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The *Nacchio* Refund: $17.8 Million Less Than Meets the Eye?

By Donald P. Board

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In this article, Board examines the decision of the Court of Federal Claims in *Nacchio v. United States* and concludes that there was no statutory basis for the taxpayer to claim an $18 million tax credit under section 1341.

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The government's appeal in *Nacchio v. United States*,[1] an $18 million tax refund case, is now pending before the Federal Circuit. Joseph P. Nacchio was the hard-charging CEO who presided over the spectacular rise — and precipitous collapse — of Qwest Communications International Inc. in the early 2000s. The ensuing investigation revealed that in the spring of 2001, Nacchio exercised options to purchase several million Qwest shares, which he immediately sold at the prevailing market price. According to the SEC, Nacchio sold the shares knowing that the market price was grossly inflated by Qwest's misrepresentations regarding the nature and sources of its revenues. When word of those irregularities began to leak out, Qwest's stock price started to slide. By the summer of 2002, it had fallen by more than 90 percent.

Nacchio was indicted and convicted in 2007 on 19 counts of insider trading. He served 70 months in federal prison, paid a $19 million fine, and forfeited $44.6 million in illegal trading profits. That may not sound like the recipe for an $18 million refund, but Nacchio is evidently not the sort of person who gives up easily.

[1] 115 Fed. Cl. 195 (2014).

The tax case began when Nacchio amended his federal income tax return for 2007 (the year of the $44.6 million forfeiture) to claim an $18 million refund.[2] His refund claim was based on section 1341, a relief provision that can give taxpayers the equivalent of a refundable credit for tax paid in an earlier year on an item of income that they were required to surrender in the current tax year.

Nacchio had reported $44.6 million on his 2001 return in connection with his stock transactions and paid $18 million in tax. He forfeited his $44.6 million in insider trading profits in 2007. This, according to Nacchio, entitled him to an $18 million "credit" under section 1341 for the tax he had paid in 2001.

This is the kind of story ("Convicted CEO Demands $18 Million Tax Refund") that pushes people's buttons. The government appears to have been no exception, and the IRS declined to hand over the money. When Nacchio sued for his refund in the Court of Federal Claims, the government did not wait to conduct discovery; it simply moved for summary judgment.[3]

The government's motion focused squarely on Nacchio's well-publicized criminal conviction and its implications for his right to invoke section 1341. Under section 1341(a)(2), a taxpayer cannot claim a credit for taxes previously paid unless he has an independent basis for deducting the amount surrendered in the current tax year. Thus, Nacchio would have had to establish his right to deduct his $44.6 million criminal forfeiture.

That must have struck the government as next to impossible. Section 162(f) bars the deduction of "any fine or similar penalty paid to a government for the violation of any law."[4] This rule reflects the

[2] Nacchio actually filed a joint return with his wife, but for simplicity, let's disregard that fact.

[3] Nacchio responded with his own motion for partial summary judgment.

[4] Section 162(f) literally applies only to attempts to deduct a fine or similar penalty as a business expense under section 162(a). Deducting a fine or similar penalty as a loss under section 165 is usually said to be prohibited by reg. section 1.165-1(a), which states that a loss deduction is subject to any provision of the internal revenue laws "which prohibits or limits the amount of the deduction" — language that arguably picks up the prohibition in section 162(f).

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public policy against letting wrongdoers use the tax system to reduce the sting of sanctions intended to punish them.

Nacchio would also have had to satisfy section 1341(a)(1), which includes the so-called claim of right requirement: It must have appeared that the taxpayer had an unrestricted right to the item in the earlier year. But a jury had found Nacchio guilty, beyond a reasonable doubt, of *willfully* violating the securities laws. This verdict meant that Nacchio knew his stock sales were illegal in 2001. Given the doctrine of collateral estoppel (issue preclusion), it would have seemed impossible for Nacchio to argue that he received his $44.6 million insider trading profit under the required claim of right.

