date, only a handful have actually been reduced to legislative language, as shown in the following sections. Each of these takes a different approach, illustrating both the variety of paths for a robot tax and the many pitfalls for such a tax. It is instructive to review these attempts to go beyond policy musings into actual legislation.

A. South Korea

The Republic of Korea has held the title of highest robot density in the world since 2010 – a record 710 robots per 10,000 employees in the manufacturing industry in 2017.⁹⁵ In part, this is due to a generous tax regime specifically designed to promote automation. Article 24 of the Restriction of Special Taxation Act (“RTSA”) provides a tax credit for investment in “productivity increase facilities.”⁹⁶ This is a literal tax credit for automation. That tax credit was 3% of the investment amount (7% for small or medium enterprises) against income tax or corporate tax.⁹⁷ The automation tax credit has been extended many times since its initial enactment in order to “[s]upport job creation through furthering economic vitality.”⁹⁸

The Act provides no definition for what constitutes a “productivity increase facility,” leaving that task to administrative guidance.⁹⁹ The Presidential Decree enforcing the RTSA refers in turn to “facilities specified by Ordinance of the Ministry of Strategy and Finance, in which investment is made for improving production process, automation of facilities, or informatization.”¹⁰⁰ The Ministry of Strategy and Finance’s Decree in turn sets forth a laundry list of specific categories of equipment that qualify for the tax credit.¹⁰¹ The categories set forth

⁹⁵ INT’L FED’N OF ROBOTICS, EXECUTIVE SUMMARY WORLD ROBOTICS 2018 INDUSTRIAL ROBOTS, 18 (2018), https://ifr.org/downloads/press2018/Executive_Summary_WR_2018_Industrial_Robots.pdf.

⁹⁶ Restriction of Special Taxation Act, Act No. 11614, Jan. 1, 2014, art. 24(1) (S. Kor.), *translated* in Korea Legislation Research Institute online database, http://elaw.klri.re.kr/kor_service/lawView.do?hseq=27406&lang=ENG.

⁹⁷ *Id.*

⁹⁸ *E.g.*, MINISTRY OF STRATEGY & FIN., KOREAN TAXATION 46, 55 (2012) (S. Kor.), <https://www.nts.go.kr/eng/data/KOREANTAXATION2012.pdf>.

⁹⁹ *Id.* (“Facilities prescribed by Presidential Decree which belong to those for the improvement and automation of processes”).

¹⁰⁰ Enforcement Decree of the Restriction of Special Taxation Act, Presidential Decree No. 26070, Feb. 3, 2015, art. 21(2) (S. Kor.), *translated* in Korea Legislation Research Institute online database, https://elaw.klri.re.kr/eng_mobile/viewer.do?hseq=43444&type=sogan&key=5.

¹⁰¹ Enforcement Rule of the Restriction of Special Taxation Act, Ministry of Economy and Finance Decree No. 614, Mar. 17, 2017, art. 12(1) (S. Kor.), *translated* in Korea Legislation Research Institute online database, https://elaw.klri.re.kr/eng_mobile/viewer.do?hseq=48860&type=sogan&key=5.

in the Ordinance include such items as computer-aided manufacturing (CAM) and computer-aided design (CAD) devices, process control systems, and warehouse loading equipment.¹⁰²

In 2017, the administration of President Moon Jae-in announced its intention to reduce the automation tax credit, in response to which legislation was enacted by the National Assembly in early 2018.¹⁰³ This announcement received much attention in the press, where it was frequently hailed (incorrectly) as a robot tax instead of a reduction in a tax benefit for automation.¹⁰⁴ Press reports indicated that the proposal was motivated by a desire to slow the implementation of automation in Korea's high-tech manufacturing sector.¹⁰⁵ Under the new law, the automation tax credit was reduced by two percentage points, and the sunset date extended from December 31, 2017 until December 31, 2019.¹⁰⁶

The Korean approach is almost unique, due to the prior existence of an explicit automation tax credit.¹⁰⁷ Korea's solution to the definitional problem is to create a white list, setting forth every single category that qualifies with specificity. This makes some sense for a tax credit, as to which a taxpayer must establish that it is entitled to the claimed tax benefit. Further, the taxpayer has an incentive to self-identify and will seek an expansive definition of the items of the list. For imposing a tax, the incentive goes the other way, and there would be a considerable resource cost for a tax authority to keep abreast of the latest technology to include on that list without taxpayers clamoring to get that new technology added.

There is some anecdotal evidence that the reduction in the automation tax credit has slowed investment in robotics, new industrial robot installations in Korea decreased in 2017 for the first time since 2012.¹⁰⁸ Whether this reflects a causative effect of the reduction in the

¹⁰² *Id.* tbl.2.

¹⁰³ *Korea's Robot Tax*, 3 ROBOTICS L. J. 1 (Aug. 24, 2017), available at

<http://www.roboticslawjournal.com/news/koreas-robot-tax-89236145>;

Yoon Sung-won, *Korea Takes First Step to Introduce 'Robot Tax'*, KOREA TIMES (Aug. 7, 2017),

http://www.koreatimes.co.kr/www/news/tech/2017/08/133_234312.html [<https://perma.cc/Z2X5-7XEH>].

¹⁰⁴ Yoon, *supra* note 103; [103.2 Last name], *supra* note 103; see also Greg Nichols, *South Korea Mulling World's First Robot Tax*, ZDNET (Aug. 9, 2017, 6:09 PM), <https://www.zdnet.com/article/south-korea-mulling-worlds-first-robot-tax/> [<https://perma.cc/5Z4G-YV27>]. Unfortunately, this error has been propagated widely in academic and journalistic circles.

¹⁰⁵ *South Korea Considers Amending Tax Laws to Slow Speed of Automation*, E&T (Aug. 10, 2017),

<https://eandt.theiet.org/content/articles/2017/08/south-korea-considers-amending-tax-laws-to-slow-speed-of-automation/> [<https://perma.cc/53YN-U7GZ>].

¹⁰⁶ *2018 Tax Amendments in Effect*, DELOITTE: TAX@HAND (Jan. 9, 2018),

<https://www.taxathand.com/article/9020/Korea/2018/2018-tax-amendments-in-effect> [<https://perma.cc/S3NB-A7SE>].

¹⁰⁷ South Korea is not the only jurisdiction with an automation tax credit. North Dakota recently enacted a tax credit "for purchases of manufacturing machinery and equipment for the purpose of automating manufacturing processes in this state to improve job quality or increase productivity." N.D. Cent. Code § 57-38-01.36 (2019).

¹⁰⁸ INT'L FED'N OF ROBOTICS, *supra* note 95, at 14. . The South Korean government recently announced plans to reverse course and increase the tax incentive in light of slowed economic growth. Jung Min-kyung, *Korea to Raise*

automation tax credit is unclear. At any rate, Korea remains the most-automated economy in the world and there is no indication of widespread abandonment of AI, robotics, or automation.

B. Italy

In 2017, a Socialist deputy in the Chamber of Deputies filed the first European robot tax bill.¹⁰⁹ The proposal was to increase the corporate income tax rate by 1% for companies “if the production activity of the company is implemented and managed predominantly from artificial intelligence systems and robotics.”¹¹⁰ Interestingly, the rate increase is abated for a company that invests at least 0.5% of its revenues each year in professional requalification projects.¹¹¹ It appears this bill was referred to committee in the Chamber of Deputies with no further action taken.¹¹²

The legislation provides no definition of “artificial intelligence systems” or “robotics.” Nor does it suggest any methods by which the Italian tax authority would determine whether a company’s production activity was “predominantly” implemented and managed by AI or robotics. This opens the door to definitional problems as to what constitutes an AI system or robot. It also creates compliance and enforcement headaches, because taxpayers and the tax authority would somehow have to allocate every company’s production activity between AI/robotics versus human activity. While no doubt the tax authority would propose regulations and guidance interpreting this legislation had it been enacted, the breadth and ambiguity of the language would make that a Herculean task.

Further, there is nothing in this legislation that would impose a tax on businesses outside Italy (or otherwise not subject to Italian corporate tax). The tax would burden Italian businesses, while doing nothing to prevent competing businesses in other countries from adopting AI and robotics in order to gain a competitive advantage. (by lowering process or increasing efficiency). Jobs would still be lost, but to foreign competition instead of domestic robots.

C. Geneva

Tax Credit Rate for Corporate Facility Investments, R&D, KOREA HERALD (July 25, 2019, 4:43 PM), <http://www.koreaherald.com/view.php?ud=20190725000653> [<https://perma.cc/VTB2-QJLJ>].

¹⁰⁹ Proposta di Legge 3 agosto 2017, n. 4621 (It.), https://d1110erj175o600.cloudfront.net/upload/images/10_2017/171002180259.pdf.

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² OPENPOLIS, *C.4621: Tax Benefits for the Use of Artificial Intelligence Systems in the Production of Goods*, OPENPARLAMENTO, https://parlamento17.openpolis.it/singolo_atto/88576 (last updated Sept. 25, 2017) (tracking the progress of bill introduced to Chamber by the Honorable Oreste Pastorelli).

Another example comes from the Grand Council of the canton of Geneva, Switzerland.¹¹³ In 2017, members of the Grand Council proposed legislation “for the maintenance of employment, quality and locality in the retail sector (introduction of a tax on automated cashiers).”¹¹⁴ Under this proposal, retail stores would be assessed a tax of 10,000 Swiss francs per month (roughly equivalent to \$10,000 in U.S. dollars at current exchange rates)¹¹⁵ for each automated cashier installed in the store. An automated cashier is defined as “any device for the payment of purchases that the customer can use without the intervention of store personnel.”¹¹⁶ A store subject to the tax may reduce its tax liability by multiplying 10% of its tax base by a ratio between the number of monthly hours of operation by human employees operating cashiers over the total number of monthly hours of operation for all types of cashiers (with the assumption that automated cashiers are in operation for the entire time the store is open).¹¹⁷

The tax would be paid to a newly-formed Geneva Foundation for Trade and Local Employment, which in turn would pay out 30% of the taxes (net of the Foundation’s expenses) to a preexisting foundation for vocational and continuing education, and 70% as a subsidy to stores with no automated cashiers.¹¹⁸ The Foundation would be given the power to issue fines for noncompliance as well as recover unpaid taxes.¹¹⁹ There is also a potential 5-year prison sentence for noncompliance, which may be the first example of a proposed criminal sanction in connection with a robot tax.¹²⁰ This proposal was ultimately sent to committee, and no further action has been taken.¹²¹

This proposal addressed the definitional problem by being narrowly targeted to a specific type of automation – automated cashiers – for which it was able to provide a reasonably precise definition. It also attempts to create a direct link between the tax and remediation of job displacement costs, which is an oft-stated goal of robot tax proponents. Nonetheless, the result of the tax, had it been enacted, would have been to slow innovation while raising prices on consumers and essentially creating a class of employees dependent on a government

¹¹³ PROJET DE LOI [PL] [PROPOSED LAW] Feb. 22, 2017, PL 12064 (Switz.), <http://ge.ch/grandconseil/data/texte/PL12064.pdf>. I am grateful to Xavier Oberson for bringing the Geneva legislation to my attention.

¹¹⁴ *Id.*.

¹¹⁵ *Swiss Francs to United States Dollar*, XE: CURRENCY CONVERTER, <https://www.xe.com/currencyconverter/convert/?Amount=1&From=CHF&To=USD> (follow hyperlink; then type “10000” into box and press yellow enter button) (last visited July 9, 2019).

¹¹⁶ PROPOSED LAW, PL 12064, art. 7 (Switz.).

¹¹⁷ *Id.* art. 10.

¹¹⁸ *Id.* art. 3, 5.

¹¹⁹ *Id.* art. 15.

¹²⁰ *Id.* art 16.

¹²¹ *République et canton de Genève, Séance du Jeudi 16 Mars 2017 À 17h*, PL 12054 [Session Thursday, March 16, 2017 at 17H], *Grand Conseil: Mémorial*, <http://ge.ch/grandconseil/memorial/seances/010401/1/14/#1562618> (explaining that Bill 12054 was sent without debate to the Committee on the Economy) (last visited July 9, 2019) (Switz.).

foundation and a tax on automation for their livelihood.¹²² Nor is it clear that Geneva's cashiers are uniquely threatened by automation or otherwise more deserving than employees in other occupations.

D. United States Autonomous Vehicle Tax Legislation

While there has been extensive talk from various politicians in the United States about a robot tax, there have been few proposals actually reduced to legislative language. Indeed, the only such examples in the United States to date deal with one specific type of automation: autonomous vehicles.¹²³

In many ways, autonomous vehicles provide a microcosm of the revenue effects that governments will face if automation becomes the norm.¹²⁴ The United States uses a per-gallon tax that pays into a Highway Trust Fund to fund road infrastructure.¹²⁵ Autonomous vehicles promise to be more fuel-efficient, and many are also intended to be fully electric. An electric autonomous vehicle may pay no tax at all, even though it adds to the wear and tear of the highway system as much as a conventional car. It is not necessarily the case that revenues will decrease with the rise of autonomous vehicles.¹²⁶ A study conducted by the Conservation Law Foundation on the economic and fiscal impact of autonomous vehicles in Massachusetts concluded that privately owned autonomous vehicles may actually lead to higher municipal tax revenues from excise taxes. While there may be a state-level decrease in gas tax revenues that reduction would depend on the adoption of electric vehicle technology. Alternatively, a gasoline-powered autonomous vehicle could actually increase gas tax revenues.¹²⁷ Nonetheless, policymakers have attempted to address this perceived problem before autonomous vehicles are widely adopted.

¹²² See Jürg Müller, *Eine Robotersteuer ist Unsinn [A Robot Tax is Nonsense]*, NEUE ZÜRCHER ZEITUNG (Aug. 22, 2017, 6:41 PM), <https://www.nzz.ch/meinung/science-fiction-im-steuerrecht-eine-robotersteuer-istunsinn-ld.1312133> [<https://perma.cc/4GWH-QY6D>] (Switz.).

¹²³ For a survey of autonomous vehicle legislation in general in the United States, see Rustin Diehl & Matthew L. Thue, *Autonomous Vehicle Testing Legislation: A Review of Best Practices from States on the Cutting Edge*, 21 U. FLA. J. TECH. & POL'Y 197 (2017). There is also an emerging debate on the taxation of unmanned aerial vehicles (i.e., drones). Pending legislation in Washington State would impose the existing aircraft excise tax on drones. See S.B. 5137, 2019 Leg., Reg. Sess. (Wash. 2019); see also Haye Kestelco, *Boulder City, Nev. Wants to Charge Recreational and Commercial Drone Pilots \$25/\$100 Per Day*, DRONE DJ (Mar. 16, 2018, 9:44 AM), <https://dronedj.com/2018/03/16/boulder-city-nevada-drone-charge/> (proposed municipal tax on UAVs) [<https://perma.cc/ZG4L-KBLY>]. These proposals are not directed at autonomous drones in particular, however, so they are beyond the scope of this article.

¹²⁴ See generally Stephen Ratner, *Taxation of Autonomous Vehicles in Cities and States*, 71 TAX. LAW. 1051 (2018).

¹²⁵ I.R.C. § 9503 (2019).

¹²⁶ Many of the supposed negative revenue effects for autonomous vehicles are really based on the assumption that they will be electric, not gas-powered. This begs the question whether a tax on electric vehicles (whether autonomous or human-driven) would be a superior alternative to a tax on autonomous vehicles.

¹²⁷ RAFAEL MARES, CHRIS STIX, & SARA DEWEY, CONSERVATION LAW FOUND., HOW AUTONOMOUS VEHICLES WILL DRIVE OUR BUDGETS: AN ANALYSIS OF THE ECONOMIC AND FISCAL IMPACTS OF SELF DRIVING CARS ON THE COMMONWEALTH OF MASSACHUSETTS 3 (2018), https://www.clf.org/wp-content/uploads/2018/07/CLF_AV_Report.pdf.

There have been discussions of many alternatives to autonomous vehicles. For example, a vehicle miles traveled (VMT) fee has been proposed, charging a per-mile fee to fund public infrastructure investments.¹²⁸ To date, however, California and Nevada are the only two jurisdictions in the United States that have enacted legislation providing for the taxation of autonomous vehicles, specifically in the context of their use by transportation network companies (TNCs).¹²⁹ At present there are few autonomous vehicles used by TNCs which meet the statutory definitions of “autonomous vehicle” – although that will soon change.¹³⁰ Nonetheless, the existing legislation provides a window into ways a legislature could approach the robot tax problem.¹³¹

In 2017, the Nevada legislature adopted sweeping legislation regulating the use of autonomous vehicles in the state.¹³² Among other things, the statute imposed an excise tax on TNCs using fully autonomous vehicles:

[A]n excise tax is hereby imposed on the use of a dispatch center, software application or other digital means by an autonomous vehicle network company to connect a passenger to a fully autonomous vehicle for the purpose of providing transportation services at the rate of 3 percent of the total fare charged for transportation services, which must include, without limitation, all fees, surcharges, technology fees, convenience charges for the use of a credit or debit card and any other amount that is part of the fare. The Department shall charge and collect from each autonomous vehicle network company the excise tax imposed by this subsection.¹³³

¹²⁸ PAUL LEWIS & ALICE GROSSMAN, ENO CTR. FOR TRANSP., BEYOND SPECULATION 2.0: AN UPDATE TO ENO’S ACTION PLAN FOR FEDERAL, STATE, AND LOCAL POLICYMAKERS 39-40 (2019), <https://www.enotrans.org/wp-content/uploads/2019/04/4-1-AV-Paper-FINAL-with-Cover.pdf>.

¹²⁹ Generally speaking, a TNC may be defined as a company or organization that provides transportation services using an online-enabled platform to connect passengers with drivers using their personal vehicles. CAL. PUB. UTIL. COMM’N, DECISION ADOPTING RULES AND REGULATIONS TO PROTECT PUBLIC SAFETY WHILE ALLOWING NEW ENTRANTS TO THE TRANSPORTATION INDUSTRY, Decision 13-09-045, at 2 (2013), <http://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M077/K192/77192335.PDF>.

¹³⁰ Andrew J. Hawkins, *Waymo’s Self-Driving Cars Are Now Available on Lyft’s App in Phoenix*, VERGE (May 7, 2019, 6:01 PM), <https://www.theverge.com/2019/5/7/18536003/waymo-lyft-self-driving-ride-hail-app-phoenix> [<https://perma.cc/22FS-SP9S>].

¹³¹ Two other states (Massachusetts and Tennessee) have considered, and so far rejected, such legislation. See *infra* note 141 and accompanying text.

¹³² Assemb. B. 69, 79th Sess., (Nev. 2017) (“An Act relating to transportation; revising requirements for the testing or operation of an autonomous vehicle on a highway within this State; authorizing the use of driver-assistive platooning technology; authorizing the use of a fully autonomous vehicle to provide transportation services in certain circumstances by persons licensed by the Department of Motor Vehicles, Nevada Transportation Authority or Taxicab Authority, providing for the regulation of autonomous vehicle network companies; providing penalties; and providing other matters properly relating thereto.”).

¹³³ Nev. Rev. Stat. § 372B.145(1).

