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TAXATION I

MAURICE HOLBROOK JACKSON, JR.

BOSTON UNIVERSITY



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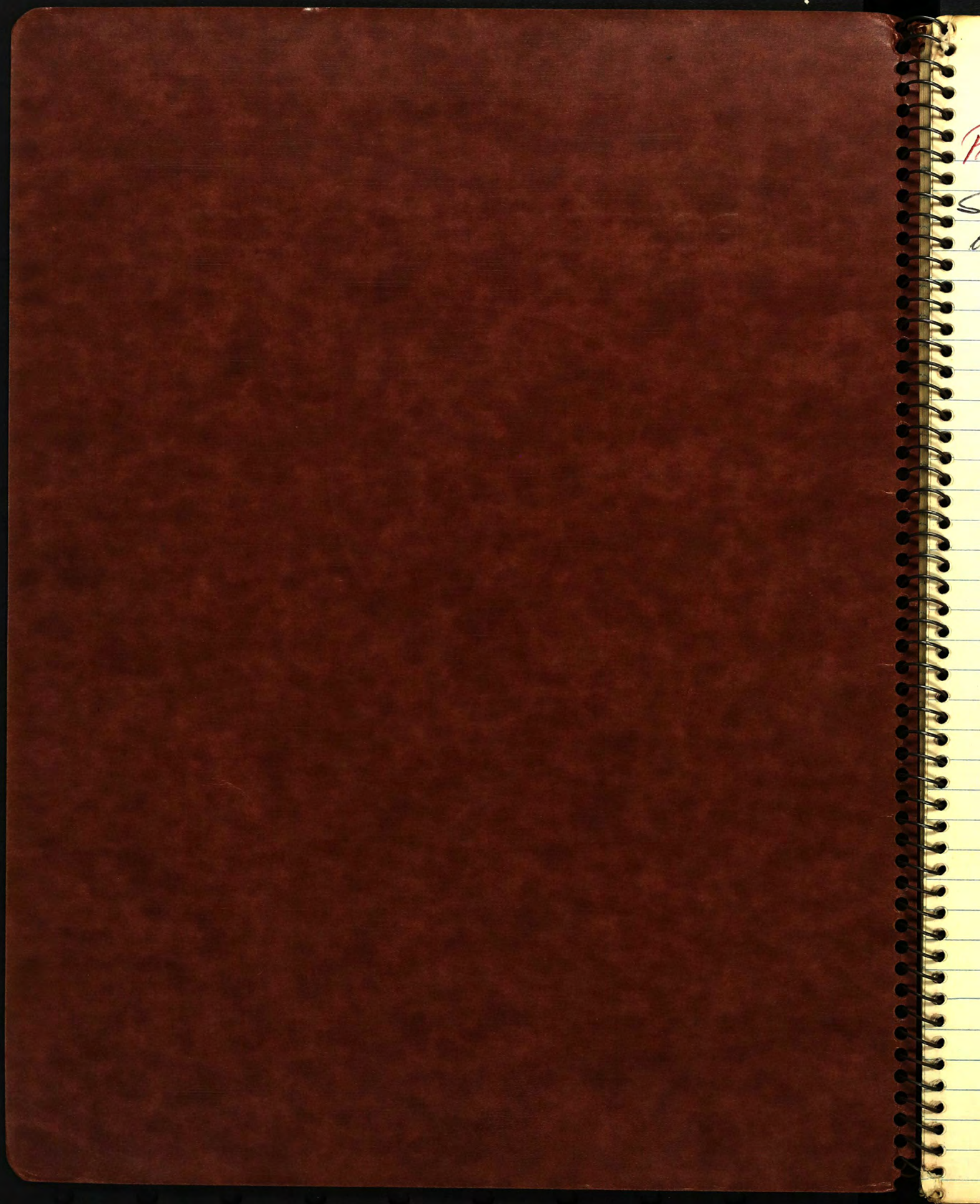
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"ANOTHER MAPLE LEAF PRODUCT"



18 SEPT. 59

Prof. Roemer

See Stanley + Kicullen
on Fed. Taxation

The regulations explain and interpret the statute (I.R.C.). Re income taxes, sec. 61 is the meat thereof.

The regulations are in two parts:

(1) Final

(2) Proposed

The reg. are classified under the two headings.

We will be dealing w/ the 1954 code.

There are basically three layers of income:

(1) Gross receipts - somewhat extra-statutory.

(2) Gross Income

(3) Taxable Income

In between 2 + 3, you can be inserted the "adjusted gross income." i.e., if you prefer not to compute + itemize your deductions, the govt. provides a rate deduction schedule wh you can elect to use and the designated deduction is subtracted from the gross income wh results in the adjusted gross income.