The Court of Federal Claims, however, saw the case very differently. Judge Mary Ellen Coster Williams flatly denied the government's motion for summary judgment on both of the issues it raised. She then entered partial summary judgment for Nacchio. She held that he could deduct his $44.6 million criminal forfeiture as a loss under section 165(c)(2). Moreover, he was entitled to a trial on whether he had received his insider trading profits under a claim of right.

The case is now before the Federal Circuit, the parties having agreed to skip the claim of right trial and go straight to the appeal.[5] The Federal Circuit may well reverse both of the lower court's holdings. However, this article examines a more basic question: Even assuming that Nacchio was entitled to deduct his criminal forfeiture and that he received his illegal trading profits under a claim of right, did he really have a case under section 1341?

Section 1341(a) and the 'Item' Concept

We are dealing with a statute, so we need to take seriously the actual language and structure of section 1341. This requires us to analyze the *Nacchio* situation using the concept central to the operation of section 1341: the "item" of income. This statute-based analysis reaches a result that neither the claims court nor the parties appear to have considered.

To claim a credit under section 1341, a taxpayer must satisfy two[6] basic requirements:

- under section 1341(a)(1), there must be "an item [that] was included in gross income for a prior taxable year . . . because it appeared that the taxpayer had an unrestricted right to such item";[7] and
- under section 1341(a)(2), there must be a deduction "allowable for the taxable year because it was established after the close of such prior taxable year . . . that the taxpayer did not have an unrestricted right to such item."

If these two requirements are met, the tax due for the current tax year is the lesser of two amounts:

- the tax for the current tax year calculated with the deduction;[8] or
- the tax for the current tax year calculated without the deduction but reduced by the amount of tax that the taxpayer would have saved in the prior tax year "solely from the exclusion of such item . . . from gross income for such prior taxable year."[9]

This second alternative — reducing the current year's tax by the amount of tax the taxpayer would have saved if he hadn't included the item in a prior year — is the section 1341 credit.

Section 1341 requires us to identify the item to which the statute refers in the two basic requirements and in the operative provision actually allowing the credit for taxes paid for that item. Whatever item we identify must play three roles.

First, the item must have been included in gross income in an earlier tax year under a claim of right. Second, it must be established that the taxpayer did not have an unrestricted right to this item, and that fact must trigger a deduction in the current tax year. Third, the section 1341 credit must be calculated by determining how much the taxpayer would have saved if he had not included the item in gross income in the first place.

The tax law does not provide an official, comprehensive definition of the term "item." However, this is a term (and a concept) in constant use. We don't need a formal definition to apply section 1341. We just need to bear in mind that an item is not simply

[5]Some press accounts have speculated that the government wanted to avoid a trial because Nacchio was expected to testify that his prosecution (as well as Qwest's collapse) was in retaliation for his refusal to cooperate with the National Security Agency on some surveillance-related matters. *See, e.g.*, Janet Novack, "U.S. Avoids Trial On Ex-Qwest CEO's NSA Claims With $18 Million Tax Refund Deal," *Forbes*, May 1, 2015. The government has stated that it wants to expedite review of the claims court's holding that criminal forfeitures can be deducted under section 165(c)(2). Given the doubtful status of that holding, the government's explanation seems more plausible.

[6]There is actually a third requirement: The taxpayer's deduction referred to in section 1341(a)(2) must exceed $3,000. Section 1341(a)(3). Because that requirement is not an issue in *Nacchio* or presumably anywhere else, we can ignore it.

[7]The second clause ("because it appears . . .") is the claim of right requirement. For present purposes, it is unnecessary to resolve or even take a position on any of the controversies concerning what is required for an item to be included in gross income under a claim of right. Let's simply assume that any item that Nacchio actually reported satisfied this requirement.

[8]Section 1341(a)(4).

[9]Section 1341(a)(5).

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a number of dollars. We may enter a bare "$52,344.76" on a tax return, but to enter it in the right place, we need to know more — for example, that it represents $52,344.76 of long-term capital gain from the sale of a collectible. Section 1341 requires us not only to consider how much the taxpayer included in gross income in the prior year but also to keep track of what those amounts represent.