The statute defines “autonomous vehicle network company” as “an entity that, for compensation, connects a passenger to a fully autonomous vehicle which can provide transportation services to the passenger.”¹³⁴ A “fully autonomous vehicle” is defined as “a vehicle equipped with an automated driving system which is designed to function at a level of driving automation of Level 4 or 5 pursuant to SAE J3016.”¹³⁵

In 2018, the California legislature enacted Assembly Bill 1184, which authorizes San Francisco to impose a local tax on TNCs using autonomous vehicles, among other things.¹³⁶ San Francisco in turn has proposed a so-called “Traffic Congestion Mitigation Tax,” a per-ride tax on rides given by TNCs using autonomous vehicles.¹³⁷ The measure contains the following definition for “autonomous vehicle passenger services: “‘Autonomous Vehicle’ means a vehicle, other than a Taxicab or Limousine, with or without a driver, equipped with and into which has been integrated technology that has the capability to drive the vehicle without the active physical control by a human operator, regardless of whether the vehicle is in driverless operation. An Autonomous Vehicle includes any vehicle capable of being driven by a remote driver.”¹³⁸ Funds raised by this tax would be applied to a dedicated Traffic Congestion Mitigation Fund, funding the local mass transit authorities.¹³⁹ If approved by the San Francisco Board of Supervisors, this measure is expected to be put before the San Francisco electorate in November 2019.¹⁴⁰

Two other states, Massachusetts and Tennessee, have considered,¹⁴¹ but so far not enacted,¹⁴² similar legislation regarding taxation. Both proposals involved a per-mile “use tax” on

¹³⁴ Nev. Rev. Stat. § 706B.030, incorporated by reference in Nev. Rev. Stat. § 372B.015.

¹³⁵ Nev. Rev. Stat. § 482A.036, incorporated by reference in Nev. Rev. Stat. 706B.040. SAE J3016 refers to standards set by SAE International establishing Levels of Automated Driving by reference to the degree of autonomy of the AV in relation to the driver, level 5 being complete autonomy and ability to drive in all conditions without human intervention. Jennifer Shuttleworth, *SAE Standards News: J3016 Automated-Driving Graphic Update*, SOC’Y OF AUTOMOTIVE ENGINEERS (Jan. 7, 2019), <https://www.sae.org/news/2019/01/sae-updates-j3016-automated-driving-graphic> [<https://perma.cc/SP24-88QK>]. These standards have been adopted by the United States Department of Transportation in developing voluntary guidance for automated driving systems. U.S. DEP’T OF TRANSP., AUTOMATED DRIVING SYSTEMS 2.0: A VISION FOR SAFETY (2017), https://www.nhtsa.gov/sites/nhtsa.dot.gov/files/documents/13069a-ads2.0_090617_v9a_tag.pdf.

¹³⁶ Cal. Assemb. B. 1184, (Cal. 2018), codified at Cal. Pub. Util. Code § 5446 (2018).

¹³⁷ S.F., CAL., ORDINANCE 190584, § 3204(a)(2) (July 23, 2019).

¹³⁸ *Id.* § 3203.

¹³⁹ *Id.* § 3208.

¹⁴⁰ Trisha Thadani, *Uber and Lyft Could Face Tax for Snarling S.F. Traffic: “Everyone Needs to Pay Their Fair Share,”* S.F. CHRONICLE (May 21, 2019, 3:55 PM), <https://www.sfchronicle.com/politics/article/Uber-and-Lyft-could-face-tax-for-snarling-S-F-13865123.php> [<https://perma.cc/JMX7-43RR>].

¹⁴¹ Sen. B. 1561/H.B. 1564, 109th Gen. Assemb., § 12(a) (Tenn. 2016); Sen. B. 2115, 191st Leg. (Mass. 2019).

¹⁴² The Tennessee bill was amended in the Tennessee Senate to remove the use tax provisions of the bill, which subsequently became law without the tax provisions. Legislative History, Sen. B. 1561/H.B. 1564, 109th Gen. Assemb. (Tenn. 2016), <http://wapp.capitol.tn.gov/apps/Billinfo/default.aspx?BillNumber=SB1561&ga=109>. The Massachusetts bill was referred to committee in the Massachusetts State Senate on January 22, 2019, and as of the date of publication has not been reported out of committee. Legislative History, Sen. B. 2115, 191st Leg. (Mass. 2019), <https://malegislature.gov/Bills/191/S2115/BillHistory>.

autonomous vehicles.¹⁴³ The Massachusetts proposal, like the Nevada law, incorporated a technical definition derived from the SAE standards of automation.¹⁴⁴ The Tennessee legislation, like the San Francisco ballot proposal, provided a nontechnical definition of autonomous vehicle to mean a motor vehicle equipped with “a system that enables the operation of a motor vehicle without the active physical control of, or monitoring by, a human operator.”¹⁴⁵

These examples attempt to define a particular type of robot—e.g., an autonomous vehicle—but in divergent ways.¹⁴⁶ The Nevada statute and Massachusetts proposals both explicitly incorporate a generally accepted technical definition, while the San Francisco and Tennessee proposals use a more general, nontechnical definition without such a reference. The Nevada and Massachusetts definitions would be easily understood in the autonomous vehicle industry, but not necessarily by judges or tax officials. If a dispute arose, the outcome could hinge on a “battle of the experts,” with a lay decision maker with limited knowledge having to choose sides on the basis of conflicting expert testimony.

On the other hand, the definitions in the San Francisco and Tennessee proposals are subject to interpretation. Even standard cruise control technology could be said to drive a vehicle without active physical control by a human operator.¹⁴⁷ It is also noteworthy that the technology need

¹⁴³ Sen. B. 1561/H.B. 1564, 109th Gen. Assemb., § 12(a) (Tenn. 2016) (“A use tax is imposed on autonomous vehicles that operate on the public highways within this state pursuant to Sections 4, 5, 9, and 10. Autonomous vehicles shall be taxed according to the number of axles. Autonomous vehicles with two (2) axles shall be taxed at a rate of one cent (1¢) per mile. Autonomous vehicles with more than two (2) axles shall be taxed at a rate of two and six-tenths cents (2.6¢) per mile.”); Sen. B. 2115, 191st Leg., § 63E(A) & (C)(1) (Mass. 2019) (“A road usage charge is imposed on autonomous vehicles that operate on the public ways within this state . . . [at] a base per-mile rate on autonomous vehicles of no less than 2.5 cents per mile”).

¹⁴⁴ Sen. B. 2115, 191st Leg., § 1(A)(2) & (3) (Mass. 2019).

¹⁴⁵ Sen. B. 1561/H.B. 1564, 109th Gen. Assemb., § 12(a) (Tenn. 2016). The amended Tennessee bill, as enacted without the tax provisions, actually contained two different definitions of “autonomous technology” in non-tax contexts. The first definition, which bars municipalities from banning the use of autonomous vehicles, defines “autonomous technology” as “technology installed on a motor vehicle that has the capability to drive the vehicle on which the technology is installed in high or full automation mode, without any supervision by a human operator, with specific driving mode performance by the automated driving system of all aspects of the dynamic driving task that can be managed by a human driver, including the ability to automatically bring the motor vehicle into a minimal risk condition in the event of a critical vehicle or system failure or other emergency event” Tenn. Code § 55-8-202(b)(1) (2016). The second definitions, applying to an exception to penalties for operating a motor vehicle with a television or video screen visible to the driver, defines “autonomous technology” as “technology installed on a motor vehicle that has the capability to drive the motor vehicle without the active physical control or monitoring by a human operator.” Tenn. Code § 55-9-105(c)(6)(B) (2016).

¹⁴⁶ Many states have defined “autonomous vehicle” or “autonomous technology” in a non-tax driving regulatory context. *See, e.g., id.*; Nev. Rev. Stat. § 482A.030; Fla. Stat. § 316.003(3); Cal. Veh. Code § 38750(a)(1)-(2); Mich. Comp. Laws § 257.2b(1); La. Rev. Stat. Ann. § 32:1(1.2). D.C. Code § 50-2351(1). In that context, “[t]he definition of ‘autonomous vehicle’ should be precise to avoid unintentional restrictions on existing, semi-autonomous technology.” Deihl & Thue, *supra* note 123, at 211.

¹⁴⁷ In a non-tax context, state legislatures use more precise language specifically to avoid this type of overbreadth. *See supra* note 146.

not actually be used, but merely must be integrated into the vehicle. This could result in overbroad taxation of vehicles that are not truly autonomous.

All of these proposals tend to disincentivize innovation by discouraging development of autonomous vehicle technology. To a certain extent, however, the taxes on autonomous vehicles may be considered an attempt to equalize the tax burdens of autonomous and non-autonomous vehicles, ensuring that operators of autonomous vehicles contribute to the support of the road infrastructure.¹⁴⁸

VII. Shaping the Future of Taxation

This article highlights the many challenges involved in creating an enforceable, administrable, and practical robot tax. However, these challenges may not stop policymakers from trying. As Adam Smith pointed out in *The Wealth of Nations*, “[a]fter all the proper subjects of taxation have been exhausted, if the exigencies of the state still continue to require new taxes, they must be imposed upon improper ones.”¹⁴⁹ In the face of an economic recession leading to dramatic unemployment, it may be politically expedient to blame AI, robotics and automation and target them for punitive taxation. Robots cannot vote, after all, nor do they make campaign contributions (although their owners might), so they may appear to be a safe target for a new tax.¹⁵⁰ Therefore, it is important to consider how to avoid the worst policy harms from a robot tax, if political necessity requires that one be enacted.

The worst possible robot tax legislation would have an ambiguous all-embracing definition of what a taxable robot is, would require an allocation between robot-generated and non-robot-generated income, and would attempt to tax activity by robots that are, or could easily be moved, outside the jurisdiction. Such a proposal would invite controversy and litigation and disincentivize innovation while doing little to address the underlying challenges of automation on employment or government revenues.

What, then, would a coherent, enforceable and practical robot tax look like? There are two potential approaches that ameliorate (although they do not eliminate) the practical difficulties of a robot tax: Restructure incentives or implement a strict structure of which robots can be taxed.

The first approach would be to structure tax incentives in ways that favor, or at least do not disincentivize, human employment. The South Korean roll-back of automation tax credits discussed in Part VI.A above provides a real-world example. Explicit tax subsidies for

¹⁴⁸ See, e.g., S.F., CAL., ORDINANCE 190584, § 3204(a)(1) (July 23, 2019).

¹⁴⁹ ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, Book V, Chapter II, Part II, Article IV (1776) (ebook).

¹⁵⁰ Compare SXSU, *supra* note 44, at 57:40 (“easier to say tax a robot” than to say “tax corporations at 90%”).

automation are rare, however. It is much more common for there to be tax incentives that have the effect of encouraging investment in AI, automation and robotics without explicitly saying so, and meaningful reforms must address those facially neutral incentives as well.¹⁵¹

Tax benefits can be structured in ways that tie the claimed benefit to employment of human workers. The recently-repealed domestic production activities deduction (known affectionately in tax circles as “Section 199” after the relevant Code section) tied the tax benefit explicitly to employment by placing a W-2 limitation on the deduction.¹⁵² The passthrough deduction in Section 199A also has a W-2 limitation, although that limitation can alternatively be met by reference to the unadjusted basis of tangible assets.¹⁵³ There is precedent, therefore, for structuring a tax benefit in a way that ties that benefit to employment. Because this is an affirmative tax subsidy of employment, not a tax on “robots,” the definitional problems are minimized.

By tying a tax benefit to W-2 wages (which presumably would produce income and payroll tax revenues), the revenue impact of the tax subsidy is reduced and may slow the process of job dislocation (leading to a reduction in those sources of revenue), without providing as large of a hurdle to innovation.

Of course, as with any tax expenditure, there is a risk that the benefit is merely subsidizing what taxpayers would do anyway. Featherbedding also becomes an issue.¹⁵⁴ This approach also does little to increase net revenue. Nonetheless, such a proposal would be preferable to a straight “robot tax.”

¹⁵¹ Compare Ooi & Goh, *supra* note 5, at 18 (suggesting the adoption of “decelerated depreciation” or “reverse depreciation,” reducing or reversing the tax benefits generally accorded for the deployment of capital assets for assets deemed to be employment-substituting); Abbott, *supra* note 6, at 169-71 (disallowing corporate tax deductions for automated workers).

¹⁵² I.R.C. § 199(b)(1) (“The amount of the deduction allowable under [Section 199] for any taxable year shall not exceed 50 percent of the W-2 wages of the taxpayer for the taxable year”), *repealed by* Tax Cuts and Jobs Act of Dec. 22, 2017, Pub. L. No. 115-97, Title I, § 13305(a), 2017 (131 Stat. 2126), effective for taxable years beginning after December 31, 2017.

¹⁵³ I.R.C. § 199A(b)(2) (2017) (“The amount determined under this paragraph with respect to any qualified trade or business is the lesser of— (A) 20 percent of the taxpayer’s qualified business income with respect to the qualified trade or business, or (B) the greater of— (i) 50 percent of the W-2 wages with respect to the qualified trade or business, or (ii) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.”).

¹⁵⁴ See, e.g., *Am. Newspaper Publishers Ass’n v. NLRB*, 345 U.S. 100, 103 (1953) (showcasing that featherbedding is not just a theoretical concern. In response to the introduction of a linotype machine for printing newspapers, which eliminated the need for human compositors to set type by hand, the International Typographical Union arranged with newspaper publishers to employ compositors to produce unnecessary duplicates for linotype-set advertisements by hand, a practice known as “setting bogus” that the Supreme Court described as “a wasteful procedure.”). It does not tax the imagination to conceive of a business hiring unnecessary employees to reach a W-2 threshold in order to claim a tax benefit, should the amount of benefit exceed the cost of the employees’ wages.

The second approach would be to implement a narrowly-targeted tax on specific, easily-defined types of AI, robotics, or automation, imposed at the level at which consumers could not practically choose alternative sources outside of their jurisdiction. The narrowness of the targeted technology avoids the definitional issues surrounding “what is a robot” disputes. It is easier to define a narrower subset, such as a “robot barista” than to attempt an all-encompassing definition of a “robot.” This task becomes even easier if the definition of a taxable robot can be tied to a non-tax technical standard (such as the SAE standards for autonomous vehicles) – so long as judges and tax administrators are able to understand and apply those standards. A South Korea-style white list is also a possibility, although an all-encompassing list of taxable AI, robots, and automation equipment seems impractical, particularly given the pace of technological change that would quickly make such a list obsolete.

The appropriate jurisdictional level of taxation would depend on the targeted type of robot. A barista must be within close physical proximity of a customer buying a latte, so a tax on robot baristas would be appropriate on a local level. A tax on autonomous vehicles using a country’s road system would be best enforced and most practically handled at a national level.

The major weakness of this second approach is the narrowness of the effect. A tax on robot baristas would likely, at least in the short run, encourage the employment of human baristas. However, it would do little for employees in other businesses or professions. Further, this approach encourages special pleading by influential interest groups, whose interests may not necessarily coincide with sound public policy.

Another, related weakness to the “rifle shot” approach is that it is most effective as to specific types of activities that can be effectively taxed at a local, regional, or national level. Viewed from an international lens, the justification for such narrowly-based taxes weakens considerably. Preserving a handful of barista jobs in a particular metropolitan area would be a drop in the bucket in the face of massive job dislocation across industries and geographic borders. International coordination could prove as elusive as in the digital tax context. Alternatively, if political pressures require implementation of a robot tax, a rifle-shot approach targeted to politically-sensitive job categories would be superior to a blunderbuss “tax all robots” proposal.

It is possible that technological advancement could permit a more direct solution. Perhaps eventually a robot or AI would become sufficiently advanced that it would be able to enter into contracts and manage bank accounts on its own behalf. In that instance, it is not far-fetched to conceive of such an advanced technology to be capable of being taxed directly, much like a human taxpayer.¹⁵⁵ For example, a cryptocurrency-based system of taxation could be

¹⁵⁵ Oberson, *supra* note 7, at 260-61.

constructed for such advanced robots to facilitate payment.¹⁵⁶ However, such technology is sufficiently far in the future that one cannot consider this to be a practical proposal.

VIII. Conclusion

Any tax system that relies on human effort to raise revenues, through income or payroll taxes, is vulnerable to dislocation with the rise of AI, automation, and robotics. Alternative revenue sources must be found, somewhere, somehow, to alleviate these burdens.¹⁵⁷ While the practicalities of implementing and administering a robot tax do not support widespread adoption of such a tax to solve this dilemma, the robot tax debate has had the salutary effect of initiating the conversation about how to address this challenge.

¹⁵⁶ See generally Ahmed, *supra* note 7.

¹⁵⁷ Some recommended alternatives include imposing a payroll tax or other additional taxes on capital income, or a VAT (in the United States, which does not currently have a VAT). See, e.g., Mazur, *supra* note 7, at 309-22; Abbott, *supra* note 6, at 171-73; Oberson, *supra* note 3, at 139-42. The search for such alternatives is beyond the scope of this article, however.

A Peruvian Tax Lawyer in a U.S. Corporate Tax Class: What Can be Explained and What Cannot be Explained

Fernando J. Loayza Jordán¹

The title of this paper is, in part, borrowed from Professor Mirjan Damaska's paper, "A continental lawyer in an American Law School: trials and tribulations of adjustment."² I have adjusted it because my experience is obviously not as broad as Professor Damaska's, and our interests are different. I do not feel confident enough to consider myself a representative of "a continental lawyer," hence the reference to my home country. My experience in U.S. legal education is limited to my experience as an LL.M. candidate in a single law school that many would characterize as different from most U.S. law schools.³ That is why I refer to "a U.S. corporate tax class." I also changed the part of "trials and tribulations of adjustments" for "what can be explained and what cannot be explained" because I am much more interested in explaining what is taught in a U.S. corporate tax class (and why is taught in a particular manner) from a comparative perspective.

Thus, this paper is more of an ethnographic comparison, inspired by classroom experiences, between U.S. and Peruvian tax law education than what Garbarino calls "hard-nose comparative work" that requires an underlying theory and a clear methodology.⁴ It is also different from most comparative works because it is not actually about an area of law itself but about how it is taught and why, visiting some of the most critical variables in legal education.⁵ Nevertheless, I have tried to keep in mind the main critiques of comparative tax studies that could also become errors in the comparisons that I intend to draw.

¹ Yale Law School, J.S.D. expected 2025; Yale Law School, LL.M. 2020; Pontificia Universidad Católica del Perú, LL.B. 2016. Thanks to Mirjan Damaška, Steven Dean, and James Whitman for reviewing previous versions of this paper and particularly to Anne Alstott for her valuable comments and all her kind encouragement during my LL.M. year. Special thanks to the kind commentators of the 23rd Annual Critical Tax Conference at the University of Florida Levin College of Law.

² Damaška, Mirjan. "A Continental Lawyer in an American Law School: Trials and Tribulations of Adjustment." *University of Pennsylvania Law Review* 116, no. 8 (1968).