The tax schedule is graduated. \therefore , the taxable person problem arises in that

by means of shifting the higher ^{part of the} income to someone else, two people will be paying taxes. e.g., H earned \$20,000 and then W was listed as having earned \$10,000 of that. Assume that on \$20,000 56% is taxable, but on \$10,000, 20% is taxable. Therefore, the total in paid taxes by two people would be 40% instead of 56% as it would have been had only one person paid.

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- (1) The first step in deter. the tax liab. of a taxpayer is to deter. the gross income. But, what const. "income?" What may be a gain economically may not be a gain tax-wise.
- (2) When is a benefit income?
- (3) To whom is it income?

Hypo:

Accountant is paid by client w/ a country loan in 1958. Act. tells son in 1958 that he can have it. Son picks it up

in 1959. - The 3 questions may be asked here.

Methods of creating another "bucket:"

- (1) Re-allocation or deflection of income - usually done among the family members.
- (2) Corporations

Capital Gains

Capital gains are treated differently from ordinary income. i.e., A buys share of stock for \$200 & sells it one month later for \$500. Is this \$300 taxable like ord. income? No, as this is a capital gain. The longer term capital gains are taxed less than the shorter term capital gains. Why? The govt. doesn't want to dampen the investment incentive.

At any rate, the tax would be computed on the \$300⁰⁰, not on the \$500⁰⁰. The \$200⁰⁰ is called the BASIS OF THE STOCK. The gain is deter. by subtracting the adjusted basis from the capital gain of \$500⁰⁰. The basis reps. the capital funds on hand, and it is not taxed because theoretically

it has been taxed before when it first came to the owner of the stock.

Capital gains are preferred, why? To encourage investment incentive; to tax the full gain on the same basis as the rate schedule of ord. income. ~~that~~ would be unfair: the capital gain on the sale of an asset is not bounded by years on a graduated scale since the appreciation on an asset may be 500% in one year rather than 50% in 10 years. So, to tax the 500% in one year would be to tax 10 years at once.

Rule of Law Value is not taxable until it is realized.

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Sec. A.

"INCOME" - Non-Cash Benefits

All benefits to a taxpayer are not taxable income w/in the meaning of the statute (Code of 1954). What kinds of benefits are taxable?

* Inventory method - one extreme holds any gain in the

net worth of one. Another extreme holds that ("income" or) benefits are only those increases in worth attributable to a definite, set source (e.g., salary).

United States v. Dresher

The right to receive income pmts. wh accrued to the P when the Optical Co. rec'd. each K represented a present economic benefit to him: the obligation of the ins. co. to pay money in the future to him or his designated beneficiaries on the terms stated in the policy. That obligation he acquired in 1939 notwithstanding the E's retention of poss. of the policy and notwithstanding its non-assignability. Plus other present econ. benefits: (1) any beneficiary named by P at the time the K was executed, or substituted by him at a later date, would get, at P's death, cost of each K + interest.

(2) P could realize cash by King w/ a putative 3rd

There are 2 kinds of accounting on wh a taxpayer can keep his books:

- 1) Cash receipts & disbursements - included when rec'd. only, i.e., in hand. A lawyer may not be paid until a year after he has earned it.
- 2) Accrual method - item of income included when the right to receive it accrues.

D (appellant) was on cash receipts method. The policy was held by the company but the ct. said that the yearly premium was taxable and should have been included. Although the assurance was that D would be paid 120 mos. of \$X in the future, ct. said this was a PRESENT benefit despite the fact that the actual money would not flow until D reached 65 under the policy. It's not necessary that the benefit

person to hold in trust for P's cash. It was a present
any ~~benefits~~ ^{payments}. to be guaranteed of a future annuity,
rec'd. under the annuity. See sec. 403 - c re the purchase of
K. annuities.

Hypo: Instead of buying the annuity
for Drescher, the company pro-
mises to pay Drescher \$200
per mo. after age 65. - This is
not a present benefit.

Benaglia v. Commissioner (p. 44)

Appellant was receiving room
and board. This was a 1936
case and was \therefore not under
the present Code. (WATCH
DATES.) At that time, it
was under sec. 22(a), the
general shotgun clause. (61
of the Code).

The Employer supplied
the food and lodging.
The Ct. said this was not
taxable since this was
for the convenience of the
employer and was required
by the employer. (Sec. 119 of the
Code is here applicable).

Under sec. 119, there are
3 requirements:

- (1) On the premises
- (2) For the benefit of the E^r
- (3) As a cond. of E^r 's emp.

TAXATION ASSIGNMENT:

pp. 33-49 & Prob 1.1 of Supplemental Problems
pp. 3-31

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* Supplemental Prob. 1.1 -

If an Sec pays income tax on your salary, you will have to pay tax on the salary + on the tax since both are taxable benefits.