Identifying the 'Items Included in Gross Income'

The government did not conduct any discovery, so Nacchio's tax return for 2001 never made it into the record. The claims court had to rely on the parties' pleadings, motions, and briefs, supplemented by accounts of that year's events in the judicial opinions from Nacchio's criminal case.

The big picture must have seemed clear enough. Nacchio had been convicted of insider trading in connection with his sale of 1.33 million Qwest shares in 2001. He had made a $44.6 million profit from the sales, which he forfeited in 2007. Now he was seeking to recover the $18 million in tax he had paid on the gain he made when he sold the shares.[10]

Based on the skeletal record before it, the claims court concluded that Nacchio had reported $44.6 million in "net gain" from the stock sales on his 2001 joint tax return and paid $18 million in taxes on that gain.[11]

On this view of the facts, the item that Nacchio included in 2001 was $44.6 million in capital gain. The only issue under section 1341(a)(1) was whether he had included this massive item of capital gain under a claim of right. The only issue under section 1341(a)(2) was whether Nacchio was entitled to deduct the loss he suffered in 2007 when he was required to surrender his $44.6 million insider trading profit. If he were to prevail on both these issues, Nacchio would be entitled to a credit under section 1341(a)(5) for the $18 million in tax he would have saved if he had not included $44.6 million of gain on his 2001 return.

This all sounds plausible enough. Yet the claims court's view of the case rests on a basic misunderstanding of the facts. Even without access to Nacchio's 2001 return, it is clear that he never reported anything close to a $44.6 million item of gain from his illegal stock sales.

The 1.33 million Qwest shares that Nacchio sold were not sitting in a brokerage account. If he wanted to sell, say, 100,000 Qwest shares, he would order his broker to sell 100,000 shares short. Simultaneously, he would cover his position by exercising 100,000 of his several million Qwest options.

The options had been granted to Nacchio as part of his CEO compensation package, so their exercise was a taxable event. For each option exercised, Nacchio realized an item of compensation income equal to the current option spread — that is, the excess of the market value of the share he received (which fluctuated between about $37 and $41 per share) over the price he paid Qwest to get it ($5.50). Even if Nacchio had exercised all his options when Qwest shares were trading at the bottom of this range ($37), the spread per share would still have been $31.50. Multiplying that by 1.33 million shares tells us that Nacchio realized at least $41.9 million in compensation income upon exercise.

Thus, whatever else Nacchio may have reported in 2001, his return would have included a very large item of compensation. Moreover, Nacchio would have reported this compensation income even if he had decided not to sell *any* of the Qwest shares he received when he exercised his options.

But Nacchio did sell his shares, which is what caused all the trouble with the SEC. Those stock sales, legal or not, were also taxable events. This means that Nacchio would have reported a second tax item in 2001 — namely, the capital gain or loss he realized from the sales. How much gain or loss did Nacchio actually report?

Without access to his 2001 tax return, there is no way to know for sure. Still, it was certainly not the $44.6 million gain the claims court supposed. The most likely answer is that Nacchio reported a small capital *loss*.

Nacchio tried to exercise his options and sell the resulting shares at the same time. Because he was taxable on his receipt of the shares, he would have held them, however briefly, with a basis equal to their fair market value upon purchase. When Nacchio sold the shares, his amount realized for tax purposes would have been the total sale proceeds

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[10]Nacchio staked out this version of the facts in the preliminary statement of his opening brief:

> The issue that this case presents is whether the Plaintiffs . . . are entitled under Section 1341 . . . to a refund in the amount of [$18 million] representing taxes that they paid in 2001 on gain attributable to Mr. Nacchio's sales that year of stock of Qwest Communications International, Inc. ("Qwest"). The Plaintiffs seek such a refund because Mr. Nacchio, as part of his sentence upon his conviction for insider trading, was made to forfeit [$44.6 million] in gain from such sales, on which Mr. Nacchio in 2001 had paid the [$18 million] in tax. The Plaintiffs contend that under Section 1341, they are entitled to a refund of the tax they paid in a previous year on income that they ultimately did not keep.

