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Taxing Composite Transactions

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Taxing Composite Transactions

*Emily Cauble**

ABSTRACT

In a variety of contexts, taxpayers engage in composite transactions—essentially two transactions in one. For instance, when an individual sells property for less than its fair market value to a friend or relative, the transaction involves a sale and a gift. As another example, from time to time, retailers run promotions offering to rebate the price of merchandise if a team wins a sporting event. A buyer of the merchandise, effectively, makes a purchase and also places a bet on the sporting event's outcome.

Tax law's treatment of composite transactions is not uniform. In some contexts, tax law fully bifurcates these transactions into their separate components. Under this bifurcated approach, a taxpayer who engages in a composite transaction receives the same tax treatment as a taxpayer who goes through the motions of engaging in the component transactions separately. In other contexts, tax law adopts a collapsed approach under which taxpayers obtain markedly different tax treatment by engaging in a composite transaction instead of carrying out the components as separate transactions. In other contexts, tax law employs a hybrid approach that partially disentangles a composite transaction into its separate components but, nonetheless, bestows upon the composite transaction tax treatment that is not identical to what follows from engaging in the components as separate transactions. In addition to the existing approaches to composite transactions, other hypothetical approaches are possible.

Each existing approach and each conceivable alternative offers various advantages and disadvantages when judged in terms of the approach's propensity to reduce tax revenue, the approach's tendency to trap unwary taxpayers while benefiting well-advised taxpayers, the likelihood that the approach will prompt taxpayers to alter their transactions for tax reasons, and the administrability of the approach.

This Article undertakes an examination of composite transactions, evaluating advantages and disadvantages of different approaches. In addition, this Article presents new survey results that shed light on the counterintuitive nature of current law.

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I. INTRODUCTION

IN a variety of contexts, taxpayers engage in transactions that could be conceptualized as two transactions in one. For instance, when an individual sells property for less than its fair market value to a friend or relative, this transaction could be conceptualized as, in part, a sale and, in part, a gift.[1] Likewise, when a taxpayer sells property for less than its fair market value to a charitable organization, the taxpayer could be described as selling property and making a donation.[2] To take another example, from time to time retailers run promotions offering to rebate the price of merchandise purchased over a given period of time if a team wins a sporting event or some other specified occurrence comes to pass.[3] This transaction could be viewed as, in part, a purchase of merchandise and, in part, placing a bet on the outcome of the specified event.[4] The examples just mentioned are by no means exhaustive. As discussed in Part II, composite transactions are plentiful and arise in a variety of different contexts.

Tax law's treatment of composite transactions is not uniform. In some contexts, tax law fully bifurcates such transactions into their separate components.[5] As a result, a taxpayer who engages in a composite transaction receives the same tax treatment as a taxpayer who goes through the motions of engaging in the component transactions separately.[6] In other contexts, tax law adopts a collapsed approach under which taxpayers obtain markedly different tax treatment by engaging in a composite transaction instead of carrying out the components as separate transactions.[7] This approach allows taxpayers who are sufficiently well-advised to elect either a collapsed approach (by carrying out the component parts as one transaction) or a bifurcated approach (by engaging in the components as separate transactions).[8] In some other contexts, tax law employs a hybrid approach, acknowledging that a composite transaction involves separate components but nonetheless bestowing upon the composite transaction tax treatment that is not identical to what follows from engaging in the components as separate transactions.[9] Like the collapsed approach, when tax law uses the hybrid approach, well-advised taxpayers can implicitly choose either the hybrid approach (by engaging in one consolidated transaction) or the bifurcated approach (by executing the components as separate transactions).[10]

Lack of uniformity across different contexts is not entirely surprising—laws governing particular composite transactions developed at different points in time and, in some instances, was shaped by courts but, in other

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1. *See infra* Section II.C.1.
2. *See infra* Section II.B.1.
3. *See infra* Section II.A.1.
4. *See id.*
5. *See infra* Section II.B.
6. *See infra id.*
7. *See infra* Section II.A.
8. *See infra* Section IV.B.
9. *See infra* Section II.C.
10. *See infra* Section IV.B.

instances, was adopted by Congress, the Treasury Department, or the IRS.[11] While a lack of uniformity may be unsurprising, it does suggest the need for an analysis of advantages and disadvantages of different approaches.

In addition to the existing approaches to composite transactions, other hypothetical approaches are possible and have been proposed in some contexts. As one alternative, tax law could employ a collapsed approach (or a hybrid approach) but prevent taxpayers from structuring their transactions to obtain a bifurcated approach.[12] Essentially, such an approach would entail recharacterizing any attempt to separate a composite transaction into its separate components as, in fact, a composite transaction that receives collapsed treatment (or hybrid treatment).[13] As a second alternative, tax law could adopt an explicitly elective approach.[14] Under this alternative, taxpayers who carried out composite transactions could file an election to dictate whether they receive collapsed (or hybrid) treatment or, instead, bifurcated treatment.[15]

Each existing approach and each conceivable alternative offers various advantages and disadvantages when judged in terms of the approach's propensity to reduce tax revenue, the approach's tendency to trap unwary taxpayers and bestow advantages upon well-advised taxpayers, the likelihood that the approach will prompt taxpayers to alter their transactions for tax reasons, and the administrability of the approach.[16] In general, across the various metrics, adopting a bifurcated approach is superior to other approaches in all respects with one exception—namely, the bifurcated approach carries with it the cost of requiring taxpayers and the IRS to value an asset absent a sale of the asset for cash.[17] In many contexts, however, this downside is not significant because valuation already occurs for other non-tax or tax reasons.[18]

Existing literature contains discussion of each of the individual examples of composite transactions discussed in this Article.[19] The contribution offered by this Article is to undertake an examination of composite

11. For example, tax law's approach to the disposition of property subject to debt in excess of fair market value was adopted by the Supreme Court. *See* Comm'r v. Tufts, 461 U.S. 300, 317 (1983). Now, it is included in Treasury Regulations. Treas. Reg. § 1.1001-2(c) (example 7). The IRS has articulated its approach to merchandise discounts determined by chance in a letter ruling. *See infra* note 29 and accompanying text.

12. *See infra* Part III.

13. *See id.*

14. *See id.* This Article adopts the terminology of explicit tax elections used by Professor Field to distinguish instances where a taxpayer merely files a form or checks a box to indicate desired tax treatment (thus, making an explicit election) as opposed to opting for desired tax treatment implicitly by structuring a transaction or engaging in different behavior to obtain desired tax treatment. *See* Heather M. Field, *Choosing Tax: Explicit Elections as an Element of Design in the Federal Income Tax System*, 47 Harv. J. on Legis. 21, 21–22 (2010) ("Most taxpayer choice is exercised implicitly through taxpayer action[—]the taxpayer arranges his economic and/or legal affairs so as to qualify for his desired tax treatment. But other taxpayer choice is explicit . . . .").

15. *See infra* Part III.

16. *See infra* Part IV.

17. *See infra* Part IV.

18. *See infra* Part IV.

19. *See infra* notes 26, 29, 38–51, 58–66, 72, 75, 166.

transactions as a collective. Discussion of the examples as a collective is a useful exercise because many issues arise in parallel fashion across the different contexts.

To demonstrate that each of the individual examples represents part of a general phenomenon, this Article will start by describing various examples of existing law's treatment of composite transactions in Part II. Because the approaches employed by current law are not the only possible approaches, Part III will describe the complete menu of options—not only the approaches currently used but also other conceivable alternatives. Next, Part IV will assess the advantages and disadvantages of different approaches. To shed some light on one potential disadvantage of tax law's current treatment of transactions that combine a gift and a sale, this part will present results of a new survey that tends to show that the current law's approach is counterintuitive. Next, Part V offers recommendations based on the advantages and disadvantages of various approaches. Finally, Part VI concludes the Article.

II. EXISTING LAW

Across a variety of contexts, taxpayers engage in transactions that could be conceptualized as involving two distinct transactions rolled into one.[20] Tax law's approach to these transactions varies from context to context. Sometimes tax law utilizes a collapsed approach—rather than disentangling the strands of a transaction, it views and characterizes the transaction in its entirety.[21] Sometimes tax law utilizes a bifurcated approach—separating the transaction into its separate components and bestowing upon each component the same treatment it would receive if the taxpayer had, in fact, engaged in the components as separate transactions.[22] In another set of

20. The examples discussed in this Article do not constitute an exhaustive list. For another set of examples, one could look to the discussion in existing literature of whether tax law should adopt a bifurcated approach to the taxation of financial instruments. *See, e.g.*, Mark P. Gergen, *Colloquium on Financial Instruments: Afterword Apocalypse Not?*, 50 Tax L. Rev. 833, 834–36, 846–51 (1995); David M. Hasen, *A Realization-Based Approach to the Taxation of Financial Instruments*, 57 Tax L. Rev. 397, 460–79 (2004); Deborah H. Schenk, *Taxation of Equity Derivatives: A Partial Integration Proposal*, 50 Tax L. Rev. 571, 579–628 (1995); Jeff Strnad, *Taxing New Financial Products: A Conceptual Framework*, 46 Stan. L. Rev. 569, 570–97 (1994); Jeff Strnad, Commentary, *Taxing New Financial Products in a Second-Best World: Bifurcation and Integration*, 50 Tax L. Rev. 545, 545–63 (1995); David A. Weisbach, *Tax Responses to Financial Contract Innovation*, 50 Tax L. Rev. 491, 507–26 (1995); *see also* Herwig J. Schlunk, *Little Boxes: Can Optimal Commodity Tax Methodology Save the Debt-Equity Distinction?*, 80 Tex. L. Rev. 859, 882–85 (2002); David A. Weisbach, *Thinking Outside the Little Boxes: A Response to Professor Schlunk*, 80 Tex. L. Rev. 893, 905–08 (2002).

21. For example, this occurs in the context of the disposition of property subject to nonrecourse debt in excess of fair market value as discussed below in Section II.A.3. *See, e.g.*, Deborah A. Geier, *Tufts and the Evolution of Debt-Discharge Theory*, 1 Fla. Tax Rev. 115, 119 (1992) ("If the debt is 'nonrecourse,' the government collapses the two component parts into the property disposition under section 1001 by including the entire debt in the amount realized (the 'collapsed approach').").

22. For example, this occurs in the context of the disposition of property subject to recourse debt in excess of fair market value as discussed below in Section II.B.2. *See, e.g.*, Geier, *supra* note 21 at 116 ("If the debt is 'recourse,' the government bifurcates the transaction (the 'bifurcated approach. . . .')").

cases tax law uses a hybrid approach—acknowledging that a transaction involves separate components but nevertheless taxing the composite transaction as a whole in a manner that differs from what would occur if the taxpayer had undertaken each component as a separate transaction.[23] This Part will proceed by discussing examples of each approach.

A. Collapsed Approach

In several contexts tax law employs a collapsed approach—taxing a composite transaction as a whole rather than breaking it apart into its components.[24] Examples of this approach include, among others, tax law's treatment of merchandise discounts dictated by chance, tax law's treatment of the sale of real estate that a taxpayer held for different purposes over time, and tax law's treatment of the sale or other disposition of property subject to nonrecourse debt that exceeds the property's value.[25] Each of these examples is discussed, in turn, below.

1. Merchandise Discounts Dictated by Chance

Prior to the 2007 World Series, a Boston furniture store ran a promotional campaign.[26] Under the terms of the campaign, any customer who purchased furniture between March 7 and April 16 would receive a full refund of the purchase price if the Red Sox went on to win the World Series.[27] At the time of the purchases, the furniture store alerted customers to the possibility that some or all of the refund might constitute taxable income.[28] Subsequently, the furniture store obtained a letter ruling from the IRS concluding that the refunds could be treated as a rebate of the purchase price and, consequently, not included in income.[29]

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23. For example, this occurs in the context of part-gift part-sale transactions, as discussed below in Section II.C.1. *See, e.g.*, Bridget J. Crawford & Jonathan G. Blattmachr, *Basis and Bargaining Sales: Income Tax and Other Concerns*, 73 Tax Law. 801, 806–07 (2020).

24. *See* Geier, *supra* note 21, at 119 (referring to the tax treatment of the disposition of property subject to nonrecourse debt in excess of fair market value as a "collapsed approach").

25. Examples provided in the Treasury Regulations make clear that debt is "recourse" for purposes of Section 1001 when the borrower is personally liable for the debt, and nonrecourse when this is not the case. Treas. Reg. § 1.1001-2(c) (example 7) ("E is not personally liable for repayment of the liability and the seller's only recourse in the event of default is to the herd of cattle."); Treas. Reg. § 1.1001-2(c) (example 8) ("In 1980, F transfers to a creditor an asset with a fair market value of $6,000 and the creditor discharges $7,500 of indebtedness for which F is personally liable.") *See also* Scott Shimick, *Amount Realized*, 2 Mertens Law of Fed. Income Tax'n § 11:9 ("A loan is recourse if the borrower is personally liable for the debt, and nonrecourse if the borrower is not personally liable for the debt and the creditor's recourse is limited to the secured asset. Otherwise, the Code does not define recourse and nonrecourse for purposes of Section 1001." (citing Treas. Reg. § 1.1001-2(c)).

26. *See, e.g.*, Paul Caron, *IRS: Furniture Giveaway to Red Sox Fans Tied to World Series Victory Treated as Purchase Price Reduction, Not Income*, TaxProf Blog (Jan. 28, 2008), https://taxprof.typepad.com/taxprof_blog/2008/01/red-sox-fans-wi.html [https://perma.cc/3TS3-WW9A]

27. *Id.*

28. *Id.*

29. *Id.* In some circumstances, customers would be required to include amounts in income—if the customer had previously been entitled to a tax deduction as a result of the

Arguably, rather than treat the entire refund as a rebate, the transaction could be conceptualized as two transactions in one—a purchase of furniture for a discount and making a bet that would pay out if the Red Sox won.[30] In order to demonstrate, consider the following example:

Example 1. Oliver purchases a couch for $1,000 from the furniture store at a time when the odds of the Red Sox winning the World Series is estimated to be 25%.

Oliver's expected payout is $250 (25% of $1,000). If he were to engage in two separate transactions that were equivalent to the transaction in which he engaged, he would: (1) purchase the couch for $750 and (2) put $250 down on a bet that would pay out $1,000 if the Red Sox won. Viewed this way, when he ultimately obtains the $1,000 refund, $250 of it should be excluded from income but not the remaining $750. The collapsed approach that treats all $1,000 as a discount (entirely excludable from income) is generally more taxpayer-friendly than the bifurcated approach.[31]

The Boston furniture company example is not the sole instance of a company engaging in this type of promotional campaign. As another example, in 2006, a Chicago-area furniture store promised shoppers a rebate equal to the cost of furniture purchased over the Labor Day weekend if the Chicago Bears held the Green Bay Packers to a score of zero in the opening game of the season—an unexpected event that came to pass.[32]

2. *Real Estate and Change of Purpose*

When a taxpayer sells real estate, any resulting gain or loss generally will be classified as ordinary income or loss if the real estate is "property held by the taxpayer primarily for sale to customers in the ordinary course of [the taxpayer's] trade or business," as described by Internal Revenue Code section 1221(a)(1).[33] Real estate fitting this description is often referred

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purchase of merchandise, for instance. *See* Letter from Jordan's Furniture to Customers (Jan. 18, 2008), https://taxprof.typepad.com/taxprof_blog/files/jordans_letter.pdf [https://perma.cc/3KK3-HCHH]. A letter ruling does not establish precedent upon which other taxpayers can rely. *See* Treas. Reg. § 601.201(l)(1) (1967) ("A taxpayer may not rely on an advance ruling issued to another taxpayer."). Nevertheless, it does provide an indication of the IRS's likely view of similar transactions. *See, e.g.*, Rachelle Y. Holmes, *Forcing Cooperation: A Strategy for Improving Tax Compliance*, 79 U. Cin. L. Rev. 1415, 1427 (2011) (describing letter rulings as providing "helpful guidance" to other taxpayers).

30. *See, e.g.*, Sheldon I. Banoff & Richard M. Lipton, *Furniture for Nothing and It's All Tax Free!*, 105 J. Tax'n 382, 382–83 (2006) (describing a similar furniture store promotion and stating, "the arrangement is in some ways analogous to each customer's purchasing both the furniture and a lottery ticket (i.e., making a wager) to win back the full amount of his ostensible purchase price," but ultimately concluding that it ought to be treated as a rebate).