Car - how much personal use did he make of it? If the car were used solely for biz purposes, this would not be a taxable benefit.

Vacation - assume that the Resort is co. owned in the Catskills. What does "biz premises" (sec. 119) mean? Probably this would be a taxable benefit. However, could it be argued that it was a fringe benefit wh was to boost the morale of the Sec, and \therefore is a non-taxable benefit?

Term life ins. has no cash value, but an ord. life ins. policy has cash value wh can be redeemed.

Life Ins. - would a term life ins. policy bought by the Sec for the Sec be a taxable benefit? The Sec can be taxed on the premiums paid by the Sec.

Moving Expenses - the new Sec has income. The old Sec is considered to be moving for biz reasons. The new Sec is deemed to be making a personal move.

Buttouse - y is a sec. 119 problem. All three questions must be

asked: is it for the purpose
+ convenience of the Sec +
is it on the "premises"?
If it were located in the
top of the building owned
by the company.

Cash allowances - Sec 119 does not
apply here because ~~of~~ the 119
provision that those things
"furnished" by the Sec would
be deductible, and a cash allow-
ance is not a furnishing
of those things, i.e., room
& meals.

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Sec. B.

* REALIZATION * (The Requirement of)
Sisner v. Macomber (p. 54)

This involved the question re
whether income from stock
dividends was taxable
income w/in the meaning
of the 16th Amendment.
Why was the dividend a "direct"
tax w/in the thinking of the
Ct.?

The Ct. said that the dividends
were not taxable because it was
not realized, and to be tax-
able, the income must be
realized. Far from being a
realization of profits of the stock-
holder, the 'stock dividend' tends
rather to postpone such

Realization, in that the fund represented by the new stock has been transferred from Surplus to Capital and no longer is available for actual distribution."

Requirement of
Realization:
Severance

Under the doctrine of Realization, there must be a severance of the gain's value from the source of the gain. i.e., "cash dividend."

Helvering v. Bruun (p. 61)

Realization is a sine qua non of taxable income. The Warner doctrine of Realization held that the income to be realized, must be derived from the capital, i.e., severed therefrom.

Completion
of
Transaction

Here, a tenant had to forfeit to D, landlord, some of D's prop. wh T had improved. i.e., D had a gain. But, this was ~~not~~ taxable because ^{although} for D to realize the gain, the prop. must be sold since the profit or gain could not otherwise be extricated, ~~the~~ →

* Supp. Problem #1.2

In Helvering v. Bruun, there was a completion of transaction. Not so here.

When Improvements can be Included under §109 of Code:

Under sec. 109 (1954 Code), the type of gain in Helvering v. Brunn is declared not taxable. Under 109, if it is agreed that improvements are to be made in consideration of occupancy of premises, those improvements will be considered "rent" and under 109, Rent is taxable.

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Inaja Land Co. v. Commissioner (p. 65)

The Ct. held that since P paid \$61,000 for the land and rec'd. only \$50,000 as a return on his investment, P did not have to pay tax on the \$50,000. "No portion of the pymt. in question should be considered as income, but the full amt. must be treated as a return of capital + applied in reduction of petitioner's cost basis." The only reason that there was no allocation of basis + a tax thereon was the impracticability of so doing. However, the general rule is that the basis would be allocated.

if a completed trans. action at which a finger could be pointed as being the date of gain.

* In answer to question in Note at bottom of p. 66, tax would be paid on \$14,000. You would

The
be
cap
gr

subtract \$50,000 from \$61,000 to get the basis. Then, subtract the basis from the sale price \$25,000, leaving \$14,000 on wh tax will be paid.

Thus, altho' y must be a realization, it does not always hold that all money wh is extracted is taxable at that or any time.

SECTION C: RECOVERY OF CAPITAL

STANTON V. BALTIC MINING CO. (p.67)

Assume that bldg. cost \$10,000 and then, due to fire, owner got \$8,000 in insurance. The FMV of the bldg. was \$20,000.

- Why isn't \$8,000 considered "income?" There has been a recoupment of capital, & ∴ the \$8,000 is involved.

Loans

Thus, a loan is not taxable since the immediate obligation to repay arises & ∴ it is no gain; and income necessarily implies a gain wh is taxable.

The govt. will not tax gross receipts, but will first allow the expenditure (capital) to be ~~first~~ recouped.

SULLINGER V. COMMISSIONER (p.70)

The cost of goods sold must be deducted from gross receipts in order to arrive at gross income.

Purchases, like other expenses, ~~to~~ to secure effect in reducing what would otherwise be taxed, must be w/in the law. (DISSENT)

Sullenger Case (cont'd.) - the cost of goods sold, tho' in excess of O.P.A. ceiling, was allowed as a proper deduction in computing the profit. (majority)

(See p. 75 of CBL.)

