

# **Generative AI for Tax**

## Looking Back, Looking Ahead

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May 10, 2024

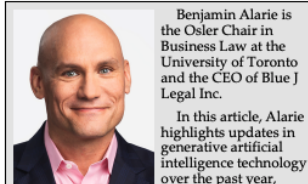
## Generative AI for Tax: Looking Back, Looking Ahead

by Benjamin Alarie

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## Generative AI for Tax: Looking Back, Looking Ahead

by Benjamin Alarie



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Benjamin Alarie is the Osler Chair in Business Law at the University of Toronto and the CEO of Blue J Legal Inc.

In this article, Alarie highlights updates in generative artificial intelligence technology over the past year, particularly for tax analysis, and he predicts further developments in AI technology for 2024.

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*As a tax law professor and artificial intelligence specialist at the University of Toronto, and as CEO of Blue J, I recognize that my professional commitments may suggest a conflict of interest in discussing generative AI for tax. Blue J's prominence in the field compounds that perception. I wish to assure readers that I've taken care to remain objective in my analysis. My goal is to contribute thoughtfully and critically to the important ongoing conversation about AI's role in tax law, while being open and transparent about my intersecting interests.*

### I. Introduction

In 2023 it suddenly seemed that everyone began talking about generative artificial intelligence.<sup>1</sup> For those who have been too

occupied with the actual practice of tax to be closely following the developments in generative AI over the last year, this installment of Blue J Predicts is for you. It will go through the key points involving generative AI from 2023 that may be relevant to your life and tax practice — there are, indeed, a few. From there, the focus will be on what to expect in the year ahead.

As we enter 2024, the intensity of the chatter about generative AI is, if anything, increasing.<sup>2</sup> Law firms<sup>3</sup> and accounting firms<sup>4</sup> have been assessing generative AI and what it means for the future of professional services.<sup>5</sup> Some law firms have launched their own internal generative AI solutions.<sup>6</sup> Accounting firms have made bold announcements about generative AI, with at least one announcing a billion-dollar investment in generative AI over the next three years.<sup>7</sup> Publishers have been making announcements, too.<sup>8</sup> Universities have been concerned about the capabilities of current AI technologies and what the expected radical improvements in AI mean for

<sup>1</sup> A search for mentions of "artificial intelligence" on taxnotes.com shows that 2023 was the year with the most mentions. As of the second week of January, 2024's rate of mentions is running ahead of 2023.

<sup>2</sup> Erin Mulvaney and Lauren Weber, "End of the Billable Hour? Law Firms Get On Board With Artificial Intelligence," *The Wall Street Journal*, May 11, 2023.

<sup>3</sup> Ray Mestring, "Generative AI: Optimizing Pursuits to Fuel Growth," *Accounting Today*, Aug. 31, 2023.

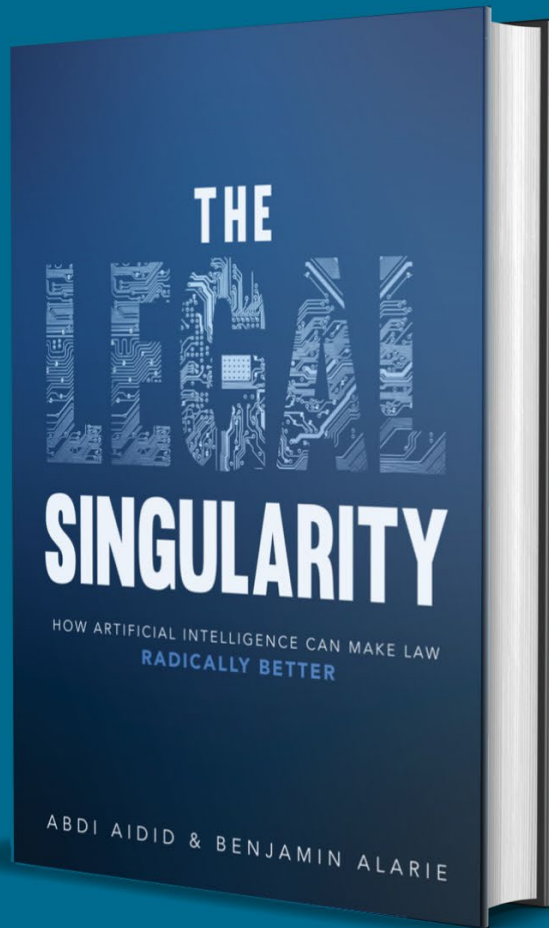
<sup>4</sup> Steve Lohr, "A.I. Is Coming for Lawyers, Again," *The New York Times*, Apr. 10, 2023.

