1-1-1964

Federal Taxation

Maynard Jackson

Federal
Taxation

97¢

NORTH CAROLINA
COLLEGE

NORTH CAROLINA COLLEGE AT DURHAM
TRUTH
1910 1960
SERVICE
DURHAM, N.C.

150 SHEETS
WIDE LINES
THREE DIVIDERS

NAME Maynard H. Jackson, Jr.
ADDRESS 1927 Cecil Street - Durham, N.C.
682-8529

NATIONAL
Made in U.S.A.

No. 33-383

Final Examination

FEDERAL TAXATION

Mr. M. E. Johnson May 22, 1964

I

John Doe, a widower in his 50's, maintains a household for himself and his unmarried 17-year-old daughter. His daughter was employed and received a salary of $660 during 1963, but Mr. Doe furnished more than half of her support. He was employed at a salary of $4,500 during 1963. He also received $50 dividend from stock in A Corporation. He paid out for allowable non-business deductions for 1963 the sum of $450.

(a) What is the amount of Mr. Doe's taxable income, assuming he itemizes his deductions? (Show computations).

(b) Is Mr. Doe a head of household for income tax purposes for 1963?

(c) Must his daughter file a return?

head of household

II

During the taxable year an accrual-basis builder constructed a large apartment house for which he received $200,000 as payment in full. However, he guaranteed his work for 5 years after completion and is bound to make good for any defects in the construction which may appear during that time.

Because of this liability, may he fail to report a certain percentage of the $200,000 in his income for the taxable year and prorate such amount not reported over the next 5 years? Explain.

III

Which person(s) or organizations must report and pay any tax which may be due in the following situations:

(a) An irrevocable 20-year trust receives $6,000 net income from property held by it and, as required by the trust agreement, distributes $900 each to A and B, the two individual beneficiaries.

(b) A partnership composed of A and B, who share profits and losses equally, realizes a net profit of $6,000.

Give answer and reasons.

IV

H separated from W under a written separation agreement by which he agreed to make periodic payments. During 1963 he operated a gambling establishment along with other activities. Which of the following items may H deduct for U. S. income tax purposes:

(a) Periodic payments made to W under separation agreement?

(b) Rent paid on the gambling establishment?

(c) Depreciation on personal residence?

(d) Christmas gifts to employees in gambling establishment?

(e) Taxi fare to and from his business?

(f) Taxi fare to the doctor's office?

(g) Interest on mortgage on home?

(h) Country club dues?

(i) Loss on sale of stock to his brother?

(j) Damage to home by lightning?

Give reasons for your answers.

V

Assume that a taxpayer has net income or loss as follows and that his taxable year is 1963:

1957	1958	1959	1960	1961	1962	1963
$8,000	$3,000	$12,000 loss	$4,000	$8,000 loss	$2,000	$3,000

Assume that the taxpayer had no income or losses for years prior to 1957. Assume further that no modifications are required to compute the carry-backs and carry-overs of the 1959 and 1961 losses.

State the number of years over which losses may be prorated and compute the amount of the carry-back and carry-over for each year and the net operating loss deduction for each year.

VI

In 1941, A gave $50,000 to his son, B. He transferred $100,000 to T upon an irrevocable trust for his wife for life, with remainder to his daughter, C; he transferred $60,000 to a revocable trust for his grandchildren. In 1963, he made exactly similar gifts.

Assume personal exemptions were $4,000 for 1941 and assume the tax bracket for gifts in 1941 is now 50% and the bracket for 1963 is 57%. Compute A's gift tax for 1963.

VII

The gross estate of D, a bachelor who died January 6, 1963, totals $1,000,000, including $500,000 in insurance to S as beneficiary. All insurance was subject to D's right to change beneficiaries and to surrender policies for cash. His debts total $600,000. Administration expenses total $50,000; and property taxes which accrued April 1, 1963, have been paid in the amount of $10,000.

Compute the amount of the taxable estate.

VIII

Mary and John Jones, residents of a community property State in which they have always lived, gave a parcel of realty to their son and daughter-in-law jointly as donees. The realty was purchased by them ten years ago for $10,000, accumulated out of the husband's earnings; its value on date of gift is $90,000. The Joneses have made no prior gifts.

(a) Compute their taxable gift for 1963.

(b) What would be the result if the Joneses lived in a non-community property state?

IX

A and B are brothers who open a bank account as joint tenants with right of survivorship. Only A supplied money to the account. A dies with B surviving him. There is $10,000 in the joint bank account. Under state law B has title to all the money through a vested right of survivorship, not through A.

How much, if any, of this $10,000 is includible in A's estate for federal tax purposes?

Taxation
Mr. Johnson
M — F 11:30 - 12:30

2253

2253

Casebook - Fed. Taxation, Griswold (w/ 1962 Supp.)
Supplement - 1964 Fed. Tax Course, CCH.

2 FEB. 64

Taxation is a statutory course.

Tax bills must originate in the House of Representatives. Art. I, sec. 8 says that Congress shall have the power to lay and collect taxes, but that taxes throughout the states must be uniform. Art. I, sec. 9 allows for proportioned taxes. Direct taxes usually go only to land; i.e., the power to transfer (stamp tax) realty.

The Fifth Amendment permits of questions re deprivation of property w/o due process of law.

Due to 10TH Amendment, States claim the power to tax.

Sixteenth Amendment - authorizes personal income tax on "income from whatever source derived."

Major revision of the Code occurred in 1954.

Treasury Dept. puts out "Treasury Rulings" which interpret the Code. Appear in Internal Revenue Bulletin.

Three general categories:
(1.) What is income?
(2.) Whose income is it?
(3.) When is it taxable?

Partnership not responsible for pymt. of tax, but must file and declare an "Information of Income" reporting the income of each ptnr. Then each ptnr. must file his own income return.

Basic Equation

Gross Income
− Deductions
ADJUSTED GROSS INCOME

Then, from the A.G.I. may be deducted non-business expenses (e.g., medical, charitable contributions). After all deductions properly made, you have the TAXABLE INCOME.

Fed. Unemployment Tax Act (F.U.T.A.) - employee not taxable; $\mathcal{E}^{er}$ is.

Self-Employment Tax - like unemployment compensation tax for salaried employees, but applicable

to self-employed people. The self-employed party must pay the full 7½% of amounts of profits over $400.00. (You pay social security only on amounts of income up to $4800.00.)

Estate Taxes —

Must be considered along w/ Gift Taxes. Donor is liable FIRST for the gift taxes; but upon his default, the donee will be liable.

Excise Taxes —

Amusement, sales, fuels, luxury, etc., taxes come in here.

Mfgrs. of liquor and cigarettes, e.g., must pay the taxes thereon, but they usually pass same on to the consumer.

Assignment: from p.1 on ....

4

4 FEB. 64

Organization of IRS –

I. Secretary – Treas.
II. Commnr of Int. Revenue
III. Deputy. Commnr.

all equal
- A. Asst. Commnr for Admn.
- B. " " of Planning
- C. " " of Operations.
- D. " " : Technical.
- E. " " : Inspection

F. Chief Counsel – answerable directly to Deputy Commnr.

G. Director of Practice
- 1. (Under Chief Counsel) 9 Regional Commnrs
  - (a.) 6 Asst. Regional Commnrs.
  - V. 64 Dist. Directors.

Court Organization – Steps:

I. Notice of Deficiency – actually preceded by Notice of Assessment, wh allows 30 days to contest the assessment (sent to TP by IRS).

II. File in tax Court – no jury trial. Could go to U.S. Dist. Ct. or you get jury trial. In the Dist. Ct., you

Tax Court v. Dist. Court

Dist. Ct. –
1. Jury trial
2. Must first pay assessment.
3. If TP wins, govt. pays interest.

Tax Court –
1. No jury trial.
2. Contest assessment w/o first paying.
3. If TP loses, must pay interest to Govt. from date of due.

must first pay and then seek refund. If you win, the govt. must pay you interest. — In tax ct., you challenge the assessment w/o paying at first. If you lose, you must pay interest from the due date.

(III.) Appeal to U.S. C.C.A.
(IV.) Appeal next to U.S. Sup. Ct.

If you go to U.S. D.C. first:
I. May appeal to U.S. C.C.A.
II. Then, may appeal to U.S. Sup Ct.

The entire record would be opened to review on appeal to U.S. D.C. or the Tax Court.

See 28 USC 1340 – re beginning suit in U.S.D.C. v. Director.
28 USC 1491 – Suits begun in U.S. Ct. of ~~Tax~~ Claims.
28 USC 1346 –

1491

1346

* (c) PRESENT FEDERAL TAXES *

(2.) Customs Duties

J.W. Hampton Co v. U.S. (p. 7)

P here says that Congress only has power to tax for the purpose of raising revenue, not to regulate imports, etc.

Held, if a tax is levied for the purpose of raising revenue, the "existence of other motives" (e.g., regulation) for the tax cannot be inquired into. "They do not lose their character as taxes because of the incidental motive."

"So long as the motive of Congress and the effect of its legislative action are to secure revenue for the benefit of the gen. govt, the existence of other motives in the selection of the subject of taxes can not invalidate Congressional action."

Art. I, sec. 2, clause 3: "... direct taxes shall be proportioned among the

Only tax on land ~~and direct poll tax are~~ is direct tax, and must be apportioned. All others need not be apportioned, including tax on conveyances of land.

Hylton v. U.S. (p.22)
Tax on ~~State~~ ~~official~~ carriages = direct tax. Unconst. if not apportioned.

The Collector v. Day (p.25)
Tax on state official ≠ tax on state itself. Thus, state officials and administrators may be taxed.

5 FEB. 64

(p.33) Pollock v. Farmers Loan & Trust Co.
Said essentially that an income tax was direct and unconst. because unapportioned.
16TH Amendment now covers and authorizes income taxes on "income from whatever source derived."

NAME CASE

Knowlton v. Moore (p.40)
Held, inter alia, that death taxes are not direct taxes. Still true today. Also, that a "tax imposed w/ reference to the ability of the person

upon whom the burden is placed to bear the same have been levied from the foundation of the govt." i.e., Progressive tax okay.

Johnson: means uniform w/in the class.

(Quaere this!) Further, held that the words "uniform throughout the United States" do not signify an intrinsic but simply a geographic uniformity.

Brushaber v. Union Pac. R. Co. (p. 44)

16TH Amendment ratified in Feb., 1913; and, stayed here took effect Oct. 3, 1913, retroactively applied to Mar. 1, 1913. — That statute was retroactive and unconstitutional.

(F.) Limits to the Nature and Objectives of Fed. Taxes

Limitations on Cong. taxing power:

1. Congress cannot tax exports.
2. Direct taxes must be apportioned.
3. Indirect taxes must be by rule of uniformity.

Are income taxes "indirect taxes"?