Brief of Plaintiffs in Opposition to the Motion of the United States for Summary Judgment and in Support of Plaintiffs' Cross-Motion for Partial Summary Judgment at 1-2, *Nacchio*, 115 Fed. Cl. 195 (2014) (No. 12-20T).

[11]115 Fed. Cl. at 198.

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(the market value of the shares at the time of sale) reduced by his selling expenses — $60,081 in brokerage fees.[12]

If Nacchio actually managed to purchase and sell his Qwest shares simultaneously, the two market values would have been the same. In that case, his amount realized from the sales would have been $60,081 less than his basis. Nacchio's 2001 return would therefore have reported a $60,081 item of short-term capital loss.

However, for the sake of illustrating the operation of section 1341, let's assume that Nacchio's purchases and sales were not quite simultaneous and that the market price of Qwest stock actually increased slightly during the gap periods. Let's posit that Nacchio sold his shares for $560,081 more than their market price when he bought them. This is just enough to leave him with a short-term capital *gain* of $500,000.

On this assumption, Nacchio's sales of his Qwest shares would have cost him about $200,000 in tax.[13] To be consistent, let's also assume that the aggregate spread on his options was about $44.1 million.[14] By the same token, let's assume that he paid about $17.8 million in tax in connection with their exercise.[15]

To summarize, Nacchio included *two* items in gross income for purposes of section 1341(a)(1). The first was $44.1 million in compensation realized when he exercised his options and received his 1.33 million shares of Qwest stock. The second was the $500,000 item of short-term capital gain we assume he realized when he sold those same shares a short time later.

Nacchio's 2007 Deduction

Tax law and securities law are distinct. As far as the IRS is concerned, Nacchio's stock sales netted him only a small gain — $500,000, as discussed above. But from a nontax perspective, the stock sales generated a $44.6 million profit, the full difference between what Nacchio paid for the shares and what he got when he sold them. Let's call this Nacchio's "SEC gain" to distinguish it from his gain in the tax sense.

In 2007 Nacchio was convicted of insider trading and required to surrender his $44.6 million SEC gain. The claims court held that he was entitled to deduct his loss under section 165(c)(2), even though the entire amount represented a criminal forfeiture. The Federal Circuit will decide whether this was the correct result. For current purposes, however, let's assume that Nacchio was entitled to the deduction.

According to section 1341(a)(2), an item included in a prior tax year cannot trigger a credit under section 1341(a)(5)(B) unless the taxpayer is able to identify a deduction to which he is entitled in the current tax year "because it was established . . . that the taxpayer did not have an unrestricted right to such item." As a relatively unproblematic example, suppose that Qwest had simply awarded Nacchio stock worth $44.6 million in 2001 and that he had not sold any shares. He would have included a $44.6 million item of compensation in gross income in 2001, as described in section 1341(a)(1). This would have triggered $18 million in tax and given him a $44.6 million basis in the shares.

Further, suppose that in 2007 Qwest shareholders had successfully challenged the stock award under a previously unnoticed provision of the corporate charter prohibiting those awards and that Nacchio had surrendered the shares. This "forfeiture" would presumably have qualified as a business expense under section 162(a) or as a loss described in section 165(c)(2). Nacchio could then have deducted an amount equal to his $44.6 million basis in the shares surrendered.

This would have been a textbook case of a deduction to which the taxpayer became entitled because it was established that he lacked an unrestricted right to an item ($44.6 million in compensation income) that he had included in a prior tax year, exactly as required by section 1341(a)(2). Nacchio would then have been entitled to claim a credit under section 1341(a)(5)(B) for the tax he would have saved if he hadn't included this item — $44.6 million of compensation — in gross income back in 2001. On those facts, Nacchio would have had every right to a credit for the $18 million in tax he paid on his compensation.

