PERSPECTIVE
Los Angeles | Daily Journal
THURSDAY, NOVEMBER 3, 2016

Trump's Tax Opinion Saved Him Around $916 Million

By Robert W. Wood

A New York Times story has scooped Trump's taxes again, this time with details culled from bankruptcy filings related to Trump's Atlantic City casinos. This time, there were no tax returns released, but backstory about how Trump may have generated that now famous $916 million loss. The details are complex, as you would expect. Some experts consider Trump's tax trick over the top aggressive. But one new and controversial find is about how Trump used a tax opinion that was not strong — some say weak — to claim the losses.

The tax opinion from Wall Street law firm Willkie Farr & Gallagher, is included with Trump's lawyers' warnings. Let's put aside the question whether this was a weak opinion until later. If it was, even a cautionary opinion can be worth a great deal. There are many gray areas in the tax law, and many gradations in tax advice, which makes the topic nuanced. Why might businesses, investors and even consumers want a tax opinion?

You might want to know if you can deduct something, exclude it from income, or report it as capital gain rather than ordinary income. You might want an opinion that you converted your house from personal use to investment property so can swap it under Section 1031. You might want an opinion that you can deduct your legal expenses above, rather than below, the line. You might want an opinion that your start-up shares qualify for tax free treatment when you sell as qualified small business stock. And the list is nearly endless. In fact, with most *any* tax issue, an opinion can make sense.

You don't want to spend $10,000 on an opinion if the deduction is worth $5,000, but you might be willing to spend $25,000 or $50,000 to save a vastly greater sum. A good tax opinion discusses the facts, legal arguments and pertinent authorities. One portion of the opinion says, "it is our opinion that…." But the vast majority of the opinion should analyze the facts and the law, presenting an even-handed assessment. Tax opinion standards generally conform to one of these choices:

Not frivolous: There's a 10 percent to 20 percent chance your argument will prevail.

Reasonable basis: There's a roughly one in three chance you'll win.

Substantial authority: There are cases both ways, but there's probably about a 40 percent chance you'll win.

More likely than not: The odds are better than 50 percent that you'll win.

Should: It's about 60 percent likely that you'll win.

Will: Your tax treatment is nearly assured.

Does an opinion get you out of penalties if the Internal Revenue Service disagrees with your return? In most cases, yes, if the opinion is of the substantial authority variety or higher. Even a "reasonable basis" tax opinion can provide protection, provided that you adequately disclose your position on your return. Many business insist on a "more likely than not" or "should" opinion. Still, much of the "it's all about the penalties" mantra is a red herring.

You don't want to end up paying all of the tax and all of the interest associated with a failed tax position, even if you can get the penalties waived! What taxpayers *really* want is to have their tax position upheld. The best reason to get a tax opinion is to help put you in the best possible light on both the facts and the law.

Don't assume that you can wait and just get an opinion if you are audited. It is too late then, and there's no penalty protection. Opinions should be written *before* the tax return is filed. Ideally, the opinion should be done in parallel with the transaction, to help shape it. Another tip? Don't give the opinion to the IRS if you are audited. An opinion is usually prepared by a lawyer for a client, subject to attorney-client privilege.

You do not want to waive privilege, since you rarely want to give it to the IRS. The opinion usually is balanced with arguments for and against your position. The opinion might give the IRS arguments they had not considered. It is safest not to provide the full opinion to the accountant. Rather, provide a short directive letter that gives the bottom line tax return preparation advice. That way, the accountant is not tempted to give the opinion to the IRS during an audit. If the accountant is not satisfied with this procedure, the accountant can be brought within the attorney-client privilege with a *Kovel* letter. The attorney hires the accountant and remains subject to the direction of the attorney as part of the representation.

Opinions are *extremely* helpful in an audit or tax dispute. There is rarely enough time to prepare thorough and targeted responses that will be convincing to the IRS. You can use the opinion's best facts and best arguments to draft advocacy letters or briefs, targeting the issues the IRS is raising. And if you can address the tax issues and resolve them, you may not have to even talk about penalties. Opinions are a good alternative to IRS rulings too.

In 2015, when Yahoo tried and failed to get an IRS ruling for its Alibaba transaction, all eyes turned to a tax opinion instead. That ended up not transpiring either, but it was a useful reminder that tax opinions are sometimes a jack of all trades. An IRS ruling is binding on the IRS, while tax opinions are not. As Yahoo experienced, there are many issues on which the IRS will not rule. Many taxpayers feel that where you *can* get an IRS ruling is generally where you do not need one! If the law is unclear and you *really* need a ruling, you may not be able to get it. If the law is settled and you are perceived as too needy for comfort, you can't get that either. Until our messy tax system changes, tax opinions can help fill the gaps.

So, was Trump's 1991 tax opinion *too* aggressive? The answer may be in the eye of the beholder. His law firm rated a key element of his plan to avoid recognizing cancellation of debt (COD) income as "substantial authority." For public companies, that is a lower standard than most companies want. But some moves are not clear, and the Willkie Farr opinion said there was little guidance in 1991.

What of the fact that the law was later changed to *stop* the kind of deal Trump did? Some may read this to mean that Trump got in under the wire. Some may read it to mean that he never should have tried it. We still don't have Trump's tax returns, and yet it seems clear that there is probably a good deal that is highly aggressive. How could it be otherwise? Yet as with so much else in the Trump saga, the latest discoveries probably will not change too many hearts or minds. But it just might help to rekindle interest in tax opinions.

Robert W. Wood *is a tax lawyer with www.WoodLLP.com, and the author of "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This is not legal advice.*