³ There are plenty of references to the uniqueness of Yale Law School. My personal favorite is the description of David Lat, a Yale alumnus himself: "For starters, is Yale Law truly a 'law school'? The school takes a highly theoretical, interdisciplinary approach to legal education that arguably takes the 'law' out of 'law school' (at least if we construe 'law' as black-letter legal doctrine). Yale Law is a great something — writer and YLS alum Elizabeth Wurtzel describes it as 'a cult of the Fourteenth Amendment... that happens to have a registrar's office' — but that something might not be a law school (at least if we view law school narrowly, as a place that teaches students legal doctrine so they can practice law)". *Why Yale Law School Isn't the Number-One Law School (In the ATL 2018 Law School Rankings)*. Above the Law Blog. June 7, 2018. Available at: <https://abovethelaw.com/2018/06/why-yale-law-school-isnt-the-number-one-law-school-in-the-atl-2018-law-school-rankings/?rf=1>.

⁴ Carlo Garbarino. *An Evolutionary Approach to Comparative Taxation: Methods and Agenda for Research*. In: *The American Journal of Comparative Law*, Vol. 57, No. 3 (Summer 2009), p. 685.

⁵ According to Jakab's overview, those variables would be the aim of legal education, content of teaching, method of teaching, structure and evaluations and examinations. András Jakab. *Dilemmas of Legal Education: A Comparative Overview*. In: *Journal of Legal Education*, Vol. 57, No. 2 (June 2007), pp. 253-265.

These critiques are related to the fact that “comparative” studies are “often limited to the description of foreign tax laws”⁶ with no context of the tax system in which they are located and its social and institutional framework. This is particularly dangerous in tax law because “Tax law is very much about local context. It is the very essence of the political orientation of any regime in any given jurisdiction. Significantly, unlike some other areas of law, this politicized characteristic of taxation is clearly evident.”⁷ In this vein, I will avoid a simply descriptive tale of how a particular aspect of taxation is taught in both countries, always trying to explain the differences between them by the way its tax legal education is structured, by the features of their legal systems or by their socioeconomic framework.

This could be interesting for Peruvian tax lawyers, but besides some gentle U.S. scholars that might find interesting to read the perspective of a visitor on how they have been teaching tax law, why would it be interesting or useful for U.S. readers to compare its tax legal education with the one from a small country in South America? I would suggest two answers: (i) tax law has developed a common international language that makes it easier to draw comparisons between the content of tax courses and (ii) Peru is the opposite of the U.S. in several ways. These two factors allow to more easily describe the differences between the two tax systems (and how they are taught) and to analyze by contrast whether those can be explained by structural differences between both countries.

I have emphasized the relevance of local context for the comparative study of tax law, and indeed, I believe that this makes it harder to draw comparisons between components of different domestic tax regimes without diving deep in its contexts. But tax law also has a relevant advantage in comparative studies. It is easier to compare⁸ because, in contrast, for example, with private law, in which the categories used by Civil Law countries can be extremely hard to “translate” to Common Law categories, tax law categories have been undergoing a process of profound global homogenization for a while now.⁹ From an international tax practice

⁶ Carlo Garbarino. An Evolutionary Approach to Comparative Taxation: Methods and Agenda for Research. In: The American Journal of Comparative Law, Vol. 57, No. 3 (Summer 2009), p. 679.

⁷ Omri Y. Marian. The Discursive Failure in Comparative Tax Law. In: The American Journal of Comparative Law, Vol. 58, No. 2 (Spring 2010), p. 465.

⁸ In contrast with Garbarino, who thinks that, on the contrary, tax concepts from different domestic tax regimes are often not easily comparable, pointing out that “[t]he problem with tax concepts is that they can often not be compared directly as they are not readily convertible into each other. In certain cases, similar terms do not have an identical legal meaning while in other contexts, different terms may mean the same.” Carlo Garbarino. An Evolutionary Approach to Comparative Taxation: Methods and Agenda for Research. In: The American Journal of Comparative Law, Vol. 57, No. 3 (Summer 2009), pp. 687-688.

⁹ The OECD has played a leading role in this homogenization process. It must be noted that, throughout time, the OECD has always chosen to influence domestic legislations by offering practical solutions to public policy problems, instead of issuing binding instruments for OECD States. This has enabled the OECD to expand its scope of action, allowing it to exert influence even in non-OECD States. This practice has been named “governance through soft law” and has turned the OECD into a sort of informal “World Tax Organization”. The outcomes of this strategy have clearly been successful: the OECD Model for Tax Treaties, the OECD Transfer Pricing Guidelines, the BEPS Project Actions and other numerous reports on tax issues are now world standards to deal with a wide variety of tax issues and have largely contribute to developed a common language between tax experts all around the globe. Regarding the “soft law” strategy of the OECD, see Marcussen, M. (2004), “OECD Governance through Soft Law”, in MÖRTH, U. (ed.), Soft Law in Governance and Regulation: An Interdisciplinary Analysis, Edward Elgar, Cheltenham

perspective, tax consulting is never about knowing the domestic tax legislation of every country involved, but about knowing an internationally shared tax language. That *tax Esperanto* is useful, on the one hand, to ask the appropriate questions to foreign colleagues and correctly understand their answers, and on the other, to respond to similar questions in the same common language and to comprehensively explain to the foreign counterpart those specific aspects of the domestic tax legislation that are outside of the mainstream categories of that common language.

On the other hand, Peru is the opposite of the U.S. in several factors that are relevant for this comparative analysis, as I will further explain through the paper: Peru is mainly a capital importing country, has a relatively weak government, is a small economy in the globalized context, and has a system of legal education informed by a formalist Civil Law tradition. These factors can explain most of the differences that will be analyzed but will not explain others. Those last may be explained by undesirable factors such as path dependency or intellectual laziness. This will be the most important contribution of the paper: to point out those aspects of the U.S. and Peruvian tax legal education that cannot easily be explained by their context, because those are the aspects that probably need to be rethought by tax professors.

This Article proceeds as follows. Section 1 compares how U.S. and Peruvian tax law courses fit in their respective law curriculums. Section 2 compares how each tax curriculum is designed and how tax courses in them interact with each other. Section 3 compares the content of corporate income tax courses and how they are taught in each country. Section 4 concludes summarizing which features of tax legal education should be questioned and presenting a warning on the influence of Big Law firms on the content of tax courses.

1. How Tax Law Courses Fit in the Law Curricula

U.S. law curricula are notably flexible. Depending on the law school, usually, at least two-thirds of the curriculum is customized by the students, who are able to choose among a broad selection of elective courses. Prerequisites for the elective courses tend to be limited, to allow more flexibility. Under the Yale Law School curriculum, for example, a student may take her first tax course, Federal Income Tax I, during her first year in law school, without having any previous experience in administrative law or in interpreting statutes and could take her Federal Income Tax II course (that includes corporate income tax) immediately after, without having taken any corporate law course before.

Besides the general flexibility already mentioned, this is possible, in part, because of the relative independence of U.S. tax law from other areas of law. The Internal Revenue Code structures its own categories, and those concepts that need further clarification are defined by the courts with reference mainly to tax law, and not by other bodies or sources of law. This

(UK), Northampton (MA, USA), pp. 103-126. Regarding the role of the OECD as an informal "World Tax Organization", see Cockfield, Arthur, "The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-Commerce Tax Challenges". Yale Journal of Law and Technology, Vol. 8, p. 136, Spring 2006.

independence is what Legosmky has identified as the discreteness of an area of law¹⁰ and is part of the arguments that support tax exceptionalism as *“the notion that tax law is somehow deeply different from other law, with the result that many of the rules that apply transsubstantively across the rest of the legal landscape do not, or should not, apply to tax.”*¹¹

However, this flexibility and lack of prerequisites also impose severe limitations on the content of tax law courses. Without having studied *Chevron*¹² in an Administrative law class, it is hard to discuss *Mayo Foundation* and how tax law should or should not receive special deference from the courts.¹³ Without previous knowledge of corporate law, its rather difficult to go deep on issues around transactional taxation, including a comprehensive understanding of the policy substance of antiavoidance rules for mergers and acquisitions.

In contrast, the Continental Law tradition is built on structuralism. The first part of Continental Law education, usually (and in the case of the Peruvian legal education, always) offers an introduction to jurisprudence and a “panoramic presentation” of the most important fields of law.¹⁴ Peruvian legal curricula, following such panoramic structuralism, situate tax law as part of public law and, therefore, require students to take a couple of constitutional law courses and at least one administrative law course before allowing them to register in the first tax course, which is compulsory for most of the Peruvian law students. With that knowledge, it is easier for students to draw analogies between the constraints on the Public Administration power in

¹⁰ Legosmky, Stephen H. *Specialized Justice: Courts, Administrative Tribunals, and a Cross-National Theory of Specialization*. Oxford: Oxford University Press, 1990. Oxford Scholarship Online, 2012, p.26-28.

¹¹ Lawrence Zelenak, "Maybe Just a Little Bit Special, after All?" *Duke Law Journal* 63, no. 8 (May 2014): 1901.

¹² *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) is one of the most important decisions in U.S. administrative law. Through it, the Supreme Court established a test for determining when to grant deference to a government agency’s interpretation of a statute under its control. For an overview on the doctrine set by this decision, the “Chevron deference”, see Brannon, Valerie C.; Cole, Jared P. (September 19, 2017). *Chevron Deference: A Primer*. Washington, DC: Congressional Research Service.

¹³ *Mayo Foundation v. United States*, 562 U.S. 44 (2011), is a United States Supreme Court case in which the Court clarified that the Chevron deference applied also to tax provisions, stating that it would not be wise to *“carve out an approach to administrative review good for tax law only”*. *Mayo Foundation* constituted a huge change in the perception of the uniqueness of tax law and, as Coder pointed out, a (perhaps mortal) wound on the idea of tax exceptionalism: *“The tax world finally recognized a stark fact of life in 2011: Tax law is not special. It took an explicit Supreme Court statement for the tax bar to become aware of its run-of-the-mill status, but that statement has prompted soul-searching [B]y and large the field assumed for decades that its unique set of issues required specialized legal treatment when it came to litigation postures, judicial deference, and administrative procedures. That notion was turned on its head [by Mayo]”* Jeremiah Coder, Year in Review: Tax Law’s Vanity Mirror Shattered, 134 *TAX NOTES* 35 (2012). For a more detailed review of *Mayo Foundation*, see Hall, Michael. "From Muffler to Mayo: The Supreme Court's decision to apply Chevron to Treasury regulations and its impact on taxpayers." *Tax Lawyer*, Spring 2012, p. 695+ and Dmitry Zelik, "Student Tax Notes: Chevron Deference In Tax Law Following The Supreme Court's Decision In Mayo Foundation V. United States" *Michigan Tax Lawyer*, 38, 22 (Fall, 2012).

¹⁴ *“In addition to an initiation into the grammar of law, the Continental student is also offered what would, to an American lawyer, appear to be a panoramic presentation of the most important fields of law. This comprehensive view of the whole is considered to be of utmost importance. It is feared that if the young lawyer fails to perceive the great contours of private and public law in school, he will seldom acquire an overview later in practice. Entangled in the jungle of practical problems, he will be deprived of the guidance that comes from an awareness of the totality of law in his particular field”*. Damaška, Mirjan. "A Continental Lawyer in an American Law School: Trials and Tribulations of Adjustment." *University of Pennsylvania Law Review* 116, no. 8 (1968): 1367.

general and on its power to tax, collect and administer those taxes at different governmental levels. The discussion about the application of the Peruvian General Administrative Procedure Act appears almost immediately, in contrast with the discussion about the application of the U.S. Administrative Procedure Act, which is rarely developed in U.S. tax courses.¹⁵

Also, by the time Peruvian students are allowed to take their first tax course, they have also taken plenty of private law courses. This is necessary given that several concepts in tax law are built upon private law concepts. For example, the concept of “property transfer” in the Income Tax Law has its own tax definition, but it is built on private law concepts borrowed from the Peruvian Civil Code. Students are also required to take corporate law before taking any courses involving corporate tax because this last also relies heavily upon concepts from the Peruvian General Corporations Act (for example, to define what kind of corporate reorganizations are considered neutral for corporate tax purposes).

The introduction to jurisprudence allows Peruvian students to become familiarized with a general legal framework: the system of sources of law,¹⁶ the hierarchy between different statutes and regulations, methods of interpretation, and general legal principles. This way of shaping their legal minds immediately pushes them to situate tax law in this framework and to raise questions about the issues in which their learned categories do not seem applicable. That is why there is no need to explain the place of Tax Authority regulations in the system of sources of law in a Peruvian tax class (they have already learned the place of regulations within the classic Kelsen hierarchy scheme¹⁷) while in a U.S. tax class, it is explained incidentally (and students don’t find it a really relevant issue). That is also why, when a U.S. professor explains that tax provisions usually are deemed in force from the date they were presented as part of a bill, i.e., before they were passed by Congress, little concerns are raised by U.S. students regarding the retroactive application of a tax provision. Peruvian students would be scandalized by such a violation of the general principle of legal certainty.

¹⁵ An interesting analysis on the compliance of the US Treasury with the Administrative Procedure Act can be found in Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack Of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 *Notre Dame L. Rev.* 1727 (2007).

¹⁶ As Whitman points out “*The question, “what are the sources of law?”, is one that is not often asked in the United States. Unlike lawyers in the civil law tradition, Americans possess no developed doctrine of the sources of law. The difference is indeed striking. Every introductory text in every civil law country begins with an orderly account of the different sources of law, of their hierarchy, and of the methods used in interpreting them. (...) No such orderly account, by contrast, is ever given of the sources of American law. Indeed, the very phrase “sources of law” is unfamiliar to most American lawyers, and readers in search of a rudimentary account of the sources of American law will search in vain. This state of affairs will seem bizarre to lawyers trained in the civil law tradition, but it is unsurprising. Americans do not, in general, think systematically about their law. The absence of any carefully worked out doctrine on the sources of law is only one symptom of a characteristic American toleration for disorder in the legal system – a toleration for multiple methodologies, jurisdictions and forms of authority. There is no single authoritative account of the sources of American law (...) American law remains a jungle. It has never become the kind of well-tended cropland that we discover in the civil law tradition*” James Q. Whitman. *The Sources of American Law*, pp. 1-2.

¹⁷ The Kelsen scheme has been highly influential in the Continental Law legal education. Most of Continental Law jurisprudence manuals have a reference to Kelsen when explaining the hierarchy principle between sources of law. See Kelsen, Hans (1960) [1934]. *Pure Theory of Law*. Translated by Knight. Berkeley, CA: University of California Press.

While Peruvian students, trained in the formalistic structuralism described, are concerned about fitting tax concepts into categories or denouncing how they don't fit in them, U.S. students are much more concerned about the practical consequences and policy issues that arise from the tax law. This is an inheritance of the legal realism that has dictated the U.S. legal training for several decades now.¹⁸ We can illustrate this difference with the way that students react to the theories or definitions of income. When a U.S. student is taught the Haig-Simons definition of income,¹⁹ her first reaction would probably be to assess its desirability or its consequences for the taxpayer activities. For a Peruvian student, it will be a new category, and therefore, her next move would be to try and fit tax provisions into that category and to understand the differences between such category and others.

2. How the Tax Curriculum is Designed

The first difference between U.S. and Peruvian tax curriculums is that in the latter, the first tax course is a general tax course, not about any specific tax unlike the U.S. curricula, in which the first tax course is associated with the Federal Income Tax on individuals. The Peruvian tax curriculum starts this way following the mentioned Continental Law tradition of providing a panoramic view before deepening in the specifics. It is also due to the custom in Peruvian Law Schools (and in most Continental Law Schools) of designing black letter law courses following the structure of the statutory bodies related to them. For example, Private Law courses tend to follow the structure of the Civil Code. In the case of tax, Peru and most of the Latin-American countries have a General Tax Act or a General Tax Code whose provisions apply to all taxes as default rules when their respective statutes don't have specific provisions. In these countries, the first tax courses are dedicated in large part to study the provisions on this General Codes and the issues arising from them.

What does the content of this General Tax course look like in Peru? It usually starts with a definition of the kinds of government-imposed obligations that can be categorized as taxes, an explanation of which are the categories of taxes and the presentation of the constraints that the tax provisions in the Constitution establish to limit the power of the different government bodies to impose each of these taxes. While doing this, students are introduced to the main taxes in the Peruvian system, learning about their main features in a nutshell. After that, the course goes on to comment on tax jurisprudence issues, such as the interpretation methods of tax provisions, the applicability of non-tax provisions to tax contexts, when tax provisions enter in force, among others. Then it usually presents the structure of a tax obligation and its

¹⁸ For a valuable overview of U.S. legal realism see Tamanaha, Brian Z. 2009. Understanding legal realism. *Texas Law Review* 87, (4) (03): 731-785 and Leiter, Brian. "Legal Realism and Legal Doctrine." *University of Pennsylvania Law Review* 163, no. 7 (2015): 1975-984. To contrast what might be called classic legal realism or old legal realism with the new legal realism, see Stewart Macaulay, *The New versus the Old Legal Realism: "Things Ain't What They Used to Be,"* 2005 *Wis L Rev* 365 (for a broad definition of new legal realism) and Miles, Thomas J., and Cass R. Sunstein. 2008. The new legal realism. *The University of Chicago Law Review* 75, (2) (Spring): 831-851 (for a narrower definition of new legal realism, limited to judicial decision-making).

¹⁹ In tax literature in Spanish is best known as the consumption plus net worth increase income measure or criteria, referring to the Haig-Simons formula $I = C + \Delta NW$, where C = consumption and ΔNW = change in net worth.

components: the taxpayer and other subjects that are liable for tax, the content of tax obligations (that may include, besides the main tax debt, fines and interests), how tax obligations are fulfilled, their general statute of limitations, and other central features of those obligations. Finally, there is also an introduction of the interactions between the Peruvian Tax Authority and taxpayers and the procedural rules that regulate tax disputes at an administrative level (tax audits, tax claims before the Tax Authority and tax appeals before the administrative Tax Court).

On the other hand, besides a brief introduction to the U.S. tax system in the introductory class of the first US tax course, all the content of such course addresses the Federal Income Tax on US individuals, without mentioning any of the issues taught in a Peruvian General Tax Course. This fact certainly raises the question of how useful it is to teach such content to Peruvian law students and how necessary it is to teach it before Income Tax. It is my impression that some of that content could be spared, but that the General Tax Course does provide to the students the tax language that most Peruvian tax statutes use. I also believe that the different content in the first course is highly influenced by the different design of the tax statutory bodies and that if the U.S. had a similar tax statutory body design as the Peruvian, general tax code plus a statute for each tax that is informed by such general tax code through shared concepts and default rules, the first tax course would need to address at least part of the content of such general tax code.

The fact that no comprehensive general overview of the U.S. tax system is provided at any point in the US students' legal education seems particularly problematic given that, in contrast with the Peruvian case,²⁰ there is taxation at several levels: federal, state, local and special-purpose governmental jurisdictions. There appears to be little discussion about how these different levels of taxation interact²¹ and, in general, how different taxes interact. There is a particular disdain for taxation outside of the federal level, and almost no attention is granted to property or sales taxes, even though they can be tremendously relevant for the budget of several states.²²

The considerable amount of constitutional content in the Peruvian general tax course and the lack of constitutional discussion on U.S. tax courses can be explained as a result of the longevity of the U.S. constitution and the youth of the Peruvian constitution:²³ the tax provisions in the

²⁰ Regional and local governments in Peru do have limited taxation power but is limited to finance some very basic public services. For example, it is strictly forbidden for them to impose any kind of income or sales tax.