31. This is not inevitably true in all cases. It is possible to imagine, for instance, a taxpayer who is subject to a low effective tax rate in the year the rebate is received and sells the furniture the next year when the taxpayer's effective tax rate is significantly higher. Such a taxpayer may be better off including a portion of the rebate in income in the low tax rate year and taking a higher basis in the furniture to recognize less gain in the high tax rate year. In other situations, too, the taxpayer may benefit more from including a portion of the rebate in income and having a higher basis in the furniture. See infra note 117 and accompanying text.

32. *See* Banoff & Lipton, *supra* note 30, at 382–83.

33. I.R.C. § 1221(a)(1).

to as "dealer property."[34] If instead the taxpayer holds the real estate for investment purposes, any resulting gain or loss will be capital gain or loss.[35]

Whether real estate is "dealer property" is determined by considering all relevant facts and circumstances bearing on whether the taxpayer held the property with the intent described in section 1221(a)(1).[36] Courts will examine facts that include, but are not limited to: (1) the frequency and substantiality of sales, (2) the extent of improvements made to the property by the taxpayer, and (3) efforts by the taxpayer to advertise the property for sale.[37]

Sometimes a taxpayer's purpose for holding real estate changes over time.[38] For example, a taxpayer may initially acquire real estate with the intent of holding it as an investment. Later, the taxpayer's plans change. The taxpayer undertakes efforts to improve and subdivide the property and sells parcels of the property in numerous transactions. Tax law, generally, takes an all or nothing approach—characterizing the entire gain or loss recognized upon sale of real estate as either capital or ordinary depending on whether the real estate is dealer property at the time of its sale.[39] To illustrate, consider the following example:

> **Example 2**. Assume, in year one, Mabel acquires undeveloped land for $700,000 with the intent of holding it as an investment. From year one to year three, the land increases in value to $1,000,000. At that time, Mabel makes substantial improvements to the land, at a cost of $100,000, and sells parcels of the land for total proceeds of $1,500,000.[40]

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34. *See, e.g.*, Gerald J. Robinson, Federal Income Taxation of Real Estate ¶ 17.13 (2023) (using the "dealer property" phrase).

35. I.R.C. § 1221(a).

36. *See, e.g.*, Biedenharn Realty Co. v. United States, 526 F.2d 409, 415–18 (5th Cir. 1976) (examining various factors including frequency and substantiality of sales, extent of improvements to the property, and solicitation and advertising efforts); United States v. Winthrop, 417 F.2d 905, 911 (5th Cir. 1969) (describing the facts-and-circumstances-based nature of the test).

37. *See, e.g.*, *Biedenharn Realty Co.*, 526 F.2d at 415; *Winthrop*, 417 F.2d at 909–10.

38. *See, e.g.*, Bradley T. Borden, Nathan R. Brown & E. John Wagner, II, *A Case for Simpler Gain Bifurcation for Real Estate Developers*, 16 Fla. Tax Rev. 279, 296–97 (2014); Edward Yorio, *Federal Income Tax Rulemaking: An Economic Approach*, 51 Fordham L. Rev. 1, 5 (1982) (providing an example of a taxpayer whose purpose changes over time).

39. *See, e.g.*, Borden, Brown & Wagner, *supra* note 38, at 296–97, 299; Yorio, *supra* note 38, at 5.

40. Conceptually, this example differs somewhat from Example 1 (as well as some of the subsequent examples). In Example 1, the parties simultaneously engage in a sale of property at a discount and place a bet on the outcome of the World Series. In Example 2, the taxpayer engages in one sale of property that was held as investment property for a period of time and later was held as dealer property. One could think of this transaction as involving both a sale of the taxpayer's interest in the investment property and a sale of the taxpayer's interest in the dealer property. Example 2 is analogous to Example 8 discussed below. In Example 8, a partnership sells property contributed by a partner. On sale, the partnership recognizes both gain that accrued prior to the time the partner contributed the property and gain that accrued after contribution, and tax law bifurcates the gain into these two separate components. *See* Sections II.A.1, II.A.2, II.B.5.

Under the facts of Example 2, provided that the real estate is classified as dealer property, Mabel will recognize $700,000 of ordinary income.[41] In theory, tax law could take a different approach and bifurcate Mabel's gain into $300,000 of capital gain (attributable to the increase in value that accrued while the land was held as an investment), and $400,000 of ordinary income (attributable to the gain that accrued after the real estate became dealer property).[42] In actuality, rather than bifurcate the gain, tax law utilizes a collapsed approach and treats the entire $700,000 as ordinary income.[43]

In Example 2, the results of the bifurcated approach are potentially more taxpayer-favorable than the results of the collapsed approach because individuals can be subject to a lower tax rate on capital gain than ordinary income.[44] If Mabel has access to sufficiently sophisticated advice, she can structure her transaction to achieve the results of the bifurcated approach.[45] In particular, she could sell the undeveloped real estate for $1,000,000 to a related entity and have the related entity undertake the subsequent development and sales activity with the aim of generating $300,000 of capital gain and $400,000 of ordinary income rather than $700,000 of ordinary income.[46]

Using this strategy requires careful engineering to avoid several potential hazards.[47] For instance, the related entity must acquire the undeveloped land in exchange for fair market value consideration.[48] In addition, Mabel must properly structure the transaction to reduce the risk that subsequent development and sales activities of the related entity are attributed to her.[49] To ensure that the capital gain is recognized later in time, rather than at the time of the sale to a related entity, Mabel would sell the undeveloped land in exchange for a note (effectively, a promise by the entity to make a payment in the future); in addition to complying with other requirements, the note must be respected as debt for tax purposes for Mabel to achieve

41. However, courts sometimes conclude that the taxpayer's original investment purpose continues to dictate characterization of the gain, particularly if outside factors beyond the taxpayer's control prompted the change to the taxpayer's activities. *See, e.g.*, Borden, Brown & Wagner, *supra* note 38, at 297–98. In these instances, courts still employ a collapsed approach, but they treat all of the gain (or loss) as capital rather than ordinary.

42. *See, e.g.*, Yorio, *supra* note 38, at 5 (describing a bifurcated approach as the "fairest result, and the result most in accord with the congressional purpose in providing preferential treatment of capital gains . . . .").

43. *See, e.g.*, Borden, Brown & Wagner, *supra* note 38, at 299 ("[T]he law appears to prohibit courts from bifurcating the gain."); Yorio, *supra* note 38, at 5.

44. This is true assuming that the gain constitutes net capital gain. *See* I.R.C. § 1(h)(1).

45. *See, e.g.*, Borden, Brown & Wagner, *supra* note 38, at 301–03; Walter D. Schwidetzky, *Integrating Subchapters K and S—Just Do It*, 62 Tax Law. 749, 785 (2009); Yorio, *supra* note 38, at 18–19.

46. *See* Borden, Brown & Wagner, *supra* note 38, at 301–03; Schwidetzky, *supra* note 45, at 785; Yorio, *supra* note 38, at 18.

47. *See* Borden, Brown & Wagner, *supra* note 38, at 304 ("The requirement for careful structuring thus makes the Bramblett structure and gain bifurcation the exclusive province of well-advised and well-healed property owners."). *Id.* at 304–12 (describing potential pitfalls).

48. *See, e.g.*, *id.* at 305.

49. *See, e.g.*, *id.* at 307–10; Yorio, *supra* note 38, at 18–19.

the desired tax outcome.[50] In some instances, the bifurcated approach produces results that are potentially less taxpayer-favorable than the collapsed approach. For instance, assume that a taxpayer acquires undeveloped land for $700,000 with the intent of holding it for investment. Over a number of years, the land declines in value to $400,000. At that time, the taxpayer makes substantial improvements to the land at a cost of $25,000 and sells parcels of the land for total proceeds of $600,000. Assuming the land is dealer property at the time of the eventual sales, the taxpayer will recognize an ordinary loss of $125,000 under tax law's collapsed approach.[51] If tax law adopted a bifurcated approach, by contrast, the taxpayer would recognize a $300,000 capital loss attributable to the decline in the land's value that accrued while it was held as an investment and $175,000 of ordinary income attributable to the gain that accrued while the real estate was dealer property. Due to restrictions on taxpayers' ability to deduct capital losses, the results produced by the bifurcated approach may be less taxpayer-favorable than the results of the collapsed approach in this example.[52] Furthermore, because the results of the collapsed approach are more favorable, a well-advised taxpayer would have no reason to structure the transaction to achieve bifurcation.[53]

3. Disposition of Property Subject to Nonrecourse Debt in Excess of Fair Market Value

When a taxpayer disposes of property subject to nonrecourse debt that exceeds the value of the property, tax law could, in theory, employ a bifurcated approach—treating the transaction as involving a disposition of property and a repayment of less than the amount borrowed.[54] Indeed, a well-known amicus brief submitted when the Supreme Court considered the *Commissioner v. Tufts* case advocated for a bifurcated approach, and while the Supreme Court instead adopted a collapsed approach, Justice O'Connor noted in a concurring opinion that a bifurcated approach might be more conceptually correct.[55] In lieu of the bifurcated approach, the collapsed approach adopted by the Court in *Tufts* and embodied in the Treasury Regulations collapses the two transactions into one—a disposition of property.[56] To demonstrate, consider the following example:

> **Example 3**. Imagine Charles acquires land for $1,000,000 using $200,000 cash and $800,000 in proceeds from borrowing on a nonrecourse basis secured by the land. Subsequently, the land declines in

50. *See, e.g.*, Borden, Brown & Wagner, *supra* note 38, at 305. Other considerations are also key, including using the right type of controlled entity. *See*, *e.g.*, *id.* at 304.

51. *See*, *e.g.*, *id.* at 296–99. For further discussion of the collapsed approach, see, for example, Yorio, *supra* note 38, at 5.

52. See I.R.C. § 1211 for restrictions on the deductibility of capital losses.

53. Moreover, if the taxpayer were to attempt to achieve bifurcation by selling the property to an entity related to the taxpayer, the taxpayer would be unable to deduct the resulting loss. *See* I.R.C. § 267(a).

54. *See* Comm'r v. Tufts, 461 U.S. 300, 317–18 (1983) (O'Connor, J., concurring).

55. *Id.* at 317–20.

56. *See id.* at 317 ; Treas. Reg. §§ 1.1001-2(a)(1), 1.1001-2(c) (example 7) (1980).

value to $700,000. At a time when there is still $800,000 outstanding on the loan, the lender forecloses on the property.

In Example 3, Charles will recognize a $200,000 loss from a sale of the land.[57] This transaction could be conceptualized as involving two transactions in one, suggesting that a bifurcated approach may better reflect what occurred. One transaction entails the disposition of land worth $700,000 that was purchased for $1,000,000. The second transaction involves borrowing $800,000 and effectively repaying only $700,000 by providing the lender with land worth $700,000 to repay the debt.

Alternatively, one might conclude that the transaction is better conceptualized as a disposition of the property in exchange for the amount of the debt and that this characterization justifies a collapsed approach.[58] However, even if viewed this way, it remains the case that Charles could engage in two separate transactions that mimicked (at least from his perspective) the non-tax effects of the transaction in which he engaged. In particular, if the lender is willing, he could reach the same end result if he paid $700,000 to the lender which the lender agreed to accept as satisfaction of the debt, and he then sold the property for $700,000.[59]

Considering this different path to the same end result suggests a possible alternative tax treatment of the combined transaction in which Charles, in fact, engaged. In particular, Charles could recognize a $300,000 loss from disposition of the land and $100,000 of cancellation of indebtedness income attributable to, in effect, repaying $100,000 less than the amount initially borrowed.[60] Instead of adopting this bifurcated approach, tax law collapses the two elements of the transaction into one.[61] Specifically, existing law essentially treats Charles as if he disposed of land purchased for $1,000,000 in exchange for repayment of the $800,000 debt so that he recognizes a $200,000 loss from sale of the land.[62]

In some cases, the results of the bifurcated approach may be more favorable to taxpayers than the results of the collapsed approach.[63] For instance,

57. *See Tufts*, 461 U.S at 317; Treas. Reg. §§ 1.1001-2(a)(1), 1.1001-2(c) (example 7) (1980).

58. *See, e.g.*, Douglas A. Kahn & Jeffrey H. Kahn, Federal Income Tax: A Guide to the Internal Revenue Code, ¶ 24.1511–1B (7th ed. 2016) ("If a loan is made to a [taxpayer] on a nonrecourse basis, the lender implicitly agrees to accept the encumbered property as full payment for the outstanding balance of the debt if the debtor does not satisfy the debt in cash or other property. . . . The debtor effectively has a put to sell the property to the creditor at any time for the then balance of the debt."); Alvin D. Lurie, *Crane's Ghost Still Spooks Tax Law: Cf.* Owen, 53 Tax Law. 363, 372 (2000) ("Another way of looking at it is that the owner, in effect, holds a put equal to the face amount of the mortgage, which establishes a floor under the value of the property as far as he is concerned.").

59. For further discussion, see *infra* notes 66–68 and accompanying text.

60. *See, e.g.*, Lawrence Zelenak, *Thinking About Nonliteral Interpretations of the Internal Revenue Code*, 64 N.C. L. Rev. 623, 656–57 (1986) (further discussing this approach).

61. *See, e.g.*, Geier, *supra* note 21, at 116–19.

62. *See, e.g.*, *id.* (noting that, when debt is recourse, tax law adopts a bifurcated approach, while, when debt is nonrecourse, tax law utilizes a collapsed approach).

63. *See, e.g.*, *id.* at 163; Adam M. Leamon, *Section 108 of the I.R.C. and the Inclusion of Tufts Gain: A Proposal for Reform*, 50 B.C. L. Rev. 1243, 1262–64 (2009); Fred T. Witt, Jr. & William H. Lyons, *An Examination of the Tax Consequences of Discharge of Indebtedness*, 10 Va. Tax Rev. 1, 60–61 (1990).

under certain circumstances, the Internal Revenue Code grants relief to a taxpayer who recognizes cancellation of indebtedness income, allowing the taxpayer to exclude it from income at the time that it is recognized.[64] A taxpayer who is allowed to exclude cancellation of indebtedness income may fare better under the bifurcated approach. In Example 3, for instance, such a taxpayer would recognize $100,000 of cancellation of indebtedness income that could be excluded from income currently and a $300,000 loss that could result in current tax savings, assuming the taxpayer recognized other gains from which the loss could be deducted.[65] By contrast, under the collapsed approach, the same taxpayer recognizes only a $200,000 loss, resulting in less potential current tax savings.

If the bifurcated approach produces a more favorable tax outcome, a taxpayer with access to sufficiently sophisticated advice at the time of the transaction may be able to structure their transaction to achieve the outcome of the bifurcated approach.[66] In particular if the taxpayer, as two separate transactions, first negotiates a repayment of the $800,000 loan in exchange for $700,000 and second, disposes of the land for $700,000, then the taxpayer achieves the tax outcome of the bifurcated approach assuming the two transactions are respected as separate.[67] If the transactions are not respected as separate, a taxpayer's attempt to use this strategy would be unsuccessful.[68]

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64. I.R.C. § 108. Section 108 provides relief, for instance, in cases of bankruptcy or insolvency. I.R.C. §§ 108(a)(1)(A)–(B). In many circumstances, the relief provided by Section 108 is accompanied by the requirement that the taxpayer reduce certain tax attributes which results in the taxpayer including a greater amount in income in another year. *See* I.R.C. § 108(b). As a result, in many cases, the relief afforded by Section 108 is the ability to defer recognition of income rather than exclude the income entirely. *See id.*

65. As another illustration, imagine a taxpayer who owns a building with a basis of $80,000 and a fair market value of $100,000 that is subject to nonrecourse debt of $130,000. If the lender forecloses on the property, the current collapsed approach results in the taxpayer recognizing a $50,000 gain from sale of the building, none of which can be excluded from income under Section 108. If, instead, tax law employed a bifurcated approach, the taxpayer would recognize a $20,000 gain from sale of the building and $30,000 of cancellation of indebtedness income that could be excluded from income currently if Section 108 applied. *See* I.R.C. § 108(a)(1).

