

## TAX NOTES TODAY®

### News Analysis -- Presidential, and Would-Be, Tax Returns

by Lee A. Sheppard

**Tax Notes contributing editor Lee A. Sheppard examines the 2003 tax returns of President Bush, Vice President Cheney, and presumptive Democratic candidate and Senate taxwriter John F. Kerry, D-Mass.**

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"People expect that from their public servants."

Who said that? George W. Bush.

About what? Releasing his tax return.

Who'd have thunk it? Bush has been president for three years, and this is the first year -- including his 2000 presidential campaign -- that he has released anything resembling a complete tax return. Regular readers of this column haven't read anything here about the president's and the vice president's tax returns because they have been in the habit of releasing only the first two pages of their returns, or selectively releasing complete returns to publications that were sworn not to pass them on. Their press people and lawyers wouldn't even return our phone calls. So we had nothing to analyze.

So what brought about the sudden change of heart? Was there a view that nearly complete tax returns could safely be released because they would go unnoticed by a press corps distracted by the disastrous Bush foreign policy? Nope, nothing like that.

Readers have gotten used to the idea that nothing much happens in the Bush administration that is not political, and the release of nearly complete returns is true to form. Bush and Cheney seem to be releasing more of their 2003 returns because their presumptive opponent's rich wife won't release hers. (*Bloomberg*, Apr. 16, 2004.) Teresa Heinz Kerry has asked for an extension to file her separate return, but probably will not change her mind about releasing it. (*The New York Times*, Apr. 23, 2004, p. A16.)

So we have nearly complete returns from the president, the vice president, and the likely Democratic nominee, but nothing from the latter's wife, who files separate tax returns. For his part, John Kerry initially declined press requests to release his tax return until a few days after the president released his return. (Returns can be viewed at <http://www.taxhistory.org/thp/thpwebsite.nsf/Web/PresidentialTaxReturns?OpenDocument>.)

The moral of the story of our examination of the returns that were released is: Don't let your financial adviser do your tax return. Bush and Kerry had banks do theirs, and we found mistakes. Cheney had an accounting firm do his, and it was the only return that was prepared correctly.

## You Tell Us

Another common theme of the returns is the filing of estimated tax underpayments forms when they would not seem to be necessary. Many of our readers, especially those in high-tax states, pay estimated taxes, and deliberately underpay them because borrowing from governments is cheap.

These readers are used to filing complicated underpayment forms, but they are also used to sophisticated account information from their states. New York State knows exactly where each estimated taxpayer stands each January, and it sends an account status summary. The IRS does no such thing, because the IRS doesn't know. Taxpayers have to tell the agency their estimated tax payment status -- yet another indicator that the IRS's customer account tracking system is not what it should be.

Cheney and Kerry filed Form 2210, "Underpayment of Estimated Tax by Individuals," to update the IRS on the status of their estimated tax payments. What gives? The IRS's customer accounts data engine (CADE), a replacement for the 40-year-old Master Files, is in the throes of development, from which it has yet to emerge. CADE implementation has been plagued by delays and cost overruns.

The linchpin of IRS computer modernization, CADE is supposed to allow examiners to have real-time electronic access to all aspects of a taxpayer's record. The delays in its implementation mean that the existing weaknesses in the Master Files will continue into the foreseeable future. (*Doc 2004-2993* [[PDF](#)] or *2004 TNT 30-26* [📄](#).) CADE is supposed to be able to process Forms 1040EZ fairly soon, but that capability, in addition to being irrelevant to more complicated returns, is regarded as an experiment in the development of the overall CADE. And of course the initial emphasis will be on getting refunds to ordinary taxpayers, whose taxes are deliberately overwithheld. (*Doc 2002-2992* [[PDF](#)] or *2004 TNT 30-23* [📄](#).)