<sup>5</sup> Gunderson Dettmer, "Gunderson Dettmer Launches ChatGD, a Homegrown Generative AI Chat App, to its Lawyers," *News*, Aug. 9, 2023.

<sup>6</sup> Nolan Ogden and Dom Megna, "Generative AI Presents Big Innovation Opportunities for Tax Departments," *PwC Tax Research and Insights*, June 5, 2023.

<sup>7</sup> Thomson Reuters, "A Year in Review: How AI Transformed the Legal Profession in 2023," Jan. 8, 2024.

<sup>8</sup> For a nice review, see Sam Sim, "Artificial Intelligence and Taxation at the Dawn of Generative AI," *Tax Notes Int'l*, Dec. 18, 2023, p. 1647.



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# Generative AI in 2023 and 2024



OpenAI launches GPT-4 in March 2023



Google and Amazon make investments in Anthropic



Google introduces Gemini, a multimodal LLM (text, audio, image, etc.)



OpenAI announces GPT-4 Turbo with 128k token context window



Microsoft integrates generative AI into its products with Copilot



**2024 advancements:** much larger context windows, improved reasoning, multi-modal models, **strong vertical gen AI solutions**

## EXAMPLE OF A VERTICAL AI SOLUTION FOR TAX



Generative AI tax research,  
powered by large language  
models and built on authoritative  
Canadian and US tax databases.

- ✓ Best-in-class content curation
- ✓ Addresses hallucinations
- ✓ Data security and privacy

The screenshot displays the Ask blue J web interface. On the left is a navigation sidebar with a search bar and a list of topics including 'Allocation Rules for Applicable Asset Acquisition', 'Requirements for Tax-Free Recapitalization Reorganization', 'Deductibility of Business Meals', 'Exceptions to IRC Section 4501', 'Taxable Events in Divorce', 'Tax Treatment of Subsidiary's Receivables', 'Allocations under 704(c) explained', 'Partnership Disguised Sale Rules', 'Considerations for Creating QPRT', and 'Remedies for Incorrect S Corporation Election'. The main content area shows a search result for 'Allocation Rules for Applicable Asset Acquisition'. The result includes a question: 'What are the rules for determining the allocation of consideration received in an applicable asset acquisition?'. The answer explains the rules under Section 1060 of the IRC, detailing the residual method for allocating consideration among different classes of assets (Class I to Class VII) and the requirements for the transferor and transferee to provide information to the Secretary of Treasury. Below the answer are 'Sources' listed as 'REGULATION § 11060-1. Special allocation rules for certain asset acquisitions.', 'STATUTE § 1060. Special allocation rules for certain asset acquisitions', 'DOCUMENT T.D. 8215', and 'PUBLICATION PI R 2000034007'. At the bottom of the interface is a search bar with the text 'Ask a question' and a search icon.

# Content Curation

- ✓ Robust curation of data sources is essential
- ✓ Must support with authoritative sources, minimizing out-of-date and obsolete materials
- ✓ Content updated daily/weekly to ensure underlying sources materials are current
- ✓ Curation must be ongoing to ensure materials remain current



How do I determine whether the Corporate Alternative Minimum Tax applies to a corporation?



Section 55 of the IRC imposes a corporate alternative minimum tax (CAMT) on an applicable corporation based on its adjusted financial statement income (AFSI). In general, an applicable corporation is a corporation that has an ...