* SECTION D: Increase in Net Worth *

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United States v. Kirby Lumber Co. (p. 73)

Is y a gain here? = Obviously, the taxpayer had an increase in net worth.

All increases in net worth are not taxable:

hypo: Father lends son \$1,000 to buy car. 4 years later, father cancels note. - No taxable gain.

It has become well settled that a profit is realized by a debtor whose obligation is extinguished by payment of an amt. less than that wh. is owing and gives such profit const. gain wh. is taxable income w/in the broad sweep of § 61(a). hypo: Father lends son \$1,000 to go into biz. 4 years later, father cancels note. - No taxable gain.

hypo: Wholesaler cancels indebtedness of retailer because he knew latter was in tight circumstances & wanted to retain retailer's biz in future. - Was y a gift here?

Gifts in Commercial Situations

Jacobson case, 336 U.S. 28 (1949) said that in a biz. arms-length situation, it is hard to find a gift. - y can be a gift in a commercial setting, but it is usually presumed as an inference of fact that y is no gift.

hypo: Corp. X is lent note by shareholder X, taking note therefor. Later, SA-X cancels note. - Would it be income?? Yes. Suppose a Corp. is beginning & A invests \$10,000 to the corp. is it income?? No. It is an increase in capital.

(Work out the problems)

See Regs. §1.61-12(b)

In the Corp X hypo: it is an income situation. SH-X being a sole shareholder, this would be a dividend.

In KIRBY, the discharge of indebtedness was held to be income.

Bradford v. Comm. (p. 73)

Indeciding the income tax effect of cancellation of indebtedness for less than its face amt., act. need not in every case be oblivious to the net effect of the entire transaction.

This was a relaxation of the KIRBY rule. The ct. said that altho' y was not a gift, y was also not a gain wh could be deemed income.

A buys B/A from B for \$20,000. \$1000 down & note for \$19,000. Prop. values drop. B agrees to re-negotiate the note for \$15,000. - Some ct. have held that this was a renegot. of the orig. purchase price, and not a gain, ∴ not taxable.

The partial forgiveness of indebtedness in a given year does not const. taxable income to the debtor if the actual effect of the entire transaction was simply to reduce the purchase price of prop. acquired in a prior year.

Ct. held here that "the fact is, that by any realistic standard the petitioner never realized any income at all from the transaction in issue."

Supp. Problem #1.3

(Stock is said to be at a premium when its market value price exceeds its nominal or face value.)

(Pro rata division: $\frac{\$10,000}{20}$ = \$500 per year.)

The bond w/ face value of \$100,000 sold for \$110,000. The \$10,000 is a premium, and since it is a 20 year bond, it must be pro-rated over 20 years. Only \$10,000 was taxable

\$110,000 - sale price
 - 90,000 - repurchase price
 20,000 - profit
 - 5,500 - premiums for 11 yrs.
 14,500 -
 - 5,000 - bal. sheet deficit
 \$ 9,500 - income

as an immediate obligation to repay the \$100,000 ^{arose} Sec. Reg. 1.61-12.

Since the bonds were bought back at \$90,000. Thus, since 9 yrs. had elapsed (at \$500 per year taxable on the \$10,000 premium), the net ~~income~~ ^{worth} income increased by \$14,500. However, due to the balance sheet deficit of \$5,000, the taxable income was not \$14,500, but was \$9,500. See Sec. 108 of Code.

The solvency or insolvency of a corp. makes a difference. If a corp. has a deficit, i.e., insolvent, the amt. thereof will be deducted from ~~the~~ "income." If a corp. is solvent, such deduction cannot be made.

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* Kirby Case showed us that gain from discharge of indebtedness can be income.

Amortization or Proration - method of spreading out taxable income.

Lakeland Ind. Co. v. Comm. (p. 78)

Stands for the proposition that on a Co. is insolvent, it can be a deduction from the apparent tax liab. to the extent of the deficit.

#2(a) Problem, (p. 81)

The wage earner is a personal situation whereas "Lakeland" is a corp. situation. So, here the answer is yes.

The insolvency of the taxpayer helps him only in this area of discharge of indebtedness. Policy dictates the judicial relaxation and the congressional relaxation in this area, e.g. §108 (Code) - gives bizmen + corps. an option to pay tax now, or can wait and deduct deficit, thus getting an adjusted basis. w/ the adj. basis, the tax would be paid down the line anyway upon the sale of the property.

* SECTION E: RECOVERIES FOR PERSONAL + Biz INJURIES

See §104 of Code.