IRS Commissioner Mark Everson has said that the future of IRS modernization will be dictated by the progress of CADE, on which the IRS "cannot afford to fail." (*Doc 2004-7735* [[PDF](#)] or *2004 TNT 68- 4* [📄](#).) All of this means that the IRS's ability to know whether a taxpayer has paid estimated taxes equal to last year's tax liability -- a basic statutory exemption from estimated tax penalties -- is a long way off. So rich taxpayers have to file Form 2210 even when, as in Cheney's case, they do not expect to owe under-estimation penalties.

## Bush

There's more than a bit of unreality when dealing with the tax returns of men who, by dint of elective office or advantageous marriage, don't have to pay their own living expenses. Two hundred years ago, when the White House was still called the Presidential Palace, its occupants had to bring their own furniture and servants, and pay their own living expenses. So the idea that a president should get a hefty salary, which he does not use to pay living expenses, is a relatively new one. (And back in the bygone days, the Secretary of Defense was called the Secretary of War.)

The president's salary is \$397,264. The Bushes reported taxable income of \$727,083, and paid tax of \$227,490 on it, after a \$4 foreign tax credit, for an effective tax rate of 31 percent. Of that total, \$401,803 was taxable interest, \$395,309 of which was earned by the Bushes' blind trust.

The Bushes did not report any tax-exempt interest. The Bushes received \$23,471 of dividends, of which \$10,595 constituted qualified dividends, eligible for a reduced rate. The Bushes' Schedule E, "Supplemental Income and Loss," income was \$2,588, consisting of royalties earned by the blind trust after reduction for taxes and depletion.

For someone who successfully promoted a rate reduction for dividends to try to get individual investors back into the equity markets, the president does not seem to have a lot of faith in those markets himself. Typical for an investor who is trying to preserve rather than augment wealth, much of the president's investments appear to be in interest-bearing instruments.

Bush's financial disclosures made when he became president showed that equities represented between 11 percent and 17 percent of his total portfolio. He also reported ownership of interests in private partnerships and real estate. (*USA Today*, Jan. 19, 2001, p. 3B.)

Bush's most recent financial disclosure lists \$8.8 million in assets, most of which is invested in government debt securities, and includes trust funds for his children. Bush listed his most valuable asset as his Crawford, Texas, ranch, valued between \$1 million and \$5 million. Financial disclosure rules being as vague as they are, Bush's estimate of personal net worth is in a range that tops off at \$22 million. Roughly \$15 million of that amount came from his 1998 sale of his interest in the Texas Rangers baseball team. (*USA Today*, Jan. 19, 2001, p. 3B.) Bush's most recent financial disclosure report was filed a year ago. (For the filing, see [http://www.opensecrets.org/pfds/pfd2002/N00008072\\_2002.pdf](http://www.opensecrets.org/pfds/pfd2002/N00008072_2002.pdf). For a summary, see <http://www.bop2004.org/bop2004/candidate.aspx?cid=1&act=pfin>.)

The Bushes contributed \$68,360 to charity, consistent with what they gave the previous year. In 2002 the Bushes gave \$69,925 to charities that included Southern Methodist University, Evergreen Chapel at Camp David, Tarrytown United Methodist Church, and the Combined Federal Campaign. Their 2003 charitable gift formed the bulk of their itemized deductions of \$95,043. The remainder included \$21,352 of ad valorem property taxes on the ranch.

The Bushes claim to live in Texas, where they do not incur state income tax. Bush pere's claimed residence in a Texas hotel room was always dubious, but Bush fils has less of a problem asserting Texas residence. Certainly the president has been roundly criticized for spending enough time at the ranch to establish residence. During the course of his presidency, he has spent nearly eight months at the ranch. (*The Economist*, Apr. 17, 2004, p. 28.) Just because there is no income tax doesn't mean nothing interesting is happening in Texas. Bush's successor as governor is advocating special taxes on topless bars to finance schools. (*The New York Times*, Apr. 21, 2004, p. A14.)