66. *See, e.g.*, Geier, *supra* note 21, at 121 (noting that current law has resulted in "structuring of transactions that exploit these discontinuities"); Leamon, *supra* note 63, at 1262, 1264–66; Witt & Lyons, *supra* note 63, at 61 (describing different structuring options that could lead to more favorable tax results); Ethan Yale, *Anti-Basis*, 94 N.C. L. Rev. 485, 530 (2016) ("In transfers involving asset-liability packages, gain or loss on the asset and liability aspects of the transaction should be reckoned separately; if they are combined, income is mischaracterized, and some taxpayers harmed by the mischaracterization will have a de facto option to change the characterization by settling the debt in a separate transaction.").

67. In a 1991 Revenue Ruling, for instance, a taxpayer borrowed $1,000,000 on a nonrecourse basis and used it to acquire a building from another party. The lender took a security interest in the building. Rev. Rul. 91-31, 1991-20 C.B. 19. At a time when the building was worth $800,000 and the amount of debt outstanding was still $1,000,000, the lender agreed to reduce the principal amount to $800,000. *Id.* The ruling concluded that the taxpayer realized $200,000 of cancellation of debt income as a result. *Id.* at 2.

68. Consider, for instance, a Fifth Circuit case from 1999, in which a taxpayer owned a building that was subject to nonrecourse debt. 2925 Briarpark, Ltd. v. Comm'r, 163 F.3d 313, 314–15 (5th Cir. 1999). In connection with a sale of the building, the lender agreed to release the liens to which the building was subject, conditional on the lender receiving the proceeds of the cash sale. *Id.* at 315. The taxpayer reported the excess of the amount of debt over

In other cases, the results of the bifurcated approach may be less favorable to taxpayers than the results of the collapsed approach. For instance, in Example 3, the bifurcated approach likely produces a less beneficial outcome than the collapsed approach for a taxpayer who does not meet the requirements that allow for current exclusion from income of cancellation of indebtedness income. To demonstrate, imagine an individual taxpayer recognizes $300,000 of capital gain from other transactions, and imagine the taxpayer is subject to a tax rate of 37% on ordinary income and a tax rate of 20% on capital gain. Furthermore, assume the taxpayer holds the land as a capital asset so that any loss from sale of the land is treated as a capital loss.[69] Under the collapsed approach, the taxpayer recognizes a $200,000 capital loss from sale of the land that offsets $200,000 of capital gain, resulting in a $40,000 tax savings.[70] Under the bifurcated approach, the taxpayer recognizes $100,000 of cancellation of indebtedness income that is treated as ordinary income,[71] and a $300,000 capital loss from sale of the land. The $300,000 capital loss offsets the $300,000 capital gain, resulting in a $60,000 tax savings, while the $100,000 cancellation of indebtedness income results in a $37,000 tax liability. In total, the bifurcated approach increases the taxpayer's tax liability by $17,000 compared to the collapsed approach. A well-advised taxpayer who fares better under the collapsed approach has no reason to structure their transaction to opt into the results of the bifurcated approach.

B. Bifurcated Approach

In the examples described above in Section II.A, tax law adopts a collapsed approach—treating as one consolidated transaction what could be conceptualized as two transactions in one (and perhaps more importantly, what could be replicated by carrying out two separate transactions). At the same time, tax law leaves open the opportunity for taxpayers to carry out the equivalent, separate transactions when doing so is more advantageous.

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the amounts paid to the lender as cancellation of indebtedness income. *Id.* at 316. The IRS asserted, and the court held, instead, that the debt from which the taxpayer was discharged should be treated as an amount realized on sale of the building. *Id.* The Fifth Circuit's decision upheld the Tax Court's holding. *Id.* at 319. The court reasoned that the sale and loan discharge were not two independent transactions. *Id.* at 319 ("[T]he debt forgiveness in the case herein was closely intertwined with the terms of the agreement. Therefore, this was a single transaction . . . ."). As the Tax Court explained, "[The lender] conditioned the discharge of the loans upon the sale of the property, and [the buyer] conditioned the purchase upon that discharge. At the end of the day, [the lender] had proceeds from the sale, [the buyer] had the property, and [the taxpayer] was relieved of the entire balance of the loans. In the foregoing context, the arrangements . . . embodied a single transaction to sell the property securing the loans." *Id.* at 317.

69. *See* I.R.C. §§ 1222(2), (4) (2021) (defining short-term capital loss and long-term capital loss as losses arising from sale or exchange of a capital asset).

70. *See id.* § 1211(b) (2021) (allowing non-corporate taxpayers to deduct capital losses fully against capital gains and to a limited extent against ordinary income).

71. *See, e.g.*, Geier, *supra* note 21, at 127 ("COD income is ordinary and potentially deferrable under Section 108 while gain from the sale of an asset is most likely capital, at least in part, and not deferrable.").

In other contexts, tax law dissects a transaction into its separate components so that the taxpayer receives the same tax treatment regardless of whether the taxpayer undertakes two transactions in one or goes through the motions of carrying out the transactions separately. Examples that fall into this category include: (1) tax law's treatment of transfers of property to charitable organizations in exchange for less than fair market value consideration; (2) tax law's treatment of the disposition of property subject to recourse debt in excess of the property's fair market value; (3) tax law's treatment of distributions made by a corporation to its shareholder that are, in part, consideration for services (or something else of value) and, in part, distributions made with respect to the shareholder's stock; (4) tax law's treatment of transactions that are, in part, a contribution of property to a corporation in exchange for stock and, in part, a shift in value from one shareholder to another; and (5) tax law's treatment of the sale of property held by a partnership that was contributed to the partnership by one of its partners. Each example is discussed, in turn, below.

1. Bargain Sale to Charity

If a taxpayer transfers property to a charitable organization in exchange for payment that is less than the fair market value of the property, tax law generally divides the transaction into a donation and a sale.[72] As a result, the tax consequences mirror what would occur if the taxpayer instead engaged in two separate, equivalent transactions that entailed donating a portion of the property and selling a portion of the property. To demonstrate, consider the following example:

> **Example 4**. Jan owns stock that she acquired several years ago for $70. The stock is currently worth $100. Jan transfers the stock to a charitable organization in exchange for $50.

In Example 4, tax law effectively treats Jan as if she sold half of the stock (acquired for $35) to the organization in exchange for $50 and made a contribution of the remaining half of the stock (acquired for $35).[73] As a result, tax law bestows upon her the same tax consequences that she would achieve if she, in fact, sold half of the stock to the organization for $50 and donated the remaining half of the stock.

2. Disposition of Property Subject to Recourse Debt in Excess of Fair Market Value

When a taxpayer disposes of property subject to recourse debt that exceeds the value of the property and obtains relief from the excess amount of the debt, tax law treats the transaction as involving two transactions in

72. *See, e.g.*, Crawford & Blattmachr, *supra* note 23, at 806–10 (describing the tax treatment of bargain sales to a charity and contrasting it with the tax treatment of bargain sales to individuals); James J. Freeland, Guy B. Maxfield & Edward E. Sawyer, *Part Gift-Part Sale: An Income Tax Analysis with Policy Considerations*, 47 Tax L. Rev. 407, 421–22 (1992).

73. I.R.C. § 1011(b) (2021); Treas. Reg. § 1.1011-2 (2022).

one—a disposition of property and a repayment of less than the amount borrowed.[74] To demonstrate, consider the following example:

> **Example 5**. Imagine Selena acquires land for $1,000,000, using $200,000 cash and $800,000 proceeds from borrowing on a recourse basis secured by the land. Subsequently, the land declines in value to $700,000. At a time when there is still $800,000 outstanding on the loan, the lender forecloses on the property and does not pursue a deficiency judgment against Selena for the remaining $100,000 owed on the debt.

In contrast to the parallel Example 3 discussed above involving nonrecourse debt, in Example 5, when the debt is recourse, the transaction is bifurcated into two transactions.[75] One transaction entails the disposition of land worth $700,000 that was purchased for $1,000,000 and results in Selena recognizing a $300,000 loss from disposition of the land.[76] The second transaction involves borrowing $800,000 and repaying only $700,000, resulting in Selena recognizing $100,000 of cancellation of indebtedness income.[77]

3. Disguised Dividends

If a corporation makes a payment to a shareholder for services or property that exceeds the fair market value of the services or property provided by the shareholder, in some circumstances, the transaction will be treated as if the payment was, in part, a payment made for services or property and, in part, a distribution to the shareholder on account of holding stock in the corporation.[78] Thus, what is in essence two transactions in one receives the same treatment that would occur if the combined transaction was, in fact, carried out as two separate transactions. To demonstrate, consider the following example:

> **Example 6**. Steve owns 100% of the stock of a corporation. Steve provides services to the corporation worth $50 and receives a cash payment of $90 in exchange.

In Example 6, Steve and the corporation likely will be treated as if the corporation paid $50 to Steve in exchange for services and distributed $40 to Steve with respect to the stock he owns in the corporation.[79]

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74. Treas. Reg. §§ 1.1001-2(a)(2), 1.1001-2(c) (example 8) (2022).
75. Treas. Reg. §§ 1.1001-2(a)(2), 1.1001-2(c) (example 8) (2022); *see also*, Geier, *supra* note 21, at 116–19 (noting that, when debt is recourse, tax law adopts a bifurcated approach, while, when debt is nonrecourse, tax law utilizes a collapsed approach).
76. Treas. Reg. §§ 1.1001-2(a)(2), 1.1001-2(c) (example 8) (2022).
77. *Id.*
78. *See, e.g.*, Joni Larson, *Corporate Distributions and Compensation Distinguished*, 7 Mertens Law of Fed. Income Tax'n § 25E:5.
79. *Id.*

4. *Transactions Involving the Contribution of Property to a Corporation in Exchange for Stock and a Shift in Value from One Shareholder to Another*

If taxpayers contribute property to a corporation in exchange for stock holdings that are disproportionate to the relative value of the property they contributed, the transaction will be taxed based upon its substance. This can involve bifurcating the transaction into a contribution to the corporation of property in exchange for proportionate stock holdings and a transfer of stock from one shareholder to the other.[80] To demonstrate, consider the following example:

> **Example 7**. A parent and their child form a new corporation. The parent contributes property worth $8,000 in exchange for 20% of the corporation's stock. The child contributes property worth $2,000 in exchange for 80% of the corporation's stock.

The Treasury Regulations provide that, if it is determined that the shift in value from the parent to the child is a gift for tax purposes, the transaction will be treated as if (1) the parent contributed property worth $8,000 in exchange for 80% of the stock while the child contributed property worth $2,000 in exchange for 20% of the stock and (2) the parent transferred 60% of the stock to the child as a gift.[81] Thus, the combined transaction receives the same tax treatment that would have followed if the parties had, in fact, separated the transaction into these two steps that are, in combination, equivalent to the transaction they undertook from a non-tax perspective.

Tax law utilizes a similar approach if the receipt of disproportionate stock holdings represents, in substance, something other than a gift. For instance, if the disproportionate receipt of stock represents compensation for services, the transaction will be treated as if the parties had, first, contributed property in exchange for stock holdings that were proportionate to the relative value of what they contributed and, second, one party transferred some stock to the other party as compensation for services.[82]

5. *Sale by a Partnership of Contributed Property*

When a taxpayer contributes property to a partnership in exchange for an interest in the partnership, the taxpayer generally does not recognize any tax gain or loss at the time of the contribution.[83] When the partnership subsequently sells the property and recognizes tax gain or loss, it must take into account the gain or loss that had accrued at the time of the contribution when determining how to properly allocate among the partners the tax gain or loss resulting from sale.[84] In effect, the gain or loss that the

80. Treas. Reg. § 1.351-1(b)(1) (2022).
81. *Id.* § 1.351–1(b)(2) (example 1).
82. *Id.* This equalizes the tax treatment with this alternative. It does not lead to the same tax treatment as another alternative—transferring the property as compensation and then contributing it to the corporation.
83. I.R.C. § 721 (2021).
84. *Id.* § 704(c)(1)(A), (C) (2021).

partnership recognizes is bifurcated into the portion that accrued prior to the contribution and the portion that accrued after the contribution. To illustrate, consider the following example:

> **Example 8**. Martin acquires land for $40. At a time when the land is worth $100, Martin and Selena form a partnership. Martin contributes the land to the partnership in exchange for a 50% interest, and Selena contributes $100 cash to the partnership in exchange for a 50% interest. Subsequently, the partnership sells the land for $120.

In Example 8, at the time that he contributes the land to the partnership, Martin recognizes no gain for tax purposes.[85] When the partnership sells the land, the partnership recognizes an $80 tax gain.[86] The partnership itself is not subject to entity-level tax on the gain that it recognizes but rather allocates the gain among the partners to take into account when computing their own tax liability.[87] Rather than allocate the entire $80 gain equally to Martin and Selena, the partnership will allocate a $70 gain to Martin and a $10 gain to Selena.[88] In effect, the entire $60 gain that accrued before he contributed the land to the partnership is allocated to Martin, and the $20 gain that accrued after Martin contributed the land to the partnership is allocated equally between Martin and Selena.

Allocating the gain in this manner ensures that the tax gain allocated to each partner corresponds to the partner's economic gain. After the sale of the land, the partnership holds $220 of cash and no other assets and bears no liabilities. Thus, each partner's 50% interest in the partnership is worth $110. Martin acquired land for $40 and contributed it to a partnership in exchange for an interest that is now worth $110. Thus, Martin has realized a $70 economic gain, so that allocating a $70 tax gain to Martin corresponds to his economic gain. Selena contributed $100 cash to a partnership in exchange for an interest that is now worth $110. As a result, she realized an economic gain of $10, which is consistent with the $10 tax gain allocated to her.

While separating the tax gain recognized by the partnership into the components that accrued before and after contribution of the property is necessary to ensure that the allocation of tax gain coincides with economic gain, it was not always the case that partnerships were required to bifurcate tax gain in this manner.[89] Indeed, prior to 1984, partnerships were provided the option of bifurcating the gain in the manner described above but not required to do so.[90] If the partnership did not opt to do so, the $80 tax gain

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85. *Id.* § 721 (2021).
86. *Id.* § 723 (2021) (providing that the partnership takes a basis in the land equal to Martin's $40 basis); *id.* § 1001(a)–(c) (2021) (providing that the gain recognized by the partnership will equal the difference between the $120 selling price and the partnership's $40 basis).
87. *Id.* § 701 (2021).
88. *Id.* § 704(c)(1)(A) (2021); Treas. Reg. § 1.704-3 (2022).
89. *See* I.R.C. § 704(c)(1)–(2) (1954).
90. *Id.*

recognized by the partnership would be allocated equally to each partner.[91] One justification offered by legislative history for not requiring bifurcation of the gain was simplification.[92] It seems that lawmakers viewed the approach that did not involve bifurcation as simpler because partnerships could allocate tax items recognized with respect to contributed property in the same manner as other items.[93] Perhaps lawmakers also viewed the method entailing bifurcation as more complicated because it requires valuation of the property as of the time of contribution.

C. Hybrid Approach

In the examples described above in Section II.A., taxpayers achieve different tax treatment by engaging in composite transactions rather than undertaking the components of the transaction separately. By contrast, Section II.B presented examples of instances when tax law bestows the same tax treatment regardless of whether the two transactions are undertaken together or apart. A final set of examples occupy a middle ground. Tax law acknowledges that a transaction involves two transactions folded into one and, to some extent, disentangles the two when assigning tax outcomes. However, the resulting tax treatment does not precisely mirror what would occur had the taxpayer, in fact, engaged in the two transactions separately. This Part will describe two examples of this approach—the treatment of part-gift and part-sale transactions outside of the charitable donation context and the receipt of so-called "boot" in a non-recognition transaction like Section 1031.

1. Part-Gift, Part-Sale Transactions

If a taxpayer sells property at a bargain under circumstances that suggest that the bargain is, in substance, a gift, tax law will treat the transaction

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91. *See id.* If the partnership were to subsequently distribute the $220 cash that it held equally to each partner in liquidation, upon receipt of $110 cash, Martin would recognize a $30 tax gain, and Selena would recognize a $30 tax loss. However, these subsequent tax items would not, necessarily, make up for the shift of $30 of the gain that accrued before contribution from Martin to Selena, given that the later items may not be recognized until a later year. Martin would recognize a $30 tax gain upon receipt of a $110 cash liquidating distribution because a partner who receives a cash distribution that exceeds the partner's basis in their partnership interest recognizes gain in the amount of the excess. *Id.* § 731(a)(1) (2021). $110 would exceed his basis in his partnership interest by $30 because his initial basis in his partnership interest would be $40 (his basis in the land), and this would later be increased by the $40 gain allocated to him upon sale of the land. *See id*. §§ 722, 705(a) (2021). Upon receipt of a $110 cash liquidating distribution, Selena would recognize a $30 tax loss. A partner who receives a liquidating distribution consisting of only cash that is less than the partner's basis in their partnership interest recognizes tax loss in the amount of the difference. *See id.* § 731(a)(2) (2021). $110 would be $30 less than Selena's basis in her partnership interest because her initial basis in her partnership interest would be $100 (the cash she contributed), and this would later be increased by the $40 gain allocated to her upon sale of the land. *See id.* §§ 722, 705(a) (2021).