But Nacchio's actual case is different. He reported two items in gross income in 2001, but his 2007 conviction and forfeiture established that he lacked an unrestricted right to only one of them.

The first item was $44.1 million in compensation, on which Nacchio paid $17.8 million of tax. To satisfy section 1341(a)(2), he would have had to identify a deduction to which he became entitled because it was established that he did not have an unrestricted right to that item.

That was impossible because it was never established (and apparently never even alleged) that

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[12]Brief of Plaintiffs, *supra* note 10, at 13 n.2.

[13]In 2001 the top individual tax rate for ordinary income (including short-term capital gain) was 39.6 percent. Combined with the 1.45 percent hospital insurance tax, Nacchio would have faced a 41.05 percent marginal rate. So $200,000 is close enough.

[14]This assumes that Nacchio reported a total of $44.6 million of taxable income in 2001, of which $500,000 was short-term capital gain. The remaining $44.1 million would be compensation equal to the taxable spread when he exercised his options.

[15]This assumes that Nacchio paid a total of $18 million in tax, of which $200,000 was tax on his short-term capital gain.

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Nacchio lacked an unrestricted right to the 1.33 million shares he received as compensation when he exercised his options. His conviction for insider trading established that he had illegally sold his Qwest shares and that he consequently lacked an unrestricted right to his $44.6 million SEC gain. But it established nothing concerning Nacchio's receipt of the shares.[16]

That, however, was the event that required Nacchio to report his $44.1 million compensation item. The SEC's insider trading case had nothing to do with Nacchio's receipt of that item. The case against him would have been exactly the same if he had inherited the shares from a rich aunt and never paid a cent in tax. The consequences for Nacchio (imprisonment, fine, and forfeiture) would have been the same as well, except that he would have forfeited even *more* because his illegal SEC gain would have been $7.3 million higher.[17]

So even assuming that Nacchio was entitled to deduct his forfeited SEC gain, this was definitely not a deduction to which he became entitled because it was established that he lacked an unrestricted right to his 2001 compensation. Accordingly, there was no way for him to satisfy section 1341(a)(2)'s deduction requirement for his $41.6 million compensation item. Hence there was no statutory basis for giving him a credit for the $17.8 million in tax he paid on that item.

Nacchio does better with his second item, the $500,000 of short-term capital gain we have assumed that he realized from selling his shares. The sales that generated his $500,000 tax gain were the same sales that generated his $44.6 million SEC gain. The modest item of capital gain he included in 2001 was simply the portion of the SEC gain that constituted gain for tax purposes.

Nacchio forfeited $44.6 million in 2007 because it was established that he did not have an unrestricted right to his $44.6 million SEC gain. This is what triggered his $44.6 loss deduction. Although Nacchio did not include the full $44.6 million as capital gain on his 2001 return, we have assumed that he did report $500,000 of it. Accordingly, it is accurate to say that Nacchio became entitled to a deduction in 2007, because it was established that he did not have an unrestricted right to the $500,000 item of capital gain that he included in income in the prior tax year. So section 1341(a)(2) was satisfied for this item.

[16]This stands in sharp contrast to the hypothetical situation described above, in which shareholders invoked a charter provision to invalidate the issuance of the shares.

[17]This is because Nacchio would not have had to pay $7.3 million (the total option exercise price) to inherit the shares from his aunt.

Nacchio was therefore entitled to a credit under section 1341(a)(5)(B) for the amount of tax he would have saved if he had not included ''such item'' in gross income in 2001. That would have been about $200,000, the tax he paid on his $500,000 short-term capital gain. That is $17.8 million less than the refund the claims court endorsed.

'Same Item' vs. 'Same Circumstances' Test

The foregoing analysis is grounded in the language and structure of section 1341. In every case, it requires that the item identified for purposes section 1341(a)(1) be the same item referred to in section 1341(a)(2). Simply tracking tax items makes it relatively easy to recognize the gigantic mismatch between the $44.1 million item of compensation Nacchio reported in 2001 and the $500,000 item of capital gain he forfeited in 2007.