Taxpayer's "standing to sue"

The fed. taxpayer generally has no "standing" to challenge the validity of Congressional appropriations. His interest in the moneys of the Treasury is considered "minute and indeterminable" and the effects of the appropriation on future taxation "remote and fluxuating and uncertain."

However, when the tax is levied, the taxpayer on whom the burden is imposed will then have standing to challenge the levy as against him.

If an assessment is passed for the purpose of raising revenue, and the funds go into the general Treasury, = TAX, even though one of the purposes may have

also been penal.
Thus, the Agricultural Adjustment Act was deemed a penalty-imposing act, not one that imposed taxes. Thus, laws re Congressional power over taxing would not apply.

Steward Machine Co. v. Davis (p. 54)
This was during the days when you could still sue the Director of the IRS.
Re Social Security Act.

6 Feb. 64

United States v. Kahriger (p. 61)
Appellee contested constitutionality of fed. tax on gambling (tax stamp).
If Congress has the power to tax, it may regulate also so long as it taxes. If Congress has the power to regulate, also, and taxes

as a means of regulation, okay, too. — Statute of U.S. held constitutional. (3 dissenters on Court here.)

* (Chapter 2) Elements of Fed. Tax Procedure *

(A.) General

Allen v. Regents of U. System of Ga. (p. 71)

Was fed. admissions tax on athletic contests sponsored by appellee constitutional?

This suit would not lie to restrain the collection of these taxes. You cannot restrain the collection of duties, imposts and excises.

You can seek to restrain the collection of income, gift, estate, excess profits or windfall taxes.

Proper Party

Today, the action would be brought against the U.S., or the Commissioner or Director as such, not against any indiv. as an indiv.

Declaratory Judgments—

The federal D.J. procedures do not apply to federal tax questions.

However, there may be declaratory rulings by the I.R.S.

You cannot pay a tax and then seek refund thru ~~the~~ any federal ~~dist.~~ cts. until you first file a claim w/ the govt. and give the govt. a chance to satisfy same.

Quere how long?

You need not pay "under protest" anymore. i.e. You need not stipulate that you pay "under protest." You may simply pay and then seek refund.

0

7 Feb. 64

U.S. v. Felt & Tarrant Mfg. Co. (p.80)

Obsolescence and exhaustion of patents here were conceded. Code 74-22 in point now.

U.S. v. Andrews (p.83)

Definitions: Capital Gains, etc.

Re. capital gains (c/g). A ~~gain c/g~~ on a capital asset = c/g. What = capital asset? Usually something held for use in biz, and not for sale. If held for sale = inventory; and, gains on inventory = income.

c/g:

1. Short-term
2. Long-term

If you gain on the disposition by sale or exchange of a capital asset held for not more than 6 mos. ~~after acquisition~~, short-term c/g. Must report 100% of gains as income.

If disposition by sale or exchange is after holding the capital asset more than 6 months, long-term c/g. You may report 50% of that gain as ord. income, or, if you are thereby thrown into a higher tax bracket (check this!), you

may report 25% of the full gain as ord. income.

Amended Claims: S/L

Andrews (?) case concerned S/L on filing new claims. If an amendment (to a timely claim) is filed after the tolling of the S/L, the amendment = new claim and will not relate back to the date of the original claim.

Smietanka v. Indiana Steel Co. (p. 87)

Can actions be brought against the successor in office on the tax complained of and paid was paid to the D's predecessor in office? (This problem would not arise today because y are no longer personal actions against the tax official.)

It was held that the suit for refund

was a personal action and must be brought against the deceased official's executor or administrator. — If no one qualifies as executor or administrator w/in 6 mos. of decedent's death, a creditor can have himself, or someone else, qualified as executor or admr.

Jurisdictional Amount and Parties

Today, if you go into Dist. Ct., your action may be against the Dist. Director of IRS (who collected the tax) (if the amt. in controversy exceeds $10,000, etc.), or against the United States regardless of amt. in controversy. — If you sue in Tax Court, D= Commissioner.

16

10 Feb. 64

Lewis v. Reynolds

May new assessment be made after S/L has run? No. But, in determining a case of a refund, the collector may redetermine your tax at any time to work an offset against the claimed refund.

Govt. does not need to go to ct. to collect. May collect by admin. means: distraint.

Deficiencies -

May be made w/o the Govt. having to go to court.

Govt. may make a JEOPARDY ASSESSMENT w/o sending notice of deficiency (p. 99) where the Govt. feels that such delay would jeopardize the collection of the assessment. e.g., Lang on Johansson's income from Patterson fight or there was danger of Johansson leaving country.

In dist. ct., you must first pay the assessment to get into ct. and have a jury trial.

Accountants before a ct. are supposed to be qtd. to matters of accounting.

Teel v. Commissioner (p.100)

After a 90 day deficiency letter notifying a TP of an assessment has been mailed, the 90 days begin to run from the date of mailing. But, an appeal by a TP, or a protest by a TP, begins to run from the date of receipt by the court.

Also, here TP did not prevail w/ the argument that the 90 days should begin to run from the date of delivery at his (TP's) home, because TP had notice and actual knowledge that the letter was at the post office.

(p.102) "A petition is regarded as filed on time if mailed on time, and actually delivered. It still seems to be good practice to see that the pet. is actually

rec'd. by the Clerk of the Tax Court w/in the prescribed time."

Payt. of deficiency will not bar you from going into tax court.

Read Helvering case carefully! (p.110)

11 FEB. 64

Helvering v. Taylor (p.110)

Is TP entitled to deduct the cost of ALL stock from the sale price of the preferred stock alone?

Ct. of Appeals held TP need not show why the assessment was incorrect nor what it should have been; TP need have only shown that the assessment was erroneous.

TP paid $96,030 for all the stock of four (4) utilities companies. He transferred to a holding co., that he organized, all of that stock and rec'd

in return, all the stock of the holding company.

The holding co., nearly a year later, sold all stock of the utilities to X corp. for $194,930.16. Then, holding co. bought or retired all the preferred + paid TP $99,000 therefor. In TP's 1928 return, he assigned the $96,030 for which he procured the utilities to the PREFERRED stock of the holding company, deducted that amt. from the $99,000 rec'd therefor, and reported the difference, $2,970, as the gain derived from the sale.

⊗ The Commr. said that the cost of the preferred shares is to the cost of all shares as the sale price of the preferred shares is to the sale price of all shares.

HELD, a TP need not show what the assess-

ment should have been, but has the burden only of showing that the assessment was wrong and that the Commnr used an arbitrary standard.

12 FEB. 64

The Dobson Episode — (1943)

"Tax benefit" Rule

Re the "Tax benefit" rule under wh the recovery of an item previously deducted does not = income unless the deduction produced a tax benefit. — Good law today still.

(dead rule today) The main Dobson Rule holds that when the Tax Court renders a decision on a question only of proper tax accounting, and that when the decision on such a question did not involve a clear-cut mistake of law, the decision of the Tax Court must stand. — A subsequent statute (Sec. 1141(a) of the

I. R. Code of 1939) killed the Dobson rule re decisions of the Tax Court, making "decisions reviewable by the U.S.C.A.D.C. "in the same manner and to the same extent as decisions of the dist. cts. in civil actions tried w/o a jury." — "Tax benefit" rule still applies today.

As a practical matter, in view of the Tax Court judges' expertise, the appellate courts will be slow to reverse.

* (Chapter 3) INCOME TAX *

"Income" Definition

Income — gains derived from capital, labor and the profits from sale or exchange of capital assets, and may consist of money, prop., services or simply a difference in values.

Checklist of income (See Handbook, sec. 423). This list is not exhaustive.

Sec. 204 (hbk.) — tax rates. Basic tax is 3%. Surtax begins at 17%. Thus, beginning rate for any indiv. is 20%. Under no circumstances does an indiv. ~~be paid~~ pay over 87% of his ~~net~~ taxable income. The surtax goes as high as 91% in some brackets.

From $300,000 on, an indiv. is subject to 91% tax.

Under 1964 amendment, this has been lowered to 48%.

Sec. 1911 (hbk.) — corp. rate. On anything above $25,000 corp. pays 52% (30% tax, 22% surtax).

Helvering v. Gerhardt (p. 120)

Today, the salaries of officers of state or federal ~~states~~ govts. are taxable.

13 FEB. 64

Fed. Employees and everyone else must pay income taxes.

Fisher v. Commissioner (p.143)

The single issue presented by this appeal is whether an amt. of $6,000 rec'd. by the TP in 1924 from his employer was a gift, as he contends, or additional compensation for services, as the Commissioner contends.

Held, whether a payment in a given case shall be deemed taxable compensation or a gift exempt from tax depends upon the intention of the parties, and particularly that of the Ex, to be determined from the facts and circumstances surrounding the transaction. In the case at bar, the Holmes Co. clearly indicated its intention by charging the

You cannot have income unless g is a sale or exchange. (??)

ployment upon its books to salary account and so reporting it in its tax returns.

Taxation is purely statutory.

Commissioner v. Duberstein (p. 146)

Rule

Where the Sup. Ct. cannot say that it is clearly erroneous of ~~that~~ the ~~the~~ Tax Ct., as the trier of fact, to have found as it did, then that finding will not and should not be disturbed.

The word "gift" does not mean gift necessarily in the same sense as "gift" at C.L. Further, despite pat rules re "gift," each case must be scrutinized on its peculiar facts.

* The donor's characterization of his action is not determinative — that is must be an objective inquiry as to whether

what is called a gift amounts to it in reality."

If a clear-cut test is called for, it's up to the Legislature to create same.

Cadillac = income.
$20,000 = no income.

14 FEB. 64

Olin O. Ellis (p. 150)

Petitioner lived in apt. bldg. which his corp. owned. He was also nighttime mgr. of the bldg. Previous nighttime mgr. had to live in — rent free — in an apt. worth $1800 per year in rents; he had to take only daytime shift and consequently moved out. — Petitioner lived rent-free in $1800.00 per year apt.

Rule: fair value of living quarters.

One may deduct the "fair value of living quarters ... furnished to Ees for the convenience of the Ers." "Not does not mean "solely" for Ers benefit. Thus, here

the court allowed pet. to ~~[illegible]~~ avoid only $1,000 (i.e., $1800 - $800 = $1000) the amount pet. would have been able to ~~[illegible]~~ avoid if Ellis were only the nightime mgr. who would have gotten only a $1000.00 apt. i.e., $800.00 per year rent was income.

Fringe Benefits –

(1.) Unemployment benefits – not taxable! But, Ee may deduct the contrib. it contributes to the fund.

(2.) Strike benefits – if cash, income and taxable. If in goods, not taxable. Not taxable, too, if the striker's rent is paid. (This is by judicial interpretation by Sup. Court.) Same for "lockout" benefits.