²¹ I clearly remember that when I learned, while an intern in a Peruvian law firm, that a resident in New York City could be taxed with a Federal, State and City income tax at the same time, my mind became dizzy of all the possible jurisdiction and multiple internal tax issues that could arise from that fact. I expected those issues to be a central part of the introductory US tax courses. My expectations were clearly unfounded.

²² In several cases, such as Texas, Wyoming, Nevada and Washington, where no state income taxes exist (neither on individuals or corporations) property and sales taxes are almost all their own-generated income. See State and Local General Revenue, FY 2015. Tax Policy Center. Available in: <https://www.taxpolicycenter.org/statistics/state-and-local-general-revenue>.

²³ Peru's current constitution was issued in 1993, under the authoritarian dictatorship of Alberto Fujimori. It is interesting to note that during the XX century, Peru issued 4 constitutions: in 1920, 1933, 1979 and 1993. There is a huge difference between the tax provisions in the first two and the latter two, which were much more detailed in

Peruvian constitution are much more detailed than in the U.S. constitution because they were approved when tax systems were much more complex. The U.S. Constitution barely has some regulation on its government taxing power in accordance with a time in which tax systems were quite primitive²⁴. In contrast, the Peruvian constitution, not only regulates which institutions exercise taxing power (the most basic and standard tax provision in constitutions) in article 74, but also certain constitutional principles and limitations that must be respected for the creation, modification, and repeal of taxes (both in article 74 and in article 79). Also, the Peruvian constitution gives taxation a unique character by forbidding its regulation during sensitive periods: it is expressly forbidden to subject tax rules to referendum (Article 32), to issue emergency decrees containing tax matters or to include tax rules in budget laws (Article 74). In what could be judged as an excess of detail, the Peruvian constitution even regulates the temporal aspect of the entry into force of annual taxes in the mentioned article 74.²⁵

After taking the general tax course, the following Peruvian tax course is usually dedicated to Income Tax (both on individuals and on corporations, both foreign and domestic) and sometimes also Value-Added Tax (VAT).²⁶ This second course is intended to be introductory and to be complemented by elective courses afterward, such as specific courses on VAT, corporate tax, International Taxation, local taxes, among others. As will be explained below, this also follows the mentioned tendency of providing a general overview before going into detail. In contrast, in the U.S. tax curriculum, even though some of the concepts of Federal Income Tax are used in the following courses, no general overview is provided. Therefore, when a U.S. student starts with any of the usually advanced tax courses (partnership taxation, international taxation, estate taxation, among others), she has had no introduction to these subjects whatsoever. Without any place in the curriculum that may help to put all this knowledge in a coherent and panoramic perspective, U.S. students could face the problem of

its regulations of the government taxing power. My preliminary research has shown that the main reason for this is that there was no need to control a government with such a weak administration and with such primitive taxing tools and that therefore it was not considered relevant to include specific tax provisions in the constitutions. That changed drastically between 1933 and 1979, period in which the government revenue shifted from tariffs and property taxes to income and consumption taxes. Regarding this change, see Contreras, Carlos. 1997. *Los Ingresos Fiscales En El Perú: Desde El Final de La Guerra Con Chile Hasta El Presente*.

²⁴ This became a problem when the need of a federal income tax arose at the end of the XIX century. The constitutional tax provisions at the time were not precisely design thinking of such tax and, therefore, the Supreme Court struck down the income tax provision contained in the 1894 Wilson–Gorman Tariff Act in the case of *Pollock v. Farmers' Loan & Trust Co.* In response, the Sixteenth Amendment was introduced in the US Constitution: “The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.” As Jensen points out “*if the United States was going to have a workable, national income tax, the Sixteenth Amendment was legally and politically necessary in 1913*”. Jensen, Erik M. “Did the Sixteenth Amendment Ever Matter? Does It Matter Today?” *Northwestern University Law Review* 108, no. 3 (2014): 799.

²⁵ For a more detailed analysis of the tax provisions in the Peruvian constitution, see Danós Ordóñez, Jorge E. *El Régimen Tributario en la Constitución: Estudio Preliminar*. Themis, No. 29, 1994 and Landa Arroyo, César. *Los principios tributarios en la Constitución de 1993. Una perspectiva constitucional*. In: *Temas de Derecho Tributario y de Derecho Público. Libro Homenaje a Armando Zolezzi Moller*. Lima: Palestra, 2006.

²⁶ For a brief explanation of the VATs, an overview of its presence worldwide (every OECD country and more than 160 countries employ a VAT) and a proposal for a US VAT, see Graetz, Michael J. “The Tax Reform Road Not Taken - Yet.” *National Tax Journal* 67, no. 2 (06, 2014): 419-439.

compartmentalizing each area within tax law and facing tax issues from only one of those compartments. The tax isolation that came from tax exceptionalism could easily turn into corporate tax isolation or partnership tax isolation.²⁷

Some explanation should also be given to the special place that Federal Income Taxation (on individuals) has as the first tax course in U.S. curriculums, and often, the only tax course that US students take during law school. As mentioned, this content is studied only during a portion of the second tax course in Peruvian curriculums. This can be explained by the gravitating importance of this tax for U.S. revenue in contrast with its far lower impact on the Peruvian budget.²⁸ but also by the complexity of both taxes: the Peruvian Income tax on individuals is rather simple compared to the U.S. Federal Income Tax.²⁹

It also must be noted that the Federal Income Tax course content includes concepts that will be the bases of the following tax courses: tax basis, realization, imputation, among others. In that sense, it is used as an introductory course in a way that a Peruvian course on income tax on individuals could not, given that the simplicity of the Peruvian income taxation on individuals does not include several of the key concepts used for corporate taxation and other areas of tax law.

Finally, there is the issue of code reading. The Federal Income Tax is sometimes the first approach of US students to code reading, and that fact increases the apprehension that U.S. law students already have regarding tax courses.³⁰ This course is supposed to train U.S. students in the application of statutory provisions, but I found their training strange. Besides some general tips (like reading thoroughly the provisions, beware of exceptions to the general

²⁷ That is what is so special about Professor Alstott Federal Income Tax II at Yale Law School, which content includes an overview of corporate income taxation, international taxation and partnership taxation in an integrated way. I truly hope such model can be replicated in other law schools and kept in YLS.

²⁸ The relevance of the Income Tax on individuals for the U.S. budget is not only far superior to its relevance for the Peruvian budget, but to its relevance in the average of the OECD countries (which can be largely explained by the lack of presence of a VAT in the U.S. previously mentioned). According to OECD data, the tax on personal income as a percentage of the total amount of taxation represents 40.73% in the US, while the OECD average is nearly half: 23.91%. See, Tax on Personal Income 2018. OECD. Available in: <https://data.oecd.org/tax/tax-on-personal-income.htm>.

²⁹ For example, the Peruvian Income Tax does not allow any tax depreciation of assets for individuals. Also, until quite recently, almost no expenses were deductible and even today are limited. For example, only since the fiscal year 2017, housing expenses were deductible for individual income tax purposes and with quantitative restrictions. Such simplicity has always been justified by the limited resources of the Peruvian Tax Authority to handle a more sophisticated individual income taxation system, a limitation that currently affects the equality principle. The argument continues asserting that only when its resources increase, a more equitable individual income taxation system could be afforded. I believe such point has largely been reached and that is long due the duty to modify the Peruvian individual income taxation system. Such is the direction pointed out by el Grupo de Justicia Fiscal (Group for Fiscal Justice), a civic platform whose goal is to contribute to the development of more equitable fiscal policies for Peru, as a goal for the following years. See Arias Minaya, Luis. El Perú hacia la OCDE - la agenda pendiente para la política tributaria 2018-2021. Grupo de Justicia Fiscal. July 2018; available at <http://cooperacion.org.pe/wp-content/uploads/2018/09/17071-El-Peru-hacia-la-OCDE-CORR-web.pdf>.

³⁰ Regarding the perception of students in U.S. law schools, Caron notes that "students follow the conventional wisdom that there are only two types of law school courses: tax and everything else". Paul L. Caron, "Tax Myopia, or Mamas Don't Let Your Babies Grow up to Be Tax Lawyers," Virginia Tax Review 13, no. 3 (Winter 1994): 520.

rules and be attentive to statutory definitions of concepts that are different to their ordinary meaning),³¹ it seems that the only training is familiarizing the students with the code by forcing them to read its relevant provisions for each section of the course and that students are supposed to learn code-reading by the examples of cases.³² At many U.S. law schools, there is no training on how to actually interpret the language in the code or discussions on the adequacy of applying a certain interpretation technique. The hierarchy or ponderation between interpretation methods, the importance of the place of the provision in the statutory body for its interpretation, when to resort to a plain language definition of the text or when to seek its meaning in other areas of law are all issues that are definitely not taught in a Federal Income Tax course while they are at the front center of the jurisprudence course that any Peruvian legal student takes on its first semester.

That is not to say that the Peruvian students don't face problems when interpreting tax provisions; the fact of the matter is that sometimes I wonder whether having too much background on statutory interpretation can become problematic for Peruvian students. Given that they start learning statutory interpretation in its first semester, most of the examples used in class come from the Civil Code and their mindset gets used to the provisions in that body of law which have an entirely different design than, for example, the one of the Peruvian Income Tax Law. The design of the latter can be explained by the dialectic between the tax legislator and the taxpayer: the legislator will want to tax certain manifestations of wealth, and the taxpayer will want to avoid such a tax. Given that the taxpayer will always find new structures to circumvent existing provisions, the legislator will always have to update the tax law with new anti-avoidance provisions regulating such structures. This legislative zeal to remake laws that can never be completely shielded from the elusive creativity of taxpayers results in the Frankensteinian appearance of many tax bodies of law. I believe that this normative format of very long statements followed by an infinite number of convoluted clarifications and exceptions to the same statement generates panic in Peruvian law students who review tax legislation, as much as in US law students.

3. How Corporate Income Tax is Taught

The first great difference between the way corporate income taxation is taught in Peru and in the U.S. is the general design of the content, where the differences between both legal traditions are clearly observable. The Peruvian Continental structuralism is clearly noted in the presentation of the corporate taxation content, which is divided into several variables of the corporate income tax obligation structure. Each variable is studied as a piece of a puzzle: students have to identify each different piece and learn how that piece fits with the others and how they all serve a function as part of the puzzle as a whole. Those variables respond to a general structure of tax obligations already developed in the mentioned General Tax Course:

³¹ For example, in the Federal Income Tax course syllabus (Fall 2019) at Yale Law School, by Professor Zachary Liscow, code-reading hints can be found, such as: "Code-reading hint #1: If you think you've read enough, you're likely wrong. Keep reading. Sometimes the rule that is given is reversed nearly 180 degrees by later material".

³² As Professor Alstott pointed out, this is possibly an unconsidered "hangover" of using the case method in a statutory course.

the objective variable (what is income for corporate tax purposes?), the subjective variable (which entities are considered corporate income taxpayers?), the timing variable (when is income recognized or realized?), the jurisdictional variable (when corporate income is considered taxable following the residence and source variables?), the measurement variable (how to value and determined corporate income?), the quantitative variable (what tax rate is applicable?), among others.

In contrast, U.S. legal realism clearly inspires the functional approach to the U.S. corporate income taxation content, which is taught following the life of a corporation. As it is said that a human being is born, grows, reproduces, and dies, it can be said that a corporation is incorporated, generates profits, distributes them, and dies (through corporate liquidation or a reorganization via merger or acquisition). The U.S. corporate income tax is taught following the development of such life, analyzing each of these “corporation life” steps. Given the emphasis on functionality, U.S. courses could not perform the segregation that their Peruvian counterparts do, because it would be impossible to explain the tax impact of each step without all the aspects that the Peruvian courses disaggregate. It would be impossible to explain the tax consequences of an incorporation process without grasping all of the variables of corporate taxation. That is why a Peruvian student will only be able to fully understand the latter at the end of the course, while the U.S. student already knows everything about the taxation of the incorporation process after finishing the corresponding corporate formation module. But, on the other hand, given the disaggregated design, Peruvian corporate taxation courses dedicate a certain time to integrate all the aspects studied and wrap up its content in the same way that they introduced it: through a panoramic view. Even though in my case that was done through the module on integration,³³ it is my impression that most U.S. corporate taxation courses do not dedicate enough time to put all the pieces together.

In other words, Peruvian corporate taxation is taught through each of the aspects of the corporate tax structure as a whole, and its U.S. counterpart is taught following each of the steps under which a corporation goes through given its purpose and functions. These differences are reflected, to a certain degree, in the way the U.S. Internal Revenue Code and the Peruvian Income Tax Law are structured. On the one hand, most of the aspects of corporate formation, distributions, reorganizations, and liquidations are established in Subchapter C, rarely having to resort to other parts of the IRC to determine the tax treatment of these transactions. On the other, each of the sections of the Peruvian ITL is dedicated to one of the aspects of the corporate tax structure previously mentioned and, therefore, it is impossible to assess the tax treatment of any of the mentioned transactions without jumping from one section of the Peruvian ITL to another. I haven't found any convincing argument to assess whether in the U.S. case the IRC influenced the way of teaching or if the way of teaching influenced the IRC, but in the case of the Peruvian Income Tax Law, it was definitely the first, following the general tendency of the content of the courses following the structure of the statutory bodies related to them.

³³ Again, this seems a particularity of the Professor Alstott Federal Income Tax II content. Integration does not seem as a usual part of U.S. introductory tax courses.

U.S. corporate taxation courses often take certain premises for granted, without any mayor discussion, in order to be able to go through its content. The most relevant of the obviated premises is the jurisdictional issue. During most of the U.S. courses, the tax treatment explained is limited to U.S. corporations receiving U.S. source income, despite the fact that it is hardly ever explicitly clarified. This would be scandalous for Peruvian standards, given that the discussion of the jurisdictional criteria, residence and source, are part of the first main tax concepts that are taught in a Peruvian Income Tax course. Under the U.S. course design, any reference to these criteria, to non-resident taxation and to foreign income taxation, is deemed as an international taxation issue and set aside from the content of the corporate taxation course. In contrast, no Peruvian Income Tax course would be deemed complete without incorporating all of these issues.

This can be explained in part by this differentiation of corporate taxation and international taxation in the U.S., but also by the relevance of non-resident taxation for the Peruvian revenue. The fact that Peru is mainly a capital importer generates that much more attention is provided to withholding taxes on non-residents, source rules, and rules applicable to branches and permanent establishments. In contrast, in the U.S., little attention is paid to these issues in the corporate tax course (i.e., no explanation about U.S. branches of foreign corporations is usually provided and almost no elaboration on the permanent establishment concept) and much more attention is given to outbound taxation issues, such as CFC rules (Subpart F of the IRC) or foreign tax credits (even after the 2017 tax reform that dramatically reduced the cases in which corporations are taxed for foreign income). In contrast, until relatively recently, Peru had no CFC rules³⁴, and the foreign tax credit rules were quite primitive, with the indirect foreign credit just entering in force in 2019.³⁵

Another relevant difference is how dependent the Peruvian corporation taxation is on corporate law concepts. As mentioned, by the time Peruvian students are allowed to take corporate taxation, they have already taken at least one corporate law course. Therefore, concepts like the corporate veil³⁶ and corporate legal personhood are already assumed by Peruvian students as a given, so there is no need to explain the “alter ego” problem, which they wouldn’t find a problem, just a “natural” consequence of corporate legislation. The fact that a corporation generates profits and is able to decide whether to distribute them or not to its shareholders is not seen as a tax deferral because the corporation and its shareholders are automatically thought of as separate taxpayers. Indeed, such separation is so strong in their minds that they do not immediately recognize the double taxation problem that taxing

³⁴ The CFC rules were introduced in the Peruvian Income Tax Act in 2012 and entered in force for the 2013 fiscal year. For an overview and analysis of the Peruvian CFC regime, see Villagra Cayamana, R. A. (2013). Análisis crítico del régimen de transparencia fiscal internacional vigente en el Perú a partir del 2013. THĒMIS-Revista De Derecho, (64), 51-73.

³⁵ For a review of the new Peruvian indirect foreign credit, see Sotomayor, Pablo. El crédito por impuesto a la renta pagado en el exterior y el Impuesto a la Renta (IR) peruano. Enfoque Derecho. October 20, 2018; available at <https://www.enfoquederecho.com/2018/10/20/el-credito-por-impuesto-a-la-renta-pagado-en-el-exterior-y-el-impuesto-a-la-renta-ir-peruano/>.

³⁶ For a useful comparative work on the corporate veil see Lezcano Navarro, José Maria. Piercing the corporate veil in Latin American jurisprudence: a comparison with the Anglo-American method. Abingdon, Routledge, 2016.

corporate income and also dividends received by shareholders generates. If the problem is not presented to them from an “economic” perspective, they usually fail to see any issue because they identify two different incomes, each being taxed on a different taxpayer. This takes as to a final relevant distinction between the discussed systems: the U.S. partnership regime.

Contrary to how Peruvian students react to the double taxation generated by corporate taxation, U.S. students immediately recognize it and find it troublesome. For them, the “natural” way of taxing this income should be the partnership regime because they identify a single income that should be imputed to the final beneficiary. They haven’t interiorized legal personhood in the way Peruvian students do, so they see corporate entities as naturally tax transparent – almost as just a piece of paper. For them, corporate taxation is an exception to the should-be-rule of partnership taxation.

Some could argue that the difference between corporate and partnership taxation is based on the difference that U.S. corporate law does, providing different classes of entities: some with a more relaxed or no corporate veil (partnership) and some with a stricter corporate veil (corporation). But such an argument is quite weak. First, because the “check-the-box” regulations adopted in 1996 implied that entities could freely elect to be treated as a corporation or a partnership, with almost no regard for their corporate form.³⁷ At least from that point on, it was clear that the distinction was made for policy reasons and not for a simple desire to follow corporate law. Second, because there is no relation between the limited liability that the corporate veil provides and the transparency of an entity for tax purposes. Third, because the regulation of a U.S. partnership from a corporate law perspective is so flexible that a partnership can function almost exactly like a corporation, leaving the tax distinction between a corporation and a partnership to the decision of the partners more than to mandatory features set by the law. Therefore, the fact that there are two available regimes for U.S. entities for tax purposes is not a result of the features of the corporate law provisions applicable to such entities but merely a policy decision, as it was a policy decision for the Peruvian legislator to establish that the general rule for entities is to treat them as opaque entities for tax purposes,³⁸ as in the U.S. corporate taxation regime.

4. Some Final Thoughts and a Warning About Big Law Influence

³⁷ The most relevant exception to this freedom to choose is that U.S. entities of the type that can be publicly traded must be treated as corporations for tax purposes.