92. S. Rep. No. 83-1622, at 90 (1954).

93. *Id.* (discussing how the sharing of tax items with respect to contributed property is identical to the sharing of tax items with respect to non-contributed property unless the partnership elects to take into account pre-contribution gain or loss when allocating items).

as partly a sale and partly a gift.[94] However, assuming the recipient is not a charitable organization, the tax consequences diverge from what would occur if instead the taxpayer had sold a portion of the property and transferred a portion of the property as a gift in separate transactions.[95] To demonstrate, consider the following example:

> **Example 9**. A mother owns a plot of land that she purchased many years ago for $20,000. At a time when the fair market value of the land is $100,000, the mother sells the land to her adult daughter for $50,000.

Likely, the transaction in Example 9 is viewed in part as a sale because the mother receives some payment for the land from her daughter and in part as a gift because the mother sells the land to her daughter at a discount. Because she sells it for $50,000, which is more than the $20,000 cost of the land, the mother will realize a $30,000 tax gain.[96] The daughter will take a basis in the land of $50,000, so that if the daughter later sells the land for $100,000, the daughter will recognize a $50,000 tax gain.[97]

This outcome differs from what would occur if the mother and the daughter engaged in two equivalent transactions separately. In particular, imagine the mother sold one-half of the land to her daughter for $50,000 and transferred one-half of the land to her daughter as a gift. On a sale of one-half of the land, the mother would realize a $40,000 tax gain (the difference between $50,000 and $10,000, which is the mother's basis in one-half of the land).[98] The daughter's total basis in the land acquired would be $60,000.[99] Thus, the daughter would recognize a $40,000 tax gain if she later sold the land for $100,000.[100] Compared to the outcome of engaging

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94. *See, e.g.*, Crawford & Blattmachr, *supra* note 23, at 806–10 (describing the tax treatment of bargain sales to a charity and contrasting it with the tax treatment of bargain sales to individuals); Freeland, Maxfield & Sawyer, *supra* note 72, at 408–09.

95. *See, e.g.*, Crawford & Blattmachr, *supra* note 23, at 806–10 (describing the tax treatment of bargain sales to a charity and contrasting it with the tax treatment of bargain sales to individuals); Freeland, Maxfield & Sawyer, *supra* note 72, at 408–09.

96. *See* Treas. Reg. § 1.1001-1(e)(1) (2022).

97. *See* Treas. Reg. § 1.1015-4(a) (2022) (providing that the daughter's basis will be the greater of (1) the amount the daughter pays for the asset ($50,000) or (2) the mother's basis at the time of the transfer ($20,000)). As a result, her basis will be $50,000 because $50,000 is more than $20,000. (This assumes no gift tax is paid so that there is no resulting increase to basis under I.R.C. § 1015(d)). *See* Treas. Reg. § 1.1015-4(a)(2) (2022). Moreover, the Treasury Regulations contain a caveat that, for purposes of determining loss on a later sale, the daughter's basis cannot be more than the fair market value ($100,000) at the time of the transfer. *Id.* Given that $50,000 is not more than $100,000, this rule will not apply here.

98. *See, e.g.*, Freeland, Maxfield & Sawyer, *supra* note 72, at 409–10 (noting that when only a portion of property is sold, typically a portion of the property's basis is assigned to the portion that is sold and that at one time the IRS had taken the position that a similar method should apply even when the taxpayer, as one transaction, engaged in a sale and a gift).

99. She would take a basis of $50,000 in the portion acquired by purchase and $10,000 in the portion acquired by gift. *See* I.R.C. § 1012(a) (2021) (providing, in general, that the basis of property will be cost, so that she takes a $50,000 basis in the portion acquired by purchase); *Id.* § 1015(a) (providing that the transferee takes the transferor's basis in property acquired by gift, subject to an exception if the property's value at the time of the gift is less than basis, so that she takes a $10,000 basis in the portion acquired by gift because the mother's basis in that portion was $10,000).

100. *See id.* § 1001(a)–(c) (2021).

in the transactions together, the outcome of engaging in the transactions separately results in the mother recognizing $10,000 more tax gain at the time of initial transfer and the daughter recognizing $10,000 less tax gain at the time of later sale.

In many cases, the results of engaging in the transactions together will be more taxpayer-favorable. This is the case, for instance, if the mother is subject to a higher tax rate than the daughter because then $10,000 of gain is subject to tax at the daughter's lower tax rate rather than the mother's higher tax rate.[101] In some cases, the results of engaging in the transactions together may be less advantageous to taxpayers than undertaking them separately.[102] For instance, if the daughter were subject to tax at a higher rate than the mother and the daughter planned to sell the land soon after the transfer, then the separate transactions produce a more favorable tax outcome.[103] Presumably, when this is the case, well-advised taxpayers would undertake the transactions separately.[104]

2. *Receipt of Boot in a Like-Kind Exchange*

Provided that various requirements are met, when a taxpayer exchanges real property for other real property, the taxpayer will not recognize any tax gain or loss at the time of the exchange.[105] If, in addition to receiving real property, the taxpayer receives other property (sometimes called "boot"), the taxpayer may recognize some gain but will not recognize loss.[106] Because the receipt of boot triggers gain recognition, tax law, in a sense, acknowledges that the receipt of both real property and boot represents two transactions in one. However, the resulting tax consequences diverge from what would occur if the taxpayer in one transaction exchanged a portion of the real property for entirely real property and in another transaction exchanged a portion of the real property for boot. To demonstrate, consider the following example:

> **Example 10**. Steve holds land (Old Land) for investment purposes that he acquired for $40,000. At a time when Old Land is worth $100,000,

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101. If the mother is subject to a higher rate of tax than the daughter, and the daughter delays selling the stock for a number of years and is still subject to a lower rate of tax at the time of the sale, then it is even more true that engaging in the transactions together is more taxpayer favorable. Doing so would result not only in subjecting a portion of the gain to tax at a lower rate but also in deferring the resulting tax liability to the time of later sale.

102. Engaging in separate transactions can also be more advantageous if the property has a built-in loss (so that a sale would allow the seller to recognize a loss), and the parties are not related within the meaning of I.R.C. § 267(b) so that I.R.C. § 267(a)(1) does not preclude deducting the loss.

103. This is the case because more gain would be subject to tax at the mother's lower tax rate and less gain would be subject to tax at the daughter's higher tax rate.

104. If the gift of a partial interest and sale of a partial interest occur very close in time or otherwise seem to be part of the same transaction, it is possible that the separate transactions could be re-characterized as one part-gift, part-sale transaction, which would undermine the attempt to achieve bifurcated treatment.

105. I.R.C. § 1031(a)(1) (2021).

106. *Id.* § 1031(b)–(c) (2021).

he exchanges it for other land (New Land) that he plans to hold for investment purposes that is worth $50,000 and $50,000 cash.

Under existing tax law, provided that this transaction meets various requirements to qualify for non-recognition treatment, Steve will not recognize for tax purposes the entire $60,000 gain built into the Old Land at the time of the transaction.[107] However, as a result of the receipt of $50,000 in cash, he will recognize $50,000 of that gain.[108]

To demonstrate how this result differs from what would occur if Steve instead engaged in two distinct, equivalent transactions, consider the following example:

Example 11. Steve holds land (Old Land) for investment purposes that he acquired for $40,000. At a time when the Old Land is worth $100,000, he exchanges a 50% interest in Old Land for other land (New Land) that he plans to hold for investment purposes, while he sells a 50% interest in Old Land for $50,000 cash.

If these two transactions are respected as separate transactions and if the exchange of Old Land for New Land qualifies for non-recognition treatment, Steve would recognize gain of only $30,000 as a result of the sale of 50% of the Old Land while he would recognize no gain as a result of the exchange of the remaining interest for New Land.[109] In this instance, the results of engaging in the separate transactions may be more taxpayer-favorable than the results of the combined transaction.[110] Therefore, provided that he is well-advised and willing to take necessary steps to increase the likelihood that the two transactions are respected as separate, he might opt into the more favorable tax outcome by engaging in the separate transactions. The transactions may be more likely to be respected as separate transactions if, for instance, a different party ultimately acquires

107. *Id.* § 1031(b) (2021).

108. *Id.*

109. *See*, *e.g.*, Howard J. Levine & Aaron S. Gaynor, *U.S. Income: Tax-Free Exchanges Under Section 1031*, 567-5th Tax Mgmt. Port. (BNA) § III.C.5 at 124–25 (describing how, at least in the case of multiple asset exchanges, taxpayers might attempt to achieve more favorable tax consequences by fragmenting the transaction into multiple transactions and discussing authority in analogous contexts that might be used to support or challenge the resulting outcome).

110. The trade-off for recognizing $20,000 less tax gain (in particular, $30,000 gain rather than $50,000) is that Steve will take a basis in New Land that is $20,000 lower ($20,000 rather than $40,000) so that, on a later sale of New Land, Steve would recognize $20,000 more tax gain. However, while Steve's ability to include less gain in income is not necessarily a permanent benefit, he may still be better off as a result of the ability to defer recognition of the $20,000 gain. Engaging in structuring to bifurcate a § 1031 transaction involving the receipt of boot into a sale for boot and a like-kind exchange might also be advantageous if the taxpayer is disposing of property that has a built-in loss. In that case, separating the transactions could potentially allow the taxpayer to recognize some tax loss currently, none of which would be recognized if the taxpayer engages in one transaction. *See* I.R.C. § 1031(c) (2021) (providing that no loss is recognized when a taxpayer engages in a Section 1031 transaction and receives boot).

each parcel of Old Land and the parcels of Old Land are not contiguous portions of the same property.[111]

III. MENU OF CONCEIVABLE OPTIONS

The examples discussed above in Part II illustrate three different approaches to taxing two transactions in one. The collapsed approach taxes the combined transaction without disentangling it into its separate components. As a consequence, well-advised taxpayers who fare better from a bifurcated approach to tax treatment can, with some effort, carry out the components of the transaction as separate transactions. The bifurcated approach ensures that carrying out two transactions in one yields the same tax outcome as engaging in the equivalent two transactions separately. When tax law utilizes this approach, taxpayers gain no advantage by structuring the transaction as combined or separate. In some in-between cases tax law, to a degree, takes into account the fact that a transaction involves two components; but nevertheless, treats the combined transaction in a way that is not identical to the tax treatment of its two separate components. Under this hybrid approach, as in the case of the collapsed approach, taxpayers with the resources necessary to engage in tax planning potentially stand to benefit from favorably structuring their transactions.

As Part IV below will discuss, the bifurcated approach offers a multitude of advantages over the collapsed approach and the hybrid approach. Before considering whether a bifurcated approach ought to be adopted in any of the specific contexts where another approach is currently used, it is useful to consider whether any other possible approaches exist.

Indeed, the three general approaches described above do not exhaust the menu of imaginable possibilities. At least two additional approaches are conceivable. First, as a modification to either the collapsed approach or the hybrid approach, tax law could effectively limit taxpayers' ability to engineer their transactions to achieve more favorable tax treatment by treating taxpayers who engage in two separate transactions as if they had engaged in a combined transaction. For example, imagine that Steve engaged in the transaction described above in Example 11 in which he separately sells a 50% interest in Old Land for cash and exchanges a 50% interest in Old Land for New Land. Tax law could treat him as if instead he had engaged in the transaction described in Example 10 (in which, as one transaction, he exchanges Old Land for New Land and cash).

To a degree, the collapsed approach and the hybrid approach already limit taxpayers' ability to engage in tax planning because sometimes taxpayers' efforts to bifurcate a transaction may not be respected. For instance,

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111. *See* Levine & Gaynor, *supra* note 109, at 194 (describing factors relevant to whether two transactions are part of the same § 1031 exchange for purposes of applying certain timing rules and stating, "presumably relevant factors would include: whether the properties are contiguous; whether one property could have been practically or legally transferred without the other property; whether there are separate buyers; whether the properties were acquired at different times and from different sellers; and whether the current sales are interdependent").

in the case of Example 11, if Steve transfers 50% of Old Land in exchange for New Land held by a given buyer close in time to his sale of 50% of Old Land for cash to that same buyer, the transactions may be recharacterized, in substance, as part of the same transaction so that they receive the same tax treatment as Example 10 (in which Steve exchanges Old Land for New Land and cash as one transaction).[112] Thus, adopting an approach that mandates that taxpayers receive the same treatment accorded to a combined transaction, even when they separate the transaction into its different components, may be more a difference of degree than a difference in kind compared to the existing collapsed approach or hybrid approach. Compared to the existing approaches, such an approach would entail increasing the likelihood that separate transactions will not be respected as separate. In the context of Example 11 for instance, one could envision a rule under which transfers of different portions of land that occur within a given period of time will be treated automatically as part of one transaction. Alternatively, in the context of Example 11, transfers of different portions of land occurring within a given period of time could establish a rebuttable presumption that the transfers were part of one transaction.

As a second alternative to the approaches currently utilized, lawmakers could adopt an explicitly elective approach.[113] In the context of Examples 10 and 11 for instance, rather than allowing taxpayers to implicitly elect their tax treatment by either engaging in transactions separately or together, taxpayers could engage in either form of the transaction but file a form electing to treat it as separate or combined. Adopting an explicitly elective approach would require addressing various design questions including the deadline for filing an election and what tax treatment applies by default if no election is filed.

For clarity, it may be useful to consider what each of these approaches would entail in the context of the specific examples of the collapsed approach or hybrid approach described above. At this stage, I am not proposing any of these alternatives. Rather, I am merely illustrating the distinctions among the different options. Each of the alternatives is described in the context of each example below. A discussion of recommendations in specific contexts will follow later after an evaluation of advantages and disadvantages.

A. Merchandise Discounts Dictated by Chance

To illustrate the conceivable options in the context of discounts determined by chance, consider again Example 1 above in which Oliver purchases a couch for $1,000 from a furniture store that agrees to rebate the entire purchase price if the Red Sox win the World Series.[114] At the time of the purchase, the Red Sox are estimated to have a 25% chance of winning.

112. *See supra* note 111 and accompanying text.

113. For a proposal to adopt such an approach in the context of change of purpose for holding real estate see, Borden, Brown & Wagner, *supra* note 38, at 312–22.

114. *See supra* Section II.A.1.

The Red Sox do, indeed, win and Oliver receives a $1,000 rebate. An IRS letter ruling adopts a collapsed approach, treating the entire $1,000 as a discount that Oliver can exclude from income.[115]

As an alternative, tax law could adopt a bifurcated approach. Under such an approach, Oliver would be treated as if he had purchased a couch for $750 and placed $250 on a bet that pays out $1,000 if the Red Sox win.[116] Under this approach, $250 of the $1,000 would be excluded from his income but not the remaining $750.

In theory, a taxpayer could achieve bifurcated tax consequences by, in fact, carrying out separate transactions. In other words, Oliver could buy the couch for $750 and place the $250 bet. In many cases, the tax consequences of carrying out the separate transactions are less favorable as they result in Oliver including a portion of the discount in income, so that Oliver would have no reason to break up the transaction. As a result, precluding taxpayers from planning into bifurcated treatment is unlikely to change the current state of affairs given that many taxpayers have no incentive to bifurcate their transactions. However, in some cases, bifurcated tax consequences could be more beneficial.[117]

Finally, lawmakers could adopt an explicitly elective approach under which taxpayers can file an election to choose between the collapsed approach or the bifurcated approach. Lawmakers would need to determine a deadline for filing such an election and specify the default treatment that would apply in the absence of a filed election.

B. Real Estate and Change of Purpose

To demonstrate the possible alternatives in the context of the sale of real estate that was initially investment property but becomes dealer property, consider again the facts of Example 2 above.[118] In that example, in year one, Mabel acquires undeveloped land for $700,000 with the intent of holding it for investment. From year one to year three, the land increases in value to $1,000,000. In year three, Mabel makes substantial improvements to the land, at a cost of $100,000, and sells parcels of the land for total proceeds of $1,500,000.