Tax return preparation cost Bush \$2,820. The Bushes' miscellaneous itemized deductions of \$42,253 were reduced to \$25,810 by the 2 percent floor. The accompanying statement shows that those deductions were for fees paid to money managers to manage the blind trust and other fiduciary fees. The Bushes' main investment vehicles are: their blind trust, the Lone Star Trust, administered by The Northern Trust Co. of Chicago; and GWB Rangers Corp., an S corporation

that formerly held the president's shares in the Texas Rangers baseball team, but now appears to hold investments.

Much has been made of the president's having benefited from the capital gains rate reductions he promoted. (*Bloomberg*, Apr. 13, 2004; *The New York Times*, Apr. 18, 2004, p. 22.) The president sold Treasury notes for \$556,798, recognizing \$51,497 of long-term capital gain. He sold another batch of Treasury notes with a short holding period for \$207,234, recognizing \$3,702 of short-term capital gain. In most cases, the president's cost basis in the notes was above par.

But the policy question raised by the president's and vice president's returns is more important than the amounts of gain. Both recognized capital gains on the sale of appreciated Treasury notes. The notes appreciated because they paid higher interest rates than the prevailing rate; that is, all of the appreciation could be chalked up to the Federal Reserve Board's historic lowering of interest rates between the time the notes were issued and the time they were sold. That means that the sales of the notes effectively converted ordinary interest income, taxable at the top rate, to capital gain, which would enjoy the benefit of those rate reductions.

This conversion isn't illegal or improper. It is bad tax policy. And it is the sort of conversion that no modern thinker about the taxation of interest-bearing securities would permit if writing the law on a clean slate. Even if a capital gains exclusion is justified as a means to encourage productive investment, it is hardly necessary to encourage investment in government securities. And conversion isn't justified by any investment policy.

The Lone Star Trust holds the Bushes' investments, plus \$460,000 in cash, due to bond redemptions, and an oil royalty interest. The Lone Star Trust earns a piffling \$3,944 in royalties from the latter, but somehow incurs \$764 of associated expenses. Turns out that \$549 of those expenses are production taxes and property taxes paid to the state of Texas, where Bush claims residence. That's what happens in states with no income tax. The rest are office expenses. The royalty income was further reduced by \$592 of percentage depletion allowance.

The president doesn't sign his own tax return; someone at the Northern Trust Company of Chicago signs it using a power of attorney. Okay, so the president is a busy guy, with countries to invade and Europeans to scold. What's so weird about his not signing his tax return? Well, it means that he might not have filed a valid return.

According to section 6012, individuals are responsible for their own tax returns. Under reg. section 1.6012-1(b)(5), an agent may make a return for an individual if good cause exists and the relevant local IRS official has granted written permission. Good cause includes the taxpayer's incapacity or continuous absence from the country, but does not appear to include invasions to effect regime change without U.N. approval. But then perhaps being president is a unique circumstance.

Even then the agent/preparer must be either a lawyer, certified public accountant, an enrolled agent, or an unenrolled preparer. The latter has very limited privileges and cannot receive refund checks on behalf of clients. SCA 200236043. (That's not relevant to Bush's return because he left his refund to apply against this year's estimated taxes.) Any agent must have a properly completed power of attorney on Form 2848 authorizing the agent to sign for the taxpayer.

The Northern Trust could have had an unenrolled agent sign Bush's return, but only an enrolled agent, accountant, or lawyer can receive his refunds. Presumably, an employee of the Northern Trust could hold the power of attorney to sign the return, but it is not clear that Northern Trust, a firm, as opposed to an individual, can have the power of attorney before the IRS to sign a tax return. At press time, the Northern Trust had not responded to our request to clarify the status of the person who signed the president's return.

## Cheney

The Cheney's reported taxable income of \$813,266, on which they paid \$258,779 in tax, after reduction by a \$6,977 foreign tax credit, for an effective tax rate of 32 percent. Of their taxable income, some \$302,602 was capital gain, and \$84,132 was qualified dividends, both of which are eligible for a 15 percent rate. The vice president's earned income included \$198,600 of salary and \$178,437 of deferred compensation from Halliburton. Mrs. Cheney gets a salary from the American Enterprise Institute.