STATUTE IRC § 56A

STATUTE IRC § 52

DOCUMENT Notice 2023-7

For the first taxable year beginning after December 31, 2022, a corporation may choose to apply the safe harbor method described in section 5.03(2) of this notice in lieu of the ...

# Addressing Hallucinations


How do researchers using generative AI ensure its findings are not invented or wrongly synthesized?

- ✓ Platform-level preventative measures against generative AI citing non-existent cases
- ✓ Provides for verifiability of answers by users

ChatGPT: [US lawyer admits using AI for research](#)



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CEO @ Blue J | Generative AI for tax experts

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Now at over 90% accuracy at answering tax research questions using generative AI!

Over the past 18 months we've been making extraordinary progress in improving Ask Blue J's performance on our internal benchmarks.

A "Pass" means that the system answered the tax research question correctly and cleanly. Our most recent benchmarking -- from this week -- shows we're now at 91.9%.

We are now going to redo our benchmarking suite questions to make them even more challenging. I'm looking forward to the day -- possibly not so far away -- when we start struggling to get Ask Blue J to fumble on any tax questions ...

For now, we will celebrate our exceeding the 90% Pass rate with a relaxing long weekend. And then get back to work on Monday to make Ask Blue J even better!

Way to go, team [Blue J!](#)

Version	Pass	Neutral	Fail
v5.1	42.9	17.1	40.0
v9.1	48.7	18.9	32.4
v9.2	59.5	10.8	29.7
11 regrade	70.3	2.7	27.0
v11.4 Reduced Sources	78.4	8.1	13.5
v11.6 Commentary	81.1	5.4	13.5
v12	91.9	0.0	8.1



<b>Version</b>	<b>Pass</b>	<b>Neutral</b>	<b>Fail</b>
v5.1	42.9%	17.1%	40.0%
v9.1	48.7%	18.9%	32.4%
v9.2	59.5%	10.8%	29.7%
11 regrade	70.3%	2.7%	27.0%
v11.4 Reduced Sources	78.4%	0.8%	13.5%
v11.6 Commentary	81.1%	5.4%	13.5%
v12	91.9%	0.0%	8.1%

# Generative AI for tax demo

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#### Tips

Ask Blue J is an incredibly powerful generative AI tool that works differently than a traditional search box. To get the most from Ask Blue J, try to provide a well-formed tax question that gives the AI guidance on what you are looking for.

[See an example](#)



Answers should not be interpreted as legal advice.



All responses should be reviewed for accuracy.

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### Under what circumstances can a taxpayer take a deduction on losses for cryptocurrency that has become worthless?



Under the Internal Revenue Code (IRC) and the guidance provided by the Internal Revenue Service (IRS), a taxpayer can take a deduction on losses for cryptocurrency that has become worthless under specific conditions as outlined in [Section 165](#) of the Code. The key conditions for a taxpayer to claim a deduction for a loss due to worthlessness of cryptocurrency include:

- Closed and Completed Transactions:** [Section 165](#) provides a deduction for losses that are evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. This means that for a taxpayer to claim a loss on cryptocurrency, there must be a definitive and identifiable event that marks the loss. Simply holding onto cryptocurrency that has declined in value does not meet this criterion unless the cryptocurrency becomes completely worthless.
- Worthlessness:** A loss may be sustained if a cryptocurrency becomes worthless, resulting in an identifiable event that occurs during the tax year for purposes of [Section 165\(a\)](#). The determination of whether an asset has become worthless is a question of fact. For cryptocurrency to be considered worthless, it must have no market value and no potential for recovery. If the cryptocurrency continues to be traded on at least one exchange, even for a fraction of a penny, it is not considered worthless for the purposes of triggering a deductible loss.
- Affirmative Steps to Abandon:** If a taxpayer takes affirmative steps to abandon the cryptocurrency, this could potentially qualify as an identifiable event allowing for a deduction. Abandonment requires an intention to abandon the property, coupled with an affirmative act of abandonment. Simply holding onto cryptocurrency that has declined in value, without taking any steps to abandon or permanently discard it, does not qualify as an abandonment under [Section 165](#).
- Documentation and Compliance:** For a loss from worthlessness to be deductible, the taxpayer must comply with all relevant tax laws and regulations, including properly reporting their investment earnings to the IRS and filing all required tax returns. The loss must be adequately documented through closed and completed transactions, fixed by identifiable events, and sustained within the tax year.
- Non-applicability of Miscellaneous Itemized Deductions Suspension:** Even if a taxpayer sustains a qualifying