³⁸ For Peruvian tax purposes, all Peruvian entities with independent legal personhood are considered opaque. Only specific Peruvian entities with no independent legal personhood, such as trusts and joint ventures that meet certain requirements are considered transparent for income tax purposes. In the case of foreign entities, only when CFC rules apply an entity would be considered as a transparent entity for income tax purposes. This last exception is the only one in which an entity with independent legal personhood is transparent and is because of specific policy objectives: to avoid the accumulation of capital in CFC entities and to raise the tax revenue by forcing the attribution and realization of CFC profits. Regarding this policy objectives, see Villagra Cayamana, R. A. (2013). *Análisis crítico del régimen de transparencia fiscal internacional vigente en el Perú a partir del 2013*. THĒMIS-Revista De Derecho, (64), 51-73.

As mentioned, it is my belief that the most important contribution of this paper is to identify which differences between the U.S. and Peruvian tax legal education can be explained by the economic, social, and legal context of both countries and which cannot. These last should be subject to review and serve as input for rethinking the way tax law is taught in both countries.

In the case of the U.S., tax professors could question whether the content of their tax courses should include an overview of the U.S. tax system that explains both the different levels of taxation (federal, state, local, and special-purpose governmental jurisdictions) and the interaction and differences between such levels. Without any introductory jurisprudence course in the U.S. curricula, one could wonder if it would be useful to have an introductory and general tax course that addresses jurisprudence issues applied to tax law. Recognizing that several issues cannot be treated properly in tax classes given the lack of knowledge on other areas of law, it seems that the position of tax courses in the tax curricula and its prerequisites should be discussed.

In the case of Peru, one could wonder why tax law courses should be compulsory in the first place and why should so many prerequisites be demanded before taking them. Also, a Peruvian professor (and students) should ask why there is rarely any policy or functional approach to tax law in an area that is highly political and if courses should be structured following tax bodies of law without further discussion. It is also questionable whether it is necessary to spend that much time in formal content and legal categories, such as the formal structure of tax obligations. On the other hand, an increasingly complex and relevant individual income taxation might require a change in the introductory tax courses as well, given the arguments displayed before.

Finally, I would like to present a warning about the heavy Big Law influence in tax legal education, both in Peru and in the U.S. During the analysis performed for this paper, this influence has become increasingly obvious. There are mainly two ways in which this influence is exercised. The first is through their offer of jobs. Obviously, law schools should prepare students to face the labor market, and law schools will want to place their alumni in the most prestigious Big Law firms. This would favor courses of practical training and heavy information transmission, to the detriment of courses with a critical approach to the current tax law and with policy analysis. The second is through professors, who have themselves been educated at these elite law schools³⁹ and have often worked in Big Law firms (or held clerk positions for high level courts) or have been influenced by the content developed by professors of such background. Through both ways, law schools can become victims of a process through which they lose their research and scholarship purposes, and therefore, lose their capacity to train legal professionals beyond mere practitioners and to develop and offer new intellectual ideas to the academic discussion.

³⁹ Elite law schools might also be referred to as “top” or “best” law schools, such as the ranking of “Best Law Schools” by U.S. News and World Report for 2019; available at <https://www.usnews.com/best-graduate-schools/top-law-schools/law-rankings>.

Such influence becomes even more negative in non-elite law schools. In the U.S. case, tax professors still usually come from Ivy-League-type schools⁴⁰ and have practiced in Big Law firms, so they are not always representative of their students, who may not be hired by these firms. In these cases, tax professors may end up teaching content that their students will not be able to apply and miss out on less sophisticated content that would be more helpful for them (e.g., state and local taxes or the regime of tax procedure for low-income to high-income clients). In the Peruvian case, tax professors in non-elite law schools rarely work at Big Law, and we could have expected them to focus their classes on their student's needs better. Regretfully, usually, that is not the case: tax professors in non-elite law schools are usually part-time professors and do not (or cannot, to be fair) invest relevant resources in designing their courses, so they basically follow the Big Law-influenced content developed by professors in elite law schools for their classes and textbooks. As in the U.S. case, non-elite law school students are not receiving a tax legal education that prepares them for the labor market they will enter (e.g., there is not enough content devoted to the special regimes for small to medium-sized businesses or to individual taxation).

There is a delicate balance between preparing students to face the labor market and surrendering legal education to Big Law demands in elite law schools. It can be dangerous both because it could lead to tax curriculums that favor pro-business positions or are too comfortable defending the law as it is, without presenting any critical approaches to the policies behind such laws. But even when the content is balanced, non-elite law school students will suffer if their law schools and tax professors do not expand such elite law school content to meet the needs the students might encounter in their careers.

⁴⁰ See Sarah Lawsky. Spring Self-Reported Entry Level Hiring Report 2019; available at <https://prawnsblawg.blogs.com/prawnsblawg/entry-level-hiring-report/>.

Tax Treatment of Business Expenses

By: Madhuri Lanka, CMA, MST Student

Introduction

This article discusses a 2020 Tax Court case involving the issue of when an expense should be treated as a start-up expense, trade or business expense, or as an income producing activity expense. This classification is crucial because the tax treatment of deductions is different for each category and therefore, affects taxpayer's calculation of taxable income and tax liability. It is important to observe whether the expenses incurred by a company were before the commencement of business or once it started carrying on business. The purpose of this paper is to discuss these types of expenses by analyzing a 2020 court case and Internal Revenue Code (IRC) sections 162 (trade or business expenses), section 195 (start-up expenditures) and section 212 (income producing activity expenses).

James Gordon Primus v. Commissioner, TC Summary Opinion 2020-2

James G. Primus, a New York accountant, bought a property consisting of 200 acres of maple trees in Quebec, Canada in September 2011. A significant number of the trees were mature and ready to produce maple syrup. Before collecting sap and producing syrup, James G. Primus thinned the maple bush and subsequently installed a pipeline to produce syrup from sap. The production and sale of maple syrup began in 2017.

At the time of acquisition of property in 2011, Primus also decided to produce blueberries. He ordered 2,000 blueberry bushes in 2014 and planted them in 2015. He cleared the area to plant blueberry bushes in 2012 and 2013.

In addition, the property also contained other species of trees, overgrown pastures, hay fields, and had twelve acres suitable for growing crops. There were also various other improvements on the property such as main house, two apartments, a garage, a barn, and a building with a pool and a gymnasium.

Primus reported a substantial amount of farming related expenses in 2012 and 2013, with most of the expenses attributable to the cost of repairs to various improvements on the property. He argued that these expenses incurred to produce and sell maple syrup and blueberries fell under IRC section 162 as expenses of a trade or business, or section 212 as expenses of an income producing activity. The IRS argued though that these expenses fell under section 195 as start-up expenditures denied the deductions, asserting that they were non-deductible start-up expenses because Primus had not yet commenced his business. Primus had not yet collected any sap, installed any infrastructure needed to convert sap into syrup, or bought any blueberry bushes. Subsequently, the U.S. Tax Court upheld the IRS's position. The court held that the expenses were not deductible as trade or business expenses until the business started functioning, at which time Primus could start amortizing them as allowed by section 195.

Section 162 Trade or Business Expenses

Deductible expenditures generally originate from a profit motivated activity. Section 162 provides all taxpayers with a deduction for their business expenses.¹ The IRC and the Treasury Regulations do not provide a precise definition of what constitutes a trade or business. Case law, however, does provide some guidelines. It states that those expenses incurred after a business had progressed beyond the start-up phase can be considered as trade or business expenses and are deductible. In *James C. Powell. v. Commissioner*,² the expenses in 2008 and 2009 related to starting a new brewery under Schedule C of Form 1040 were denied because the taxpayer failed to show that he actually began the business operating activities in 2008 and 2009. Section 162 permits a taxpayer to deduct ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. A taxpayer is not carrying on a trade or business under section 162(a) until the business is functioning as a going concern and performing the activities for which it was organized. Going back to the *Primus* case, since the business had not begun operating in 2012 or 2013, the expenses claimed were rightfully not treated as trade or business expenses and therefore, were not deductible.

Section 212 Expenses for Production of Income

Section 212 provides for individuals to deduct expenses they incur for the production, or collection of income, or for the maintenance and conservation of income producing property (an investment activity). Thus, the requirement of an activity being profit motivated has two aspects: (1) a determination of whether an expenditure originates from an activity engaged in for profit (section 162), and (2) for individuals, a distinction between a trade or business and an investment activity (section 212). A tax advisor must examine all the facts and circumstances surrounding the activity in which the taxpayer incurs expenses in order to make this distinction.

It can sometimes be difficult to classify expenses as falling under section 162 or section 212 . For example, consider an individual who owns and rents out a home to a long-term tenant who handles the care and maintenance. Is this a trade or business activity with deductions allowed under section 162 and perhaps also section 199A that allows a deduction for qualified business income? Or is it an investment activity with deductions allowed under section 212 and no section 199A deduction?

Another distinction between section 162 and section 212 activities is where an individual realizes a loss on the sale of an asset. If the individual used that asset in a business, the individual likely has an ordinary loss under section 1231.³ In contrast, if the taxpayer realizes a loss on the sale of an investment asset, the loss is treated as capital loss which receives less favorable tax treatment.

¹ IRC section 162 provides, "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

² *James C. Powell. v. Commissioner*, T.C. Summary Opinion 2014-235. The *Powell* case was not addressed in *Primus* case.

³ Under section 1231, the exact treatment depends on the total gains and losses from such property for the year.

In order to deduct a business or investment expense, it must also be considered “ordinary”. Although neither section 162 nor 212 provide a definition or application of this requirement, the Treasury Regulations under section 212⁴ indicate that for an expense to be ordinary, it must be reasonable in amount and it must bear a reasonable and close relationship to the income-producing activity or property. Also, case law has held that for an expense to be ordinary, it must be customary or usual in the context of the industry or business community.⁵ In addition to being ordinary, a deductible investment or business expense must also be “necessary”. The Supreme Court has indicated that an expense is considered necessary if it is “-appropriate and helpful-” in the taxpayer’s business.⁶ Clearly in the *Primus* case, it is not immediately obvious that the expenses for property improvement, for example, can be considered either ordinary or necessary and thereby might not be deductible, but might instead be capitalizable.

Section 195 Start-up Expenditures

According to section 195, start-up expenditures are ordinary and necessary business expenses paid or incurred by an individual or corporate taxpayer for the creation or acquisition of an active trade or business, or to conduct an activity engaged in for profit or the production of income before the time the activity becomes an active trade or business. Under this section, a taxpayer may elect to deduct the first \$5,000 of such qualified start-up expenditures. However, this amount is reduced (but not below zero) by the amount by which the cumulative start-up expenditures exceed \$50,000. The taxpayer can amortize the remaining start-up expenditures over a 180-month period beginning in the month business begins.⁷ In the *Primus* case, the court concluded that the expenditures were start-up expenditures under section 195, but it is not deductible until the year the business activity begins.

Conclusion

The *Primus* case serves as a reminder of the importance of properly classifying various types of expenses that are related to business or investment activities for tax purposes. A taxpayer can claim business expenses as deductions only after the business has commenced. Prior to that point, the taxpayer should track its start-up expenditures per section 195 so that it can start amortizing them once the business begins.

It is also crucial for a taxpayer to maintain books and records that substantiate income, expenses, and credits to claim in measuring income tax liability. The taxpayer should ensure that expenses are ordinary and necessary in carrying a trade or business under sections 162. To

⁴ Per Reg. 1.212-1(d), to be deductible under section 212, an expense must be “ordinary and necessary” meaning that such expense “must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.”

⁵ *Cavanaugh, Jr. v. Commissioner*, 123 AFTR 2d 1279 (2019), Code Sec(s) 162.

⁶ *Welch v. Helvering*, 290 U.S. 111 (1933), *Haas & Associates Accountancy Corp. v. Commissioner*, 117 T.C. 48 (2001), Affd. 55 Fed. Appx. 476 (9th Cir. 2003).

⁷ Reg. 1.195-1(a).

qualify as a start-up expenditure under section 195, the taxpayer must prove that expenses of creating an active business are incurred after a particular business is acquired or established but before the business actually begins operations. In summary, for individuals with for profit business entities, it is important for the taxpayers to understand when business related expenses are deductible to accurately file the tax returns and avoid claiming deductions in the wrong year or overlooking deductions.

Not Signing a Return

By: Liubov (Luba) Shilkova, MST Student

What consequences can arise for a taxpayer who does not sign a tax return? Also, what requirements must be met by a representative in order to sign the form on behalf of the taxpayer? Let's take a closer look at *Dixon vs. U.S.*¹, a case from the U.S. Court of Federal Claims that was decided in February 2020. This case reminds us how important it is to pay attention to instructions and comply with the regulations when taxpayers or their representative file tax forms.

Alan C. Dixon was an Australian national who resided in the United States and was one of the owners of an Australian corporation, Dixon Advisory Group Proprietary Limited. Since he paid taxes to Australia, he was eligible to apply for the foreign tax credit. This would allow him to get a refund for a portion of his federal income taxes for the 2013 and 2014 tax years, so he filed amended returns for these years. Mr. Dixon filed and signed under penalties of perjury his original 2013- and 2014-income tax returns, Forms 1040, on October 23, 2014 and October 13, 2015, respectively.

In 2016, John Castro entered in a contract with Mr. Dixon to serve as Mr. Dixon's tax representative. In 2017, Mr. Castro submitted an Internal Revenue Service (IRS) Form 2848, *Power of Attorney (POA) and Declaration of Representative*, that gave Mr. Castro authority to represent Mr. Dixon before the IRS. However, the form was filed improperly for signing tax returns purposes. The boxes on Form 2848 that indicated Mr. Castro was authorized to sign Mr. Dixon's tax returns were not checked. In addition, Mr. Dixon did not sign Form 2848, which was one of the requirements. Therefore, Mr. Castro did not have authority to submit tax returns or amended returns for Mr. Dixon. The Form 2848 was not considered an effective power of attorney.

Then, in April 2017, amended returns, Form 1040X, for the 2013 and 2014 tax years seeking refunds of \$137,656 and \$1,588,653, respectively, were submitted and signed by Mr. Castro. Mr. Dixon did not sign these returns despite the fact that the form provided a space to sign and recited a declaration that the signature was under penalties of perjury.² No power of attorney form was attached to the these amended returns.

The IRS assessed additional taxes against Mr. Dixon for the 2013 tax year based on his 2013 amended return, seeking \$161,447 (plus \$19,609.56 in interest) and a failure-to-pay penalty in the amount of \$6,429.65 (plus \$4,785.35 in interest). Mr. Dixon paid these amounts in 2017

¹ *Dixon v. U.S.*, 125 AFTR 2d 2020-986 (Fed. Cls., 2020).

² For the 2013 and 2014 version of the Form 1040X, this declaration states: "Under penalties of perjury, I declare that I have filed an original return and that I have examined this amended return, including accompanying schedules and statements, and to the best of my knowledge and belief, this amended return is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge."

when submitting his 2017 tax return. However, he did not file an administrative claim for a refund of the additional amounts assessed.

In May 2018, the IRS audited Mr. Dixon's 2014 tax return. Mr. Castro responded to the Information Document Request (IDR) twice by providing additional documentation and submitting arguments challenging the IRS's authority to conduct the audit. In February 2019, Mr. Dixon filed the lawsuit against the IRS.

Valid and Duly Filed Claims

The IRS argued that this case must be dismissed because Mr. Dixon's refund claims were not duly filed in accordance with regulations and requirements of the forms. The court agreed with the IRS based on the following reasonings. According to Reg. §301.6402-2(a), "if a taxpayer is required to file a claim for credit or refund using a particular form, then the claim, together with appropriate supporting evidence, shall be filed in a manner consistent with such form, form instructions, publications, or other guidance found on the IRS.gov website."³

Also, for claims to be valid and duly filed, Reg. §301.6402-2(b) requires that the "statement of the grounds and facts must be verified by a written declaration that it is made under the penalties of perjury."⁴ However, a claim which does meet these requirements shall not be taken into account for refund purposes. Form 1040X meets these requirements and has a space to sign under the penalties of perjury statement to confirm that the amount claimed for the refund is correct. Reg. §301.6402-2(e) states that taxpayers may authorize fiduciaries to sign and submit a form on their behalf. In this case, a valid power of attorney, such as Form 2848, or other proof of representative capacity must be attached to a signed tax claim or return. Mr. Dixon's claims did not meet this requirement as the requested proof was not attached to the form. Form 2848 had been filed and signed by Mr. Castro, but it did not grant him authority to sign the tax return on behalf of his client, as the appropriate boxes were not checked. Even if the power of attorney was signed in December 27, 2019, the court determined that it did not satisfy the requirements as it was dated after the amended returns were filed. Therefore, the court held that the refund claims were not valid.

Applicability and Validity of Tax Regulations

Mr. Dixon also argued that the regulation at issue was inapplicable based on his interpretation that anyone can sign a tax return under penalties of perjury, and no regulation was needed as the relevant statutes were clear and allowed Mr. Castro to sign the tax returns. The court rejected these arguments.

When courts render decisions on the meaning of the statutes, they focus on the interpretation of the law made by Congress. Citing the *Chevron U.S.A. Inc. v. Natural Resources Defense*

³ Reg. §301.6402-2. Claims for credit or refund.

⁴ Reg. §301.6402-2. Claims for credit or refund.

Council,⁵ the court determined that in order to decide whether a regulation is ambiguous, the courts must apply the “traditional tools” of construction that help in interpretation including the text and structure. By applying this method, the court held that Reg. §301.6402-2 is clear. The IRS had an interpretation similar to the court’s, and no additional interpretation was needed. According to the plain text and language of the law, Mr. Dixon’s interpretation was not correct.

The second argument was also rejected under §§6011, 6061, 6065, 6402 and 7422 the IRS is authorized to issue regulations governing the requirements of a return, including the signatures on returns and claims for tax refunds. According to these statutes, taxpayers must personally sign tax returns under the penalties of perjury or other documents required by the IRS, unless otherwise allowed under regulations.⁶ Also, Reg. §301.6402-2 allows taxpayers to sign tax returns by another person if a power of attorney is provided. As long as the IRS’s regulation specifies how taxpayers must sign their tax returns and other required documents, it is reasonable and consistent with the statutes. This is why Mr. Dixon’s argument about invalidity was rejected.

Finally, the court also took into account Mr. Dixon’s argument that the IRS waived its ability to object to his tax return as it opened an audit for the 2014 amended return and contacted Mr. Castro. Even if the IRS accepted tax returns, it does not mean that the waiver occurred since it was not a final action. The court referred to this concept in the holding in *Angelus Milling Co. v. Commissioner*⁷ in which the Supreme Court held that the waiver doctrine is not available just because “somewhere under the IRS Commissioner’s roof is the information which might enable him to” determine whether a refund is valid. This information is referring to the situation when the IRS was not on notice that Mr. Dixon’s tax returns were invalid until after the litigation began. Therefore, Mr. Dixon’s argument was rejected by the court.

Conclusion

All Mr. Dixon’s complaints were rejected as he did not sign the amended tax return personally or provide a valid power of attorney for his preparer. This suit was dismissed for lack of jurisdiction. This is an interesting case for taxpayers and tax professionals as it covers situations that deal with how important it is to comply with the regulations and follow the filing instructions.

⁵ *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

⁶ IRC §6065 Verification of returns.

⁷ *Angelus Milling Co. v. Commissioner*, 33 AFTR 837 (USSC, 1945).

