United States Senate
Committee on Finance

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Statement of Sen. Chuck Grassley
On the Committee's Vetting Process of Nominees and the Nomination of Ron Kirk as United States Trade Representative
Submitted as Part of the Committee Record
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I would like to take a few moments to respond to a March 9 Politico article. This article reports, citing anonymous sources, that staff is the driving force behind this Committee's vetting of nominees' tax returns. I found it interesting that while these sources didn't shy away from blasting Finance Committee staff, they chose to remain anonymous. But the Politico isn't the only publication in town that didn't get the Committee's process right. The Washington Post reported on March 4 that Finance Committee staff reviews tax returns of ALL nominees coming before the Senate and conducts full fledged IRS audits. I want to set the record straight – the Senate Finance Committee only reviews tax returns for those nominees that come before this Committee and does NOT conduct audits. Since this Committee has jurisdiction over tax issues, it is only right that it reviews tax returns for nominees coming before this Committee.

I want to stress that the Finance Committee is not doing anything different now from what it has always done under the leadership of either Senator Baucus or me. We are vetting nominees for the current administration the same way we vetted nominees for the previous administration. We have always asked for the last three years' tax returns and reviewed them with the assistance of the Joint Committee on Taxation. Then, as now, many nominees have had to answer questions arising from the review of their tax returns. Some nominees were not able to be confirmed, and some prospective nominees were not nominated as a result of vetting by the Finance Committee.

The tax issues of the nominees considered by the Committee this year came to be public only because the nominees chose to proceed. Chairman Baucus and I agree that if a nominee chooses to proceed after tax issues are identified, then the public should be informed of those issues. In every case, the nominee is aware that we will make this information public.

The Finance Committee has an obligation to thoroughly vet every nominee that comes before it. Many, if not all, of these individuals will make decisions that will impact the lives of many people. The purpose of the vetting process is neither to embarrass anyone, nor to further inject

politics into the process. Rather, the purpose of the vetting process is to ensure that nominees may be trusted with the responsibilities that come with serving in a Senate-confirmed position.

By ensuring that these individuals are paying their taxes, something which they should be doing anyway, we are ensuring they are, at a minimum, complying with the rules that in many cases they will help create and administer.

I feel that much of the criticism leveled at the Finance Committee is based on a misunderstanding of what the Committee actually does. Or, it is might be a deliberate attempt to create a distraction from the tax problems recent nominees have been found to have. One of my colleagues in the Senate—not on this Committee—according to one press account, was concerned with "the maze of forms and onerous reviews for nominees…"

If by "maze of forms" this individual is referring to the IRS Form 1040, then I agree that it is maze-like. But we shouldn't hold the people who are literally running this country to a lower standard than the more than 130 million individuals and families that file a tax return every year.

Those criticizing this Committee's vetting process have taken the cowardly approach of attacking Committee staff. I think it's ridiculous I even have to say this, but Chairman Baucus and I drive the vetting process for all nominees. Committee staff either works for Chairman Baucus or myself, and staff does what we ask them to do. It's unacceptable that someone would attempt to blame a nominee's tax errors on the individuals who discovered or asked questions about those errors.

Finally, I think this criticism is completely off-base when it comes to what the American people demand of us. I haven't received any letters from my constituents in Iowa saying that important government officials should be excused from their tax obligations. Secretary Geithner was found to owe an additional $48,268 in total, Senator Daschle, around $140,000, and Mayor Kirk $7,785. I wonder if the critics of the Committee's process believe they shouldn't have paid these taxes. I am going to keep doing what I have always done and thoroughly vet, in a fair and efficient way, every nominee that any President sends to this Committee.

In the case of the nominee being considered by this Committee today, I am grateful for his cooperation with me, Chairman Baucus and the Committee staff. In the true spirit of transparency and cooperation, he has responded to all questions about his taxes directly and honestly. He also agreed in communications with the staff to release information about his tax issues. Mr. Chairman, I ask unanimous consent to insert in the record the staff memo regarding his tax returns. I also ask unanimous consent to insert those portions of his written responses to the Committee's questions regarding the issues for which he amended his tax returns.

I will also say what I have said before. I believe that all nominees should be held to the same standard when it comes to compliance with the tax laws. Mayor Kirk was required to amend his returns and pay additional tax as a result of the vetting process. This is not because he was purposefully trying to avoid taxes. Each of the issues for which he amended his returns was considered by him and his preparer at the time the returns were prepared. However, upon further review of some of the calculations, he agreed that some of them needed to be changed. In addition, if he was not subject to the PEASE limitations on his itemized deductions, the amount he owed as a result of these changes would have been less.