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115. *See id.*

116. *See id.*

117. For example, assuming Oliver wins the bet, bifurcated tax consequences cause Oliver to include more in income but also have a higher basis in the furniture. In particular, if he includes nothing in income when he receives the furniture for free, his basis would be $0, while, if he includes $750 in income when he receives the furniture for free his basis would be $750. Imagine Oliver is subject to a low tax rate at the time of the initial transaction and a higher tax rate in later years and Oliver uses the furniture in a business, for instance, and is able to obtain a tax benefit in later years by taking depreciation deductions, which are determined by reference to his basis in the furniture. He might be better off including a larger amount in his income in the year in which he is subject to a low rate of tax if he can, at the same time, get the benefit of higher depreciation deductions in years when he is subject to a high rate of tax. For another example of a situation in which bifurcated tax treatment may be more taxpayer-favorable, see *supra* note 31.

118. *See* Example 2, *supra* Section II.A.2.

Current law employs a collapsed approach but allows taxpayers to engineer their transactions to achieve bifurcated treatment.[119] In particular, assuming the improved land is dealer property in year three, this transaction produces $700,000 of ordinary income.[120] The gain that accrued while the land was investment property and the gain that accrued after Mabel's change of purpose are collapsed into one item that receives ordinary income treatment because Mabel holds the land as dealer property at the time of the ultimate sale.[121] Mabel could achieve a better tax outcome by selling the undeveloped land for $1,000,000 to a related entity that subsequently develops and sells parcels of the land.[122] She would, effectively, bifurcate her gain into the $300,000 that accrued while the land was investment property that would be treated as capital gain while $400,000 would be treated as ordinary income.[123]

One alternative that tax law could adopt is a bifurcated approach.[124] Under such an approach, even without a taxpayer selling the undeveloped land to a related entity, gain (or loss) in the case of a change of purpose would be bifurcated into the portion that accrued while the real estate was investment property, which would receive capital gain (or loss) treatment, and the portion that accrued after the change of purpose, which would receive ordinary income (or loss) treatment.[125]

A second alternative is to retain the current collapsed approach but preclude taxpayers from planning into bifurcated treatment.[126] Under this approach, Mabel recognizes $700,000 of ordinary income in Example 2. Moreover, Mabel's efforts to separate the transaction will not change the result. If she sells the undeveloped land to a related entity that later develops the land, her entire $700,000 gain will still be treated as ordinary income.

A third and final alternative involves utilizing an explicitly elective approach. Other scholars have proposed such a method.[127] Under this approach and under the facts of Example 2, Mabel could file an election that would determine whether her entire $700,000 gain is treated as ordinary income or, instead, is treated in part as capital gain ($300,000) and in part as ordinary income ($400,000). Adopting an elective approach would necessitate addressing a number of design questions. First, if Mabel files no election, is the gain (or loss) collapsed or bifurcated? Second, by when must Mabel file the election? Others have proposed that the election should be filed within a reasonable time of the effective date of the election (in other

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119. *See supra* Section II.A.2.
120. *See id.*
121. *See id.*
122. *See id.*
123. *See id.*
124. *See also* Borden, Brown & Wagner, *supra* note 38, at 318 (describing various alternatives to current law including adopting an explicitly elective approach, allowing bifurcation even without taxpayers structuring transactions to achieve bifurcation, or eliminating bifurcation even when taxpayers attempt to achieve it).
125. *See id.*
126. *Id.*
127. *See id.* at 314–20.

words, within a reasonable time of the date of the taxpayer's change of purpose), perhaps with the tax return for the year in which the change of purpose occurs.[128] An alternative later deadline would require that the taxpayer file the election in the year when the taxpayer ultimately sells the real estate. The earlier deadline may lessen the election's tax revenue-reducing effects because taxpayers cannot wait and see whether the transaction ultimately produces a gain or loss before deciding whether to file.[129] The earlier deadline may also be easier to administer because it requires filing an election close to the time when the taxpayer and the IRS must determine the real estate's value.[130] If, instead, the taxpayer files the election during the year of ultimate sale, the election potentially would be filed many years after the taxpayer's purpose for holding the real estate changed.[131] Yet, the taxpayer and the IRS would need to determine the value of the real estate at the time of the change of purpose to ascertain what amount of gain or loss had accrued while the real estate was held as an investment. While having an earlier deadline may mitigate the election's tax-revenue-reducing effects and may be more administrable, having a later deadline may mitigate the election's tendency to trap unwary taxpayers. Taxpayers may be more likely to obtain tax advice when reporting the tax consequences of an ultimate disposition of the real estate and, in connection with obtaining such advice, could be made aware of the availability of the election and its effects.[132] By contrast, because there is nothing else about the transaction to report in the year when the change of purpose occurs, taxpayers may be less likely to obtain any guidance about the availability and effects of the election at the time of the change of purpose for holding the real estate.[133]

C. Disposition of Property Subject to Nonrecourse Debt in Excess of Fair Market Value

To demonstrate the possibilities in the context of a disposition of property subject to nonrecourse debt that exceeds the value of the property, consider Example 3 above.[134] In that example, Charles acquires land for $1,000,000, using $200,000 cash and $800,000 proceeds from borrowing on a nonrecourse basis secured by the land.[135] Subsequently, the land declines

128. *See id.* at 316–17.
129. *See id.* at 319–20.
130. Along similar lines, see *id*. at 320 ("Requiring the election to be made at the time of conversion would help ensure that the property owners determine the fair market value of the property at that time and reduce the potential for manipulation later.").
131. *See id.* at 318–19.
132. Ultimately, whether or not this is true is an empirical question. However, it is quite plausibly the case, and existing data provides at least some support. In particular, existing data does show that a significant number of taxpayers seek assistance at the tax reporting stage. For example, in 2001, 67% of lower-income taxpayers claiming the EITC used paid preparers. *See* Leslie Book, *Preventing the Hybrid from Backfiring: Delivery of Benefits to the Working Poor Through the Tax System*, 2006 Wis. L. Rev. 1103, 1115.
133. *See infra* Part V.
134. *See* Example 3, *supra* Section II.A.3.
135. *See id.*

in value to $700,000.[136] When there is still $800,000 outstanding on the loan, the lender forecloses on the property.[137]

Current law employs a collapsed approach to this transaction.[138] Rather than disentangling it into a component that involves the land (producing a $300,000 loss) and a component that involves the debt (producing $100,000 of income), Charles recognizes only one item (a $200,000 loss).[139] Tax law allows Charles to structure his transaction to achieve a different outcome.[140] If he engages in separate transactions—one that involves repaying $700,000 to the lender in satisfaction of the debt and one that involves sale of the property for $700,000—then his tax consequences will be bifurcated into $100,000 of cancellation of indebtedness income and a $300,000 loss from sale of the land, as long as the transactions are respected as separate.[141]

One alternative approach tax law could adopt is a bifurcated approach.[142] Under such an approach, regardless of whether Charles carries out the transaction in two parts or one, he will recognize $100,000 of cancellation of indebtedness income and a $300,000 loss from sale of the land.[143]

As a second possibility, tax law could continue to use a collapsed approach but preclude taxpayers' attempts to plan out of collapsed treatment.[144] Under this approach, even if Charles engaged in two separate transactions, he would be treated as if the lender had simply foreclosed on the property so that he would recognize a $200,000 loss from disposition of the land.[145]

As a final possibility, tax law could employ an explicitly elective approach.[146] Under such an approach, the parties could file an election that would dictate whether the foreclosure would receive collapsed or bifurcated treatment.[147] Adopting an explicitly elective approach would require setting a deadline for filing the election and determining what treatment applied by default in the absence of a filed election.[148]

136. *Id.*
137. *Id.*
138. *See supra* Section II.A.3.
139. *See id.*
140. *See id.*
141. *See id.*
142. *See id.*
143. *See id.*
144. For discussion of the existing ability (and existing limitations on the ability) to plan out of collapsed treatment, see *supra* notes 66–68.
145. Even under current law, in some cases, the two separate transactions may not be respected as separate transactions. *See supra* note 68 and accompanying text.
146. See *supra* note 14 for a discussion of the explicit tax election terminology.
147. Indeed, under some circumstances, when the terms of a debt instrument are modified as part of a sale or exchange, the parties can explicitly elect whether the modification will be treated as occurring before or after the exchange. *See* Treas. Reg. §§ 1.1274-5(b)(1)–(2) (1994).
148. Filing deadlines and default rules are key parameters for any tax election. *See* Field, *supra* note 14, at 66–67, 70.

D. Part-Gift Part-Sale Transactions

To take stock of the available options in the context of part-gift part-sale transactions, consider again Example 9 above.[149] In that example, a mother owns land that she acquired for $20,000.[150] At a time when the fair market value of the land is $100,000, the mother sells the land to her daughter for $50,000.[151] Under current law, the mother realizes a $30,000 tax gain, and the daughter takes a basis in the land of $50,000; if the daughter later sells the land for $100,000, the daughter will recognize a $50,000 tax gain.[152] If the individuals would fare better from a fully bifurcated approach, the mother could, in fact, sell one half of the land to her daughter for $50,000 and transfer one half of the land to her daughter as a gift.[153] Engaging in two separate transactions would cause the mother to realize a $40,000 tax gain and the daughter to take a total basis in the land of $60,000 so that the daughter would recognize a $40,000 tax gain if she later sold the land for $100,000.[154]

As one alternative to current law, tax law could adopt a bifurcated approach.[155] Under such an approach, regardless of whether the taxpayers engaged in two separate transactions or folded the two transactions into one, they would achieve the same tax outcome—namely, the mother realizing a $40,000 tax gain and the daughter taking a $60,000 basis in the land.

As a second alternative, tax law could continue to treat the combined transaction the way that it currently does.[156] In other words, the mother would continue to realize a $30,000 tax gain while the daughter would take a basis in the land of $50,000.[157] However, unlike current law, tax law could thwart taxpayers' attempts to structure their transactions to achieve fully bifurcated treatment.[158] In particular, tax law could treat a separate transfer of a portion of the land by gift and a sale of a portion of the land as part of one transaction, resulting in the mother realizing a $30,000 tax gain and the daughter taking a basis in the land of $50,000.

As a final alternative, tax law could make use of an explicitly elective approach—taxpayers engaging in a part-gift, part-sale transaction could file an election that would determine whether the transaction could receive the treatment accorded by current law or, instead, the fully bifurcated treatment.[159] Adopting an explicitly elective approach would require

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149. *See* Example 9, *supra* Section II.C.1.
150. *Id.*
151. *Id.*
152. *See supra* Section II.C.1.
153. *See id.*
154. *See id.*
155. This would parallel the approach used in the case of a bargain sale to charity. For discussion of bargain sales to charity, see *supra* Section II.B.1.
156. For discussion of current law's approach, see *supra* Section II.C.1.
157. *Id.*
158. For discussion of the potential for structuring part-gift part-sale transactions to achieve fully bifurcated treatment, see *id.*
159. For discussion of the explicit tax election terminology, see *supra* note 14.

answering a number of design questions.[160] First, lawmakers would need to determine the deadline for filing the election. Perhaps, for instance, taxpayers would be required to file it with the tax return for the year in which the part-gift, part-sale transaction occurred. Second, lawmakers would need to determine whether, in the absence of an election to the contrary, taxpayers would by default receive the outcome available under current law or, instead, would receive the fully bifurcated result. Finally, given that the election affects both the donor–seller and the donee–buyer, lawmakers would need to decide whether one (and, if so, which one) or both of the parties must file the election for it to be effective.

E. Receipt of Boot in a Like-Kind Transaction

Finally, to inventory the possible approaches to the treatment of the receipt of boot in a like-kind transaction, consider again Example 10 above.[161] In that example, Steve holds Old Land for investment purposes that he acquired for $40,000.[162] At a time when Old Land is worth $100,000, he exchanges it for New Land that he plans to hold for investment purposes that is worth $50,000 and $50,000 cash.[163] Under current law, Steve likely recognizes a $50,000 tax gain as a result of this transaction.[164] This differs from what would occur if he exchanged a 50% interest in Old Land for New Land while selling a 50% interest in Old Land for cash. In particular, if he engaged in those two separate transactions, he would recognize a $30,000 tax gain.[165]

In lieu of current law, tax law could utilize a bifurcated approach under which Steve would recognize a $30,000 tax gain regardless of whether he engaged in two separate transactions or an equivalent, combined transaction.[166] As a second alternative, tax law could strictly limit the effectiveness of tax planning by treating Steve's attempt to engage in separate transactions as if he, instead, engaged in one combined transaction so that he recognizes a $50,000 tax gain regardless of whether he engages in two separate transactions or an equivalent combined transaction.

As a final alternative, lawmakers could give taxpayers the ability to explicitly elect between the two outcomes.[167] In other words, when Steve engaged in the combined transaction, he could file an election that would dictate whether he recognized a $30,000 tax gain or a $50,000 tax gain.[168]

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160. *See also* Field, *supra* note 14, at 66–73 (describing "Key Considerations for Designing Explicit Elections" generally).

161. *See* Example 10, *supra* Section II.C.2.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. *See also* Stephen B. Cohen, *Apportioning Basis: Partial Sales, Bargain Sales and The Realization Principle*, 34 San Diego L. Rev. 1693, 1704 (1997).

167. For discussion of the explicit tax election terminology, see *supra* note 14.

168. While it may seem clear that Steve would opt for the lower amount of gain, this is not always the case. If Steve recognizes less gain, he also takes a lower basis in New Land so that he will recognize more gain on a later sale of New Land. Generally, taxpayers will benefit from the ability to recognize gain later rather than sooner. However, not always.

Lawmakers would need to determine the deadline for filing the election.[169] Perhaps it would be due with the taxpayer's tax return for the year of the transaction. In addition, lawmakers would need to specify whether, in the absence of the election, the existing approach or the bifurcated approach dictated the resulting tax consequences by default.[170]

IV. ADVANTAGES AND DISADVANTAGES

There are various advantages and disadvantages inherent in each of the conceivable options described above. This Section will proceed by analyzing how each option would fare when judged by various metrics—namely: (1) the approach's propensity to reduce tax revenue, (2) the approach's tendency to trap unwary taxpayers and benefit well-advised taxpayers, (3) the degree of inefficiency caused by the approach, and (4) the administrability of the approach. As this discussion will reveal, the bifurcated approach is generally superior across all metrics except administrability; further, in some contexts the challenges of administering a bifurcated approach are less severe than in other contexts.

A. Tax Revenue Loss

In the context of any given example discussed above in Section II, neither the collapsed (nor hybrid) approach nor the bifurcated approach is universally more favorable than the other approach for all taxpayers.[171] In general terms, the reason that one approach is not universally more taxpayer-favorable is that taxpayers have different tax profiles. For example, some may be subject to a higher effective tax rate on one type of income than another; for others the reverse may be true. To take some specific examples, in Example 3 discussed above in which a taxpayer disposes of property with a value less than the nonrecourse debt secured by the property, whether the collapsed approach or the bifurcated approach is more taxpayer-favorable often depends on whether the taxpayer meets the requirements to exclude from income cancellation of indebtedness income.[172] As another illustration, in Example 9, in which a mother partly sells and partly gifts property to her daughter, the mother and daughter may fare better under the hybrid approach than the bifurcated approach if the mother is subject to a higher rate of tax than the daughter.[173] By contrast, if the daughter is subject to tax at a higher rate than the mother

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For instance, a taxpayer may not benefit from deferral if the taxpayer anticipates being subject to a higher rate of tax at the time of later sale, especially if the taxpayer predicts that the later sale will happen in the near future rather than the distant future.

169. *See* Field, *supra* note 14, at 70 (noting that any explicit tax election is accompanied by various "technical requirements" including requirements related to "when the election is made").

170. *See id.* at 66–69 (discussing default rules in connection with tax election generally).

171. Even in the case of merchandise discounts dictated by chance, for instance, bifurcated treatment can be more taxpayer-favorable in some cases. *See supra* note 117 and accompanying text.

172. *See supra* Section II.A.3.