Deduction for Travel Expenses When Involved with More Than One Business

By: Ajmeri Zahan, MST Student

Brown v. Commissioner, T.C. Memo. 2019-30, is a U.S. Tax Court case issued on April 8, 2019. This case involved the IRC §162 business deduction for travel expense, where the couple were denied a deduction for the husband's weekly travel expenses from his residence to an out-of-state business location, as he failed to prove that his residence was his "tax home." An interesting fact is that the husband, who prepared the tax return, was a CPA with years of experience and training; likely indicating that these travel rules can be complex in some situations.

Deductible Travel Expenses for Business

IRC Section 162 allows a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Ordinary and necessary business expenses include "traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business." For example, travel fares, meals and lodging, and expenses incident to travel are treated as qualified business expenses. In order to determine whether a taxpayer is "away from home," the "tax home" must first be determined.¹

Tax Home

Generally, a taxpayer's "home" for purposes of section 162(a)(2), means the vicinity of his principal place of employment rather than his personal residence.² If a taxpayer has more than one place of business, the tax home is the principal place of business. Principal place of business is determined based on total time ordinarily spent in each place, level of business activity, and the significance of income. If the principal place of business is temporary, rather than indefinite, a taxpayer's personal residence may be the "tax home."³ A taxpayer who works at a temporary place of employment away from his residence may be considered "away from home" for purposes of section 162(a)(2). When a taxpayer accepts employment either permanently or for an indefinite time away from the place of his usual abode, the taxpayer's tax home will shift to the new location, the vicinity of the taxpayer's new principal place of business.⁴ In such circumstances, the decision to retain a former residence is a personal choice.

¹ IRC Section 162

² *Mitchell v. Commissioner*, 74 T.C. 578, 581 (1980)

³ *Peurifoy v. Commissioner*, 358 U.S. 59 (1958). The *Peurifoy* case was not addressed in the *Brown* case.

⁴ *Markey v. Commissioner*, 490 F.2d 1249 (6th Cir. 1974). The *Markey* case was not addressed in the *Brown* case.

Accordingly, expenses incurred in commuting from a taxpayer's personal residence to a taxpayer's business or place of employment are generally nondeductible personal expenses.⁵

Background of the Case

Michael E. Brown (H) and Miriam L. Mercado-Brown (W), Georgia residents, were denied the husband's business deductions for weekly travel expenses incurred in 2012 and 2013 between his residence in Georgia and the workplace in New Jersey. H is a CPA with an undergraduate degree in accounting and a master's degree in finance. He provides finance related services to his clients and operates a "concierge CFO business." For tax years 2012 and 2013, Mr. Brown filed returns as married filing jointly. For each of those years, he had three forms Schedule C each showing his home address in Atlanta as the business address with H as the proprietor. H did not claim any home-office deduction in any of those years.

From April 2011 to April 2012, H worked for Parkmobile USA, Inc. in Atlanta. H reported substantial gross income from Parkmobile, and a deduction of travel expense of \$7 was allowed by the IRS. During 2012 and 2013 tax year, he worked for Project Next, Inc. But, he reported no income from this source and did not claim any travel expense. He also worked for Pango USA, an Israeli technical company from 2012 to 2014 via online and reported no income for that.

H's main source of income during 2012 and 2013 was from American Furniture Rental, Inc. (AFR) where he worked as an independent contractor under a three-year consulting agreement. According to the agreement, he started working for AFR from October 2, 2012, and would continue until October 2, 2015, unless terminated. The agreement provided that AFR would reimburse H for certain business expenses, but it specifically excluded reimbursing him for any travel expense to and from Pennsauken, NJ (the business location). He worked for AFR four days a week in Pennsauken. On the 2012 and 2013 Schedule C, H reported \$37,500 and \$159,759, respectively, of compensation received from AFR and claimed deductions of \$10,065 and \$52,617, respectively, as deductions for travel expenses for the cost of his weekly travel from Atlanta to Pennsauken. H worked for AFR until August, 2014. H reported \$25,000 of income and no expense on W's 2013 Schedule C, and that income was part of his income received from AFR. The issue in this case was whether the Browns could claim a deduction for travel expenses. The answer depends on what H's tax home was during those two tax years.

The Brown's Position

The Browns claimed that during 2012 and 2013, H had worked at multiple locations and had no principal place of business. Therefore, his tax home would be his permanent residence in Atlanta. His testimony supported that he worked for three different companies: "one

⁵ *Zbylut v. Commissioner*, T.C. Memo. 2008-44.

exclusively from Atlanta (Park Mobile)”, another predominantly from Atlanta (AFR), and a third from wherever he was at the time, which more often than not was Atlanta (Pango USA)”. He also testified that most of the administrative and marketing work was performed in Atlanta.

The IRS’s Position

Mr. Brown’s tax home became Pennsauken when he executed the consulting agreement with AFR. As a result, H cannot deduct his weekly travel expenses from Atlanta to Pennsauken. For tax years 2012 and 2013, the IRS determined deficiencies of \$3,669 and \$17,905, respectively in the Brown’s federal income tax, and accuracy-related penalties of \$734 and \$3,581 for those years, respectively.

Findings of the Tax Court

Although much of the H’s work did not require him to be physically present at the business location. In the case of AFR, he had to work in Pennsauken four days a week and travel between Atlanta and Pennsauken every week keeping his residence in Atlanta. He suggested that his engagement with AFR was temporary as the agreement could be terminated by either party. But, as the agreement with AFR was for three years, he could not expect it to be concluded within a short period. Similar facts were present in *Giesbrecht v. Commissioner*, where the court decided that the “taxpayer’s contract employment was indefinite, entitling him to no deduction for traveling expenditures because contract-employment location became tax home.”⁶

From October 2012 through 2013, H’s sole source of income was AFR and he spent most of his time (four days a week) in Pennsauken working for AFR. Although he performed some work for AFR while back home in Atlanta during long weekends. He performed most of the marketing and administrative work from Atlanta. However, he performed marketing for his concierge CFO business using computer applications that could be done from anywhere. Also, he did not describe anything about the administrative work performed from Atlanta and the total time spent on it. H did not provide any evidence that the work necessitated him being in Atlanta to accomplish it. As a result, Pennsauken was H’s principal place of business as well as tax home. Mr. Brown testified that “in mid-2013, he negotiated with AFR’s CEO a change in arrangement that allowed him to work alternate two-week periods in Pennsauken and in AFR’s Atlanta office.” He also said earlier that when he first joined AFR, he was in a hotel room weekly for 17 months. The court found that these two statements contradicted each other. H failed to prove that beginning in mid-2013, he worked alternate two-week periods in Pennsauken and in AFR’s Atlanta office. He also failed to prove that in 2013 he worked less than four days a week every week in Pennsauken.

⁶ *Giesbrecht v. Commissioner*, TC Memo 1995-118

As Pennsauken was found to be H's tax home, to get a deduction for the travel expense H would have to prove that he traveled to Atlanta from his tax home for trade or business purposes. He did not claim a home-office deduction for the business use of his Georgia residence. Also, he did not describe any client meetings, or work assignments, or business-related tasks that necessitated him being in Atlanta. Thus, he failed to prove that his travel was for trade or business purposes and therefore, was disallowed for the deduction.⁷

Accuracy-Related Penalties

Since, Pennsauken was his tax home, H would not get any deduction for the expenses incurred for weekly travel from Atlanta to Pennsauken. As those expenses were not deductible, accuracy-related negligence penalties were upheld against the taxpayers for year 2012 and 2013.

For the "negligence or disregard of rules or regulations", there is an accuracy-related penalty of 20 percent of the amount of an underpayment of tax under IRC §6662.⁸ The term "negligence" means any failure to make a reasonable attempt to comply with the Internal Revenue Code and any failure to keep adequate books and records or to substantiate items properly.⁹ Negligence is also defined under *Marcello v. Commissioner*, as "lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances."¹⁰

As a CPA with an undergraduate degree in accounting, a master's degree in finance and years of experience and training, the court found that H should have been aware of "the dubiousness of [his] reporting position." The IRS satisfied the burden of production regarding the Browns' negligence about the tax home and produced a completed penalty approval form and declaration of the examiner that established timely supervisory approval. The court sustained the IRS's imposition of the accuracy-related penalties for the examination years.

Conclusion

⁷ The court referred to *Mazzotta v. Commissioner*, 57 T.C. 427 (1971), where a taxpayer could not deduct travel expenses from his place of major employment to his residence, a place of minor employment, because "the primary motivation for the taxpayer's trips from his major place of employment to his residence was personal." The court also cited *Karp v. Commissioner*, T.C. Memo. 1976-325, where the court noted that "even though a taxpayer performs some business of a minor nature at his residence, he may not deduct the expense of travel to this place of business if his travel to the place is principally motivated by a desire to return to his residence, a purely personal motive, and only incidentally by business reasons."

⁸ IRC §6662(a) and IRC §6662 (b)(1)

⁹ IRC §6662(c)

¹⁰ *Marcello v. Commissioner*, 380 F.2d 499 (5th Cir. 1967). The *Marcello* case was not addressed in the *Brown* case.

This case is a good example of “principal place of business” and “tax home” regarding §162. It’s important to determine where the business owner’s “tax home” and have supporting records to claim a business deduction “while away from home.” If a taxpayer fails to prove his/her tax home for the year in which a business deduction for travel expense is claimed, accuracy-related penalties may be imposed. Also, it’s important to determine which expenses are “ordinary and necessary business expenses” and if there is any personal interest relevant to the expenses.

Tax Treatment for Post-Retirement Payments

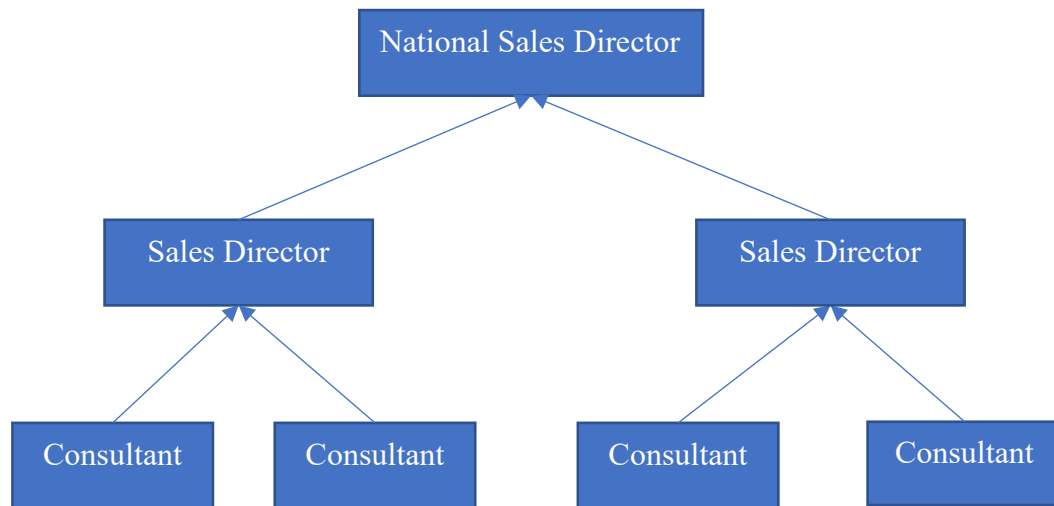
By: Xiaoyue Tan, MST Student

When there is established precedent, can a taxpayer reach a different result? On February 18, 2020 the Tax Court held that Eileen Dunlap, an ex-national sales director of Mary Kay Cosmetics, Inc., was subject to self-employment (SE) tax on her post-retirement payments from Mary Kay.¹

Background

Mary Kay Cosmetics, Inc. is a manufacturer and seller of cosmetics and related products. Ms. Eileen Dunlap was a Mary Kay beauty consultant and worked as a salesperson independent contractor. She purchased products at wholesale prices from Mary Kay and resold them at retail prices. She received commissions and bonuses from Mary Kay for the products she sold. With excellent sales skills, she became a sales director in 1981. As a sales director, she recruited and trained beauty consultants to sell Mary Kay products. She received commissions and bonuses based on the sales of the consultants in her tier. Mary Kay made monthly payments to its independent contractors, like Dunlap, and no taxes were withheld from the payments. If one of her consultants stop working for Mary Kay, Dunlap’s monthly payment was reduced. Dunlap and the consultants she recruited had agreements with Mary Kay that set forth their duties, rights, and commission structure.

Once Dunlap recruited a certain number of sales directors, she was promoted to national sales director in 1988. She had sales directors and consultants in her tier but had no direct authority over them. Mary Kay did not have an employer-employee relationship with their national sales directors, sales directors, and consultants. The flowchart below is Mary Kay’s operational structure.



¹ Dunlap, T.C. Summary Opinion 2020-10 (2/18/20).

As a national sales director, Dunlap could participate in the Family Security Program (FSP). FSP provided national sales directors with financial security when they retired. Under FSP, Dunlap's contractual relationship with Mary Kay would be terminated when she turned 65. She would then begin to receive 15 years of FSP payments based on her average sales activity as well as her tier's average sales activity. In January 2006, she was eligible to receive FSP payments. Under the agreement, she was entitled to 60 percent of her final average of commissions during her last 15 years of service. The FSP agreement stated that she was not an employee of Mary Kay.

A preamble to a July 1, 1991 FSP restatement was specifically prepared for Dunlap:

[E]ach National Sales Director desires to participate in this program in exchange for the offer by Mary Kay Cosmetics, Inc. to acquire at retirement the valuable goodwill and all other rights associated with the business, including future goodwill generated by her continued support and loyalty to Mary Kay Cosmetics, Inc.

The FSP program was funded by the general assets of Mary Kay. The FSP statement clearly stated that the plan was intended to be a non-qualified deferred compensation arrangement. It was not a qualified pension, profit-sharing, or stock bonus plan formed for the exclusive benefit of its employees or their beneficiaries. Dunlap remained retired during 2014 and 2015 and did not have any other trade or business during those years. The IRS determined that she had income tax deficiencies for 2014 and 2015 tax years because she had mistakenly reported the FSP payments as ordinary income rather than as net earnings subject to self-employment.

The sole issue before the Tax Court was whether FSP payments received by Dunlap were subject to self-employment tax.

Self-Employment Tax

Self-employment tax is the key point in this case. SE tax is imposed on the net earnings from self-employment. Reg. 1.1402(a)-1(c) defines net earnings from self-employment:

Gross income derived by an individual from a trade or business includes gross income received (in the case of an individual reporting income on the cash receipts and disbursements method) or accrued (in the case of an individual reporting income on the accrual method) in the taxable year from a trade or business even though such income may be attributable in whole or in part to services rendered or other acts performed in a prior taxable year as to which the individual was not subject to the tax on self-employment income.

In other words, SE income for the current year includes income received by a cash-basis individual. It also includes income accrued by an accrual-basis individual in the current tax year from a trade or business, even though the income may be attributed in whole or in part to work or services performed in earlier tax years. In this case, the FSP payments Dunlap received from Mary Kay were fixed based on the average tier sales activity before retirement. Therefore, Mary Kay's FSP payments to Ms. Dunlap clearly were subject to self-employment tax.

Danielson Rule

The IRS relied on *Peterson v. Commissioner*² as precedent to support that the FSP payments Dunlap received were subject to the SE tax. In the *Peterson* case, all important facts were the same as those of the *Dunlap* case. Ms. Peterson was also a national sales director who entered an FSP agreement with Mary Kay and received FSP payments. Peterson argued that the FSP payments were made in exchange for the sale of her business back to Mary Kay. However, the Tax Court decided that the FSP payments were subject to SE tax instead of capital gain tax. The Court of Appeals for the Eleventh Circuit affirmed the court's opinion. There are only two differences in these cases: their retirement year and the Circuit they reside in. Peterson retired in 2009 but Dunlap retired in 2006. For the *Peterson* case, the Court of Appeals for the Eleventh Circuit affirmed the Tax Court's opinion whereas Dunlap resided in the Ninth Circuit.

Ms. Dunlap argued that she should not be bound by the holding of the *Peterson* case because her FSP terms were different from Peterson's. She used the preamble text in the 1991 restatement which supported her argument that she sold her business or goodwill to Mary Kay and that the FSP payments were for the sale of a capital asset. Therefore, the FSP payments should be subject to capital gain tax instead of SE tax. She claimed that the preamble text in the 1991 restatement prove that Mary Kay FSP payments were made in exchange for her business and valuable future goodwill generated by her continued support and loyalty to Mary Kay.

The court referred to the *Danielson* rule:

a party can challenge the tax consequences of his agreement as construed by the Commissioner only by adducing proof which in an action between the parties [to the agreement] would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, et cetera.³

To show that her case is different from the *Peterson* case, Dunlap must present valid evidence according to the *Danielson* rule. However, there was no agreement between Mary Kay and Dunlap with respect to any sale of a business or goodwill. Except the preamble to the 1991 restatement, there was no evidence in the record that would support a sale of business or goodwill.

Conclusion

Judge Gerber held that the FSP payments Ms. Dunlap received from Mary Kay were subject to SE tax. The FSP payment amount was based on the quantity and quality of her prior labor, which was fixed. She failed to prove that her case was different from the *Peterson* case because there was a lack of a written agreement. A taxpayer needs to provide proof of different facts or legal interpretation to challenge tax consequence when there is precedent. Also, because Dunlap's case is a "small claims" one in Tax Court, there is no ability for her to appeal the decision to the Ninth Circuit Court and the case cannot be treated as precedent for any other case.⁴

² *Peterson v. Commissioner*, 827 F.3d 968 (11th Cir. 2016), aff'g T.C. Memo. 2013-271.

³ *Commissioner v. Danielson*, 378 F.2d 771 (3d Cir. 1967).

⁴ Section 7463(b).

Tax Maven

The Contemporary Tax Journal's Interview with Mr. Robert J. Kovacev

By: Liubov (Luba) Shilkova, MST Student

Robert J. Kovacev is a tax controversy partner in Norton Rose Fulbright's Washington, DC and San Francisco offices. His experience includes tax and transfer pricing controversies, tax incentives (such as the research tax credit and alternative energy tax credits), as well as the economic substance and other judicial doctrines. Prior to entering private practice, Mr. Kovacev was a senior litigation counsel with the U.S. Department of Justice, Tax Division, where he was responsible for litigating some of the largest and most complex civil tax cases in the nation. In that position, he worked closely with the Internal Revenue Service's (IRS) Large Business & International (LB&I) Division and top management of the Justice Department's Tax Division to shape litigation strategy on high-priority tax enforcement issues. The amounts at issue in each of these cases ranged from \$10 million to more than \$1 billion in claimed tax benefits. Mr. Kovacev was also lead counsel in several important summons enforcement matters, including the Wells Fargo tax accrual workpapers case.

Mr. Kovacev is Co-Chair of the Legislative and Administrative Developments Subcommittee, American Bar Association Tax Section's Civil and Criminal Penalties Committee. He is also Vice-Chair, of the Section's Tax Policy & Simplification Committee. He is a member of the SJSU Tax Advisory Board where he assists in planning for the TEI-SJSU High Tech Tax Institute and providing advice to the MST program.