Note: In any type of tort damage suit, recoveries w/ rep. a reimbursement for lost profits are income. Since the profits would be taxable income, the proceeds of litigation w/ are their substitute are taxable in like manner.

hyp: Mrs. Glenn Muller made arrangements w/ movie studio to pay her \$400,000 "in discharge of their liab. to her for invasion of her privacy" (studio made picture of her H's life + there were scenes about her). Why phrase it that way instead of stating that y was a sale of her rights to the studio? In the way phrased, she was trying to bring the profit of \$400,000 w/ in §104 (a)2. However, the only difficulty is that when the ar-

Dams. for violation of the anti-trust acts are treated as ord. income or they rep. comp. for loss of profits. The test is not whether the action was one in tort or K but rather In lieu of what were the dams. awarded?

arrangement was made, the tort had not been committed.

Raytheon Production Corp. v. Comm. (p. 89)

On the suit is not to re-^{cover} lost profits but ^{paymt.} was not income because the paymts. were simply recoupment of loss of profits due to certain limitations, is loss of potential customers not taxable. However, and good will, & que: altho' the inj. party may not be deriving a profit as a result of the dam. suit itself, the conversion thereby of his prop. into cash is a realization of any gain made over the cost or other basis of the good will prior to the illegal interference.

* Gifts, "Windfalls," and the like *

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Comm. v. Glenshaw Glass Co. (p. 91)

Issue: whether ~~the~~ rec'd. as ~~to~~ rec'd. \$200,000 in punitive dams. exemplary dams. for fraud) conceded $\frac{1}{3}$ to be taxable because or as ^{the} punitive ~~dam.~~ $\frac{2}{3}$ that amt. was paid on a big trans. portion of a treble damage action. D alleged that the \$200,000 antitrust recovery must was a windfall and that he reported by a taxpayer Congress did not intend to include windfalls as taxable. D that is contemplated w/ alleged the \$100,000 to be re- the 1954 Code, sec. 61(a)? recovery to lost profits. In anti-trust cases, dams. for lost profits are trebled. The taxpayer realized the money in question free of any restrictions as to use. The paymts. in contr. come: "gain derived from whatever source." 61(a).

contributions nor gifts. There is no indication that Congress intended to exempt them from coverage. Ct. will act in accordance w/ the legis. design to reach all gain constitutionally taxable unless specifically excluded.

* Soc. G. Control + Claim of Right *
U.S. v. Lewis (p. 99)

Taxpayer wanted to deduct the \$11,000 in 1944; govt. wanted to estab. it as deductible in 1946. This would have been under \$1341 if the 1954 Code had then been effective. Ct. decided on the year 1946. Why? 1944 was still open in that the S/L had not run, so why 1946? Was the \$11,000 "income" in 1944?

\$1341 would have allowed the year 1944

Rutkin v. United States (p. 101)

An unlawful gain, as well as a lawful one, const. taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it.

It is known that profits from an illegal biz are taxable. Our y is something like Embezzlement, it can be argued that the gain is not taxable income because an obligation to repay arose immediately upon the receipt. However, a circuit Ct. case held that embezzled funds are taxable. (Contra: Wilcox case).

* CHAPTER II - The Indiv. Non-Biz. Taxpayer *

Boordus v. Comm.

See secs. 74 + 117, 1015

(p. 120)
Corp. decided to give \$95,000 founder's day gift to founder of corp. who is still Pres. of the corp. - This would tend to be taxable. If founder had been

A transaction might be a gift as that term is used in the gift tax law, w/o being a "gift" for income tax purposes. Farid-S-Sultaneh v. Comm. (p. 115 chk.)

retired, he would prob. have been in better shape.

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Chap. 2 (cont'd.)

(1.) Gifts, Prizes and Fellowships §102
Bogardus v. Comm. (cont'd.)

The giving of the \$256 founder's day gift would be non-taxable if ~~the~~ the man was retired & no longer active.

If, however, the man were still at the helm of the corp., the \$256 would be taxable.

This would be a benefit to the corp., too, because the other $\ees would know of the bonus and would work hard and more carefully. i.e., the bonus would be an incentive.

The only group wh would not be taxed on a bonus or retirement pay would be a minister. It would be deemed a gift.

Kaiser v. United States

(para. 1173 of CCH)

"We hold that the strike benefits rec'd by P under the facts of this case are not taxable income."

(Good dissent here.)

A striker picked up \$25⁰⁰ per week to buy food, milk, etc. The appellate court said this was not income. A deter. factor was that the striker had not belonged to the Union

Bequests - (102 of Code)

not includable unless γ is income from prop. wh is bequeathed.

If A receives prop. by gift or inheritance, the value of the prop. it self is tax-exempt under §102(a), but he must report the income of the property thereafter.

If a fund were given to trustees for A for life w/ rm. over, the income rec'd. by the trustees + paid over to A would be income of A under the statute. This scheme assigns the entire benefit of the gift exclusion to the remainderman.

before the strike began.

A covenant not to sue would be such as to render the proceeds taxable.