173. *See* Example 9, *supra* Section II.C.1.

and the daughter plans to sell the land soon after the transfer, the mother and the daughter may fare better under a bifurcated approach than under a hybrid approach.[174]

Assuming variation across taxpayers in terms of which approach is more favorable, mandating one approach will tend to raise more tax revenue than allowing taxpayers to choose between different approaches.[175] Taxpayer choice could involve the ability to explicitly elect one approach or the other by filing a form.[176] Alternatively, taxpayer choice could involve implicitly electing between approaches by structuring a transaction as either two transactions in one or two separate transactions.[177] Arguably, an explicitly elective approach would sacrifice more tax revenue than an implicitly elective approach because more taxpayers may be unable or unwilling to take the steps necessary to achieve more favorable tax treatment when those steps involve changing the form of a transaction than when those steps involve simply filing a form.[178]

In summary, from a tax revenue standpoint, an explicitly elective approach likely fares the worst, followed by an implicitly elective approach. Compared to approaches that allow taxpayers to choose, mandating either a bifurcated approach or a collapsed (or hybrid) approach would raise more tax revenue.

B. Fairness—The Approach's Propensity to Trap Unwary Taxpayers and Advantage Well-Advised Taxpayers

From a fairness standpoint, the different approaches vary in terms of their propensity to trap unwary taxpayers and advantage well-advised taxpayers. On this metric, the mandatory approaches fare the best. If all taxpayers automatically receive bifurcated treatment, collapsed treatment, or hybrid treatment, regardless of how they structure their transactions and regardless of any filings they make, then taxpayers who do not have access to sophisticated tax advice will not miss the opportunity to obtain more favorable tax treatment by structuring a transaction differently or filing

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174. *See id.*

175. In the context of explicit tax elections, for instance, existing scholarship notes their revenue reducing effects. *See, e.g.*, Field, *supra* note 14, at 30–31 ("[A] well-advised rational taxpayer will almost always exercise [an explicit tax] election in a way that minimizes its tax liability, at the expense of the fisc."); George K. Yin, *The Taxation of Private Business Enterprises: Some Policy Questions Stimulated by the "Check-the-Box" Regulations*, 51 SMU L. Rev. 125, 130 (1997) ("If the taxpayer is well-advised, the election, which has ramifications for tax purposes only, will always be to the detriment of the fisc.").

176. *See, e.g.*, Field, *supra* note 14, at 21–22.

177. *Id.* at 22.

178. *See, e.g.*, *id.* at 31 ("[W]ith an explicit election (as opposed to an implicit election), taxpayers need not alter their non-tax economic arrangements in order to obtain favorable tax treatment. That is, explicit elections generally lack 'frictions' that impede the use of the election for tax minimization purposes."). For discussion of "frictions" and tax planning, see, for example, Leigh Osofsky, *Who's Naughty and Who's Nice? Frictions, Screening, and Tax Law Design*, 61 Buff. L. Rev. 1057, 1058, 1069–74 (2013); David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 Colum. L. Rev. 1312, 1323–34 (2001).

a form.[179] Relatedly, mandatory tax treatment also limits the advantages well-advised taxpayers gain from favorable tax structuring and favorable tax elections.[180] By contrast, allowing taxpayers to choose their tax treatment will disproportionately advantage taxpayers with access to sophisticated advice.[181]

Not all elective approaches will necessarily trap unwary taxpayers to the same degree.[182] Arguably, an explicitly elective approach that simply requires a taxpayer to file a form is less likely than other elective approaches to trap unwary taxpayers as long as the deadline for filing the election coincides with the due date for the taxpayer's return.[183] By contrast, an election that must be filed at another point in time during the year or an implicitly elective approach that requires the taxpayer to carry out the transaction in a given way (as is the case with Example 9, for instance) may be more likely to trap unwary taxpayers.[184]

The reason that the timing of the decision matters is that taxpayers are generally aware of the requirement to file tax returns; further, if they cannot comply independently, they often seek assistance with tax return preparation.[185] By contrast, many taxpayers may be unaware of the myriad ways in which altering their transactions can affect tax consequences and may

179. For discussion of how tax elections and tax planning opportunities can trap unwary taxpayers generally, see *infra* note 183.

180. For discussion of these advantages, see *infra* note 183.

181. The same is true of tax elections and tax planning opportunities generally. Regarding explicit tax elections, see, for example, Field, *supra* note 14, at 31 ("[A]n election, while technically available to all eligible taxpayers, may be functionally available only to the wealthiest, most sophisticated group of taxpayers, who can best navigate the complexity of the election process."); Edward Yorio, *The Revocability of Federal Tax Elections*, 44 Fordham L. Rev. 463, 467 (1975) (discussing how making tax elections irrevocable would have the result of making it so that "[m]any elections would become traps for the unwary and only those taxpayers with the best tax advice would be secure"). Regarding tax planning generally, see, for example, Schizer, *supra* note 178, at 1319 ("[W]ealthy and well advised taxpayers have an edge in planning . . . .").

182. *See also* Field, *supra* note 14, at n. 60 ("[T]o the extent that an explicit election is used in lieu of an implicit election, the use of an explicit election may actually increase fairness by enabling lower-income and less sophisticated taxpayers to avail themselves of the choice at lower cost.").

183. *Id.* For discussion of filing deadlines and the propensity to trap unwary taxpayers, see Emily Cauble, *Tax Elections: How to Live With Them If We Can't Live Without Them*, 53 Santa Clara L. Rev. 421, 480–81 (2013). It is worth noting, however, that adopting an explicitly elective approach does not erase all the advantages bestowed upon taxpayers who design transactions with tax consequences in mind. In the context of composite transactions, for instance, if the election was only available to taxpayers who engaged in composite transactions (so that they could select collapsed or bifurcated treatment) but not available to taxpayers who engaged in the transactions separately (so that their only option was bifurcated treatment), the availability of the election would not erase the advantages of planning. This may be less concerning in some contexts, if, for instance, the composite transaction is the transactional form that taxpayers would generally tend to select even without thinking about tax consequences.

184. For discussion of the greater burdens imposed by implicit tax elections, see Borden, Brown & Wagner, *supra* note 38, at 304; Field, *supra* note 14, at n. 60. For discussion of how earlier filing deadlines may be more likely to trap unwary taxpayers, see Cauble, *supra* note 183, at 480.

185. *See supra* note 132 and accompanying text.

not think to ask for assistance in planning transactions during the year.[186] Thus, when planning transactions, many taxpayers are likely left to their own devices while they may be more likely to seek expert assistance when preparing tax returns.[187]

1. Gauging the Likelihood of Trapping Unwary Taxpayers

In May 2023, I conducted an online survey to gauge the likelihood that an implicitly elective approach will trap unwary taxpayers. The survey was made available on a survey platform called Prolific.[188] Individuals register with Prolific to become eligible to take online surveys in exchange for payment for each completed survey.[189] Participants received $3 for completing all questions in the survey. The mean time to complete the survey was 3.4 minutes, and the median time to complete the survey was 2.5 minutes.

The survey was conducted using Prolific's option to request a U.S. representative sample.[190] When using this option, Prolific divides the sample into subgroups based on demographic data so that the proportion of each sample that falls within various subgroups is comparable to the corresponding portion of the U.S. population based on U.S. census data.[191] Information about the income and formal education of the 501 respondents is reported in an attached Appendix.[192]

The survey presented respondents with a scenario similar to Example 9.[193] In particular, the survey directed respondents to consider the following scenario:

> "A mother owns a plot of land that she purchased many years ago for $20,000. Currently, the land is worth $100,000. The mother wants to transfer the land to her adult daughter. The mother is deciding between two options. The two options are:

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186. For discussion of how tax planning opportunities can trap unwary taxpayers generally, see *supra* note 183.

187. *See supra* note 132.

188. In an earlier survey involving other economically similar transactions (most of which were not composite transactions), I also included one fact pattern involving a part-gift, part-sale transaction. Responses to the open-ended questions in that survey suggested that at least some respondents may not have fully understood the facts of the scenario (in particular, they seemed to perceive the transactions as economically different). Therefore, I conducted this follow-up survey and included questions to test respondents' understanding of the facts.

189. *Prolific's Payment Principles*, PROLIFIC (March 14, 2024), https://researcher-help.prolific.com/hc/en-gb/articles/4407695146002-Prolific-s-payment-principles [https://perma.cc/Z4S3-682K].

190. *Representative Samples*, PROLIFIC (May 31, 2023), https://researcher-help.prolific.co/hc/en-gb/articles/360019236753-Representative-samples [https://perma.cc/P6AN-RL4E].

191. *Id.* Of the 501 respondents, 5.8% identified as Asian, 12.58% identified as Black or African American, 3.2% identified as Hispanic or Latino/a/x, 73.7% identified as White, 3.8% identified as more than one of the preceding options, and 1% selected something other than the preceding options. Of the 501 respondents, 50.11% identified as female, 47.6% identified as male, and 2.4% identified as non-binary or supplied another response. Of the 501 respondents, 48.16% fell within the 18–44 age range, 37.96% fell within the 45–64 age range, and 13.99% were 65 or older. This data was collected in the survey conducted by the author.

192. *See infra* Appendix.

193. *See* Example 9, *supra* Section II.C.1.

Option 1. The mother transfers the entire plot of land to her adult daughter in exchange for $50,000 (the value of ½ of the land).

Option 2. The mother transfers ½ of the plot of land to her adult daughter in exchange for $50,000, and the mother transfers the remaining ½ of the plot of land to her same adult daughter in exchange for $0."[194]

The survey asked respondents the following question: "How *will* current U.S. income tax law treat these two options? Your *best guess* is fine." Respondents were presented with two answer choices: (1) "The U.S. income tax outcome of options 1 and 2 will be the *same*" and (2) "The U.S. income tax outcome of options 1 and 2 will be *different*." The order of the answer choices was randomized so that some respondents were presented with "same" as the first answer choice while others were presented with "different" as the first answer choice.

Respondents were then asked to rate how confident they were that the two options produced the same (or different) tax outcomes on a scale with five options ranging from "not at all confident" to "extremely confident." The survey then asked participants to supply a response to an open-ended question asking *why* they thought the tax outcome would be the same (or different). Next, the survey asked whether participants thought the tax outcome *should* be the same or different and then asked them to rate the strength of that opinion on a scale with five options, ranging from "not at all" to "extremely" strong.[195]

After respondents answered all these questions, the survey presented two questions used to verify comprehension of the fact pattern. In particular, the survey asked respondents: "How much money does the mother receive under the two options?" Respondents could select: "the amount of money received by the mother under options 1 and 2 is the *same*" or "the amount of money received by the mother under options 1 and 2 is *different*."[196] Next, the survey asked, "How much land does the daughter receive under the two options?" Respondents could select: "the amount of land received by the daughter under options 1 and 2 is the *same*" or "the amount of land received by the daughter under options 1 and 2 is *different*."[197] Finally, the survey solicited the information about the respondents summarized in Tables 1, 2, and 4 in the Appendix.[198]

Of 501 respondents who completed the survey, 354 (71%) correctly responded to the comprehension check questions by indicating that,

194. This is the fact pattern included in the scenario contained in a survey conducted by the author.

195. The order of the answer choices to the question asking about what the tax outcome should be was randomized so that some respondents saw "same" as the first answer choice, while others encountered "different" as the first answer choice. For any given respondent, the order was consistent across all questions.

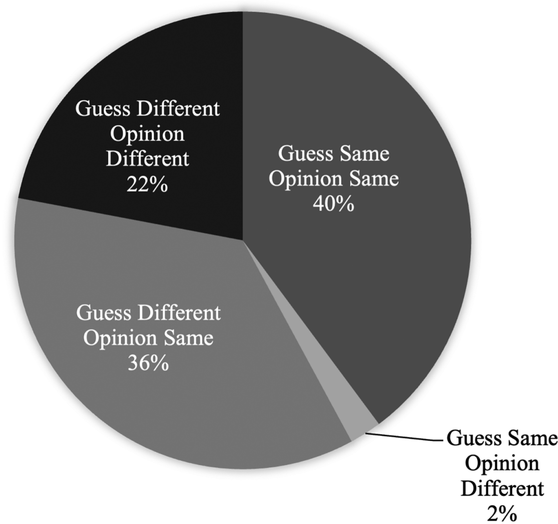
196. Here, again, the order of the answer choices varied randomly but, for any given respondent, the order was consistent across all questions.

197. Here, again, the order of the answer choices varied randomly but, for any given respondent, the order was consistent across all questions.

198. *See infra* Tables 1, 2, 4. The requested information is also summarized in note 191 *supra*.

under both options, the mother receives the same amount of money, and the daughter receives the same amount of land. Within that subset of 354 respondents, as shown in Figure 1 below, 58% guessed that the two options would receive different tax treatment (which consists of 22% who guessed they would receive different tax treatment and opined that they should receive different tax treatment and 36% who guessed they would receive different tax treatment but opined that they should receive the same tax treatment). Meanwhile 42% of these 354 respondents guessed that the two options would receive the same tax treatment (including 40% who guessed that the two options would receive the same tax treatment and also opined that they should receive the same tax treatment and 2% who guessed that the two options would receive the same tax treatment but believed that they should receive different tax treatment).

Figure 1. Summary of Survey Results



Under current law, at least if the two transactions in Option 2 are respected as separate transactions, the two options do, in fact, produce different tax outcomes.[199] Therefore, one way to frame these results is to say that 42% of the 354 respondents would, based on their guesses, fall into a trap for the unwary if they did not receive tax advice prior to engaging in the transaction. When prompted to consider tax consequences, they guessed that the two options produce the same tax outcome when, in fact, they do not. In addition, when asked to explain their guesses, 59.7% of this group offered explanations related to the economic similarity of the two transactions. For example, one respondent wrote, "The total amount paid and the total land transferred would be the same." Another wrote, "Because the same amount of money was exchanged in both scenarios." Thus, a large

199. *See supra* notes 98–100 and accompanying text.

portion of this group seems to intuitively expect that economically similar transactions will produce the same tax outcome, and therefore, might be caught unaware in situations when this is not the case.

Of course, in some ways, this 42% figure may understate current law's propensity to trap unwary taxpayers. This figure reflects what respondents in the survey guessed when prompted to consider tax consequences. Some taxpayers may simply act and select a transactional form without considering tax consequences. In addition, when they encounter this situation in a survey, some respondents may be more likely to guess the tax outcome is different because they expect the survey will only ask them about an aspect of law if it is counterintuitive. As one respondent who guessed that the options produce different tax consequences wrote, "Because our tax laws are incomprehensibly baroque, and you wouldn't set up the question if there wasn't some strange distinction between two ways of doing the exact same thing." One might expect respondents thinking along these lines to fall into the category of taxpayers who opine that the options should receive the same tax treatment even though they guess that the options will produce different tax outcomes, and a large slice of the 354 respondents (36%) fall into this category. Moreover, 22.8% of the respondents in this group explained their guesses by referring to the complicated nature of tax law. For example, one wrote, "Because that is the way tax law is. Nobody really understands the entire tax code and it tends to treat every individual thing as separate from all others and taxes them as such." Another wrote, "Because the tax laws are complicated, and while I know nothing about them, I would assume that if you do things differently, the outcome will be different." A third wrote, "Because there seem to be quite a few oddities and loopholes when it comes to tax laws." A fourth wrote, "Because I have never not been confused by tax code, even when I worked as an accountant. It's awful."

In other ways, this 42% figure may overstate the likelihood that current law will trap unwary taxpayers. If most taxpayers engaging in part-gift, part-sale transactions are well-advised and receive guidance prior to selecting a transactional form, they will not act based upon their intuitions. Nevertheless, even in that case, the results shed light on the counterintuitive nature of existing rules.

C. Inefficiency

As discussed above, the different approaches vary in terms of their tendency to sacrifice tax revenue—mandating either a bifurcated approach or a collapsed (or hybrid) approach would raise more tax revenue than an explicitly elective approach or an implicitly elective approach.[200] The different approaches also vary in terms of their tendency to trap unwary taxpayers and bestow advantages upon the well-advised.[201] On this metric, it seems plausible that an implicitly elective approach will trap many

200. *See supra* Section IV.A.
201. *See supra* Section IV.A.

unwary taxpayers, and the survey's results provide some tentative support for this view.