Cheney's most recent financial disclosure lists between \$19 million and \$86 million in assets. Cheney does not have a blind trust; rather, his investments are in publicly traded mutual funds. Most of those funds hold tax-exempt bonds and government securities, designed to preserve rather than enhance wealth. Mrs. Cheney also reported a sizable holding in Simon & Schuster shares. Although a blind trust is the custom for politicians' investments, there is no legal requirement that a trust be established. (*The New York Times*, May 16, 2003, p. A22. For a summary of Cheney's personal finances, see <http://www.bop2004.org/bop2004/candidate.aspx?cid=2&act=pfin.>)

Given investment habits that mimic those of Mrs. Dodge, the Cheney's gross income was much higher than their taxable income, reaching \$1,999,332, since it included \$627,005 of tax-exempt interest. Their effective tax rate on their gross income is less than 13 percent. The Cheney's reported \$287,875 of long-term and short-term capital gain on sales of \$8.45 million of Treasury securities. Again, that gain would probably be attributable to interest rate differentials. Those sales produced the bulk of their \$302,602 of reported capital gain.

The Cheney's paid \$44,728 in real estate taxes and gave \$321,141 to charity, all but \$507 of which were cash contributions. Mrs. Cheney received \$338,518 of book royalties, which she donated to charity after reducing that amount by \$4,122 of legal fees, \$10,837 of self-employment tax, and \$6,763 of expenses of writing. The reported charitable gift of the royalties was \$320,634. The difference represents the 15 percent haircut caused by the itemized deduction limit to which the Cheney's are subject. The \$507 property contribution consisted of 12 shares of a private oil company.

Lynne Cheney earned \$49,539 in director fees from the board of *Reader's Digest*. She reported a \$50,343 profit from her consulting business on Schedule C, mostly consisting of her *Reader's Digest* fees, which she reduced by \$5,763 of expenses. Those expenses consisted largely of tax return preparation fees of \$4,113, and \$1,650 for the continuing expense of a 2002 termination of a joint defined benefit plan. The other half of the \$3,300 total pension plan termination expense, paid to Aon Consulting, was allocated to Schedule A.

The Cheneys file a joint return, but how can \$4,113 of tax return preparation expense be attributable to Mrs. Cheney's consulting business, when Mr. Cheney is a multimillionaire with a vastly more complicated financial life? The Cheneys' fees for tax return preparation and audit representation were vastly higher than that, and the \$4,113 is just part of the fees that were allocated to various places on the return. Of a total of \$54,836 of tax preparation and audit representation expenses, \$46,611 was deducted on Schedule A (though not on the designated line), \$4,112 on Schedule E, and \$4,113 on Mrs. Cheney's Schedule C. The Cheneys' 2001 return was examined by the IRS in 2003.

The Cheneys' reported \$147,990 of miscellaneous deductions were capped at \$122,632 by the 2 percent floor. Readers, rich people have a lot of expenses. All those people in suits who constantly meet with them routinely charge five-figure fees. The Cheneys paid \$68,292 in investment advisory fees, which sounds like a lot, but is reasonable considering the size of their portfolio. The Cheneys reported \$24,862 of unreimbursed employee business expenses, which represents the cost of filing annual financial disclosure with the Office of Government Ethics.

## **Kerry**

Why is Teresa Heinz Kerry's failure to release returns important? For starters, it's a rather obvious political gaffe, which draws attention to Heinz Kerry's ketchup fortune, estimated to be \$500 million. No less than *The New York Times* -- the sort of reliably Democratic paper that would be inclined to endorse Kerry -- has called for the release of Mrs. Kerry's returns in the wake of Kerry's delayed release of his Vietnam war records. "We hope the senator realizes that there cannot be too much disclosure by a candidate seeking the trust of the public for the nation's highest office," the editors snorted. (*The New York Times*, Apr. 22, 2004, p. A26.)