Now, γ is at least an attempt to tax the proceeds (\$10,000) to the widow of a retired E^{ee} . Under 101(b).

γ is an exclusion of \$5000 (aggregate amounts) in amts. received by the beneficiaries or the estate of an E^{ee} , so long as "such amts. are paid by or on behalf of an E^{ee} and are paid by reason of the death of the E^{ee} ."

See sec. 74 for Awards, Prizes - Awards and prizes are taxable so long as they are not made primarily in recog. of religious, charitable, educational, etc. Further, if recipient did not take any action to enter the contest, and is not required to render substantial future services, it is deemed a gift.

Supp. Prop. #2.1

The \$16 is not taxable. Further, under §117, a \$300 monthly exemption is allowed. So, $\$1600 + 10 \times \$400 = \$5,000$. Since $10 \times 300 = \$3000$, the allowed exemption, then $\$5000 - \$3000 = \$2000$ (the amt that is taxable).

The taxable amt. for teaching would be the going value of such teaching services. ^{unless all candidates were required to teach (even those without scholarship or fellowship)}

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§101 of Code

Supp. Prob. 2.2 ~~*LIFE INSURANCE*~~

As to W, the \$100,000 would not be taxable (W being the bene. under the policy). §101(a)(1)

If H transferred the policy to his son (S) for valuable consid. - \$100, that would still be taxable.

As to W, the interest would be taxable.

§101(a)(2) provides an insulation for the transfer to a certain degree.

§101(a)(1) is an insulation against taxing benefits to beneficiaries.

Quaere: If W chose to pay \$11,200 per year, the question could be raised, is the excess above \$10,000 (i.e. \$1,200) really "paid by reason of death?" =

Comm. v. Pierce (p. 133)

Under §101(d), W would pay tax on \$200. In addition to the proration of \$10,000 per year, widow gets \$1,000 exemption.

Under case law pre-1954, widow would not have

If you cash in your policy (even a few days before death), income which is taxable will be the diff. between premiums paid and surrender value of policy, i.e. amount realized by the surrender.

paid tax on any of the \$11,200. — Son would have had to pay tax on full \$1200 under §101 since that exemption applies only to ~~the~~ a living spouse.

If W had exercised her option to leave the \$100 to w/ the Ins. Co. & receive only \$3000 interest per year, that would have been taxable since the \$1000 widow's exemption applies only on 4 years' payments of benefits under the policy to widow.

Under §101(f), the death is the pivotal point.

* ANNUITIES * Sec. 72 of Code Supp. Prob. 2.3

Reg. 1.72-5 (A)(2) — because of the adjustment & frequency of payments, 1/2 year must be added to his 15 year life expectancy.

\$500

750 (gotten by \$5000 x 15)

Capital investment was \$50,000. The question arose, how much of the yearly return will be a return of capital and how much equals interest. 3% of \$50,000 (investment in K) is \$1,500 and that will be taxable.

The remainder of the yearly income will be non-taxable as being return of capital.

Under §72(b), you must determine the ratio to determine the exclusion.

(expected return) →
$$\frac{\text{Inv. inc.}}{\text{Ex. Ret.}} = \frac{\$50,000}{\$3,500} = \frac{50}{75} = \text{tax } 2/3 \text{ } 66\frac{2}{3}\%$$

If you outline the life exp.
you have a chance to beat
the govt.

(Work on getting dollars
& cents answers).

* Comp. for Personal Injuries or Sickness
Under sec. 104, it would be better to
be retired from a co. or Army
under disability rather than
old-age pymts.

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Simms v. Comm. (p. 143)

Supp. Prob. #2.4 -

Under §213, could X deduct the
premium paid for the policy?
Yes. §104. This would be true
even if the amt. of premium
had been deducted from his
paycheck. What if the E^{ee} had
paid the premium? §106 - not
taxable.

Re the \$5000 - non-taxable

Re the \$800 - non-taxable

Re the \$150 per wk. - §105(d) allows
a \$100 per wk. exemption. So,
\$50 would be taxable.

hypo: X Co. has no special sick plan.
A (E^{ee}) stays home 4 days ^{sick} & returns
to work, and is no interruption
in A's salary. Was the salary
rec'd. during the 4 days taxable?
— Would depend on whether the
Co. had a "plan" w/in the

See Haynes v. U.S., p. 144.

The only time when wage continuation is non-taxable is one that is the only thing the $\text{\ee is getting. e.g., $\text{\ee gets $\text{\$}150$ per wk. wages continuation + $\text{\$}50$ per week for sickness ins. premium from $\text{\ee . - Only $\text{\$}50$ (med. expenses) would be non-taxable.