(3.) Sick benefits – excluded up to $100.00 per week.

(4.) Vacation expenses - income to the vacationing Eee when paid by Eer. Bonus trips = income to Eee who wins and takes the trip.

17 FEB. 64

Accounting methods -

(1.) Cash method - cash earnings received or constructively recv'd. during taxable period. May deduct only expenses or deductions actually paid during the taxable period.

(2.) Accrual method - all income rec'd. and to wh you ~~have~~ get the right during the taxable period.

Fringe Benefits (cont'd.) -

Suppose Eer installs air conditioning, or a water cooler; would ~~that~~ be income to Eee? No, but it would be deductible by the Eer.

Dean v. Commissioner (p. 155)

Was y a correct claim for income tax v. the TP based

on the rental value of property held in the name of a corp. of wh the TP & his wife are the sole shareholders?

Held, yes. "It was the TP's legal obligation to provide a family home and if he did it by the occupancy of a property wh was held in the name of a corp. of wh he was president, we think the fair value of that occupancy was income to him."

Beneficiaries of a Deceased Employee

Sec. 101 (b) of 1954 Code - up to $5000 may be paid to the beneficiaries of a deceased employee free of income tax. All over that is taxable income to the beneficiaries.

Prizes and Awards -

The only exceptions to the rules that prizes and awards

ARE INCOME are scholarship & fellowship grants, and those prizes and awards received in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement. In the case of the latter exception, the recipient must be selected w/o any action on his part and must not be required to give substantial future services.

18 FEB. 64

ALIMONY — (Sec. 414 CCH)

If it qualifies as a periodic pymt, income to W, deductible by H. If any part is for support of children, not deductible (but H may be able to claim exemption).

Separation agreement pymts made under pmt before 1954 are not deductible. After 1954, deductible. — However, re pre-1954 agreement,

H & W could amend the Agmt after 1954 or negotiate a new one after 1954 to qualify H to deduct the alimony pymts.

Alimony

To qualify as alimony the pymts. must be periodic pymts. Note 10 yr. lim.

Lump sum pymt. not a periodic pymt and would not be income to W nor deductible by H.

Note: Problems in back of CCH are sometimes used by Johnson on exams!!

Baker v. Commissioner (p. 161)

These qualified as periodic pymts. under the rule, that is, under the present law today: income to W, deductible by H.

Illegal Income—

Illegal gains are taxable as "income from whatever source derived" and not excluded elsewhere in the statute.

Can may deduct gambling losses provided they do not exceed the amt. of gambling gains.

Commnr. v. Wilcox (p. 165)
Has been overruled.
*366 U.S. 213 - embezzlement funds are taxable, but govt's lien would be inferior to the embezzled owner's lien. "Claim of Right" doctrine discussed. Read. James v. U.S., 366 U.S. 213 (1961).

Damages — (Sec. 412 CCH)
Punitive or exemplary dams. are taxable income.
If the dams. replace a loss that would have been taxable, the dams are taxable.
If the dams. are for injury to reputation or character, not taxable.
The dams which replace property are not income but they require

readjustment of the ~~basis~~ property's basis.

19 Feb. 64

Comm'r v. Glenshaw Glass Co. (p.168)

Legislative Policy

The broad intention of Congress is to tax all gains except those specifically exempted.

Thus, these punitive damages recovered by TP were held to be taxable income. "The mere fact that the pymts. were extracted from the wrongdoers as punishment for unlawful conduct cannot detract from their character as taxable income to their recipients."

509
Ins. 512 and Compensation for Injuries + Sickness - The "Sick Pay" Exclusion (Sec. 512 CCH)

Edward I. Weinroth (p. 172)

The question here is whether the "sick pay" exclusion

applied to Weinroth.

TP = teacher requested by principal of his school to review during summer certain books to be used the following Sept. in school. TP on a 12 mo. K of pgmt. TP sick during summer.

Held, TP not entitled to "sick pay" exclusion. Sec. 105 (1954 Code) requires that the claimant be "absent from work", and TP here was not. "An employee is not absent from work if he is not expected to work." ... If (TP) had done nothing during the months of July and August he would still have been entitled to the entire amount of his salary. The board of education did not expect or require that he work for it during his vacation. ... "We think it significant that the bd. of ed. did not charge petitioner w/ sick leave and thus evidently did not

"absent from work"

consider him at work for the period in question."

This finding is questionable because, as a practical matter, a teacher would be compelled to do what his principal asks because of threat (though unspoken) of non-renewal of the teacher's K. Also, the principal may be deemed to be the bd. of ed. for all intents and purposes.

914

* Govt. Pymts., Subsidies and Biz Contributions *
(Sec. 914 CCH)

(i.e., govt. subsidies to farmers)

Taxable income = subsidies, because they are in lieu of income or to aid biz and would help where income to the biz would have done the job had there been income.

If the Commr rules

big contributions to be contributions to capital, not income to the business concern.

Telservice Co. of Wyoming Valley v. Commr (p.181)
See p. 1438 CCH.
(This is same case in Sec. 1429 CCH, Contribs. to Corp. by Nonstockholders)
Here, corp. could not claim zero basis.

20 Feb. 64

hypo: Corp. gets $10,000 contribution to capital w/ wh it builds bldg. (Naturally, no depreciation maybe deducted.) Then, a few years later, corp. sells bldg. for $5000, & that $5000 income to corp.? Yes.

* Income or Bequest *

Bank of N.Y. v. Helvering (p.189)
Decedent directed by will that the executors would

get 5% of the estate for their services. State statute provided for 2%. Executor claimed the 3% difference as a non-taxable bequest. — This was allowed. Legacies, as here, are not taxable as income, but are taxable for estate tax purposes. (Estate taxes are higher than gift taxes.) (But, estate taxes are not as high as income taxes.)

Lyeth v. Hoey (p. 192)

A write controversy was compromised.

Ct held that the TP who got (e.g.) $1000 due to compromise would still be liable for tax on the amount passed under the will (e.g., $5000)!!

To avoid that, compromise w/ the agreement

that the beneficiaries pay the tax ~~benefit~~ differential.

21 Feb. 64

* Income or Capital (Sec. 1506 CCH)

Hort v. Commr (p. 198)

See 313 U.S. 28 & §1506 CCH; Sec. 1241 Code (1954).

Entire amt. held to be ~~capital~~ income.

"Simply because the lease was 'property' the amount received for its cancellation was not a return of capital, quite apart from the fact that 'property' and 'capital' are not necessarily synonymous in the Revenue Act of 1932 or in common usage. ...

"... That amt. was not a return of capital because pet. acquired the lease as an incident of the realty devised to him by his father." ... Rent is taxable, and the Code, said

the court, does not distinguish rental pymts. and a pymt. which is clearly a substitute for rental pymts.

X Annuities and Life Ins. Proceeds (Sec. 503 CCH

Ins. not taxable except that part rec'd. as interest.

Annuities not taxable except the excess of contributions by TP.

You pay income tax on the amt. which you receive and which you did not contribute. But the deduction of your contribution must be prorated. e.g., You receive $12,000 annuity for wh you paid $7,700.00 (i.e., 64.16% of $12,000). Thus, you pay tax on all amts. rec'd. over 64.16% [may round off to 64.2] of the amts. rec'd.

Same rule applies to life insurance.

24 FEB. 64

Read annuities carefully. May see this again soon.

There are three basic questions in income taxation:
1. What is income?
2. When is it income?
3. Whose income is it?

* Discharge of Indebtedness (§ 18 CCH)
United States v. Kirby Lumber Co.
~~(2) Old Colony Trust Co. v. Commr.~~ (p. 208)
On corp. sells bond for $100.00 and buys it back for $90.00, the corp. has had an income of $10.00. Note: result would be different if the corp. were dealing w/ its own STOCK rather than bonds.

Rule: "prop. of like kind"

Where is a sale or exchange of property of like kind, no taxable situation. But it must involve prop. of unlike kind for the situation to = taxable.

Assign: begin on p. 208
(find corresponding CCH sections.

25 FEB. 64

Read the Tax Digest regularly.

Rule

Sec. 1.61-12(c) of I. R. Regs provides, "If the corp. purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year."

If Kirby had made $200,000 initially by orig. selling the bonds w/ a premium attached, that premium ($200,000) would have been taxable income to Kirby Lumber Co.

Rule: debt barred by S/L

On a cor fails to collect a debt from a solvent Dor due to tolling of Statute of lims., the debtor has had income. It must be a gift or income, and it's not gift.

(p. 211) Helvering v. American Dental Co.

If a Cor merely desires to benefit a Dor & w/o any consid. yfor cancels the debt, the amt. of the debt is a GIFT from the Cor to the Dor and need not be included in the latter's gross income. (Must distinguish gift from income.)

This writ of certiorari concerned the taxability, as income, of rent and interest on accounts owed by the TP which were cancelled by its creditors.

26 FEB. 64

Willard Helburn, Inc. v. Commr. (p. 219)

Re devaluation of foreign money (pound sterling).

On TP took deduction of the orig. amt. of cost before devaluation, even though he paid #84,047.36 less actually due to devaluation, he had income to that extent. ——— Now, if TP had not taken the pre-devalued cost, but had waited until selling the goods and then taken the actual cost after devaluation, TP would not have had a problem.

* (Chap. 5) Whose Income Is It? *

* (A.) General *

Lucas v. Earl (p. 225)

A tax-evasion scheme is illegal and will not be abided. But, an attempt to legally avoid paying taxes, by taking advantage of all and every advantage the law allows, is okay. The distinction must be made.

Here, H & W in Calif. had community prop. K between them. H earned $X, ½ of wh accrued to W by virtue of their K. — Held; this was income to H.

Jones v. Page (p. 228)

Bobby Jones, golfer, made deal to make pictures. His lawyer

advised Jones that he could avoid taxes by setting up a trust fund, attempting to spread out the income over several years.

Held, this was clearly an attempt or scheme devised solely for the purpose of illegally evading taxes. The ct held that a TP's intent will be scrutinized, and on this illegal intent is found, the scheme will not be allowed. — This was income to Jones, therefore, and not to Jones' father.

"Conceding that a TP has the right to decrease the amt. of his taxes or to avoid them by legal means, in every instance on that is attempted, a court may

look thru the transaction and determine whether it is legal or violates the intent of the statute."

hypo: Lena Horne et al. perform w/o charge for N.A.A.C.P. benefit. — No income to Lena Horne et al. Income to N.A.A.C.P., but they (NAACP) are ? ← not taxable, of course.

hypo: Lena Horne performs for Ed Sullivan Show and directs that her check be paid to NAACP. — Income to Lena Horne.

Thus, a performance for a charitable organ., w/o pay is not taxable to performer.