The *Times* pointed out that Geraldine Ferraro's husband initially refused to release his tax returns, bogging down his wife's campaign for an entire month. There's been some bleating about Heinz Kerry's privacy, but she married a guy who wanted to be president, and the marriage itself has an air of convenience. There is a prenuptial agreement. Heinz Kerry assumed the risk that someone outside of Pittsburgh would ask about her finances.

John Kerry is not rich on his own, at least by East Coast standards. On his 2002 financial disclosure form, he listed assets in his own name as valued between \$409,000 and \$1.8 million. He individually owns Treasury securities and Massachusetts tax-exempt bonds, and has direct investments in the shares of drug companies, oil companies, software companies, phone companies, and banks. Kerry listed assets jointly held with his wife as valued between \$300,000 and \$600,000. (*The Boston Globe*, Nov. 13, 2003, p. A22.)

Nonetheless, the Center for Public Integrity has opened a window on the joint finances of the Kerrys. Their joint income is in the staggering range of \$15.5 million to \$77.5 million, and their total assets are somewhere between \$200 million and \$800 million. Not surprisingly, most of that income comes from H.J. Heinz Co. shares, valued at roughly \$22 million, which throw off several million annually.

Mrs. Kerry apparently has more faith in American equities than either Bush or Cheney. She has large direct holdings in a variety of large public companies, ranging from Del Monte and Hershey to Home Depot to banks to Japanese manufacturers. Mrs. Kerry has numerous small

investments in software and electronic commerce companies. She also has large holdings of tax-exempt bonds, as might be expected, and interests in investment partnerships, which could be hedge funds. Mrs. Kerry's huge portfolio also includes a restaurant and some undeveloped land. (For a summary of Kerry finances, see <http://www.bop2004.org/bop2004/candidate.aspx?cid=4&act=pfin.>)

Kerry has opted out of federal campaign financing, as has Bush, so there is a perception that some of that ketchup money will find its way to the Kerry campaign. Mrs. Kerry's money could legally be used to finance "independent expenditures" on Kerry's behalf. There is precedent in Kerry's career. His first wife, who was also rich, bankrolled his political career. And Kerry has already borrowed against a \$10 million Beacon Hill mansion he owns jointly with his wife. (Federal Election Commission rules permit that borrowing but do not require ownership of the couple's residences to be disclosed.) Perhaps the reasoning is that fire must be fought with fire -- Bush has Air Force One, Cheney has Air Force Two, and the Bush campaign is thought to have \$200 million available to spend, of which \$108 million is in cash.

H.J. Heinz Company, for its part, has sought to diminish suspicions that it would have a financial role in the Kerry campaign. Seems that America's Republican ketchup-eaters are annoyed about the prospect that their dollars might be financing the Kerry campaign. The family-controlled company has sent letters to television and radio shows stating that ketchup profits will not go to Kerry. American culinary preferences being what they are, however, this misperception has not affected ketchup sales, and has even caused some voters to buy more of the dubious red sauce. Teresa Heinz Kerry, who is not on the company board, does use the company plane -- which is painted to look like a ketchup bottle -- to campaign for her husband. (*The London Times*, Mar. 31, 2004, p. 16.)

John Kerry reported separate taxable income of \$346,664, on which he paid \$102,152 in tax, for an effective tax rate of 29 percent. Of his gross income of \$398,338, \$147,000 comprised his Senate salary, and the rest was attributable to book royalties and the \$175,000 gain on the sale of a quarter-interest in a 17th-century Dutch painting. That painting is the only asset he reported that he jointly owns with his wife.

The painting, Adam Willaerts's "The Arrival of Frederick and Elizabeth, Prince and Princess of the Palatinate, at Flushing, 29th April 1613," is considered a masterpiece. Half of the painting is owned by a Connecticut art dealer, and hangs in his gallery; the other quarter is owned by Mrs. Kerry, who assigned half of her original half to her husband. It was sold to a private collector for \$2.7 million. (*The Boston Globe*, Apr. 20, 2004, p. F1.)