Gen. Rule
of Law

Florida
Quaere:

* Tax Free Interest *

Only the int. on Municipal and State bonds is non-taxable.

meaning of $\text{\$}105(d)$. ^{Quaere:} How ltd. can the advance arrangements be between the Co. + A before it can be said γ is a "plan"? ^{Quaere:} What if you decide to "mend your nerves" and take off to Florida for 3 weeks, but you keep on getting your salary? ^{Quaere:} What if pregnant woman who leaves work & keeps on getting salary? Taxable w/o some other ill. Usually, γ must be some illness in addition to the pregnancy.

The gen. rule is that the first 7 days of illness are not excludable unless you spend at least one of those 7 days in the hospital. Otherwise, only the time after 7 days could be counted.

The "Florida" man could prob. claim sickness on the ground that hypertension is a sickness requiring recuperation.

Re the $\text{\$}25,000$ - not taxable under $\text{\$}104(a)(2)$

$\text{\$}103$. Interest rec'd. from Bonds (esp. on they are for public good) is not Taxable.

This section 103 has been used frequently by areas inducing new industry.

This is capital gain - taxable.

} The gain on the sale of municipal bonds is not insulated by 103. Further, this gain is not really interest.

* PERSONAL DEDUCTIONS *

Gen. Rule

Starting off w/ personal deductions. (Personal, living and family expenses are not deductible.) These are other than biz. expenses and would see host if the standard 10% deduction were taken. The following are exceptions to above rule.

Ochs v. Comm. (p. 154)

Extraordinary Medical Expenses

Ct. found that this was "good living" rather than med. expenses. The two must be distinguished.

Quere: What about the "Florida man?"

Note: { In preparation for the Chap. 3 probs., read ahead from 194 to 262 rather rapidly.

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[These become important at end of year when you have to decide whether to take the standard deduction or itemize. Usually, people don't keep records of these small things.

Normally, school expenses are not deductible, but to send a child to a school for retarded or blind kids due to its similar cond.

is deductible. (See supp. prob. 2.9)

Supp. Prob. 2.10

* This would be deductible if TP's mother was at the home for aged for med. reasons. If so, the full expense is deductible including meals & lodging.

* If at the home for aged not purely for med. reasons but only partially so, the med. expenses must be separated from the other expenses involved.

Gen. Rule

There must be MEDICAL CARE for the prevention, treatment, cure, etc. So a sink garbage disposal unit would not be deductible.

Diagnosis

If you're at hospital for a phy. check-up thinking that you have something wrong, & you stay & for a night and then find out que nothing's wrong, deductible. sec. 213(c)(1)(A) "for the diagnosis."

If M.D. tells you to eat a lot of red meat each day, you can't count those daily steaks off as med. expenses. You can't deduct your grocery bill.

Travel Expenses - if you just go to Fla. to rest, not deductible.

TEST:

If you go to Ariz. on doctor's orders for Asthma, under 213(e)(1)(B), the "transportation primarily for + essential to med care." Transportation is a term of art and may not include meals along the way etc.

Supp. Prob. 2.7

The bed, power lines, iron lung and respirator would be deductible, but the question of capital expense (permanent expenses) might pose a prob.

RULE

Not so, however. The Regs. say that capital expenses of longer than 1 year not deductible, except on they are NOT a significant addition to the home.

So, the added room would not be deductible since it added value to house.

Bassett Case (Supp. materials - C.C.H.)

B tried to lump all med. expenses and pre-pay them. Ct. said no since they were not really expenses yet.

Note, the med. expenses are extraordinary, i.e., above the first 30% of med. expenses.

If you have operation in 1957 and pay it in 1958, you may get away if you don't have intent to defraud.

* Charitable Contributions *

Havemeyer v. Comm. (p. 162)

These are deductible when made to a stable, formal type donee.

Xmas gifts are not deductible.

Supp. Prob. 2.13

Would probably be deductible since nephew's selection was not the reason for the estab. of the scholarship and was selected in the regular course of matters. However, if it can be shown that there was some collusion, not deduct.

Supp. Prob. 2.15

\$750 deductible. \$2,250 deductible.
\$250 may be deductible. The Regs. suggest as much.

21 OCT. 59

Supp. #2.13 (cont'd.)

If it had been a provision that the scholarship was to go to a blood rel. of donor, not deductible. Would be a gift.

But, the mere fact that a nephew happened to have been chosen does not mean there would be no deduction (same if son had been so selected) since it was an objective

method of selection.

Must be public to be a charitable contribution.

A C.C. is not taxed in the gross estate of donor.

The amt. given is the market value of the thing, i.e., Bonds worth \$75 par, \$100 face value. The donation of one would be \$100 + that could be deducted.

Hospitals
and
Schools

Hospitals & schools pay no taxes. School can't buy businesses and insulate the biz income. There will be tax on the ^{unrelated} ~~return~~ income. This does not include investment income (no tax paid by Harvard on income from Harvard-owned apt. houses).