NOTE: Inheritance taxes paid by estate.

27 FEB. 64

Revenue Ruling 71

The value of services need not be included in gross income when rendered directly and gratuitously to an organization which is eleemosynary in nature. Where, however, pursuant to an agreement or understanding services are rendered to a person for the benefit of an organization, and an amt. paid to such organization by the person to whom the services are rendered, the amt. so paid = income to the person performing the services. ~~even though at the time of the~~ See sec. 1.61-2 (c) of the I. R. Regs.

(Lectured thru p. 248).

28 FEB. 64

Income of Children (Sec. 211 CCH)

Parent is liable to see that the tax is paid.

Children w/ income of $600.00 or more must pay income tax. Regardless of amt. of minor's income, if the minor is a student or under 19 years of age, and the ~~father~~ parent furnished more than half his support, the parent may claim the minor as a dependency exemption.

Husband and Wife

* Where wife is supporting an able-bodied H, she may not claim him as a dependent (sec. 213 CCH; Code sec. 152) nor as an exemption.
* A H may deduct his W as an exemption (not as a dependent), however.

(Land does not depreciate.)

2000

2 March 64

See new tax statute at Circulation desk.

Nat'l Carbide Corp. v. Commr. (p. 248)

Whether the total earnings of the subsidiary are taxable to the " and not to the parent.

Special Corporate Taxes

Re excess profits, see sec. 2018 CCH, et seq.). This tax encourages reinvestment rather than bare accumulation. Sec. 2223 CCH shows how you figure out the tax.

U.S. v. Cumberland Pub. Ser. Co. (p. 256)

The directors were the S/H, too. The corp. refused to deal w/ the purchaser and chose to liquidate, thereby avoiding the incidents of taxation which would have been incurred by selling to the purchaser.

Avoiding taxation legally is legal.

The S/H, after liquidation, sold individually to purchasers. The Commr. claimed the

corp. really got the sale proceeds via "conduit theory." — That theory was rejected. T/Appellee.

* TRUSTS (1829 CCH) *

"Clifford TRUST"

These cases are founded upon Helvering v. Clifford, a home case involving a trust created by H for benefit of W, the principal to revert to H after 5 yrs, if H still live. H = Tee too, and had much control over the trust. — Held, "income" from trust to W = income to H. The H was chgd.

⊛ Criteria for taxability of Settlor:

w/in short time — (1.) Reversion to grantor (ca. 10 years), or retention by grantor of title.

(2.) Power of grantor or non-adverse party to

control beneficial enjoyment of trust.

(3.) Reservation of important admin. powers to the grantor or a non-adverse party other than in a fiduciary capacity.

Any one of the above will justify finding that the grantor is taxable income to the grantor.

If not taxed to the settlor - grantor, the trust is taxable as an indiv. It gets a credit for amts. paid to beneficiaries, and the beneficiaries are taxable on the amts. they receive. Thus, unlike a corp., a trust would avoid double-taxation since the trust does not pay taxes on the amt. paid to beneficiaries.

5

Income Taxable to the Grantor

Secs. 671-678 of 1954 Code

Corliss v. Bowers (p. 261)

Petitioner had power to alter or abolish the trust at his will. HELD, income to pet., the settlor. Fact that legal title was in trustees was not controlling. "Taxation is not so much concerned w/ the refinements of title as it is w/ actual command over the prop. taxed — the actual benefit for which the tax is paid. ... The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not."

Fulham v. Commr. (p. 263)

Held, taxable to the grantor because he retained the controlling hand over something he seemed to give away.

4 March 64

Trust Income

In Douglass v. Wilcutts, (p. 275) alimony trust was involved. Held, income to husband. "... The net income of the trust fund, wh was paid to the W under the decree, stands on substantially the same footing as though he had rec'd the income personally and had been required by

the decree to make the pymt. directly.

On income to the trust = settlor's income: ("Clifford Rules")

1. On S retains power to name other benes.

2. On principal or income will revert to him wpin 10 years, EXCEPT on it is irrevocably payable to certain types of charities for at least two (2) years (the same types of charities that allow indiv. the 30% deduction for contributions thereto). Code 641 - 668.

3. Where reversionary interest will take effect only upon death of bene.

4. On S or non-adverse party has control or power to revoke.

5. On trust is created for benefit of the S.

"Spray Power" - where S reserves power to change the bene., except that the S does

not reserve the power to make himself a beneficiary.

(F), p. 283 – the trust agreement should provide that in case of an irrevocable trust, S would be liable for the tax, and to that extent T should be liable to S for reimbursement.

Support Trusts

After 1954 Code, only that amt. actually applied to support of kids would be taxable income to S; the remainder would be income to the trust.

Income Not Taxable to S (§§641-668 Code '54)

Irwin v. Gavit (p. 287)

This was income, and not merely a bequest.
– (M. E. J likes dissent better.)

A trust reports as an individual.

§102(a) Sec. 505 CCH, Code §102
Whereas gross income does not include the value of prop. acquired by gift, bequest, devise or inheritance §102(b) Gross income DOES include the income from any such property mentioned above.

5 March 64

Income Tax Return Exercise

See pamphlets

Sick Pay Benefits –
may get as much as $100 per week. May deduct $100 for first wk. of illness only if hospitalized at least 1 day during the illness.

6 March 64

New Tax Law – 1964
In the lower tax brackets, the T/P will have ca. 1/5 less deducted in withholding.
New bill has decreased the w/holding from 18% to 14% effective 3/7/64.
Tax rate will be less, too: beginning at 16% and going up to 77%.

Persons over 65 now can deduct ALL

expenses for medical costs and drugs.

Charitable deductions — now 30% regardless of type of charity (so long as it is non-profit organ.).

Capital gains on sale of houses: people over 65 won't have to pay any taxes on gains therefrom up to $20,000, provided they had lived in their home at least 5 of the 8 years next preceding the sale.

Travel allocations — full expenses of combined business-pleasure trips can be deducted.

To qual. for long-term capital gain, must hold prop. at least 3 YEARS, not "more than 6 mos." as before.

Charitable Deduction ~~Dedu~~ denied on one donates a work of ~~tang~~ art to a museum but reserves the right of enjoyment in himself for his life.

10 March 64

Read CCH on DIVIDENDS.

Income Tax Return Part V. –
Will be covered by sec. 51 of pamphlet.

Schedule C (Form 1040) [p. 32 pamphlet]
N/C.

* Gains & Losses *

While short-term gain = ord. income, short-term losses may be deducted from long-term gains.

Read in CCH.

11 March 64

While you may not deduct the fed. tax from your state tax, you may deduct the state tax from your fed. tax.

Depreciation

Can you depreciate a depreciable item which you are not using but which went into disuse before it was fully depreciated?

Rule

In order to be depreciable, the item must be an income producing one, or an item used in biz. Thus, purely family car not depreciable.

12 March 64

TP figured his tax (line 12) on the basis of this Joint Return Table on p. 8 of pamphlet.

If one expects to earn ~~or~~ ~~revenue~~ income from which wholding will not be taken, one must file a Declaration

of Estimated Income (form 1040-ES) Tax. See p. 57 of pamphlet; CCH sec. 2518.

Alternative Tax — (§1514 CCH; Code Sec. 1211 (b)).

Assignment:

13 March 64 (Friday)

* Family Partnerships (Sec. 1725 CCH, Code §704) *

Often used an an income-splitting device. They are recognized.

A father, e.g., may give outright to his son an interest in a ptnrshp. But, the son must have a legitimate interest and PARTICIPATION in the ptnrshp.

Requirements

Thus, for income tax purposes these ptnrships are valid so long as the donee have (own) a capital interest and the ptnrshp. is one in wh capital is a material income-producing factor.

The mere fact that

a ptrship will be recog. as valid under State law, does not mean it will be valid for tax purposes.

A bona fide Pr between H + W is recog. for fed. income tax purposes, even though they cannot legally be ptrs under a state's law.

Commn'r. v. Culbertson (p. 299)

Was this a valid family pr? — the sons were supposed to render services.

Commn'r ruled (and Tax Ct. sustained; 5th Cir. rvsd.; Sup. Ct. rvsd 5th Cir. and remanded for finding re whether this = bona fide (Pr) that all of the income was taxable to the father.

Wofford v. Commn'r. (p. 308)

H + W set up ptrship. and themselves as trustees for their minor daughter. — Held, the Pr was valid so was

the trust. Thus, 1/3 of the PL income should have been attributable to the trust as a ptnr.

OTHER FAMILY ARRANGEMENTS

White v. Fitzpatrick (p. 312)
CT ruled that since husband maintained certain amt. of control and since H had control over his W, the income should be taxable to H, not W.
This was a gift and lease-back.

* (Chapter 6) DEDUCTIONS AND CREDITS *

You may take a personal deduction of $1000 or 10% of your adjusted gross income, whichever is lesser.
To your advantage to itemize if deductions exceed 10% of your adj. gr. income.

16 March 64

y is no distinction between adopted and natural kids being exemptions for tax purposes.

* Business Expenses *

What is "ordinary and necessary"?"

Welch v. Helvering (p. 323)

Code, sec. 162 – "In computing net income y shall be allowed as deductions ... all the ord. and necessary expenses paid or incurred during the taxable year in carrying on any trade or biz."

Here, pet. had been head of a grain corp. wh had undergone involuntary bankruptcy. Pet. thereafter became a commission grain salesman, and, to estab. his credit again, voluntarily paid the creditors of the bankrupt corp.

HELD, though these

payments may have been "necessary" in order to carry on his biz, they were not ord. but, in fact, were extraordinary.

"Unless we can say from facts w/in our know. that these are ord. & necess. expenses according to the ways of conduct and the forms of speech prevailing in the business world, the tax must be confirmed."

Rule

X Distinction Between Business Expenses and Personal, Living, and Family Expenses. X

Cohan v. Commr (p.329)

The B/P is on the T/P to show the deductability of claimed deductions.

Sup. Ct. has held that T/P need not show exactly how much his tax should have been, but only that the assessment was excessive.

Cost of entertainment can qualify as an ordinary and necessary bis expense on it is related to the TP's trade or bis + is of a character reas. expected to benefit the trade or business.

Re Entertainment expenses, see Sec. 614 CCH.

Coughlin v. Commn'r. (p. 334)

Tax lawyer took tax course at N.Y.U. + deducted expense thereof.

HELD, allowed. "He was morally bound to keep so informed and did so in part by means of his attendance at this session of the Institute. It was a way well adapted to fulfill his professional duty to keep sharp the tools he actually used in his going trade or business."

Quaere: May a banker, who runs a farm or racing stable on Long Island, deduct the ~~expenses~~ losses therefor? Depends on whether the farm or stable is a business or a hobby.