However, *Nacchio* is not the first case in which a taxpayer has sought a section 1341 credit despite an item mismatch. Decisions in these cases invariably quote the statute, with its multiple references to a specific tax item. But, with few exceptions,[18] the courts have not followed through. Instead of applying the statutory ''same item'' test, the courts have tried to deal with these cases by asking whether the taxpayer's deduction in the subsequent tax year arose from the ''same circumstances, terms, and conditions'' as the prior year's taxable receipt.[19]

The same circumstances test originally had nothing to do with item mismatches. It was formulated by the Tax Court in 1966 in *Blanton v. Commissioner*.[20]

Blanton involved a taxpayer who had repaid $3,600 in director's fees to a corporation after the IRS denied the corporation a compensation deduction for that amount. The director sought a section 1341 credit for the tax he had paid on his $3,600 item of compensation.

The Tax Court held against the director because he had repaid the tax under a contract he had

[18]The clearest exception is probably Judge David Aldrich Nelson's concurrence in *Kraft v. United States*, 991 F.2d 292 (6th Cir. 1993). *Reynolds Metals Co. v. United States*, 398 F. Supp.2d 692 (E.D. Va. 2005), came close when it rejected a taxpayer's claim that it was entitled to a credit for taxes paid on $110 million of income in prior years because it was subsequently required to incur $110 million in environmental remediation expenses. The court held that the taxpayer had not satisfied section 1341(a)(2), citing as one of the reasons that the remediation payments had failed to ''restore'' or ''repay'' an item previously included in gross income.

[19]*See, e.g.*, *Dominion Resources Inc. v. United States*, 219 F.3d 359, 367 (4th Cir. 2000); *Kraft*, 991 F.2d at 295; *Bailey v. Commissioner*, 756 F.2d 44, 47 (6th Cir. 1985); and *Griffiths v. United States*, 54 Fed. Cl. 198 (2002).

[20]46 T.C. 527 (1966), *aff'd per curiam*, 379 F.2d 558 (5th Cir. 1967).

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entered into in a year after his taxable receipt of compensation income. According to the Tax Court:

> Under section 1341(a)(2), the requisite lack of an unrestricted right to an income item permitting deduction must arise out of the circumstances, terms, and conditions of the *original* payment of such item to the taxpayer and not out of circumstances, terms, and conditions imposed upon such payment by reason of some subsequent agreement between payor and payee.[21]

Blanton was not an item mismatch case. The director had reported a $3,600 item of compensation income. He became entitled to a deduction in the subsequent year because it was established that under his contract with the corporation, he lacked an unrestricted right to this item, which is why he repaid the $3,600.

So *Blanton* posed no structural problem under section 1341(a)(1) and (a)(2) — the two provisions involved the same item. The director lost the case on a timing point. He repaid the $3,600 under a contract that he entered into *after* the year in which he had reported his $3,600 receipt. This meant that the director's lack of an unrestricted right to the $3,600 item did not rest on "facts in existence" when he included the item in gross income. That's enough to bar a claim under section 1341 under some interpretations of what it means for a taxpayer not to have an unrestricted right to an item.[22] But it has nothing to do with whether the item reported in the earlier tax year is the same item described in section 1341(a)(2).

The extension of *Blanton*'s same circumstances test to an item mismatch case is illustrated by another well-known decision, *Bailey v. Commissioner*.[23] William Bailey operated a pyramid marketing scheme through Bestline Products Corp. In 1977 the Federal Trade Commission fined him more than $1 million for violating a 1971 consent decree. Bailey naturally concluded that the fine was deductible. He then claimed a credit under section 1341 for the taxes he had paid on the salary, dividends, and bonuses he had received from Bestline in prior tax years.