The different approaches also vary in terms of their tendency to cause taxpayers to alter their behavior to account for tax consequences. This tendency may be the greatest when tax law uses a collapsed (or hybrid) approach to taxing composite transactions but allows taxpayers to opt into a bifurcated approach by engaging in two separate transactions.[202] The tendency of the collapsed (or hybrid) approach to cause taxpayers to alter their behavior depends, in part, on how drastically a taxpayer must modify their transaction to achieve more favorable tax consequences.[203] In the case of some of the examples, more extreme change is required than in the case of others. For instance, in the case of Example 3, in which a taxpayer disposes of property subject to nonrecourse debt that exceeds the property's value, the taxpayer cannot obtain bifurcated treatment unless the lender agrees to accept payment equal to the value of the property in full repayment of the debt.[204] When more significant changes are required to obtain more favorable tax treatment, on the one hand, tax consequences may inspire fewer taxpayers to alter their transactions mitigating inefficiency. On the other hand, for taxpayers who do undertake the necessary alterations, the non-tax changes they undertake are more considerable, exacerbating inefficiency.[205]

If a given tax approach applies automatically regardless of whether a taxpayer engages in a combined transaction or separate transactions, taxpayers can simply utilize whichever transactional form is best from a non-tax perspective. There is no tax reason to adopt a different transactional form. Likewise, under an explicitly elective approach, there is no tax reason to adopt a given form (at least in some cases).[206] Taxpayers can utilize a

202. *See, e.g.*, Borden, Brown & Wagner, *supra* note 38, at 313 (noting that the current regime in the context of change of purpose for holding real estate causes "economic distortions"); Yorio, *supra* note 38, at 27 (noting that a bifurcated approach to characterizing gain recognized upon sale of real estate after a change of purpose for holding real estate "eliminates the incentive to devise costly and inefficient techniques for avoiding the tax penalty which is now effectively levied upon the taxpayer who subdivides or develops property to facilitate its sale").

203. The changes the taxpayer must undertake could be conceptualized as "frictions" that might discourage tax planning. For discussion of "frictions" and tax planning, see, for example, Osofsky, *supra* note 178, at 1058, 1069–74; Schizer, *supra* note 178, at 1323–34.

204. *See supra* Section II.A.3.

205. *See also* David M. Schizer, *Sticks and Snakes: Derivatives and Curtailing Aggressive Tax Planning*, 73 S. CAL. L. REV. 1339, 1356 (2000) [hereinafter Schizer, *Sticks and Snakes*] ("Ultimately, the effect of any reform on the planning option turns on empirical questions. Some taxpayers will be stopped from planning . . . On the other hand, some taxpayers will change their transactions to avoid the reform."); David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in Tax Law*, 84 CORNELL L. REV. 1627, 1669–70 (1999) [hereinafter Weisbach, *Line Drawing*] ("[W]e cannot simply interpret the models as suggesting that lines in the tax law should be made harder to avoid. A line can be too hard to avoid, at least from an efficiency perspective . . . If a line is too hard to avoid, there may be few shifts, but each shift will have a large cost.").

206. However, if the election were available only to taxpayers who engaged in composite transaction (and they could explicitly elect collapsed or bifurcated treatment), but the explicit election was not available to taxpayers who engaged in the transactions separately (so that their only option was bifurcated treatment), the availability of the election would not

form selected for non-tax reasons and make a filing to select the resulting tax treatment. This metric is also related to accuracy of taxation. If economically similar transactional forms are taxed differently, at least one of the transactional forms is, in a sense, taxed inaccurately.

In summary, while a mandatory approach or an explicitly elective approach mitigates the tendency of tax consequences to influence the transactional form a taxpayer selects, an implicitly elective approach exacerbates this tendency. Nevertheless, drawing any firm conclusion about how the approaches fare from the standpoint of efficiency is difficult. A mandatory approach eliminates the possibility that tax consequences will cause a taxpayer to engage in two separate transactions even when, tax consequences aside, carrying out a combined transaction would be more desirable. However, it is possible that adopting a mandatory approach could prompt a taxpayer to abandon the transaction in favor of a different transaction entirely that would not have been undertaken but for a consideration of tax consequences.[207]

D. Administrability

Using a collapsed (or hybrid) approach to taxing composite transactions and allowing taxpayers to structure their transactions to achieve bifurcated treatment may be the easiest approach to administer. Compared to an approach that involves foreclosing attempts to plan into bifurcated treatment and mandating collapsed (or hybrid) treatment, it avoids the need to police the boundary between attempts to engage in separate transactions that will be respected and those that will not. For example, consider a transaction in which a mother sells a portion of land to her daughter for fair market value and, later, transfers a portion of the land to her daughter as a gift. Foreclosing attempts to plan into bifurcated treatment requires determining whether these two transactions ought to be treated as parts of a combined part-sale, part-gift transaction or, instead, respected as two separate transactions.

Compared to a mandatory bifurcated approach, a collapsed (or hybrid) approach also avoids the need to value assets absent a sale of assets for

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erase the incentive to select a form for tax reasons. This is less of an issue in contexts where the composite transaction is the form taxpayers generally prefer for non-tax reasons.

207. *See, e.g.*, Schizer, *supra* note 178, at 1320 ("[E]ven if some planning is stopped, total planning waste could still increase if those who continue to plan face higher costs."); David A. Weisbach, *Disrupting the Market for Tax Planning*, 26 Va. Tax Rev. 971, 973 (2007) ("[A] s the government shuts down the easy to find and use shelters, taxpayers must spend more to find new ones and also more to implement the new ones."); David A. Weisbach, *Ten Truths About Tax Shelters*, 55 Tax L. Rev. 215, 239 (2002) ("[B]ecause we cannot perfectly identify shelters, attacks on shelters make those shelters that remain worse."); *see also* Philip A. Curry, Claire Hill & Francesco Parisi, *Creating Failures in the Market for Tax Planning*, 26 Va. Tax Rev. 943, 950 (2007) ("A benevolent government therefore faces a difficult tradeoff. By declaring a given tax strategy 'illegitimate,' the government boosts its tax revenue, but induces taxpayers to expend resources in the search for additional tax strategies."); Schizer, *Sticks and Snakes*, *supra* note 205, at 1356; Weisbach, *Line Drawing*, *supra* note 205, at 1669–70.

cash. Consider, for instance, Example 9 above.[208] In that example, a mother owns land that she acquired for $20,000. At the time when the fair market value of the land is $100,000, the mother sells the land to her daughter for $50,000. To apply the hybrid approach currently used, the parties and the IRS do not need to determine the precise value of the land at the time of the transfer. To classify the transaction as a part-gift, part-sale transaction (as opposed to simply a sale), it is only necessary to know that the value of the land is more than $50,000.[209] By contrast, if the transaction was fully bifurcated into a sale of a portion of the land and a gift of the remaining portion, the value of the land at the time of the transfer (here $100,000) must be ascertained to determine what portion of the land (here $50,000/$100,000 or 50%) is sold by the mother when she receives a payment of $50,000 from her daughter.[210] It is worth noting that, in the case of a bargain sale to charity, tax law employs a bifurcated approach that necessitates valuation of the property at the time of the part-sale, part-donation to a charitable organization.[211] Arguably, in that context, it is even more likely that taxpayers already determine the value of the property at the time of the part sale, part donation, so that little additional administrative burden accompanies a requirement to do so for purposes of facilitating the bifurcated approach.[212] Further, as Crawford and Blattmachr have noted, assuming the charitable recipient is exempt from tax on gain recognized upon later sale of the property, adopting a hybrid approach would sacrifice more tax revenue in the case of a bargain sale to charity of property with a built-in gain than in the case of a part-gift, part-sale transaction involving two taxable parties.[213]

An explicitly elective approach, under which taxpayers can engage in a combined transaction and file an election that dictates whether it receives collapsed (or hybrid) treatment or bifurcated treatment, allows taxpayers to avoid the need to value assets absent a cash sale by opting for collapsed (or hybrid) treatment.[214] However, when taxpayers opt for a bifurcated approach, the need to value assets will arise for the IRS and not just for

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208. *See* Example 9, *supra* Section II.C.1.

209. *See infra* note 234.

210. *See also* Cohen, *supra* note 166, at 1698.

211. *See supra* Section II.B.1.

212. This would be the case, for instance, if the taxpayer claims a charitable contribution deduction as a result of the transaction.

213. *See* Crawford & Blattmachr, *supra* note 23, at 809 (“Because of the basis apportionment rules, Tom is forced to recognize more gain in the bargain sale to the charity. This result makes sense because the charity is a tax-exempt organization. In most cases, the charity will not owe any income tax on a subsequent sale of the property. Tom recognizes comparatively less gain in the bargain sale to Edwina, but as an individual taxpayer, Edwina likely will realize taxable gain on a subsequent sale of the property. In other words, the government will have ‘another bite at the apple[]’. . . .”).

214. A similar observation can be made about some existing explicit tax elections. For instance, in some contexts, taxpayers can decide whether or not to adjust a partnership’s basis in its assets following a transfer of a partnership interest by making or not making a section 754 election. I.R.C. §§ 743, 754 (2018). Making such adjustments elective rather than mandatory could be described as motivated, at least in part, by the goal of obviating the need to value each of the partnership’s underlying assets at the time of each transfer of a partnership interest.

the taxpayer who, apparently, decided that the hassle of valuing assets was worthwhile if required to achieve the taxpayer's preferred tax treatment.[215] The timing for filing the election may also affect valuation difficulties. If the election must be filed soon after the time when the asset's value is relevant, valuation difficulties may be less than what would occur if the election can be filed later.[216] Requiring that the election must be filed sooner, however, may make it more likely to trap unwary taxpayers who may be less likely to receive advice about the election if it does not arise in the context of preparing a tax return.[217]

While a mandatory bifurcated approach requires valuation, the task may be less onerous in some contexts than others. Therefore, it is useful to consider what requiring valuation would entail in the context of each of the specific examples of the collapsed approach or the hybrid approach discussed above.

1. *Merchandise Discounts Dictated by Chance*

First, consider the tax treatment of discounts determined by chance. In Example 1 above, Oliver purchases a couch for $1,000 from a furniture store that agrees to rebate the entire purchase price if the Red Sox win the World Series.[218] At the time of the purchase, the odds of the Red Sox winning is estimated to be 25%. The Red Sox win, and Oliver receives a rebate of $1,000. Under a mandatory bifurcated approach, Oliver would be treated as if he had purchased a couch for $750 and placed $250 on a bet.[219] Under this approach, when Oliver receives $1,000, $250 of it would be excluded from his income but not the remaining $750.[220]

Applying this approach would require an estimation of the odds of the Red Sox winning as of the date of any given purchase. While this may at first seem daunting, betting markets could supply the necessary data, and for administrative ease, the furniture store could report the necessary information to each customer at the time of purchase. Indeed, prior to obtaining a favorable letter ruling, the Boston furniture store told customers that it would issue Form 1099s to customers who received rebates valued at $600 and above.[221] Furthermore, for purposes of adequately planning for the possibility of making rebate payments, the furniture company—or, perhaps

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215. For general discussion of other administrative burdens created by explicit tax elections, see Field, *supra* note 14, at 29–30.

216. *See supra* notes 128–130 and accompanying text.

217. *See supra* notes 132–133 and accompanying text.

218. *See supra* Sections II.A.1, III.C.

219. *See* Banoff & Lipton, *supra* note 30, at 382–83 (describing a similar furniture store promotion and stating, "the arrangement is in some ways analogous to each customer's purchasing both the furniture and a lottery ticket (i.e., making a wager) to win back the full amount of his ostensible purchase price," but ultimately concluding that it ought to be treated as a rebate).

220. *See id.*; Sections II.A.1, III.C.

221. *See* Paul Caron, *IRS: Furniture Giveaway to Red Sox Fans Tied to World Series Victory Treated as Purchase Price Reduction, Not Income,* TaxProf Blog (Jan. 28, 2008), https://taxprof.typepad.com/taxprof_blog/2008/01/red-sox-fans-wi.html [https://perma.cc/7ZZ8-EJSM].

in many cases, a third party that provides insurance to cover the possible payments—likely undertakes such an analysis even if not required to do so for tax purposes.[222]

2. Real Estate and Change of Purpose

Second, consider the sale of real estate that was initially investment property but becomes dealer property. In Example 2 above, in year one, Mabel acquires undeveloped land for $700,000 with the intent of holding it for investment.[223] From year one to year three, the land increases in value to $1,000,000. In year three, Mabel makes substantial improvements to the land, at a cost of $100,000, and sells parcels of the land for total proceeds of $1,500,000. Under a mandatory bifurcated approach, gain (or loss) in the case of a change of purpose would be bifurcated into the portion that accrued while the real estate was investment property, which would receive capital gain (or loss) treatment and the portion that accrued after the change of purpose, which would receive ordinary income (or loss) treatment.[224] In this example, Mabel's $700,000 total gain on ultimate sale would be bifurcated into $300,000 of capital gain and $400,000 of ordinary income, assuming the land initially was investment property that became dealer property in year three.[225]

In this context, the required valuation task is somewhat daunting. At the time of the ultimate sale, the taxpayer and the IRS must determine what the value of the undeveloped land was—perhaps many years ago—at the time that the taxpayer's purpose for holding the land changed.[226] In some cases, the taxpayer may have had reasons to create contemporaneous records of the land's value at that time. Perhaps the taxpayer sought financing from a third party to help fund development costs and obtained an appraisal of the land to secure that financing for instance. However, contemporaneous evidence of the land's value will not be available in all cases.

3. Disposition of Property Subject to Nonrecourse Debt in Excess of Fair Market Value

Third, consider the disposition of property subject to nonrecourse debt that exceeds the value of the property. In Example 3 above, Charles acquires

222. *See, e.g.*, Melissa Lafsky, *Here's Why Yankees Fans Aren't the Only Ones Rooting Against the Red Sox*, FREAKONOMICS (Oct. 18, 2007), https://freakonomics.com/2007/10/heres-why-yankees-fans-arent-the-only-ones-rooting-against-the-red-sox [https://perma.cc/8DSJ-4B5P] (noting that the furniture company that ran the Red Sox promotion obtained such an insurance policy); Banoff & Lipton, *supra* note 30, at 382 (describing how a furniture company that ran a similar promotion obtained insurance from "Odds-On Promotions, a company that specializes in prize reimbursement for such events as hole-in-one outings and for half-court shots at basketball games").

223. *See supra* Section II.A.2.

224. *See supra* Section II.A.2 and Section III.B.

225. *See id.*

226. *See, e.g.*, Yorio, *supra* note 38, at 7, 25 (noting questions about the administrative feasibility of a bifurcated approach because it would require determining when the taxpayer's purpose changed and the value of the property at that time).

land for $1,000,000, using $200,000 cash and $800,000 proceeds from borrowing on a nonrecourse basis secured by the land.[227] Subsequently, the land declines in value to $700,000. At a time when there is still $800,000 outstanding on the loan, the lender forecloses on the property.

Under a mandatory bifurcated approach, Charles would recognize $100,000 of cancellation of indebtedness income and a $300,000 loss from sale of the land.[228] Applying this approach requires determining the $700,000 value of the land at the time of the foreclosure. This task is not particularly onerous for two reasons. First, unlike the example involving a taxpayer whose purpose for holding real estate changes over time, in this example, valuation is relevant close in time to when the taxpayer reports the resulting tax consequences. In particular, the land's value at the time of the foreclosure is the necessary piece of information, and the taxpayer would report the tax consequences for the year in which the foreclosure occurs. Second, for non-tax reasons, the lender likely obtains an appraisal to determine the value of the property even without tax law requiring a valuation. Therefore, adopting a bifurcated approach would not obligate taxpayers to bear any new valuation burdens.[229]

4. *Part-Gift, Part-Sale Transactions*

Fourth, consider the tax treatment of part-gift, part-sale transactions. In Example 9 above, a mother owns land that she acquired for $20,000.[230] At the time when the fair market value of the land is $100,000, the mother sells the land to her daughter for $50,000. Under a mandatory bifurcated approach, the transaction would be treated as if the mother sold 50% of the land for $50,000, resulting in a $40,000 tax gain, while the mother transferred 50% of the land to her daughter as a gift.[231] To determine what portion of the land is sold rather than transferred by gift, the parties must determine the value of the land at the time of the transfer.[232] In some cases, valuation is simple—if, for instance, the mother transfers publicly traded stock rather than land. In other cases, valuation is more difficult. However, for various tax and non-tax reasons, the parties may undertake a valuation at the time of the transfer even if tax law does not employ a bifurcated approach. In particular, even under the approach currently used, taxpayers must at least know an approximate value of the asset at the time of transfer.[233] Taxpayers need this information to determine whether the asset is worth more than the purchase price to properly classify the transaction as

227. *See* Example 3, *supra* Section II.A.3.
228. *See id.*; Section III.C.
229. Whether or not the valuation provides credible evidence of valuation for tax purposes is another question. For discussion of whether non-tax valuations provide credible evidence of valuation relevant for tax purposes, see Leandra Lederman, *Valuation as a Challenge for Tax Administration*, 96 Notre Dame L. Rev. 1495, 1500–02 (2021).
230. *See* Example 9, *supra* Sections II.C.1, III.D.
231. *See supra* Sections II.C.1, III.D.
232. *See also* Cohen, *supra* note 166, at 1698.
233. *Id.*

a part-gift, part-sale or a sale.[234] Second, special rules apply if the property's value at the time of the transfer is less than the greater of the mother's basis or what the daughter pays for the land.[235] To determine whether these special rules apply, approximate valuation is also necessary, and, if the special rules do apply, knowing the exact value becomes necessary.[236] Furthermore, as Professor Kwall noted, a transferor typically has non-tax reasons for wanting to know the amount being transferred and would, therefore, at least have an approximate idea of value in mind at the time of the transfer.[237] In addition, as Professor Kwall notes, valuation may be necessary for purposes of federal and state transfer taxes.[238] For all of these reasons, the incremental valuation burden that would accompany the adoption of a mandatory bifurcated approach may not be particularly significant.