18 MARCH 64

The Line Between Expenses and Capital Expenditures

(Sec. 725 CCH) → Items that must be capitalized.
(Sec. 605 CCH)

Amounts paid or incurred for the acquisition of assets having a more or less permanent value (more than one year). Such items must be capitalized. If the expenditure will add to the value of the TP's building, equipment, etc., or extend their useful life, it is a capital expenditure, for which the deduction is ltd. to the proportionate amount consumed in the taxable year.

← What is a capital expenditure?

See Secs. 263 and 162 of Code, 1954.

Hotel Kingkade v. Comm. (p. 339)

T/P claimed that expenditures for certain repairs were current expenses, and not capital expenditures.

Held, these were capital outlays. "Gen., an expenditure should be treated as of a capital nature if it brings about the acquisition of an asset having a period of useful life in excess of one year or if it secures a like advantage to the taxpayer which has a life of more than one year. And in order to constitute an ORD. and NECESSARY EXPENSE deductible from

(Regs. 1-263 in pt.)

gross income under (statute), the expenditure must relate to the carrying on of the biz, it must arise in the normalcy of the particular biz, and it must be incurred in the usual course of the operation of the biz. It may be unusual and it may seldom recur. But it must be customary and of frequent occurrence in the type of biz involved."

These expenditures were not customary and of frequent occurrence.

See 47 Harv. L.R. 669 (1934).

This controversy matters only because of the desirability sometimes of taking the deduction now or having to wait until the sale of the asset.

"Reasonable
Sec. 162 (a)(1) Code '54

SPECIAL PROBLEMS
Allowance For Salaries"

The IRS will look to the substance of the matter to deter. if the monies rec'd. are reasonable as salaries in the tax sense.

In Long Island Drug Co. v. Comm'r, p. 346, the Comm'r disallowed as salaries certain percentages of profits paid to officers. The corp. was disallowed its claimed deduction.

19 MARCH 64

Travelling Expenses

Sec. 162(a)(2) '54 Code
Sec. 1.162-2 Regs.
Sec. 615 CCH

... While Away From Home."

O'Toole v. Comm'r. (p. 351)

T/P required to live at hotel, wh employed him, for about 5 days a week in Long Beach, N.Y. T/P maintained home for his wife and children in Laurelton, N.Y., 15 miles away, where T/P spent his week-ends.

Held, the deduction for expenses of travelling between Long Beach & Laurelton were not proper.

"Home" as used in the statute means the T/P's principal place of biz or employment. The job, not the T/P's pattern of living, must require the travelling expenses.

Peurifoy v. Comm'r. (p. 352)

Petitioners = construction workers working in Kinston, N.C., but all of whom lived in

other N.C. towns. They worked there continuously for 20 1/2, 12 1/2 and 8 1/2 months, respectively.

Held, not deductible because the employment was not temporary, but indefinite.

⊛ Generally, a T/P is entitled to deduct unreimbursed travel expenses under the statute only when they are required by the exigencies of business.

⊛ To this rule, however, the Tax Court has engrafted an exception which allows a deduction for expenditures of the type made in this case when the T/P's employment is "temporary" as contrasted w/ "indefinite" or "indeterminate!"

Under new 1964 tax law, if you have to move to

a new town in order to take up a new job, and you must move over 20 miles, that expense is deductible.

Peurifoy case is not precedent for anything other than the Peurifoy case; and the IRS has said it will not be bound by the Peurifoy result. Note: since U.S. Sup. Ct. did not entertain and pass on the Peurifoy case, the IRS is not bound by the finding of the Ct. of Appeals.

Congressmen have special provision in 162(a) (last sentence) wh allows deduction of travelling expenses (some). There is a $3000.00 maximum deduction.

See supp. case on p. 39 of supplement.

(See Johnson's pamphlet on travelling expenses.)

20 MARCH 64

⊗ Meals and lodgings are deductible only when travelling away from home overnight on business.

"Home" is where your principal place of biz or employment is, not necessarily on your family lives.

If one plans to move somewhere for biz purposes, and plans to stay there "temporarily" but for over a year, that length of time would disqualify the employment as "temporary" w/in meaning of Flowers case exception.

⊗ Entertainment Expenses — If biz and pleasure are mixed, you may deduct only that amt spent for biz.

Read notes, bot. p. 357, carefully.

Public Policy

Tank Truck Rentals, Inc. v. Comm'r. (p.359)

Fines for violations of the law are not deductible. Thus, fines for carrying loads heavier than allowed by State law, were non-deductible.

Comm'r. v. Sullivan (p. 358)

Issue: whether amts. expended to lease premises and hire employees for the conduct of alleged illegal gambling enterprises are deductible as ordinary and necessary business expenses w/in the meaning of (statute) of the Code.

Held, YES.

Proceeds of theft are taxable. But, are expenses therewith connected deductible?

23 MARCH 64

Interest ~~Losses~~ (p. 370)

(See "THIN INCORP." — on the corp. has benefits by getting a loan rather than investing in capital. Quaere? Cbk., p. 372.)

Discussed Wetteran case, p. 370.

On a corp. pays 52% tax on a dollar, and pays a dividend to a s/H who happens to be in 91% bracket, the T/P-s/H must pay 91% of the 48¢ he gets as a dividend. Thus, that dollar is taxed 96%!!

Discussed credit for foreign taxes.

Re taxing of resident aliens, see Sec. 2409 CCH.

.48
.91
.48
43 2
43.68 = .44

Missed class 3/24/64.

25 March 64

(Casualty) Losses (sec. 165, 1954 Code).
(CCH sec. 1308 et seq.)

"Other casualties" not confined to acts of nature, but includes damages due to some sudden, unexpected happenning or cause rather than some progressive deterioration. e.g., auto accident losses.

Under new 1964 law, T/P must absorb the first $100.00 of the ~~losses~~ personal casualty or theft loss. If H & W file jointly, they would only have to absorb $100.00 from their joint losses due to theft or casualty. Thus, it is advantageous, if married, to file jointly as far as these losses are concerned. —— If the loss is a biz loss, you (T/P) may deduct all; i.e., there is no $100.00 floor. —— The $100.00 floor applies to each loss. Thus, if you have $75.00 stolen on 2/1/64,

and $75.00 stolen on 6/1/64, you cannot deduct any loss!

Rosenberg v. Comm'r. (p. 385)

Loss to a dwellinghouse due to termites was rapid and sudden, not prolonged and gradual. Held, loss deductible.

"... The primary characteristic of casualties wh will fall w/in the meaning of (the code) is that of the suddenness of the occurrence."

"Comparatively speaking, an invasion of a colony of termites wd destroy the timbers of a bldg. in a month, three mos., or a year, is a sudden destruction, when from natural depreciation it would have required from 25 to 50 years or longer for them to have been substantially injured.

The facts of each case must be considered to determine suddenness.

Loss on Sale of Personal Residence is NOT deductible on the residence was used as such up to the time of the sale.

If the prop. was lived in, then rented for a period and then sold, the loss is deductible. Thus, loss from sale of BIZ PROP. is deductible.

Helvering v. Owens (p. 390)

Car accident. Car was around 21 years. —

Computation of Loss

The loss was the difference between the value of the car immediately before and immediately after the loss. The amt. of the loss is not the amt. of repair bills.

In deducting loss to appreciated prop., you may not deduct more than the adjusted basis of the property.

* Bad Debts *

Sec. 166 Code 1954.
CCH §1301 et seq.

You take the B/D in the year in which it becomes worthless; and, if subsequently collected, you have income.

Two accounting methods:

1. Deduct each bad debt on a segregated basis.
2. Set up Reserve for Bad Debts based on percentage of loss per year, and charge against such reserve the bad debts incurred. — Most often used of the two systems in biz.

Code (1954) makes distinction between biz and personal bad debts.

Personal Bad Debts

In personal bad debts, they are treated as short term capital losses and you can deduct only up to $1,000 per year. If your bad debt exceeds that in any single year, you may carry forward the difference as much as five (5) years.

Business Bad Debts

If T/P loses money through investing in biz, T/P may deduct up to $25,000. If H&W invest, they may deduct up to $50,000 if they file jointly. (Check this.)

To qualify as a "small biz corp." (p. 401 cbk.), the corp. must have assets of less than $1,000,000 and fewer than 250 employees.

Depreciation and Related Deductions

(1954 Code, secs. 167-169, 171, 611-616)

Based on the recovery of capital.

See CCH, sec. 1108 et seq.

Once you choose a method, you must stick w/ it unless Comm'r. consents to change.

Helvering v. F. & R. Lazarus & Co. (p.402)

Depreciation does not necessarily follow the legal title to realty. Thus, the tenant-T/P (99 yr. lease) was allowed depreciation to his equitable interest.

Life tenant and lessee entitled to depreciation during their lives.

Methods of Deter. Depreciation.

Must first deter. whether you are dealing w/ a capital asset, or whether you are dealing w/ a depreciable asset.

Then, you determine the expected life of the depreciable asset.

Methods:

(1.) STRAIGHT LINE —

If you deter. that the life of the asset is 40 years, e.g., you divide that into the cost of the

prop., less salvage ~~value~~ and that is ~~divided~~ spread in equal annual installments over the life of the prop. — Most simple method.

2. Declining Balance Method — Under this, a constant percentage is used, but it is applied each yr. to the amt. remaining after the depreciation of previous years has been charged off. ~~It~~ ~~[illegible]~~ Under sec. 167 (b)(2), the rate used in this method cannot be more than twice that under the straight line method. Thus, if prop. has useful life of 10 years, a rate up to 20% may be used.

3. Sum of the Digits Method — Results in larger depre. in early years.

4. Annuity Method –

26 MARCH 64

If you find out that the salvage value will exceed the book value, no depreciation can be taken. See Cohn v. U.S., (p.408).

(p416) May depreciate some intangibles, but NOT GOOD WILL.

(§§1102 - 1117 CCH)

OBSOLESCENCE —

A form of depreciation, though it is different.

Gen. Rule

Obsolescence under the Act requires that the operative cause of the present or growing uselessness arise from external forces wh make it desirable or imperative that the property be replaced.

(secs. 611-616, '54 Code)

DEPLETION —

Closely related to depreciation, but not based on recovery of capital like

27½% of the gross income allowed as deduction

depreciation. DT (depletion) is designed to make allowance for the value of capital consumed in the process of producing income

The usual objection of anti-depletionists is that this deduction is not ltd. to the recovery of the capital actually invested.

3 April 64

Installment Sales (Sec. 1001 CCH) –

Once election is made, T/P must stick to it.

If over 30% of the sale price will be rec'd in the taxable year, you cannot qualify for the "installment method!"