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- 4. Documentation and Compliance:** For a loss from worthlessness to be deductible, the taxpayer must comply with all relevant tax laws and regulations, including properly reporting their investment earnings to the IRS and filing all required tax returns. The loss must be adequately documented through closed and completed transactions, fixed by identifiable events, and sustained within the tax year.
- 5. Non-applicability of Miscellaneous Itemized Deductions Suspension:** Even if a taxpayer sustains a qualifying [Section 165\(a\)](#) loss, such a loss might be disallowed under [Section 67\(g\)](#), which suspends miscellaneous itemized deductions for tax years 2018 through 2025. This suspension could affect the deductibility of losses on cryptocurrency investments made for personal investment purposes.

In summary, a taxpayer can take a deduction on losses for cryptocurrency that has become completely worthless within the tax year, provided that the loss is evidenced by closed and completed transactions, fixed by identifiable events, and the taxpayer has complied with all relevant tax laws and regulations. The cryptocurrency must have no market value and no potential for recovery, and the taxpayer must have taken affirmative steps to abandon the cryptocurrency if it has not become completely worthless.

Like this answer?



## Sources

[ADMIN](#) [CCA 202302011](#) Summarize[ADMIN](#) [Notice 2014-21](#) Summarize[ADMIN](#) [Rev. Rul. 2019-24](#) Summarize[COMMENTARY](#) [News Stories: Appraisal Required to Deduct Cryptocurrency Charitable Donations](#) [taxnotes](#) [COMMENTARY](#) [News Stories: No Loss Deduction for Decline in Crypto Values](#) [taxnotes](#) [COMMENTARY](#) [Practice Articles: Everything We Know — and Don't — About Taxing Cryptocurrency](#) [taxnotes](#) [COMMENTARY](#) [Viewpoint: Changing the Treatment of Losses From Cryptocurrency Investments](#) [taxnotes](#) [View additional related material](#)[Settings](#) [FAQ](#) [Logout](#)

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## CCA 202302011

Published: 2023-01-13

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Citation/Reference:	CCA 202302011, 2023-1031
Type:	IRS Chief Counsel Advice
Released:	2023-01-10
Published:	2023-01-13
Jurisdiction:	Federal - United States of America

events occurring in such taxable year. Treas. Reg. section 1.165-1(d)(1).

Section 165(g) provides that if any security which is a capital asset becomes worthless during the taxable year, the loss shall be treated as a loss from the sale or exchange of a capital asset. Section 165(g)(2) defines a security as a share of stock in a corporation; a right to subscribe for, or to receive, a share of stock in a corporation; or a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or a government or political subdivision thereof, with interest coupons or in registered form. Cryptocurrency B is none of the items listed in section 165(g)(2), and therefore section 165(g) does not apply.

For individual taxpayers, section 67(b)(3) characterizes section 165(a) losses, other than those from casualty, theft, and wagering, as miscellaneous itemized deductions.<sup>2</sup> Under current law, section 67(g) disallows all miscellaneous itemized deductions for tax years beginning after December 31, 2017, and before January 1, 2026.