Mr. Kovacev graduated *Magna Cum Laude* with a Bachelor of Arts (B.A.) degree from Harvard College in 1994. He then earned a Juris Doctor (J.D.) degree from Columbia Law School in 1997.

Mr. Kovacev is a 2009 recipient of the John Marshall Award, the highest award for trial of litigation given by the Department of Justice. He also received the Mitchell Rogovin Award for providing outstanding support to the Office of Chief Counsel by the IRS in 2009. He was recognized as the Outstanding Attorney by the Department of Justice, Tax Division in 2008, 2009, 2010. His Twitter account is recognized by Forbes as one of the top tax-related accounts.

Mr. Kovacev is a leader in the emerging field of taxation of robotics and artificial intelligence, and he frequently writes and speaks at conferences on these topics. He has authored a number of articles including "A Taxing Dilemma: Robot Taxes and the Challenges of Effective Taxation of AI, Automation and Robotics in the Fourth Industrial Revolution," *The Ohio State Technology Law Journal*, 2020; "Refund Claims: Don't Leave Money On The Table," *Tax Executive Magazine*, March 12, 2018; "International Tax Cooperation or Global Tax Chaos: Views from the Pacific Rim Tax Conference," *MNE Tax*, March 12, 2018; "Don't tax the robots," *San Francisco Chronicle*, January 21, 2018, "The Challenges of Administering a Robot Tax," *Law360*, September 25, 2017; "Expert Contributor, Topic 138, Corporate Tax Shelters: Reportable Transactions, Checkpoint Catalyst, October 1, 2015.

Mr. Kovacev has also co-authored articles such as "INSIGHT: Promise and perils of tentative refunds—tax controversy aspects of NOL carrybacks under the CARES Act," *Bloomberg Law*, April 2020; "Changes to IRS Appeals May Create Problems for Taxpayers," *Law360*, October 26, 2016; and "New Tax Litigation Troubles For Liquidating Trustees," *Law360*, May 5, 2016. Some of his speaking engagements include "Life Cycle of IRS Controversy from Cradle to Grave," TEI Houston, Houston, Texas, February 27, 2020; "Federal Tax Controversy – Campaigns and Data Analytics," 35th Annual Tax Executives Institute-San Jose University High Tech Tax Institute, Palo Alto, California, November 5, 2019; and "The Challenges of Social Media for Tax Practitioners," American Bar Association Tax Sections May Meeting, Washington, DC, May 11, 2019.

I had the pleasure to interview Mr. Kovacev online on May 8 via Zoom. Our encounter was a short, yet inspiring and memorable one. Following are Mr. Kovacev's answers to our journal's questions.

1. How did you get involved in the tax field? Was that your plan when you were in college?

No, it really was not my plan when I graduated from law school. I started out as a general civil litigator, and I was in private practice doing regular litigation cases with no particular focus on tax. In 2006, I received the opportunity to join the Tax Division at the Department of Justice. It was my first introduction to the tax side of litigation and I really enjoyed the challenge of explaining complex tax concepts to judges and jurors who were not tax experts.

2. What stands out as one or two of your most significant accomplishments in your career?

I would count my robot tax article "A Taxing Dilemma: Robot Taxes and the Challenges of Effective Taxation of AI, Automation and Robotics in the Fourth Industrial Revolution," published in *The Ohio State Technology Law Journal*, 2020 as one of my most significant achievements because it addresses a cutting edge area of law. Making a meaningful contribution to scholarship and policy in an emerging field does not come around every day, so this was a unique opportunity for me to have an impact on the future of tax. I was thrilled I had a chance to do that.

Note: *The Contemporary Tax Journal* is pleased to be able to reprint Mr. Kovacev's article in this summer 2020 issue of our journal.

3. How do you keep up to date with changes in tax law and new types of business transactions of the digital era?

I use Twitter. There is a very active tax Twitter family with people who are tax professionals: professors, CPAs, tax lawyers. This is a very insightful, very intelligent and

engaged group on Twitter dealing with tax issues. They contribute actively to public discourse about tax by discussing current events and tax policy issues, as well as everyday tax issues that they are seeing in practice. Twitter is often my first stop when I am trying to keep up with today's fast-paced environment where tax policy is changing on a daily basis.

4. What do you think is one key area of our federal or state tax system that could/should be improved and why?

I think one area is tax incentives particularly for innovation, like the research tax credit. We have a research tax credit in this country, but it is very limited, complicated, and there are all sorts of administrative and compliance burdens associated with it. So, a lot of companies just do not bother even though they are entitled to it because they are actually doing research. In comparison, other countries, for example, Ireland, China, or other economic rivals, have incentive systems for developing intellectual property, developing research and supporting innovation in industries like technology and pharmaceuticals that are more advanced than ours. So, if I were to suggest one area that we should change in terms of improving the tax system in this country, it would be coming up with an innovation tax incentive system that works.

5. What do you think is the biggest challenge facing tax professionals today?

The biggest challenge today is the speed at which everything is changing. And we are seeing this now [during the pandemic] more than ever when you find out a new tax law is being proposed, and then the next day it is passed with all sorts of new amendments. And the next day the IRS has issued some FAQs, and then the day after that the IRS changes the FAQs because events are unfolding so quickly. The biggest challenge for all tax professionals, experienced or just starting out, is keeping track of all these changes as they are happening in real time. The advice you give to your clients really depends on what the law is now, not what it was five years ago or even five days ago. So, I think this is the biggest challenge facing people: just keeping up with how quickly tax law and tax policy are changing these days.

6. What advice do you have for students preparing for a career in tax?

The practice of taxation is becoming more and more about technology, and that is dealing with robotic process automation, artificial intelligence, and data analytics. As a result, technological advances mean that you need to be aware of and proficient in these different technologies and the software. It does not mean that you need to learn how to code, but it does mean that you need to be flexible and adaptable and willing to adopt these technologies as they come forward. The pace of change technologically in the profession now is much greater than it has ever been. And if you are just starting out, you actually have an advantage because you do not have 20 to 30 years of experience looking at books, now you have to figure out how to deal with all this

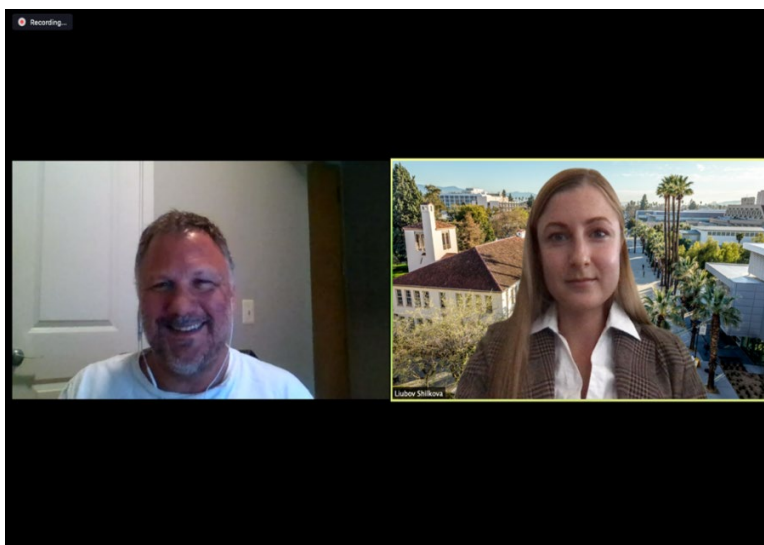
software. You are starting out right now used to this change, the challenge is you need to keep up with the change as it gets faster and faster.

7. If you could have dinner with anyone, who would it be?

I would say the physicist Richard Feynman because I remember when I was young, I read his autobiography about when he was starting out as a young professor. He was brilliant, and he received the Nobel prize in physics, but he was not one dimensional. He performed on the drums in a samba band during Carnival in Rio, he had an art exhibition of his sketches and paintings, and he was able to develop all these different talents to express himself. He was an unorthodox person, and he was able to be successful in his field and not give up all those other aspects of his personality. I really admire that. Plus, I just think he would be a fun guy to sit down and have a meal with.

8. What is the most unusual item in your office or something in it that has special meaning to you?

I spoke at the AI tax conference at The Ohio State last year, and one of the items given to the speakers as an appreciation gift was called a “tin can robot.” Basically, it is a machine that can be assembled around a soda can and this contraption can walk, crawl, and act like a mini-robot. It is fascinating to watch. So, that is the most interesting thing that I have in my office.



Robert Kovacev and Liubov (Luba) Shilkova, May 8, 2020 (during the COVID-19 sheltering-in-place time period).

Fun Tax Facts

By: Rachana Khandelwal, MST

Squirrels – Tax the Spirit!

In early 19th century in Ohio, most taxpayers spent time in the woods hunting for at least 100 squirrels in order to get a tax credit of \$3 against their property tax. The state legislature passed this unusual law to help farmers protect their animal feed stocks from this spirited animal entering their barns, and also giving them a tax break.¹

Día de Muertos



Photo Credit: Jim Kyle from Flickr

The makers of the James Bond movie, *Spectre* (2015), reportedly negotiated \$20 million worth of tax incentives for showcasing Mexico City and its skyline in the fictional 'Día de Muertos' (*The Day of the Dead*) parade scene.² Since then, the parade has become a reality, and is now an annual event bringing in more than 100,000 tourists to Mexico City.³

¹ Chris Studor, Property taxes too high? Early settlers here got a 'squirrel discount', The Post, July 21, 2018 available at http://www.thepostnewspapers.com/medina_county_news/property-taxes-too-high-early-settlers-here-got-a-squirrel-discount/article_c0d78a7b-7209-582c-a8cf-7bf787d24222.html.

²Brian Bardwell, From Mexico With Love: How Sony Got Millions in Incentives to Rewrite 007 Film, Tax Analysts, March 3, 2015; available <http://www.taxhistory.org/www/features.nsf/Articles/D0DB13181492C8E285257DFD0048BA22?OpenDocument>.

³Mexico City stages first Day of the Dead Parade, BBC, October 29, 201; available at <https://www.bbc.com/news/world-latin-america-37813562>.

Out of the Tax Arena for 37 years

Madison Square Garden, one of the world's most famous sports arenas has not paid property tax since 1982 resulting in an estimated revenue loss of over \$500 million for New York City. The tax break given to the corporation as an incentive to remain in New York City was supposed to only last for ten years, however, the city failed to insert a sunset date for the tax exemption.⁴

The Swiss Military Tax

Citizens of Switzerland must perform mandatory military service once they reach the age of 19. If deemed unfit to perform service, they are liable for a Military Service Exemption tax of 3 percent on their taxable income until the age of 37. This tax also applies to Swiss citizens residing abroad.⁵

Interestingly, Roger Federer, the world champion tennis player, was exempted from conscription and paid 3 percent tax on his annual income. In 2008, he paid 450,000 Francs, which was approximately 466,000 USD.⁶ The Federal Tax Administration of Switzerland refers to this tax as a compensation charge.⁷

⁴ The Madison Square Garden Property Tax Saga, EACCNY; available at <https://eaccny.com/news/member-news/the-madison-square-garden-property-tax-saga/>.

⁵ Military Service Exemption Tax, The Swiss Authorities Online, available at <https://www.ch.ch/en/military-service-exemption-tax/>.

⁶ LE NEWS, Roger Federer- A Few Facts, January 29, 2018; available at <https://lenews.ch/2018/01/29/roger-federer-a-few-facts/>.

⁷ Swiss Federal Tax Administration, *The Swiss Tax System*, 2019 edition, page 34; available at <file:///E:/Downloads/Das%20schweizerische%20Steuersystem.pdf>.

CPA Exam Sample Questions

The following REG questions are a sample of those released to the general public by the AICPA in 2019. They are included here with permission of the AICPA.

1. Lemon owned 2,000 shares of Spectrol Corp. common stock that were purchased in year 1 at \$10.50 per share. In year 4, Lemon received a 5% non-taxable dividend of Spectrol common stock. In year 5, the stock split 2-for-1. In the current year Lemon sold 800 shares. What is Lemon's basis in the 800 shares of stock sold?
 - a. \$4,000
 - b. \$8,000
 - c. \$8,400
 - d. \$16,800

Answer: a

2. Vale is a 50% partner in Ball Partnership. Vale's tax basis in Ball on January 2, year 1, was \$60,000. Ball did not have unrealized receivables, appreciated inventory, or properties that had been contributed by its partners. On December 31, year 1, Ball made a \$10,000 *nonliquidating* cash distribution to each partner. The Ball Partnership income tax return reported the following items for year 1:

Tax-exempt interest income	\$80,000
Dividend income	12,000

What total amount of gross income from Ball should be included in Vale's year 1 adjusted gross income?

- a. \$6,000
- b. \$16,000
- c. \$36,000
- d. \$46,000

Answer: a

3. Prime Corp. is an accrual-basis, calendar-year C corporation. Its current year reported book income before federal income taxes was \$300,000, which included \$17,000 corporate bond interest income. A \$20,000 expense for term life insurance premiums on corporate officers was incurred. Prime was the policy owner and beneficiary. What was Prime's current-year taxable income as reconciled on Prime's Schedule M-1, *Reconciliation of Income (Loss) per Books with Income per Return*, of Form 1120, *U.S. Corporation Income Tax Return*?
- a. \$320,000
 - b. \$300,000
 - c. \$283,000
 - d. \$280,000

Answer: a

4. On January 1, the partners' interest in capital, profits, and losses of Studio Partnership were:

<u>Partners</u>	<u>Percentages</u>
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Ross	15%
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Stone	35%
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Taylor	50%
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On April 9, Stone sold his entire interest to Taylor. For tax purposes, which of the following statements is correct regarding Studio's status as a partnership?

- a. Studio terminated as of January 1.
- b. Studio terminated as of April 9.
- c. Studio terminated as of December 31.
- d. Studio did not terminate.

Answer: d

Tax Policy Analysis

H.R. 5457 Carbon Reduction and Tax Credit Act

By: Madhuri Lanka, CMA, MST Student

H.R. 5457 (116th Congress), Carbon Reduction and Tax Credit Act, was introduced on December 17, 2019 by Congressman Sean Patrick Maloney (D-NY-18). The primary objective of this bill is to amend the Internal Revenue Code of 1986 by imposing an excise tax on the carbon content in various types of fuels, such as coal, oil, and natural gas, thereby encouraging people, businesses, and governments to contribute less to the global carbon footprint. In effect, the proposed bill seeks to mitigate the risks posed by the global climate change phenomenon with the least adverse impact on the economy, via penalizing the various industrial and consumer activities that use fuels with high carbon content.

Fossil fuels like coal, and natural gas, when burned, produce carbon dioxide (CO₂) – a greenhouse gas, that directly contributes to so-called *global warming* and damages the health of humans and the environment. To a certain extent, this damage can be compensated for by taxing the carbon content of the fuels at any stage in the fuel's product cycle. The bill, if enacted, would impose a tax of \$40 per ton of the carbon content in the fuel produced at a coal mine or an oil or gas well located in the United States or fuel that has entered the United States for consumption or warehousing. The bill requires the tax rate to be adjusted annually for the effect of inflation.

Currently, energy prices do not reflect the costs of greenhouse gas emissions (GHG) and the consumers of these fossil fuels do not pay for the damage caused by their contribution to carbon emissions. Instead, this cost is borne by people around the world and future generations. Imposing a carbon tax can help to address this negative externality by raising the price of energy consumption to reflect more of its social cost.

A carbon tax would be mostly borne by energy-intensive industries and low-income households. Lawmakers could use the resulting revenue from the carbon tax to offset the adverse impacts of carbon emissions, invest in clean energy, lower individual and corporate taxes, reduce the budget deficit, or for other uses. Or, as called for in H.R. 5457, the funds can be given to individuals in the form of a refundable tax credit of up to \$1,000 per person available to most individuals.

Application of Principles of Good Tax Policy

This section analyzes H.R. 5457 using the twelve principles set out in the AICPA’s *Guiding principles of good tax policy: A framework for evaluating tax proposals*.¹

Criteria	Does the proposal satisfy the criteria? (explain)	Result (+/- /NA)
<p><i>Equity and Fairness</i> – Are similarly situated taxpayers taxed similarly? Consider the tax effect as a percentage of the taxpayer’s income for different income levels of taxpayers.</p>	<p>There are two criteria in this principle to evaluate whether the tax proposal under consideration is equitable and fair. They are horizontal and vertical equities as described and applied next.</p> <p>Horizontal equity means that similarly situated taxpayers are taxed similarly. Tax incentives can cause similarly situated taxpayers to pay different amounts of tax. The issues of horizontal equity may arise if particular industries or economic sectors that predominantly emit non-CO2 GHG emissions (e.g., methane) are exempted from the carbon tax regime, while industries or sectors of comparable size are included based on their CO2 emissions. Then, there is differentiation in tax payment by similarly situated taxpayers.</p> <p>The bill also allows a refundable tax credit up to \$1,000 for each individual taxpayer and each dependent of the taxpayer. The proposal does not meet horizontal equity because similarly situated taxpayers pay different amounts of tax though their income levels are the same because use of carbon fuels is not tied to income levels. For example, CO2 emissions result from a typical passenger vehicle. Also, the credit incentive is not tied to tax indirectly paid for carbon emissions as everyone gets the same credit amount. Thus, for both the tax and the credit, horizontal equity is not met.</p> <p>Vertical equity means that taxpayers with a greater ability to pay should pay more tax than taxpayers with a lesser ability to pay. The impact of a carbon tax would differ among economic groups depending on the extent of</p>	<p>-</p>

¹ American Institute of CPAs (AICPA), Tax Policy Concept Statement 1 – Guiding Principles of Good Tax Policy: A Framework for Evaluating Tax Proposals, 2017. Available at <https://www.aicpa.org/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf>.