* NET OPERATING LOSS DEDUCTION *

Diamond A Cattle Co. v. Comm'r. (p.429)

As of 1958, the total period wh may be taken into ~~account~~ what in effect is

a single account (in the sense that no more big income will be taxed than the aggregate net income over the period) is now nine (9) years, that is, three (3) years of carry-back, the taxable year in which the loss occurs, and five years of carry-over.

Held, on the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall.

When Congress passes an act in language that is clear and unambiguous, and construed and read in itself can mean but one thing, the act must

be judged by what Congress did and not by what it intended to do.

Medical Expenses

May deduct medical expenses in excess of 3% of the adjusted gross income.

Note: Are certain non-deductible items; e.g., losses, expenses, and interest between related taxpayers. (see p. 436)

* (CHAPTER 7) WHEN IS IT INCOME? — OR DEDUCTIBLE? — ACCOUNTING PROBLEMS. *

["Discussed" Burnet case, p. 440.]

6 April 64

T/P may use, as a taxable year, a calendar year or a fiscal year; but, once assumed and employed, any change must be approved

by the Commr.

* <u>Y are two basic methods of accounting:</u>

1. Cash ~~basis~~ method
2. Accrual method.

Cash Basis

A note is not income when rec'd.; it is not "cash". And, a check is not always "cash".

Schlemmer v. U.S. (p.446)

Held, the $30,000 note from the company, being unbacked due to shortage of funds, did not = "cash!" The old debt remained, and the note was no more than added security. There must be more than difference in the mere form of prop. to justify a charge of income.

(51 See Harv. L.R. 1115) On the cash basis, items of income are ordinarily included in the year in which they are "received."

and items of deduction are taken in the year in which they are "paid."

"Constructive Receipt" - roughly speaking, it may be said that an item has been "constructively rec'd" when it has been unqualifiedly made subject to the taxpayer's demand. E.g., salary credited to an employee though not withdrawn (44 F.2d 476); interest credited on savings bank deposits (38 B.T.A. 960); and matured bond coupons, even though the T/p is absent and unable to cut the coupons (74 F.2d 147).

Lavery v. Commr. (p.448)
A T/p is deemed to have rec'd items of gross income which have been set ~~aside~~ apart for or credited to him w/o restriction.

Income wh is credited to ... or set apart for a T/P and wh maybe drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the T/P w/o any substantial limitation or restriction as to the time or manner of pymt. or cond. upon wh pymt is to be made, and must be made available to him so that it maybe drawn at any time, and its receipt brought w/in his own control and disposition.

7 April 64

Acer Realty Co. v. Commr. (p.454)

The question here was whether pet. was in constructive receipt of rent from its tenant, the Sanatorium Co., for the year 1938 in the amount of $8,700.

Held, the T/P enjoyed the benefit of the economic gain when the right to receive credit for the rent accrued. The power to dispose of income is the equivalent of ownership of it.

Commr. v. Oates (p.455)

There was a total retirement fund owing to T/P, but the Co. from wh he retired paid him $1000 per month.

Held, T/P not liable now for the excess of commissions over and above $1000 per month. The new K, whereby T/P agreed not to receive ~~the~~ more than $1000 per mo.,

was binding. T/P had no right to demand or to receive anything in addition to what he had agreed to accept, namely $1000 per month.

Prepaid Income

Astor Holding Co. v. Commissioner (p.460)

If an amt. is deposited w/ a lessor merely as security for the performance of covenants, w/ no present right or claim of full ownership in the lessor, it is not treated as taxable income unless and until something happens to make the deposit, or a portion of it, the prop. of the lessor. Whether a pymt. falls into one category or the other depends upon the facts of the particular case.

8 April 64

Expenses Paid in Advance

Comm'r. v. Boylston Market Ass'n. (p.463)
T/P had paid at once an ins. premium to be pro rated over several years thereafter.

Commr. sought to charge the full premium in the one year when paid or tendered, but the court held that T/P should deduct for each tax year the pro rata portion of the prepaid insurance applicable to that year. "The pymts. are prorated primarily because the life of the asset extends beyond the taxable year."

Income Rec'd. Subject to Contingencies or Liabilities

Held in North American Oil case, that " If a taxpayer receives earnings under a CLAIM OF RIGHT and w/o restriction as to its disposition, he has rec'd income which he is required to return, even

though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent."

U.S. v. Lewis (p. 466)

This case seems to differ from the North Amer. Oil case.

9 APRIL 64

(Secs. 412, 807, 808 + 809 CCH) * BUNCHED INCOME *

Re damages. If you receive damages for something that would have been income, those damages are income. E.g., X is injured by auto, and misses 5 weeks from work. When damages are awarded, that amt. attributable to loss of income would be taxable as income.

Robertson v. U.S. (p469)

An artist or musician may spread out the income from a completed work over the preceding 36 months.

"Charles Spicer", p.473.

Settlement out of court same as damages for tax purposes, gotten by judgment.

---

10 April 64

ACCRUAL METHOD

Ohmer Register Co. v. Com'r. p.476

Co. pays its salesmen commissions, and is on the accrual method. Co. wants to deduct the commissions as they fall due, though before actually paid.

Held, allowed.

Assignment:
Read remainder of section, but class will begin on p.522

13 April 64

(See Supp.) Com'r. v. H. B. Ines Co. (p. 483)

Cost of annuity Ks made w/ ins. co. by D onbehalf of 4 retiring employees, was deducted in 1953 by an entry in that year on the D's books. However, the Ks w/ ins. co. were not finalized until 1954.

Held, deductible in 1954.

"Both receipts and liabilities are to be reported by accrual-basis taxpayers not when cash changes hands, but when all the events ... occur wh fix the amt. of the liability and deter. the liability to pay it. ... Thus, neither the resolution of respondent's board of directors, nor the entry on its books, in themselves establish the proper accrual of the claimed liability in 1953. ... Since the obligation to pay was not certain until 1954, the expenditure

was not "paid or incurred" in 1953, w/in the meaning of section 23, 1939 Code.

Auto. Club of Mich. v. Com'r. (p. 493)

Since 7/26/61, sec. 456 (e)(2) of the Code [prepaid dues income of membership organizations wh elect to come under this provision]: such income is taxable ratably over the period of time that such services are required to be rendered, not exceeding 36 months.

The dues paid were ~~de~~ ~~taxable~~ income to the club all in the year when paid even though the services bought by ~~the~~ the members were to be rec'd during the following year (dues paid in Dec., covering the 11 months next succeeding).

The legislature did not intend that a T/P be permitted to set up a reserve for every possible contingency of the following year. The reserve ~~will~~ may be set up, but that reserve would still be income in the year received.

2/12/53

14 APRIL 64

The "Tax Benefit" Program

If you deduct an item and later get that item back, that amt. would be income. This question may arise w/ respect to recoveries or eventual non-pymt. of a good ~~many~~ many different sorts of previously deducted items, e.g., taxes which are subsequently found to be invalid or excessive, bad debts, interest, business expenses, recoupment of losses, and other amounts.

The tax benefit principle should be applied in the case of all recoveries of previously deducted amounts except "depreciation, depletion, amortization, or amortizable bond premiums." Under sec. 1016 (a)(2)(B) of the 1954 Code, the T/P may, at his election, restore excessive depreciation or depletion previously claimed for wh no tax benefit was received.

Perry v. United States p. 500

Note carry-backs and carry-forwards of net operating loss deduction under sec. 172, 1954 Code.

* Income of Decedents * (p. 505)
See sec. 1805 CCH.

* Change of Accounting Method *

Brookshire v. Com'r. (p. 506)
T/P sought to change from cash to accrual method, but due to failure to make appropriate adjustments, w/ the result that T/P got an undeserved benefit.

Zimmerman Steel Co. v. Com'r. (p.516)
T/P deducted interest on a loan that he knew he would not pay because he knew he was going into bankruptcy.

15 APRIL 64

Taft v. Helvering (p.519)
Joint returns: in making a joint return the husband and wife should report their deductions in reporting their aggregate net income upon which the tax was to be computed. ... If a single joint return is filed it is treated as the return of a taxable unit and the net income disclosed by the return is subject to both normal and surtax as though the return were that of a single individual. In cases, therefore, in wh the H or W has allowable deductions in excess of his or her gross income,

such excess may, if joint return is filed, be deducted from the net income of the other for the purpose of computing both the normal and surtax.

The principle that the joint return is to be treated as the return of a "taxable unit" and as though it were made by a "single indiv." would be violated if in making a joint return each spouse were compelled to calculate his or her charitable contributions as if he or she were making a separate return.

Capital losses of one spouse maybe deducted on a joint return from the capital gain of the other.

the
ing
d

t the
be

le
ugh

d
t
e
o

s
e

ne
cted

Consolidated Returns may be filed by corps. that meet statutory tests of affiliation.

Great Western Power Co. v. Com'r. (p.522)
Gen., a discount is prorated over the life of a bond. Proration = amortization. The discount is really a premium at wh the co. sold the bonds.
When T/P (the co.) redeemed the "Series B 7%" bonds, part of the expense of redemption and ~~the~~ part of the premium were paid in cash; and part of the B bonds were redeemed by exchanging certain "General Lien Convertible 8% Gold Bonds." T/P wanted to deduct all expenses and premiums paid in the year of redemption.
Held: deduction allowed of so much

of it as applied to bonds redeemed for cash. However, since the B bonds had a discount that was required to be amortized, and since there was an exchange of B bonds for Gen. Lien 8 bonds, the deduction as to that amount ~~of~~ wh applied to the bonds retired by exchange was disallowed. "If the retired bonds had not been called, the expense items incurred in connection w/ their issuance would properly be amortized over the remainder of their life. Here the petitioner substituted a new obligation for the old." Thus, that part of the deduction which applied to the exchanged bonds was required to be amortized over the life

of the newly substituted bonds.

Installment Sales (see p. 525)

Long Term Ks or Completed Ks
Regs. sec. 1.451-3 allows the return of income (a.) ratably over the period of the K instead of at the time the pymts. are actually rec'd., or (b.) on the completion of the K.

* Inventory *

hypo: Gross sales = $100,000.
Beginning inventory = $15,000.
Then, purchases = $60,000.
Thus, total "goods available for sale" = $75000. Then, from that you subtract the value of the "ending inventory" = $15000. Thus, "cost of goods sold" = $60,000. Thus, $100,000 − $60,000 = $40,000 gross profit.
— The usual problem

arises in determining the value of the ending inventory (wh will be the beginning inventory the next year). Thus, two methods of deter. ending inventory are used:

1. Last in, first out (LIFO).
2. First in, first out (FIFO).

(Johnson arrived at 12:05 P.M., and assuming lecture was in status quo.)

16 April 64

17 April 64

Bargain Purchases (Sec. 416 CCH.)