## Worthless Cryptocurrency

Cryptocurrency B has substantially decreased in value; however, its value was greater than zero, it continued to be traded on at least one cryptocurrency exchange, and A did not sell, exchange, or otherwise dispose of the units of Cryptocurrency B. "The mere diminution in value of property does not create a deductible loss. An economic loss in value of property must be determined by the permanent closing of a transaction with respect to the property. A decrease in value must be accompanied by some affirmative step that fixes the amount of the loss, such as abandonment, sale, or exchange." *Lakewood Assocs. v. Commissioner*, 109 T.C. 450, 459 (1997); Treas. Reg. section 1.165-1; see also *Higgins v. Smith*, 308 U.S. 473, 475 (1940) ("[D]eductions are permitted for losses 'sustained during the taxable year.' The loss is sustained when realized by a completed transaction determining its amount."); *United States v. White Dental Mfg. Co.*, 274 U.S. 398




## Section 165.

- Documentation and Compliance relevant tax laws and regulation required tax returns. The loss must be identifiable events, and sustained during the taxable year.
- Non-applicability of Miscellaneous Section 165(a) loss, such a loss for deductions for tax years 2018 to 2026 for cryptocurrency investments made during the taxable year.

In summary, a taxpayer can take a deduction for a loss in the taxable year, provided that the loss is sustained during the taxable year, the taxpayer has complied with all relevant tax laws and regulations, there is no potential for recovery, and the tax asset has become completely worthless.

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## Sources

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Section 165(a) of the Code provides a deduction for losses sustained during the taxable year and not compensated for by insurance or otherwise. A loss is allowed as a deduction under section 165(a) only for the taxable year in which the loss is sustained. For this purpose, a loss is treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and as fixed by identifiable events occurring in such taxable year. Treas. Reg. section 1.165-1(d)(1).

Section 165(g) provides that if any security which is a capital asset becomes worthless during the taxable year, the loss shall be treated as a loss from the sale or exchange of a capital asset. Section 165(g)(2) defines a security as a share of stock in a corporation; a right to subscribe for, or to receive, a share of stock in a corporation; or a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or a government or political subdivision thereof, with interest coupons or in registered form. Cryptocurrency B is none of the items listed in section 165(g)(2), and therefore section 165(g) does not apply.

For individual taxpayers, section 67(b)(3) characterizes section 165(a) losses, other than those from casualty,



## Summarize

The IRS memorandum, CCA 202302011, issued on January 10, 2023, clarifies that taxpayers cannot claim a loss deduction under section 165 of the Internal Revenue Code for cryptocurrency that has declined in value but is not considered worthless or abandoned. The document outlines that for a loss to be deductible, it must result from a closed and completed transaction, be fixed by identifiable events, and actually sustained during the taxable year. Since the cryptocurrency in question still holds some value and the taxpayer retains control over it without having taken steps to abandon or dispose of it, no deductible loss under section 165 is recognized. Additionally, even if a loss were considered sustained, it would be disallowed due to the suspension of miscellaneous itemized deductions for tax years 2018 through 2025 under section 67(g). The memorandum also discusses the definitions and tax treatment of digital assets and cryptocurrencies, emphasizing that a decrease in value alone does not constitute a deductible loss unless accompanied by an affirmative step that fixes the amount of the loss, such as a sale, exchange, or abandonment.

Section 165.

4. Documentation and Compliance relevant tax laws and regulator required tax returns. The loss n identifiable events, and sustain

5. Non-applicability of Miscellaneous Section 165(a) loss, such a loss deductions for tax years 2018 t cryptocurrency investments ma

In summary, a taxpayer can take a c the tax year, provided that the loss the taxpayer has complied with all r no potential for recovery, and the t become completely worthless.

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## RESPONSIBILITY

- ✓ Transparency about the data used to train LLM.
- ✓ Safeguards to reduce risk against hallucinations, including no answer response.



## ACCOUNTABILITY

- ✓ Oversight from a dedicated team of AI and legal experts.
- ✓ Curated database of US federal tax law.
- ✓ Verifiable answers with links to relevant source materials.



## SECURITY

- ✓ Strict privacy controls to protect confidential data.
- ✓ Enterprise level security with 3rd party verification.



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