The Sixth Circuit rejected Bailey's claim. First, section 162(f) barred him from deducting the fine at all. Second, even if Bailey *had* been entitled to deduct the fine, his repayment obligation did not arise from the same circumstances as his original receipt. The court of appeals observed:

> The $1,036,000 Bailey paid in 1977 was a civil penalty imposed under 15 U.S.C. section 45 for his multiple violations of an FTC consent order. The payment, therefore, arose from the fact that Bailey violated the consent order, and not from the "circumstances, terms, and conditions" of his original receipt of salary and dividend payments from Bestline. Indeed, the amount of the penalty was not computed with reference to the amount of his salary, dividends, and bonuses, and bears no relationship to those amounts.[24]

This was plainly the right result. But the court could have reached it directly by applying the statutory same item test. The items that Bailey included in gross income in his prior tax years were compensation and dividend income from the corporation. His deduction (assuming he was entitled to one) related to the $1,036,000 that he was fined for violating the consent decree. The imposition of this fine did not establish that Bailey was not entitled to his compensation and dividends. He was not ordered to disgorge any ill-gotten items. He would have been liable for the fine (up to $10,000 per violation)[25] regardless of whether he had received any compensation or dividends. So even if the fine had been deductible, Bailey would not have satisfied section 1341(a)(2).

Although the same circumstances test leads to the right result in *Bailey*, it could easily produce the wrong result in a case like *Nacchio*. The problem is that the events that generate two distinct tax items may occur simultaneously or within a short span of time. The events may even be part of a single transaction or a series of closely related transactions. They may involve the same parties and depend on similar conditions. The dollar amounts of the items may be the same or related in some understandable way. The more factual overlaps there are, the more likely it is that a court or jury will conclude that the events arose from the same "circumstances, terms, and conditions."

Nacchio, for example, exercised his options and sold shares in coordinated transactions that may have been carried out within a few minutes of one another. All he had to do was make quick calls to

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[21] 46 T.C. at 530 (emphasis in original).

[22] If the director's duty to return the excessive compensation had been part of the "circumstances, terms, and conditions" of his *original* agreement with the corporation, he would have won. *See Van Cleave v. United States*, 718 F.2d 193 (6th Cir. 1983). The contractually focused analysis of *Blanton* and *Van Cleave* has been expanded to include more general understandings and expectations that there were "facts in existence" at the time of the receipt. *See Dominion Resources*, 219 F.3d 359.

[23] 756 F.2d 44 (6th Cir. 1985).

[24] *Id.* at 47.

[25] 15 U.S.C. section 45(l).

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the human resources department (to exercise the option) and his broker (for the stock sale), both of which he could have done without even getting up from his desk. The sum of his two tax items ($44.1 million in compensation plus $500,000 in capital gain) was $44.6 million. Except for his brokerage fee, this is the same amount as Nacchio's SEC gain and the loss he suffered in the subsequent forfeiture. So a court or jury could be forgiven for concluding that his forfeiture arose from the same "circumstances, terms, and conditions" as the $44.1 million in compensation income he reported in 2001.

Same circumstances or not, section 1341 makes it quite clear that a credit for taxes paid on an item is unavailable unless (1) the item was included in gross income in a prior year; and (2) the taxpayer became entitled to a deduction because it was established that he did not have an unrestricted right to the item he included. The same circumstances test may have its place in a case like *Blanton*, in which the test addresses a timing point that is not resolved by the statute. But there is no basis for allowing the existence of shared circumstances to overrule the express requirements of section 1341(a)(1) and (a)(2). If the items are not the same, the circumstances in which they arose are irrelevant.

High-Profile Risks

Nacchio illustrates one of the risks posed by high-profile cases that involve dramatic or morally charged issues: The court and the litigants assume they already know what the case is about. Pausing to conduct discovery may seem like a distraction.

However, obtaining and looking closely at Nacchio's 2001 tax return could have made a big difference. Instead, the case was decided based on the pleadings. Needless to say, those are documents with axes to grind. When the tax stakes are high, one has to wonder whether a court should be asked to make a decision on that basis.

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