Rose v. Trust Co. of Georgia (p. 532)

Held, the transaction here in question was a purchase in good faith. In such case no taxable income would be derived until the disposal of the stock, except, of course, that arising from dividends.

The gen. rule is that y is no income realized thru purchase.

STOCK OPTIONS (CCH Secs. 2207A, 2208A, 417)

(Chap. 8) * CAPITAL GAINS AND LOSSES *

Secs. 1001-1231 of '54 Code; CCH secs. 407, 1501-1532.

C/G = gain on the sale or exchange of a capital asset.

A capital asset (C/A) is something held outside the ordinary course of business; i.e., other than inventory.

C/G must be reported; C/L (capital loss) may be reported.

C/G is taxed differently from ord. gain.

Types of C/G & C/L:

1. Long-term - on C/A held 6 mos. or more.
2. Short-term - on C/A held less than 6 months.

(Note: where you sell B/A due to involun. conversion (e.g.,

destroyed, stolen, seized, requisitioned or on B/A is, condemned by urban renewal), your tax consequences may be delayed, if you re-invest in like kind w/in one year after the sale-by-involuntary-conversion, until the like kind is sold or exchanged; and the like kind will assume the same basis as ~~that of the~~ B/A had. See sec. 1420 CCH.)

20 April 64

See p. 547; Chap. 15 CCH, and problems and answers in the back of CCH.

Personal effects are given capital gains treatment, but not capital loss treatment. — Seems illogical when you look at the gen. rules, but that is the law.

4/21/64 - missed class - covered to page 577

22 April 64

Chapin v. Com., p.577, held that "interest pymts. to a bank for funds borrowed to purchase an endowment policy are not deductible as part of the consideration paid for that policy under 22 (b)(2)(A)." ~~[old statute]~~ Thus, the interest pymts. were disallowed as part of the cost of the policies.

* "Sale or Exchange" — *

See 1502 – 1509 CCH.

Has been held that income from the "sale" of royalties is ordinary income. See Myers case, note, p.588.

Com. v. Gillette 364 U.S. 130

23 April 64

F. Identification of Prop. Sold, and Application of Consideration

When there is a stock split, the basis of the orig. stock must be allocated so that the proportion of basis to

value remains. But, the stock shares must be identified in order to deter its basis, unless all shares have the same basis.

Hamlin's Trust v. Com.

T/P bought going newspaper biz. Buyer paid additional price for covenant not to compete w/in given geographical area. It was mention that the stock was worth $100.00 per share but K price reflected that stock was ~~worth~~ purchased for $150.00 per share.

Held, $100.00 = capital gain; $50.00 was for good will and was ordinary income.

G. Amount Realized

Miller v. U.S. p. 604

Second mtges. have no value, it was held, and need not be reported, therefore. However, if first mtge is paid on long enough, the second mtge would acquire and increase in ~~at~~ value.

---

24 April 64

BASIS

§1436 CCH et seq.
§§ 1011-1022 '54 Code

Prop. Acquired By Gift (§1437 CCH)

In gift taxes, the donor has a $3,000 exemption per year, the donee has a $3,000 exemption per year, and each person has a $30,000 lifetime exemption.

Problems, p. 610

(A) The spread is covered by estate taxes, not income taxes.

Problem, p. 613 –
(a.) She has $50.00 gain because the basis in the hands of the donor was $100.00. (b.) She'd have a $50.00 loss.

Farid-Es-Sultaneh v. Com. (p. 613)
Court held this transfer was not a gift, but was for consideration. Therefore, her basis was the value to her at the time of her acquisition. (quaere?)

(Read Crane v. Com., p. 619.)

When you depreciate depreciable property, you must subtract the amt. depreciated from the basis to determine your true basis.

ALLOCATION OF BASIS

Suppose X buys B/A for $10,000, and later sells 1/3 of B/A – X could

either allocate 1/3 of the cost of B/A to the 1/3 portion sold, or he could reduce the $10,000 basis by the amt. of the sale price of the 1/3 (e.g., if he sold 1/3 of B/A for $4,000, he could $10,000 − $4,000 = $6,000 ∞).

Assign – Omit chap. 9. Begin reading on p. 803 (Estate & Gift Taxes). Will cover chaps. 11 & 12.

27 APRIL 64

[ASIDE: URBAN RENEWAL Pymts. permits of no tax consequences ~~capital gains~~ if $ can be re-investment in "like kind" w/in one year.]

Century Electric Co. v. Com. (p. 638)
For issues, see p. 641.

WASH SALES (p. 653)

Check this !! Sec. 2213 CCH.

Result in non-taxable gains on capital assets.

hypo: X has $1000 loss which he could not deduct because he had no off-setting capital gain. X owns B/A w/ $2000 basis. So, X sells B/A for $2000. The $1000 capital gain

would be "washed away" by the $1000 loss that can now be deducted. Then X can reinvest in like kind by buying W/A for $2000. Further, the basis of W/A would be $2000.00.

Chap. 11 ESTATE TAXES; GIFT TAXES

Estate & gift ~~and~~ taxes are taxes on the transfer of property.

If a gift is made w/in three years of death, it is prima facie in causa mortis, and the burden of rebutting same will be on the T/P. If the gift is in causa mortis, it is thrown back in the estate and taxed under estate tax laws (more expensive to T/P than gift taxes).

In this case (gift

w/in 3 years of death), the fed. govt. will usually assess a gift tax first and then assess estate taxes. If the govt loses on estate tax claim, they have still got the gift taxes. If the govt prevailed on the estate taxes claim, they will allow deduction of the gift taxes.

Estate Taxes

Tax on the right to transfer property.

The tax is on the taxable estate: the gross estate minus deductions - plus - a $60,000 - deduction.

28 April 64

The value of the gross estate = the F.M.V. at the time of death, or at the time of 1 year thereafter, at the discretion of the executor or admr.

$280 - per mo.
12
560
280
$3360 per year
6 - years
$20,160

'54 Code, sec. 2035

A gift in causa mortis will be legal and effectual, but will still be prima facie a part of the gross estate for estate tax purposes. Any gift, whenever made, in causa mortis is includible in gross estate for estate tax purposes, and the three year statute only creates a prima facie presumption of a gift in causa mortis.

'54 Code, sec. 2036

Retained Life Estate — If one conveys prop. for less than adequate and full consideration, and retains

a life estate therein, that prop's value includable in the gross estate for estate tax purposes.

'54 Code, §2037 — Transfers Taking Effect at Death — includable in gross estate.

'54 Code, §2038 — Revocable Transfers includable in gross estate.

'54 Code, §2039 — Annuities — includable in gross estate.

Sec. 2926 CCH — Life Insurance

In order for the life ins. to be includable in decedent's estate, the decedent must have retained power and control over the insurance policy. Any vestige of ownership by decedent will make the proceeds ~~on~~ from the ins. will be includable in decedent's gross estate.

Deductions From Gross Estate

1. Debts of decedent
2. Expenses of admin (5% of all that comes in + 5% of all that goes out = his fee)

[redacted]

29 April 64

Re "Gross Estate", see sec. 2911 CCH.

Deductions (cont'd.)

3. $60,000 indiv. exemption [redacted]
4. Marital deduction (sec. 2935 CCH)
5. Credits due to state and [redacted] foreign death taxes, and gift taxes on gift is includable in the estate. See sec. 2932 CCH.
6. Charitable bequests (sec. 2936 CCH)

Reciprocal Trusts -

A maneuver to avoid estate taxes; two people w/ substantially similar holdings make, by will, reciprocal trusts; and, the first one to die will have no estate.

— This has been held ineffective to avoid estate taxes, because it is done for consideration.

If one has a reversionary int in a life ins. policy, the estate of such person is chargeable w/ 5% of the face value of the policy.

F.M.V. — price w/h a willing buyer will pay to a willing seller in the open market, neither party being under any compulsion

1. Prop. Owned By the Decedent

Helvering v. Safe Deposit & Trust Co. (p. 808)

The powers of apptmt. of decedent in the three trusts were not includible in the decedents gross estate for estate tax purposes, if they had been exercised, includible.

However, today sec. 2041 says all powers of apptmt

created after Oct. 22, 1942, exercised or unexercised, are includible. The only way to avoid this will be to release the power before death.

Proceeds of Wrongful Death Action

Ord.; these proceeds go to the beneficiaries of decedent & are not subject to being reached by Cors.

Rhodes v. Com. p 812
Decedent had assigned to her certain shares of Internat'l. Shoe Co.

Fair v. Com.

p. 817

These Cuban "immovables" were classified as real property; and the general rule is that real estate as such located outside of the U.S., belonging

1 MAY 64

4 MAY 64

Mc Gehee v. Commissioner (p.835)

"We do not think that because a stock dividend is not taxed as income to the stockholder it must necessarily be included as a part of a gift made in contemplation of death, of the shares upon which it was declared.

The gift tax is to be measured by the value of the transferred prop. as of the date of the donor's death.

4. Retained Life Estates
Sec. 2036 of the 1954 Code

Nichols v. Coolidge (p.841)

1201

May v. Heiner (p. 846)

A retained life estate makes the transfer occur at or after the time of death. In the usual case, therefore, the prop. would be includible in the decedent's gross estate for estate tax purposes.

However, here it was held that the principal of the trust fund could not take effect in possession or enjoyment until the death of the decedent, but that the transfer in question "was not made in contemplation of death w/in the

legal significance of those words. It was not testamentary in character and was beyond recall by the decedent. At the death of Mrs. May no interest in the property held under the trust deed passed from her to the living; title thereto had been definitely fixed by the trust deed.

The rule of May v. ~~Heiner~~ was quickly circumvented by Congress so that all reserved life estates, created after March 3, 1931, are includible in the gross estate for estate tax purposes.

5 MAY 64

Dower and Courtesy are includible in the gross estate even though they pass by, operation of law, at death. See §2915 CCH.

And see sec. 2916 CCH re Interest of Joint Owners.

§2921 CCH -

Any transfer under wh the decedent retained the use, poss., right to the income, or other enjoyment of the transferred property for his life, or for any period which does not in fact end before his death, is taxable.

This rule applies to transfers, also, in wh the decedent retained the right, either alone or in conjunction w/ any person, to designate the persons who shall possess or

enjoy the property or the income therefrom.

Re "Transfers w/ Power to Change The Enjoyment", see §2922 CCH.

Always be aware of dates of effective tax statutes because these will be on Bar Exams.

Reciprocal Trusts — (§2923 CCH)
If one trust is made in consideration for another trust, that would be a reciprocal trust. If the terms of trust #1 by B give A a L/E, rm to X, and the terms of trust #2 by A give B a L/E, rm to X, then although A only had a L/E under T#1, the law will deem the prop. under T#1 to be a part of A's estate, provided that

the trusts were executed in consideration for each other. Rationale: A will be deemed to have executed T#1.
— Same for B re T#2.