Turns out Kerry may have had an excuse for initially refusing to release his tax return; he's had to amend it already. The Dutch painting is properly regarded as a "collectible," gain on which is taxed at a 28 percent rate, rather than as a capital asset, taxed at a 20 percent rate, as he had originally reported. The difference in tax was \$11,577. (*Bloomberg*, Apr. 16, 2004.)

The law finally got sensible about whether tchotchkes that are capital assets should be eligible for the lowest capital gains rate. Their owners may regard them as investments, but public policy does not. That'd be section 1(h)(4) and (5). Long-term collectibles gain is taxable at a 28 percent rate. Collectibles are defined in section 408(m) as "any work of art, any rug or antique, any metal

or gem, any stamp or coin, any alcoholic beverage, or any other tangible personal property specified by the Secretary for purposes of this subsection."

But you don't have to break out the code to figure out that art, as a "collectible," is not eligible for a reduced capital gains rate. It's right there on page D-8 of the instructions for Schedule D. The specific instruction for line 20 of schedule D says that "collectibles include works of art, antiques, metals (such as gold, silver, and platinum bullions), gems, stamps, coins, alcoholic beverages, and certain other tangible property." There's a nice little worksheet to figure out what you have to pay 28 percent on. Let's give due respect to the yeomen who prepare the return instructions, who explain the law every year in baby talk so people determined to prepare their own returns can do so.

Kerry is patriotically overpaying his estimated tax, having filled out Form 2210 incorrectly. Had he filled out the form correctly, his underpayment penalty would have been a mere \$162, rather than the reported \$1,854 that would be due based on his amended return, according to a calculation done for Tax Analysts by Steven [Bankler](#), a San Antonio CPA and return preparer.

Kerry's preparer seems to have forgotten to use the exception based on payment of last year's tax. Kerry's Form 2210, as filed with his original return, allows the IRS to make the penalty calculation, which would be \$1,555, based on the original return and his failure to tell the IRS what he paid in 2002. It is because the IRS is incapable of comparing one year's tax liabilities with the previous year's tax liabilities that taxpayers must make the comparison themselves on Form 2210 if they are not to be unduly penalized.

Kerry received \$89,220 in royalties on his campaign book, *A Call to Service: My Vision for a Better America*, of which he donated \$43,650 to charity. We've been around this block before with politician authors. (*Tax Notes*, May 19, 1997, p. 889.) The most efficient way to get royalties to charity is to assign the copyright to the charity in the first instance, rather than running them through one's tax return. But then the act of generosity doesn't show up on public disclosure of the tax return, and what's the point of that?

We can't fully explain Kerry's inefficiency, however. Massachusetts levies tax on gross income, at 5.4 percent. When the state tax is combined with the federal charitable deduction, receipt of the royalties and donation of them should have left Kerry with \$84,402 to give to charity, according to [Bankler](#). Yet he gave about half that amount.

Moreover, Kerry's donation is inconsistent with prior years' donations. In the last few years, he's managed to scratch up \$20,000 to donate from his Senate salary of \$140,000. This hefty cash outlay was undoubtedly possible because he has been married to the ketchup heiress for the last nine years. In 2003 his gross income was more than twice the amount of his Senate salary, due to the sale of the painting, yet he somehow was unable to donate all of his royalties.

Also appearing every year on Kerry's Schedule A is exactly \$3,000 of unreimbursed business expenses. In prior years, for returns for 1999 through 2002, that item was reported as an unreimbursed employee business expense subject to the 2 percent floor. For 2003 Kerry reported the item as an "other" business expense on line 27 of Schedule A, where it would not be subject to the 2 percent floor. What business expenses do senators have? Well, they have to file financial disclosure reports every year, and we assume this fee went to filling this obligation.

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