I appreciate Mayor Kirk's engagement and enthusiasm to assume the responsibilities of the United States Trade Representative. Based on his responses to my questions, there appear to be some policy areas in which our views converge. But there are some other areas in which I continue to have concerns, particularly where his responses provided insufficient detail to determine whether we can have a convergence of views.

That said, if Mayor Kirk is confirmed, I believe that we could work together to advance a pro-growth trade agenda that would contribute importantly to our national economic recovery. I've always felt that a President is entitled to have the person he wants to join his Cabinet unless there is a compelling reason to oppose a nominee.

Ron Kirk

Responses to Senate Finance Committee Supplemental Questions—February 6, 2009

Please provide the legal analysis demonstrating that the honoraria assigned to the fund were not income to Mr. Kirk.

The proper treatment of honoraria assigned to a charity has been examined by tax counsel. The tax treatment of such honoraria has been a controversial matter for decades. As the late Professor Bittker recited, Assistant Attorney General (later Justice) Jackson sparred with a Congressional Committee over an IRS ruling that the proceeds of Eleanor Roosevelt's radio broadcasts, which were paid by the sponsor to designated charities, were not taxable to her. His premise was that the doctrine of constructive receipt cannot create income where there is none. She had declined to work for money and was only willing to serve for charity's sake. Bittker & Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 75.2.4.

This situation is similar to that of Mr. Kirk. In these times of economic trouble, colleges and universities are suffering from a drop in contributions and assistance. Mr. Kirk's generosity has enabled Austin College to continue its educational mission.

The IRS has since changed its position on the taxation of payments that a speaker or entertainer requests to be paid to a charity. Treas. Reg. § 1.61-2(c) provides:

> *The value of services is not includible in gross income when such services are rendered directly and gratuitously to an organization described in section 170(c). Where, however, pursuant to an agreement or understanding, services are rendered to a person for the benefit of an organization described in section 170(c) and an amount for such services is paid to such organization by the person to whom the services are rendered, the amount so paid constitutes income to the person performing the services.*

Consistent with this regulation, the IRS ruled in Revenue Ruling 79-121, 1979-1 CB 61, that an honorarium payable to an elected official but paid at his request to an exempt educational institution was includible in the official's income and deductible as a charitable contribution.

However, Congress legislatively overturned the regulation and ruling in the context of certain elected and appointed federal officials. Section 7701(k) of the Internal Revenue Code of 1986, as amended, provides:

> *In the case of any payment which, except for section 501(b) of the Ethics in Government Act of 1978, might be made to any officer or employee of the Federal Government but which is made instead on behalf of such officer or employee to an organization described in section 170(c)--*
>
> > *(1) such payment shall not be treated as received by such officer or employee for all purposes of this title and for all purposes of any tax law of a State or political subdivision thereof, and*
> >
> > *(2) no deduction shall be allowed under any provision of this title (or of any tax law of a State or political subdivision thereof) to such officer or employee by reason of having such payment made to such organization.*
>
> *For purposes of this subsection, a Senator, a Representative in, or a Delegate or Resident Commissioner to, the Congress shall be treated as an officer or employee of the Federal Government.*

Although the Supreme Court ruled that the government-wide ban on the receipt of honoraria by any government employee violated the First Amendment in *United States v. National Treasury Employees Union*, 513 U.S. 454 (1995), the Code provision has not been updated or changed.

The confusion around the presence of this provision is understandable. Although Mr. Kirk was not a federal elected official, it was a commonly reported practice among members of Congress and others with whom he associated and he and his accountant reasonably presumed that the non-taxability of these payments was settled for all taxpayers. Accordingly, like Mrs. Roosevelt and like his colleagues who served in elective Federal positions, he did not report the income paid to Austin College and was not entitled to a deduction for those amounts. This logical conclusion, it turns out, is contrary to the IRS' current position.

Generally, Mr. Kirk's 2004-2007 returns consistently treated the honoraria paid to Austin College by excluding them from income and not deducting them. He assumed that because the honoraria went directly to the College, there was no tax consequence to him. Nonetheless, in reviewing Mr. Kirk's return, tax counsel noted that his 2005 return reported the payments in a manner inconsistent with all other periods. Four of the 2005 payments were excluded from income, but a charitable contribution deduction was taken on the Kirks' return. This treatment was inadvertent, appears to be a return preparation error, and is inconsistent with how the Kirks have conducted themselves. Accordingly, the Kirks would owe an additional $2,657 for income and Medicare taxes (net of deducting half of the Medicare contribution) for 2005. Apart from 2005, no charitable contributions were claimed for fees paid directly to Austin College.