Power of Apptmt (§2924 CCH)
This is where a pwr. of apptmt is given to another, the "donee of the power."
Only powers defined as GENERAL powers of apptmt can result in "taxability" except in certain very special cases outlined below." (See §2924 CCH).

Assign. - CCH §§ 2924 - 2935.

6 MAY 64

Read "annuities" on your own.

State St. Trust Co. v. U.S. (p.857)

Held, the corpora of the trust was includible in decedent's gross estate, even though he had conveyed the prop. in fee by trust. "But ... the powers conferred on the trustees, considered as a whole, are so broad and all inclusive that within any limits a Mass. ct. of eq. could rationally impose, the trustees, within the scope of their discretionary powers, could very substantially shift the economic benefits of the trusts between the life tenants and the remainderman."

Read McLAIN v. JARECKI, p.860.

Note: the legal conveyance is not controlling on the tax Commissioner in

determining the includibility of prop. in gross estate.

7 May 64

Deductions -

Taken from gross estate. e.g., $60,000 exemption, costs of admin., debts of decedent, gift taxes paid on property included in the estate, other taxes on estate or property therein

Credits (p. 949)

N.C. has inheritance tax, and 4 are specific forms for same. Most (or maybe all) states have an inheritance tax.

Inheritance tax is a credit and not a deduction. Income tax is a deduction but not a credit.

If 4 is a possibility of reverter in the decedent, that may make such

property includible in his gross estate.

The law of taxation re cont. & vested rms. is different from the law of property.

The value of the possibility of ~~the~~ reverter must be over 5% of the total gross estate in order for the full value of such possibility to be included. Otherwise, just the value of the possibility will be included.

Revocable Transfers

Usually includible. So held in Reinecke case, p. 878. Depends on retention of suff incidents of ownership.

8 May 64

G.S. 105-2 to 105-31 - N.C. Inheritance taxes.

Check on computation of value of a life estate.

Absent: dentist → (8 May 64)

---

11 May 64

No questions on course exam on inheritance taxes (state). This is a course in federal taxation.

Valuation of a Life Estate - Given the age of one, look at mortuary table and determine no. of years he is expected to live. Then look under annuity table and determine the value of a dollar. If the man is 25, he can be expected to live another 38.5 years. One dollar is

worth $14.846 over 38.5 years. Then, deter 4½%

GIFT TAX

Any complete and irrevocable transfer to another, whether in trust or otherwise, may qualify as a gift for gift tax purposes to the extent that it is not supported by an adequate and full consideration in money or money's worth.

This complements the estate tax.

Gift tax - Code 2501 et seq.

§2970 CCH et seq.

Gift tax paid by donor. If he fails, the donee may have to pay.

Each donee exemption of $3000 may be deducted by the donor. If husband gives the gift, and he has a wife w/ $3000 donee exemption, he could deduct $6,000 total. Further, each has $30,000 lifetime exemption.

Gift is CUMULATIVE

See illustration on p. 2946 of CCH (sec. 2972 CCH). The tax on the gift is deter. at the present tax rate for gifts.

§2972 CCH –

Examples of taxable gifts:

1. Transfer by a corp. to A. (This = gift from the stockholders even if A should be one of them.)
2. Indirect gift.
3. The irrevocable assignment of a life ins. policy, the donor reserving no power as to the monetary disposition thereof.
4. Joint bank account created by A for A+B = gift to B to the extent of the amt. drawn by B.

Future Interests (CCH §2982)

12 May 64

Any gift of a fut. int. is not excludible. A fut. int., for tax purposes, is any interest where a certainty of postponement of poss. or enjoyment of the thing completely and irrevocably transferred.

Exclusions may be taken under the law existing at the time the gift was made. However, on the other hand, in figuring the tax on a gift, you apply the current tax rate.

Transfers

Richardson v. Com. p. 965

TPs had stock that they transferred to their wives. If the transfer was made before 6-6-32, no gift tax. If made thereafter, tax. What acts = a gift?

Ct held that until

a donor relinquishes dominion ~~and~~ or control, a gift is not completed.

A completed gift involves two major ingredients: (a) an intention to make a gift, and (b) certain ritualistic or ceremonial conduct involving relinquishment by the donor of what is called "dominion" or "control."

There was here, prior to the enactment of the gift tax provision, no physical delivery of the certificates to the donees nor any attempt to transfer them to their names on the books.

You value as of gift at the time of the transfer.

Does gift tax apply to land outside of U.S.? If made by a Resident of U.S., taxable. The tax is not on the property;

it is a tax on the transfer (an excise tax).

Note (G), p. 968 - Answer: It is taxable because the gift tax is on the transfer, although the property transferred was a tax-exempt bond.

Renunciation v. Disclaimer - A renunciation is usually deemed a gift because it is the giving up of a power once held. A disclaimer, being a denial ever to accept the gift by will in the first place, is usually not a gift.

13 May 64

Estate of Sanford v. Com. (p. 970)

When T/P released the power to modify the beneficiaries (other than himself) of the trust, it was then a gift. It was the relinquishment of the power wh was taxed as a transfer and not the transfer in trust.

A transfer of prop. upon trust, w/ power reserved to the donor either to revoke it and recapture the trust property or to modify its terms so as to designate new beneficiaries other than himself is incomplete, and becomes complete so as to subject the transfer to death taxes only on relinquishment of the power at death.

Smith v. Shaughnessy (p. 978)

Re cont. fut. interests.

The term "property"

reaches every species of right or interest protected by the laws and having an exchangeable value.

Where the grantor has neither the form nor substance of control and never will have unless he outlives his wife, we must conclude that he has lost all "economic control" and that the gift is complete except for the value of his reversionary interest.

Note (B), p. 982

No. Ct did not allow it See 54 Harv. L.R. 519 (1941); and see Hopkins v. Magruder, 34 F. Supp. 381 (D. Md. 1940). Check this! Ct's ruling was that there was no reduction in value of the land due to release of H's inchoate right of dower.

If a transfer of "property," in the broadest sense of the word, is not for good and adequate consideration in money or money's worth, it is a GIFT to the extent of the inadequacy of the consideration.

"Consideration" in gift tax law means only "money or money's worth." Thus, the consideration that may support a K may not be "adequate consideration" for gift tax ~~statutes~~ purposes, i.e., "Love and affection" would not be adequate consid. w/in meaning of gift tax ~~statutes~~.

Galt v. Com. (p. 985)

14 May 64

§ 2912 – gifts of foreign property are includible for gift tax purposes. 1962 amendment to '54 Code.

Com. v. Wemyss (p. 990)

Love and affection as consideration to the husband was not adequate consideration for gift tax purposes. There must be adequate consid. in money or money's worth.

To allow detriment to the donee to satisfy the requirement of "adequate and full consideration" would violate the purpose of the statute and open wide the door for evasion of the

gift tax.

Harris v. Com. (p.994)

In marriage separation settlement, if parties agree between themselves, ~~[illegible]~~ the prop. transferred = gift. If the settlement is by virtue of a court order, no gift tax consequences.

Here, the court's acquiescence in the the settlement of the partys made the settlement a court order, and no gift tax consequences attached.

Exam:

1. Income
2. Estate
3. Gift

Tenancies by the Entirety

Sec. 2515 of Code.
Sec. 2516 of [redacted] CCH

Suppose H buys ~~[illegible]~~ B/A and takes ~~[illegible]~~ deed making W a tenant by the entirety. If this is done, is that a gift to

W of 1/2 of B/A.

However, H has election to treat that portion of B/A as a gift to W, or he may elect not to. If he does not, upon his death, H would have full amount go into his estate since he bought B/A and paid full purchase price.

Problem, p. 1009

1937
- $50,000 to son A
- 100,000 to wife by trust w/ rm. to granddaughter, C
- 5,000 to son B via ins. premium

1941
- $ 50,000 to son A
- $100,000 to wife by trust w/ rm. to C
- 50,000 to son B (ins. premium)

1959
- 50,000 to son A
- 100,000 to wife w/ rm to C
- 5,000 to son B (ins. prem.)

Ins. premiums of $5000 paid each year. (See below table on CCH p. 2946.) (Three different tax codes, w/ their own allowable exemptions, are involved.)

WILL BE ON EXAM VERBATIM!

Questions will come from back of the book.

The variations in years will involve only exclusions. The tax to be applied will be as of 1959.

15 MAY 64

J A entitled to two exemptions: for the L/E and for the rem? No. You cannot include the exclusion of a future interest.

If a transfer is made for money or money's worth, no gift. If transfer is made for less than adequate consid. in money or money's worth, there has been a gift to the extent of the inadequacy. A transfer for love and affection is a gift.

Answer to problem on p. 1009:

The $60,000 by revocable

trust to the grandchildren was not a gift.

PROBLEM, p. 1009

1937 — 155,000
1938 — 5,000
1939 — 5,000
1940 — 5,000
1941 — 155,000
1942 — 5000
1943 — 5000
1944 — 5000
1945 — 5000
1946 — 5000
1947 — 5000
1948 — 5000
1949 — 5000
1950 — 5000
1951 — 5000
1952 — 5000
1953 — 5000
1954 — 5000
1955 — 5000
1956 — 5000
1957 — 5000
1958 — 5000
1959 — 155,000

* Taxable gifts through 1958:

$ 100,000
200,000
110,000 (ins. premiums to son)
20,000 (charity) (not incl. in left column)
$ 430,000 — GROSS GIFTS

* Exclusions or deductions through 1958:

$10,000 ($5,000 donee exemption x 2)
16,000 ($4,000 donee exemption x 4)
48,000 ($3,000 donee exemption x 16)
Not entitled to marital deduction from gifts to wife because it was a gift of a terminable interest. Entitled to donee exemption.
Not entitled to donee exclusion for C's gift, because no exclusion is allowed for a gift of a future interest.
$9,000 (donee exemption to wife: $5,000 + $4,000)
$20,000 (charity)
$103,000 total

* $ 430,000
− 103,000
* 327,000 (net gifts)
− 30,000 (lifetime exemption)
$ 297,000 total taxable gift thru 1958.

Compute tax on $297,000 —
On $250,000 = $49,275
On 47,000 = $11,280 (24% of 47,000)
Total tax = $60,555

*1959 GIFT —

* Exclusions and deductions:

$3,000 - son
3,000 - wife
10,000 - charity
$16,000 total
+ 30,000 lifetime exclusion
+ 103,000 (previous excl. + deducts.)
$149,000 (exclusions thru 1959)

$430,000 (gifts thru 1958)
+ 165,000 (1959 gifts)
$595,000
- 149,000
$446,000 - taxable gift in 1959.

Tax on $446,000 = $96,313
- 60,555
$35,760

payable for 1959 taxes