Lost in Translation

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The Assignment

From its inception, the Tax Code has limited taxpayer ability to claim certain losses. Over the past 100 years, tax authorities have introduced a variety of loss limiters aimed at a number of different practices, adding significant complexity to the code and imposing burdens on taxpayers and their advisors. 

This panel explores these provisions, focusing on the purported ills that motivate them, the features of the tax code that make them necessary, and the mechanisms they employ. The goal is to explore proposals to rationalize and perhaps simplify the Code's current scattershot approach.
Omitted Material

• General Anti-Abuse Rules
  – Substance over Form
  – Step-Transaction Doctrine
  – Economic Substance
  – Other statutory provisions granting the IRS the authority to recharacterize transactions
A Taxonomy of Loss Provisions
Preventing Loss Transfers

- IRC § 1051 (gifts – shifting basis)
- IRC §§ 172 and 382 (NOLs – control/continuity/value)
- IRC § 704(c) (partnership pre-contribution G/L allocations)
Deducting Personal Losses

• IRC §§ 165(c), 262

• Treas. Reg. § 1.165-9 (converted property – shifting basis)

• IRC § 183 (hobby losses – schedular)
Protecting the Realization Requirement

- IRC § 1091 (wash sale rules – disallowance/basis adjustment)
- IRC § 267 (related party sales – disallowance/nonrecognition of gain)
- IRC § 707(b)(1) (partnership related party sales – disallowance/nonrecognition of gain)
- Treas. Reg. §§ 1.1001-1(e), 1.1015-4 (part gift/part sale – disallowance/basis shifting)
- IRC § 1041 (spousal Xfer – nonrecognition/basis transfer)
Tax Alchemy and Capital Losses

IRC § 1211 (schedular approach to capital losses)
Preventing Noneconomic Losses

- IRC § 704(b) (Partnership Subst. Econ. Effect - Reallocation)
- IRC §§ 704(d), 1336(d) (losses limited to basis – Disallowance/carryover)
- IRC § 465 (at risk – Disallowance/carryover)
- IRC § 469 (passive activity losses – Disallowance/carryover)
Corporate Loss Limiters

- IRC § 351 (formation - nonrecognition/Xfer basis)
- IRC § 311 (distributions – disallowance/basis reset to FMV)
- IRC § 336(d) (liquidations – disallowance/basis reset to FMV)
- IRC § 362(e) (formation – basis reduction on contribution)
- Consolidated Return Regs/Ilfeld (no doubling losses)
Hidden Tax Increases

IRC § 68 (deduction limitations)

IRC § 361(1) (non-corporate loss limitations)
Give up on goals

• Allow loss transfers
• Allow deductions of personal losses
• Don’t protect the realization requirement
• Allow tax alchemy
• Allow tax and economic results to deviate
• Allow doubling of losses in corporate context
Eliminate the Causes

- Realization requirement
- Annual accounting period
- Preferential rates for capital gains
- Global approach to gains and losses
- Taxpayer unit
- Classical corporate tax system
- Inclusion of debt in basis
What Works?

• Basis shifting

• Passive Activity Loss Rule, but…
  – Underinclusive (doesn’t apply to corporations)
  – Overinclusive (suspends real losses)
Specific Reform Proposals

• Eliminate hidden tax increases (IRC § 461(l))
• Reassess whether we need all the rules designed to match tax and economic results
• Eliminate duplication and incoherence in the corporate loss limiting rules
• Use consistent language across different sections/regs
Other Possible Solutions
Thank You