If the other contributions paid to Austin College were to be included in Mr. Kirk's income and then deducted as charitable contributions, the additional taxes would be $4,249 for over four years.

Mr. Kirk wishes to address the following unresolved matters with the Senate Finance Committee before filing amended tax returns.

Deduction of Tax and Accounting Fees. Expenses incurred by a taxpayer in preparing that portion of the taxpayer's individual federal income tax return that relates to the taxpayer's business as a sole proprietor or partner, and expenses incurred in resolving asserted tax deficiencies relating to the business, are deductible as trade or business expenses in determining the taxpayer's adjusted gross income under section 62(a)(1). *See, e.g.*, Rev. Rul. 92-29, 1992-1 C.B. 20; PLR 9234009.

Prior to Mr. Kirk becoming a law firm partner and Mr. and Mrs. Kirk first being elected to corporate boards, the Kirks did not require an accountant to prepare their returns and did not incur tax preparation and accounting expenses. Only when Mr. and Mrs. Kirk required more detailed tax advice, relating to the intricacies of reporting these categories of business income and associated deductions, did the family engage an accountant. The family's accountant, Mr. X, had years of experience in preparing returns for law firm partners and other self-employed persons. In preparing the Kirks' income tax returns for 2005, 2006 and 2007, Mr. X determined that approximately 90% of his professional time was devoted to tax issues associated with Schedule C (including, for this purpose, line 21 of Form 1040 and the 1040 SE) and Schedule E. Accordingly, this is the manner in which he prepared the Kirks' returns, reflecting accounting and tax preparation fees. He did not further allocate between Schedule E and Schedule C because it had the same impact on reporting AGI and self-employment income.

Mr. X's practice includes numerous clients who are required to make complex quarterly K-1 and self-employment income reporting filings (for example, other law firm partners). By way of comparison, Mr. X has prepared tax returns for the children or parents of clients. He estimated that these much simpler returns took between 2 and 3 hours of his time, whereas he spent approximately 45 professional hours working on the Kirks' tax returns each year. Mr. X charges an hourly rate for his services. The additional time spent on the Kirks' returns (and that of other law firm partners) is largely due to the fact that (a) Mr. Kirk was required to file quarterly statements of partnership earnings, (b) Mr. and Mrs. Kirk earned self-employment income from several different sources, and (c) the Kirks were entitled to deduct numerous corresponding business expenses. Mr. X's work for the Kirks was ongoing throughout each year and was primarily devoted to complications caused by trade or business income and expense.

The data collection and analysis associated with Schedule E requires an overwhelming majority of tax preparer time. Neither the number of forms nor the income associated with Schedule E, versus Schedule A, provides an accurate means of calculating where tax and accounting fees should be allocated. Under these circumstances, reasonable differences of opinion may exist over whether the actual amount that should be deductible "below the line" is appropriately 10%, or perhaps slightly more. Mr. and Mrs. Kirk believe that the 10% allocation of accounting and tax preparer costs in their 2005, 2006 and 2007 federal income tax returns is valid. They are prepared to adjust the allocation of "below the line" non-business portion of tax and accounting expenses to $1,500 for 2005, $1,750 for 2006, and $2,000 for 2007 – effectively doubling the allocation - in recognition of the fact that reasonable differences of opinion may be present in this instance.

Deductibility of Mavericks tickets. Mr. Kirk was able to have his electronic calendar restored for the periods in issue in order to document the persons attending Maverick games with him, their business relationship, and the extent to which they revolved around other business meetings or the business relationship and items that would have been discussed at the time. He provided the following documentation of his business guests at the Mavericks games and confirmed that his practice was to hold business meetings or discussions the day of the game, or in some cases on the next day or two. Accordingly, Mr. Kirk's expenses for tickets at least meet the Associated Entertainment standard (and in some cases, the directly related test), and he should be allowed the deduction for the 33 games listed below. His expenses were approximately $600/game (4 seats at $147 each plus $10 for parking), which equals a cost of $19,800 over 3 years and deductions of $9,900 total. Mr. Kirk would then agree to pay $2,594 in additional taxes, as opposed to $6,100.

Plasma TV. As mentioned previously, the $3,000 value of the TV when it was donated to the YMCA in 2006 was a good faith estimate. Mr. Kirk contacted the electronics dealer from whom he purchased the television, and additional internet searches were conducted, but contemporaneous values for that model television used in 2006 could not be established. Mr. Kirk did learn that the purchase price of the television was closer to $6,000, and that the price of plasma televisions declined substantially thereafter, to about $3,000 in 2005. Accordingly, the Kirks would agree to reduce the value of the deduction to $1,500.