5. *Receipt of Boot in a Like Kind Transaction*

Finally, consider the treatment of the receipt of boot in a like-kind transaction. In Example 10 above, Steve holds Old Land, which he acquired for $40,000, for investment purposes.[239] At a time when Old Land is worth $100,000, he exchanges it for New Land that is worth $50,000, which he plans to hold for investment purposes, and $50,000 cash.[240] Under a mandatory bifurcated approach, Steve would be treated as if he sold 50% of Old Land for cash and exchanged 50% of Old Land for New Land.[241] To determine what portion of Old Land is exchanged for cash and what portion is exchanged for New Land, Steve must ascertain the value of Old Land. Assuming that Steve acquires New Land from an unrelated party, Steve presumably would determine the value of Old Land and New Land regardless of any requirement to do so for tax purposes.[242] Determining the value of each property is necessary to ensure that the parties engage in an

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234. In the case of a part-gift part-sale, property is typically sold for less than its fair market value. Therefore, identifying a part-gift part-sale requires knowing the property's fair market value (or at least having an idea of the value that is precise enough to know that the value is more than the sales price).

235. *See* Treas. Reg. § 1.1015-4(a) (1960) (providing that, for purposes of determining loss on a later sale, the transferee's basis cannot be more than the fair market value ($100) at the time of the transfer).

236. For a similar observation in the context of parallel rules that apply to gifts, see Emily Cauble, *Tax Law's Loss Obsession*, 2018 Utah L. Rev. 979, 1015 (2018).

237. *See* Jeffrey L. Kwall, *When Should Asset Appreciation Be Taxed?: The Case for a Disposition Standard of Realization*, 86 Ind. L. J. 77, 97–98 (2011).

238. *See id.* at 96–97.

239. *See* Example 10, *supra* Section II.C.2.

240. *See id.*

241. *See* Sections II.C.2, III.E.

242. In this way, the example is similar to the example involving the property that is contributed to a partnership, discussed above in Part II.B.5. Determining the value of property at the time that a partner contributes it to a partnership is necessary to apply existing tax rules that take into account the pre-contribution built-in gain or loss when allocating tax items the partnership recognizes later. Assuming the partners deal with each other at arms-length, presumably they would determine the value of the property at the time of the contribution for non-tax reasons irrespective of a tax requirement to do so. Thus, the incremental valuation burden imposed by tax law is not significant.

even exchange. Thus, in this context, valuation is not a significant obstacle to adopting a bifurcated approach.

6. *Summary*

While adoption of a bifurcated approach requires valuation of assets at a time when they are not being transferred in a cash sale, in many contexts, the resulting burden is not considerable. This is the case because, in many contexts, for various tax or non-tax reasons, taxpayers will value the assets at the relevant time even if tax law does not adopt a bifurcated approach. One context in which this may not hold true involves a taxpayer whose purpose for holding real estate changes over time. In that context, requiring that taxpayers and the IRS, at the time of eventual sale, look back to determine the value of the undeveloped land at the time of the taxpayer's change of purpose imposes a potentially significant burden. Valuation of real estate can be challenging even when it occurs contemporaneously.[243] Here, the valuation may be even trickier given that it requires looking back to estimate value at an earlier time.[244]

V. RECOMMENDATIONS

Adopting a mandatory bifurcated approach offers advantages over other approaches across the metrics of tax revenue collection, fairness, and efficiency. The approach mitigates tax revenue loss because taxpayers cannot choose between different tax approaches to reduce their tax burdens, either explicitly by filing an election or implicitly by opting for a different transactional form.[245] Furthermore, under a mandatory bifurcated approach, taxpayers do not sacrifice an opportunity to obtain more favorable tax treatment by filing a different election or designing a transaction differently.[246] Thus, the approach is less likely to trap unwary taxpayers than the alternatives that allow taxpayers to select their tax outcome explicitly or implicitly.[247] Finally, compared to an implicitly elective approach, under a mandatory bifurcated approach, tax consequences may be less likely to induce taxpayers to redesign their transactions.[248] The only potential

243. For general discussion of the difficulty of valuing real estate, see, for example, Brian D. Galle, David Gamage & Darien Shanske, *Solving the Valuation Challenge: The ULTRA Method for Taxing Extreme Wealth*, 72 Duke L. J. 1257, 1283 (2023) ("[F]ormulaic valuation also obviously struggles as applied to many non-financial assets, such as land, jewelry, and art. Indeed, many Swiss wealth tax cases involve disputes over the value of real estate that are not much different from those we might see in the United States."); Lederman, *supra* note 229, at 1498–99, 1501–02.

244. It is also possible that the passage of time may ease the process of determining valuation if additional, comparable parcels of real estate have sold during the intervening period that could be used to estimate the value of the real estate in question.

245. *See supra* Section IV.A.

246. For discussion of how tax elections and tax planning opportunities can trap unwary taxpayers generally, see *supra* note 183.

247. *See supra* Section IV.B.

248. Whether or not this would occur is not entirely free from doubt because it is possible that foreclosing the ability to implicitly elect tax treatment by bifurcating a transaction or

disadvantage to a mandatory bifurcated approach is administrability.[249] In particular, the approach requires that taxpayers and the IRS value assets at a time when the assets are not being sold for cash.[250] However, in most of the contexts discussed above, taxpayers already undertake the necessary valuation for non-tax or other tax reasons.[251] Therefore, at least in these contexts, the incremental burden of adopting a mandatory bifurcated approach is not considerable. In one context—transactions involving the sale of real estate by a taxpayer whose purpose for holding the real estate changes over time—the valuation required by a mandatory bifurcated approach admittedly would be tricky.[252] In this context, if lawmakers opt for another approach—such as an explicitly elective approach—they ought to carefully consider the tradeoffs inherent in various design features of the election. For instance, the due date for filing the election can significantly affect its tendency to erode tax revenue as well as its tendency to trap unwary taxpayers, and these two considerations tend to pull in opposite directions. In addition, the deadline for filing the election will affect the difficulty of obtaining the necessary valuation information. In order to demonstrate, consider the following example.

> **Example 12**. Mabel acquires undeveloped land for $700,000 with the intent of holding it for investment. Over a number of years, the land increases in value to $1,000,000. At that time, Mabel makes substantial improvements to the land, at a cost of $100,000 with the plan of engaging in significant selling activity to sell parcels of developed real estate.

Under an explicitly elective approach, Mabel would have the ability to file an election that would determine whether her entire gain or loss would be characterized as ordinary income, or instead, her gain or loss would be bifurcated into $300,000 of capital gain and ordinary income or loss attributable to any gain or loss that accrues after she begins to develop the land.[253] Several deadlines for the election are possible, including: (1) within some set number of days of when her purpose for holding the real estate changes, (2) the due date for her tax return for the year in which the change of purpose occurs, or (3) the due date for her tax return for the year of the ultimate sale of the real estate.[254]

As others have noted, mitigating tax revenue loss would weigh in favor of adopting the earliest deadline.[255] If Mabel is allowed to wait and file after the ultimate sale of the property, she can benefit from hindsight and

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engaging in a consolidated transaction will merely inspire taxpayers to engage in other tax-motivated transactional structuring. *See supra* Section IV.C.

249. *See supra* Section IV.D.
250. *See id.*
251. *See id.*
252. *See supra* Section IV.D.2.
253. *See supra* Section III.B.
254. *See* Field, *supra* note 14, at 70 (noting that any explicit tax election is accompanied by various "technical requirements" including requirements related to "when the election is made"); *see also supra* Section III.B.
255. *See supra* note 129 and accompanying text.

make whichever election proves to be most beneficial at the time in light of whether the land is ultimately sold for a gain or a loss and other tax items she recognizes at the time.[256] While an earlier deadline more effectively mitigates loss of tax revenue, it may also be more likely to trap unwary taxpayers.[257] If the election must be filed during the year and is not associated with a tax return, taxpayers without access to regular tax planning advice are unlikely to be aware of the election in time to file it.[258]

Adopting the latest filing deadline may do the most to mitigate the tendency to trap unwary taxpayers. If the election is filed with the tax return on which the taxpayer reports the consequences of selling the real estate, the taxpayer may be the most likely to obtain tax advice on the advantages and disadvantages of filing the election.[259] One downside, however, to the latest deadline is additional loss of tax revenue.[260] Furthermore, adopting the latest filing deadline also gives rise to the same valuation difficulties inherent in a mandatory bifurcated approach. Specifically, if the taxpayer files the election at the time of the ultimate sale of the land, then the taxpayer and the IRS are faced with the same difficulty inherent in the mandatory bifurcated approach of looking back to determine the value of the land at the time that the taxpayer's purpose for holding the real estate changed.[261] With an earlier deadline, the taxpayer is in a better position to obtain—and the IRS is in a better position to require—contemporaneous evidence of the property's value.[262] Because an elective approach with a late deadline leads to the same valuation difficulties as a mandatory bifurcated approach, it makes little sense to adopt the elective approach in lieu of a mandatory bifurcated approach that is more desirable when judged by metrics other than valuation difficulties.

As a compromise possibility, tax law could opt for a deadline that required filing the election with the tax return for the year of the change of purpose.[263] From a tax revenue standpoint, this possibility does not allow taxpayers to benefit from a wait and see approach and file only after ultimate sale of the property.[264] From an administrability standpoint, the deadline would be soon after the taxpayer's change of purpose, making more feasible the prospect of obtaining and requiring close to contemporaneous evidence of the property's value.[265] Assuming the taxpayer obtains assistance in filing tax returns and assuming that the taxpayer's return filing advisor is aware of the taxpayer's real estate activities, the taxpayer may be

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256. *See supra* note 129 and accompanying text; *see also supra* Section III.B.
257. *See supra* Section III.B.
258. If taxpayers engaged in real estate development have regular access to tax planning advice, then this consideration might be given little weight in this context.
259. *See supra* Section III.B.
260. *See supra* Section III.B.
261. For discussion of this difficulty in the context of the mandatory bifurcation approach, see supra note 229 and accompanying text.
262. *See supra* Section III.B.
263. *See* Borden, Brown & Wagner, *supra* note 38, at 316–17 (noting that the election might be due with the tax return for the year in which the change of purpose occurs).
264. *See supra* Section III.B.
265. *See id.*

more likely to be made aware of the election in time if the election is associated with a tax return rather than due within a specified number of days of the taxpayer's change of purpose. Thus, if lawmakers adopt an explicitly elective approach, this intermediate deadline may most effectively balance the various considerations.

VI. CONCLUSION

In most contexts, adopting a bifurcated approach to the tax treatment of two transactions in one offers advantages over other alternatives. A bifurcated approach mitigates tax revenue loss compared to approaches that allow taxpayers to implicitly or explicitly elect between bifurcated treatment and collapsed treatment (or between bifurcated treatment and hybrid treatment). Also compared to these alternatives, a bifurcated approach is less likely to trap unwary taxpayers. Finally, compared to an approach that allows taxpayers to choose between different transactional forms to implicitly opt between bifurcated treatment and collapsed treatment (or hybrid treatment), a bifurcated approach may reduce the tendency of tax law to influence taxpayers' decisions about transactional form. One disadvantage to a bifurcated approach is that it may require asset valuation at a time when a taxpayer is not disposing of an asset in a cash sale. In many contexts, the required valuation is not particularly onerous because, for various tax or non-tax reasons, the taxpayer already undertakes the necessary valuation. Even in contexts where adopting a bifurcated approach would impose a new valuation requirement, this disadvantage does not necessarily outweigh the other advantages of the bifurcated approach. Furthermore, even if a bifurcated approach is abandoned in these contexts, it is not the case that a collapsed approach is the only available alternative.

APPENDIX

The income of survey respondents is shown in Table 1 below, which, for comparison purposes, is displayed alongside corresponding population data (for the year 2021, the most recent available). In general, compared to the U.S. population, a larger share of the sample reports household income in the $25,000 to $100,000 range and a smaller share reports income above $100,000.

Table 1. Income of the Sample Compared to U.S. Population Income

Total Household Income Before Taxes	**Percentage of Sample for the year 2022**[266]	**Percentage of U.S. Total Households Based on 2021 Household Income**[267]
Less than $25,000	17%	17.44%
$25,001 to $50,000	27.4%	18.76%
$50,001 to $75,000	21%	16.18%
$75,001 to $100,000	14.8%	11.86%
$100,001 to $150,000	13%	15.89%
$150,001 to $200,000	4%	8.25%
More than $200,000	2.8%	11.61%

The formal education of respondents is summarized in Table 2 below.

Table 2. Formal Education of the Sample[268]

Highest Level of Formal Education	**Percentage of Sample**
Some High School or Less	1%
Completed High School or Obtained GED	13%
Trade School	2.4%
Some College	19.4%
Associate's Degree	12.2%
Bachelor's Degree	34.5%
Master's Degree	13.4%
Advanced Degree (Such as PhD, JD, Medical Degree)	4.2%

Table 3 below summarizes the formal educational attainment of the U.S. adult population, based on census data. Comparing tables 2 and 3 reveals that the respondents in the sample tend to have achieved higher levels of formal education than the population generally. For instance,

266. The percentage of sample statistics were provided by the author and are based on a survey conducted by the author.

267. *See* U.S. Census Bureau, Current Population Survey: Selected Characteristics of Households by Total Money Income (2022), https://www.census.gov/data/tables/time-series/demo/income-poverty/cps-hinc/hinc-01.html [https://perma.cc/LR78-2BA7].

268. This table was generated by the author and represents data collected in a survey conducted by the author.

approximately 52.1% of survey respondents earned at least a bachelor's degree, compared to 34.8% for the entire U.S. adult population.

Table 3. Educational Attainment—Census Data

Formal Educational Attainment	**Percentage of U.S. adult population based on Census data**[269]
Less than high school graduate	9.56%
High school graduate	29.20%
Some college no degree	16.50%
Associate's degree	9.95%
Bachelor's degree	22.08%
Master's degree	9.47%
Professional degree or doctoral degree	3.27%

In addition, the survey asked for information about tax classes taken. Overall, approximately 78.6% of the sample reported having never taken a tax course. The remainder had taken at least one tax course—at the high school level, college-level, graduate level, or some other course (such as an online course or employer-training). More detail is contained in Table 4 below.

Table 4. Sample—Tax Courses Taken[270]

Has Taken	**Percentage of the Sample**
A High School-Level Course on Taxation Only	6.8%
A College-Level Course on Taxation Only	4.6%
A Graduate-Level Course on Taxation Only	1.2%
Some Other Course on Taxation Only	2.4%
More than One of the Above	6.4%
None of the Above	78.6%

269. U.S. Census Bureau, Educational Attainment of the Population 18 Years and Over, by Age, Sex, Race, and Hispanic Origin (2022), https://www.census.gov/data/tables/2022/demo/educational-attainment/cps-detailed-tables.html [https://perma.cc/M4EY-ZWVU].

270. This table was generated by the author and represents data collected in a survey conducted by the author.