	<p>energy price changes and on regional energy production and consumption patterns. These factors are not related to ability to pay. For example, a high-income individual might rely primarily on solar energy and pay directly and indirectly much less carbon tax than a lower income individual.</p> <p>Also, a carbon tax would fall more heavily on workers and investors in carbon-intensive industries as well as on regions that depend heavily on carbon-intensive fuels, particularly coal. In this aspect, a carbon tax could then be viewed as regressive, meaning that the tax disproportionately impacts households with lower incomes. H.R. 5457 aims to address regressivity via a refundable tax credit of \$1,000 to each individual taxpayer and each dependent of taxpayer. However, this tax credit is the same for all individuals, and phases out if exceeds (\$157,000 of adjusted gross income (\$315,000 for a married couple filing jointly)).</p>	
<p><i>Certainty</i> – Does the rule clearly specify when the tax is owed and how the amount is determined? Are taxpayers likely to have confidence that they have applied the rule correctly.</p>	<p>H.R. 5457 clearly states the amount of tax and the tax base. The bill provides that a tax is imposed at \$40 per ton of the carbon content of coal, gas and oil well located in United States for consumption, use or warehousing. However, the bill is not clear as to who the tax is directly imposed on with the obligation to pay it to the government and how frequently it is to be remitted. It also does not state how the carbon content is to be measured.</p>	<p>+/-</p>
<p><i>Convenience of payment</i> – Does the rule result in tax being paid at a time that is convenient for the payor?</p>	<p>A carbon tax is a form of pollution tax. It levies a fee on the production, distribution or use of fossil fuels based on how much carbon their combustion emits. The government sets a price per ton on carbon, then translates it into a tax on electricity, gasoline, or oil. However, the carbon tax proposed by H.R. 5457 appears to be imposed at the time of mining or drilling or when imported into the U.S. This may not be convenient as the producer or importer has not yet realized revenue from its product. On the other hand, the producer or importer must consider this added cost which is one of the goals of the bill in aiming to reduce</p>	<p>+/-</p>

	reliance on carbon fuels. Also, the bill does not state who pays and when which makes it difficult to fully consider this principle.	
<i>Effective Tax Administration</i> – Are the costs to administer and comply with this rule at minimum level for both the government and taxpayers?	<p>The purpose of the proposal is that a well-designed tax could efficiently reduce the emissions that cause climate change, encourage innovations in cleaner technologies and, cut other pollutants. The resulting revenue could finance tax reductions, spending priorities or deficit-reduction policies that could offset the tax’s distributional and economic burdens. Ideally, a carbon tax is levied at a point where the greatest share of emissions is included in the tax base and so, a minimum number of entities is subject to the tax with respect to compliance with this rule.</p> <p>However, IRS will have new administration costs such as writing rules on how this tax is imposed and collected, new tax forms and, new audit activity to be sure that the rules are followed. In addition, the IRS will have a significant workload to ensure that the \$1,000 tax credit is properly administered.</p>	+/-
<i>Information Security</i> – Will taxpayer information be protected from both unintended and improper disclosure?	Likely no effect. The bill does not introduce any new information reporting or compliance requirements that could potentially expose more taxpayer information to third parties.	NA
<i>Simplicity</i> - Can taxpayers understand the rule and comply with it correctly and in a cost-efficient manner?	One of the major issues with a carbon tax is that it is not simple. The carbon tax fails to meet the principal of simplicity because taxpayers need to maintain new recordkeeping and producers will likely devote a good amount of time to figuring out the tax and paying it over properly. Generally, any new tax will make the overall tax system more complex than before. Also, the new credit that applies to over 100 million individual taxpayers will add complexity in understanding how it interacts with other tax provisions.	-

<p><i>Neutrality</i> – Is the rule unlikely to change taxpayer behavior?</p>	<p>The carbon tax fails to meet the principal of neutrality because it will affect the business decisions of taxpayers. The intention of the proposed bill is to levy a tax on how much carbon the use, production and distribution of fossil fuel emits. So, the bill is likely to change the behavior of businesses and individual taxpayers to use fewer carbon-based fuels in their production or use at coal mines, gas and oil. Thus, the proposal does not meet the principle of neutrality although the sponsor’s intent is to affect decision-making.</p>	<p>-</p>
<p><i>Economic growth and efficiency</i> – Will the rule not unduly impede or reduce the productive capacity of the economy?</p>	<p>A carbon tax aims to make individuals and firms pay the full social cost of carbon pollution. In theory, the tax will reduce pollution and encourage more environmentally friendly alternatives. However, critics argue a tax on carbon will increase costs for business and reduce levels of investment and economic growth. The proposed bill has a neutral effect on this principle having both pros and cons. The pros such as encouraging firms and consumers to look for alternatives, e.g. solar power, raising revenue which can be spent on mitigating effects of pollution, reducing environmental costs associated with excess carbon pollution. The efforts to find energy alternatives can create jobs. The cons such as higher tax can discourage investment and economic growth. It may also cause some firms to shift production to countries without a carbon tax.</p>	<p>+/-</p>
<p><i>Transparency and Visibility</i> – Will taxpayers know that the tax exists and how and when it is imposed upon them and others?</p>	<p>The carbon tax does not meet the principal of transparency and visibility. This is because the tax laws and rules are unnoticeable to taxpayers unless the government, IRS or EPA takes some effort to publicize the information regarding the carbon tax added to the price of fuels that the producers or importers use, produce and distribute in gas, oil and coal mines. Consumers are unlikely to realize why the prices of certain fuels increased unless they are provided with the information about carbon tax and the refundable tax credit they will be getting. It is crucial to highlight such information especially on tax returns so that</p>	<p>-</p>

	<p>the taxpayers understand the increases in credit amounts while indirectly making tax payments of the carbon tax.</p>	
<p><i>Minimum tax gap</i> – Is the likelihood of intentional and unintentional non-compliance likely to be low?</p>	<p>The number of taxpayers will be smaller than if the tax were owed directly by consumers. Also, the producers subject to the tax tend to be large sophisticated taxpayers who are able to comply with tax obligations. Thus, noncompliance is unlikely to occur, and the tax gap is expected to be low.</p> <p>On the other hand, there could be a chance for non-compliance with respect to individual taxpayers based on these issues: trying to get maximum refundable tax credit, or giving misleading information about dependents though there are no such people in reality. This may happen because the refundable tax credit amount is \$1,000 to each taxpayer and to each dependent of that taxpayer. People may be enticed to get a maximum credit and try to produce incorrect information to obtain a greater credit than allowed.</p>	<p>+/-</p>
<p><i>Accountability to taxpayers</i> – Will taxpayers know the purpose of the rule, why needed and whether alternatives were considered? Can lawmakers support a rationale for the rule?</p>	<p>The lawmakers have a strong rationale for this bill because rising carbon emissions create a host of potential economic and environmental threats, including human health risks, reduced agricultural productivity, and, ecosystem deterioration. Thus, policymakers are trying to establish a price on carbon emissions by levying a tax.</p> <p>It is essential for the lawmakers to explain the purpose and scope of the bill to taxpayers. Otherwise taxpayers might not understand why it is proposed and why they will receive a refundable tax credit.</p>	<p>+/-</p>
<p><i>Appropriate government revenues</i> – Will the government be able to determine how much tax revenue will</p>	<p>The carbon tax bill does meet the appropriate government revenues principal because government could easily measure how much to be raised by the carbon tax and how much the credit will cost. Government will have all the necessary information as to how much carbon-based fuels we consume now. In addition, the amount of tax credit to</p>	<p>+</p>

likely be collected and when?	be claimed can be reasonably estimated on the extensive taxpayer data the IRS has.	
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Rating Summary

The table below summarizes the ratings of how H.R. 5457 stacks up against the principles of good tax policy.

Criteria	Result
Equity and Fairness	-
Certainty	+/-
Convenience of payment	+/-
Effective Tax Administration	+/-
Information Security	NA
Simplicity	-
Neutrality	-
Economic growth and efficiency	+/-
Transparency and Visibility	-
Minimum tax gap	+/-
Accountability to taxpayers	+/-
Appropriate government revenues	+

Conclusion

Based on the above analysis, H.R. 5457 has neutral and negative effects on all the tax policy principles except appropriate government revenues. The intention of the bill is to reduce the carbon dioxide emissions and to encourage people, businesses and governments to contribute less to the global carbon footprint. The bill proposes to impose \$40 per ton on the carbon content contained in fuels that are produced in coal, gasoline and oil located in United States. The Tax Policy Center estimates that this amount of carbon tax would increase gas prices by 36

cents per gallon.² The rationale behind this bill is that increasing the cost of carbon-based fuels will motivate companies to switch to clean energy. These include solar energy, wind energy, and hydro-powered sources. The carbon tax will also increase the price of gasoline and electricity to encourage consumers to choose energy-efficient appliances and activities, and further reduce greenhouse gas emissions.

H.R. 5457 takes into account that a carbon tax would fall more heavily on workers and investors in carbon-intensive industries as well as on regions that depend heavily on carbon-intensive fuels, particularly coal, and takes necessary steps to address this disparity. It should be seen that the low-income taxpayers who pay higher taxes would get refundable tax credits. To this effect, the bill proposed to allow a refundable credit of \$1,000 for each taxpayer and dependent of each taxpayer subject to thresholds. The sponsors should evaluate and explain the reason for this large credit and why it is not connected to any effort to reduce use of carbon-based fuels.

A carbon tax offers several means to combat the problems caused by carbon emissions. As discussed in this article, there are challenges in designing and administering an effective carbon tax policy that meets the principles of good tax policy. Yet, some improvements can be made as noted here in addition to clarifying the terminology used in the bill.

² Tax Policy Center, Briefing Book, What is a carbon tax?; available at <https://www.taxpolicycenter.org/briefing-book/what-carbon-tax>.

Tax Policy Analysis

H.R. 4286 (116th Congress) - Virtual Apprenticeship Tax Credit Act of 2019

By: MST Students in BUS 223A Tax Research Class for Fall 2019¹

Representative Ted Budd recently introduced the *Virtual Apprenticeship Tax Credit Act of 2019* in September 11, 2019. This proposal would add IRC section 45T to provide taxpayers a credit for 30 percent of the qualified virtual training expenses paid or incurred during the tax year, up to \$2,500 tax credit per year.

What is a Virtual Apprenticeship?

Students who may not live close to college or be able to physically attend classes can enroll in the virtual apprenticeship program to develop skills that align with the continually changing workforce. The virtual apprenticeship program provides an engaging experience in a virtual environment for job training and professional development. The qualified virtual training expenses related to the virtual apprenticeship program can generate a 30 percent credit. H.R. 4286 defines these expenses as “related to developing or expanding an industry-recognized virtual apprenticeship program for elementary and secondary school students.”

What is the Purpose of H.R. 4286?

There are millions of Americans who are unemployed even though there are many jobs that remain unfilled. Many employers struggle to find employees with the necessary skills. Most students obtain a four-year degree, but they still graduate without the skills that employers want. There are not many alternative options for post-high school graduates except earning an associate’s or bachelor’s degree. To resolve this issue, Rep. Budd proposed the *Virtual Apprenticeship Tax Credit Act of 2019* to encourage employers to provide virtual apprenticeship programs to students while in grades K to 12:

I introduced this bill with the hope of incentivizing businesses to invest in the recruitment and training of a stronger and more competent workforce for future generations. By offering a tax credit to employers who invest in the funding of virtual apprenticeship programs, more diverse learning options will be available to students from all backgrounds.²

How Does This Bill Work?

¹ This article was assembled and finalized by MST student and journal editor Xiaoyue (Tina) Tan using notes from her classmates.

² “Rep. Budd Introduces Bill to Increase Virtual Apprenticeships.” U.S. Congressman Ted Budd, September 11, 2019. <https://budd.house.gov/news/documentsingle.aspx?DocumentID=646>.

Under H.R.4286, any business that develops or expands an industry-recognized virtual apprenticeship program for elementary or secondary school students can get a virtual apprenticeship tax credit. This general business credit is equal to 30 percent of the qualified virtual training expenses paid or incurred during the taxable year, limited to a credit of \$2,500 per year. There is no double benefit allowed so these expenses cannot generate any other deduction or credit, up to the virtual training credit claimed.

Application of Principles of Good Tax Policy

The following section applies the twelve principles of good tax policy to *Virtual Apprenticeship Tax Credit Act of 2019* by MST students. These principles were laid out in the AICPA’s *Tax Policy Concept Statement No.1-Guiding Principles of Good Tax Policy: A Framework for Evaluation of Tax Proposal*.³

Principals of Good Tax Policy

Criteria	Does the proposal satisfy the criteria?	+/-
<p>Equity and Fairness – Are similarly situated taxpayers taxed similarly? Also consider any different effects based on an individual’s income level and where they live.</p>	<p><i>Horizontal Equity and Fairness:</i> Taxpayers with similar abilities to pay should pay the same amount of tax. H.R. 4286 proposes a credit only for businesses for certain virtual training expenses related to elementary and secondary school students. It is not available to all taxpayers even though a non-business taxpayer could also incur the training expenses. Thus, comparing businesses and individuals of similar income, H.R. 4286 does not meet horizontal equity and fairness. Another aspect of horizontal equity that is not met is that the credit is only for expenses for providing training to K to 12 students and not other individuals. If the virtual apprenticeship program is offered to college students, the business cannot get this credit.</p> <p><i>Vertical equity and fairness:</i> Taxpayers with a greater ability to pay should pay more tax. The virtual apprenticeship tax credit is 30% of the qualified virtual training expenses paid during a taxable year, up to a maximum amount of \$2,500 and is nonrefundable. If a business spends \$8,334 on qualified virtual training expenses, it can offset \$2,500 of its tax liability. If a taxpayer spends more than \$8,334, the credit is capped at \$2,500 despite the higher spending.</p>	<p>-</p>

³ American Institute of Certified Public Accountants (AICPA) Tax Division. (January 2017). *Tax Policy Concept Statement No.1-Guiding Principles of Good Tax Policy: A Framework for Evaluation of Tax Proposals*; available at <https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf>

	The proposal does not satisfy the equity and fairness principle.	
Certainty – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?	Under the certainty principle, the tax rules should clearly specify how the amount of payment is determined, when payment of the tax should occur, and how payment is made. H.R. 4286 clearly specifies that the virtual apprenticeship tax credit is 30% of the qualified virtual training expenses paid during a tax year. However, the bill does not define “industry-recognized virtual apprenticeship program.” Thus, taxpayers will not know what expenses qualify. Therefore, the proposal does not fully satisfy the certainty principle.	+/-
Convenience of payment – is the tax due at a time that is convenient for the payor?	A tax payment should be convenient for the taxpayer to pay at a time or in a manner. The more difficult a tax is to pay, the more likely that payment will not happen. The virtual apprenticeship tax credit is a type of general business credit which may be claimed on the tax return. Taxpayers can accurately estimate the amount of this credit before filing their tax return, so the bill does satisfy the convenience principle. If the bill is approved, the IRS may add a line to Form 3800 for this credit. Therefore, If the bill is passed, the credit is calculated on the business’s tax return and can be considered in computing estimated tax payments for the tax year.	+
Effective Tax Administration – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change.	Under the effective tax administration principle, costs to collect a tax and comply should be kept to a minimum for both the government and taxpayers. Virtual apprenticeship tax credit is relatively new, so there is new work for the IRS in issuing guidance and likely, a new tax form. The proposal does not satisfy this principle because the costs of government administration could be high.	-
Information Security – Will taxpayer information be protected from both unintended and improper disclosure?	It is necessary to protect taxpayer information from all forms of unintended and improper disclosure. The proposal does not mention any consideration of preventing identity theft. It is not clear whether the beneficiaries of the programs created by businesses will need to be reported by the business. As long as students’ personal information and employers’ confidential information are not disclosed, the proposed tax rule likely satisfies the information security principle.	+

<p>Simplicity – can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?</p>	<p>Simplicity is important so that taxpayers can understand the rules and easily comply with them. Complex tax rules can increase the possibility that tax liabilities will not be properly determined. In H.R. 4286, the calculation is relatively straight forward</p> <p>However, the definition of qualified virtual training expense is not clear. The bill defines that “qualified virtual training expenses as expenses related to developing or expanding an industry-recognized virtual apprenticeship program for elementary and secondary school students.” It does not define what that type of program is and does not clearly specify which fields of industry qualify and which do not. It also does not explain if indirect expenses related to developing an industry-recognized virtual apprenticeship program qualify for this credit. In this case, the proposal does not satisfy the simplicity principle.</p>	<p>-</p>
<p>Neutrality – The effect of the tax law on a taxpayer’s decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.</p>	<p>The purpose of the neutrality principle is to ensure that a taxpayer’s decision is not affected by a tax rule. In this case, Rep. Budd is trying to encourage employers to develop virtual apprenticeship programs to train K to 12 students for future work. It does not offer a credit for other job training programs. Thus, it violates the neutrality principle by influencing business’ decisions on creation and design of job training programs.</p>	<p>-</p>
<p>Economic growth and efficiency – will the tax unduly impede or reduce the productive capacity of the economy?</p>	<p>If a tax rule unduly impedes or reduces the productive capacity of the economy, it does not satisfy the economic growth and efficiency principle. H.R. 4286 introduces a virtual apprenticeship tax credit. Online programs could save costs of school supplies, transportation, and housing. It might increase the productive capacity of the economy by helping young people gain important job skills before they graduate from high school.</p> <p>An unknown factor is whether this new K to 12 job training will result in fewer students going to college which could lead to an increase in unfilled jobs requiring a college education.</p>	<p>+</p>
<p>Transparency and Visibility – Will</p>	<p>A tax rule should be visible to taxpayers so that they can figure out their tax liability in advance. Eligible taxpayers</p>	<p>-</p>

<p>taxpayers know that the tax exists and how and when it is imposed upon them and others?</p>	<p>should know that this credit exists and how to qualify for it and claim it. In this case, taxpayers might not be aware there is a credit for virtual apprenticeship program. This proposal is relatively new, and it is not mandatory for taxpayers. Rep. Budd wants to use this proposal to influence taxpayer’s behavior to improve job skills among more people. To achieve this goal, the government must spread awareness of this credit.</p>	
<p>Minimum tax gap – is the likelihood of intentional and unintentional non-compliance likely to be low? Are there any way people may intentionally or unintentionally avoid or evade this tax or rule?</p>	<p>A good tax rule should minimize the tax gap. In this case, calculation for the virtual apprenticeship tax credit is simple and clear. Even though non-compliance may happen because of unclear definitions of qualified virtual training expenses, the likelihood of intentional and unintentional non-compliance is relatively low and the IRS can issue even preliminary guidance before the effective date.</p>	<p>+</p>
<p>Accountability to taxpayers – Do taxpayers have access to information on tax laws and their development, modification, and purpose; is the information visible?</p>	<p>Taxpayers should have access to information on tax rules to understand the purpose and modification of the rules. Rep. Budd states clearly the purpose of this credit is helping students develop skills that align with the rapidly evolving workforce. We do not know though how virtual apprenticeship programs work and what makes them effective. It is also not clear why Rep. Budd believes this credit will incentivize businesses to develop the programs. The proposal does not satisfy the accountability principle.</p>	<p>-</p>
<p>Appropriate government revenue – will the government be able to determine how much tax revenue will likely be collected and when?</p>	<p>The government needs to be able to reasonably estimate tax revenues which should be generated in a stable and reliable way so that government can have flexibility to adjust budgets for changing needs. The virtual apprenticeship tax credit is relatively new, so government cannot determine the amount of credit which would be claimed in taxable year. There is no other comparable tax credit. Also, it likely cannot determine whether the maximum \$2,500 is the right amount to provide an appropriate economic benefit from virtual apprenticeship programs created by the credit. Therefore, it may be difficult to estimate how much taxpayers’ tax liability would be reduced; in other words, how much government revenue will be decreased. The appropriate government revenue principle is not satisfied.</p>	<p>-</p>

Summary

H.R. 4286 only satisfies five out of the twelve principles of good tax policy. The virtual apprenticeship program might help students save on education-related costs and provide more educational opportunities. The proposal might increase the productive capacity of the economy by better ensuring a ready workforce for the future. When thousands of people have jobs, the consumption ability will increase. Government can collect more taxable income because of higher economic growth.

Some changes can be made to meet more principles. For example, all terms should be defined in the new rule to reduce uncertainty.

Also, most people do not know what a virtual apprenticeship is and the benefit of providing them to K to 12 students and why a tax credit is a good technique for creating these programs relative to other approaches. Presenting data on these matters can help the proposal meet the accountability to taxpayers' principle. In addition, to better meet the equity principle, more taxpayers should be eligible for the credit.