At least 10% must be given before any deduction will be effective.

If are §§ limitations: you can give up to 30% (20 + 10%) so long as the 10% is given.

Gifts to Political Parties ^{Quere:} is a distinction made between specific and gen. lobbying groups? The gen. idea is to prevent

making deductible contributions to pol. parties.

hypo: Brick mason works free to build hospital. — The time is not deductible. Only money or property are deductible. Nor is blood deductible.

hypo: A tells E to pay his paycheck to Red Cross. — This may be interpreted as being an assignment of income, & is taxable.

* ALIMONY *

See secs. 71 & 215.

Before 1942, alimony was ~~not~~ deductible as being a mere debt. It was not considered income to the W. After the statutes, alimony was considered "income" to W and deductible by H.

This is an income-splitting device.

§ 71 (A) (1) was the orig. stipulation re divorce or separation pymts. wh were decreed by a ct to be paid by H to W.

Joint Returns — In 1948, Joint Returns were allowed. Each would ~~have~~ have 1/2 of the combined income as being taxable. This applied even

though H & W were living apart. So, that made 71(a) (1) less important.

§ 71(a)(2) and (3) are not retro-active.

Quaere: Why is there a requirement of periodic pymts. ??? = The concepts of lump pymts. & periodic pymts. are different.

When you are dividing the capital (house, car, stock), it is taxable since there is no redirection of H's income, and no rationale for giving H a big deduction.

If a lump sum is paid in installments, it is treated as periodic alimony pymts. under § 71(c).

Support for minor kids is not deductible, 71(b).

23 Oct. 59

After 1954, the periodic pymt. of alimony will result in the splitting of income.

Deduction under § 215. Inclusion under § 71.

What about lump sums paid periodically? § 71 has a 10 yr.

plan which allows H & W under certain circumstances, to take advantage of the split of income. If the lump sum is paid periodically for a period of less than 10 years, it will not be treated as alimony, but as a regular lump sum.

Supp. Problem #2.16

One argument could be: \$750 = first installment w/ \$26 deduction each year from the \$256 for the 12 1/2 years. However, probably it would be accepted by the Comm. as 2 separate transactions.

You should try here to work out a method for H AND W to get the lowest possible net cost.

The amt. for kid's support would not be considered alimony.

* Ins. - H deducts, W includes. The premiums could const. alimony (assuming separation agreement so provided). If H had rights/revocation, no alimony here on Ins.

Are these pymts. "income" to the wife under § 61? To treat alimony as a deduction to one and inclusion of the other, you must go to the special sections of Code (71) other than 61. It's like a grocery bill as to H.

* Interest *

To deduct interest, it must really be interest.

Supp. Prob. #2.17

Interest deducted must be interest paid or accrued during the taxable year. It must be on indebtedness.

If the \$1000 was contributed to capital, the \$56 would not be interest, i.e., pymt. on risk capital would not qualify for deduction.

Supp. Prob. #2.18

This would not be int. supported by consid. It is intra-family & a gift.

Note: Dividends paid by a corp. are not deductible.

Supp. Prob. #2.19

A timing prob. He can deduct the int (\$1000), but when? He would have to prorate, & the giving of the note by the bank, & receipt of another from TP for the int. in the same transaction would not qualify TP for a deduction.

* Taxes *

Taxes + int. are deductible, but why? Little justification (assume

ing personal taxes). It is prob.
a disinclination to tax a tax.

You can't deduct tax paid by
someone else under pre-1954.
However, under 164(c), the
tax paid by retailer ~~can~~ can be
deducted by TP on the tax
is separately stated + passed
on to the consumer.

27 Oct. 59

* Casualty Losses * Sec. 165 ('54 Code)

Important to bizmen who want to
get a write-off for their losses.
But, we're concerned w/ indiv. non-
biz losses.

hypo:

A buys Criscraft boat in June for
\$4500 + sells it for \$3500 in Sept.
Has A had a "loss" w/in the
meaning of §165? - No.
Same for sale of residence, car.

Under 165(c)(3) - casualty loss-
es despite no biz. The question
usually is what is meant by
"other casualty."

Sonic boom = deductible.

* Termite Cases - fast, unexpected ter-
mite damage deductible. Must be
sudden. If it was happening over
a period of time, no deduction.

* Hurricane - usually deductible.
Value of loss might be questioned.

So, y is a requirement of suddenness and unexpectedness.

* Drought - would dam. here be deductible?
If in Texas? Hurricane in Fla.?
Even in Fla., still probably deductible.
But, a drought is not sudden, so
y may be a question.

hypo: Car hit by uninsured man, yours
uninsured. - Deductible loss.

hypo: Suppose you knock off your watch
as your normally swinging arm
hits tree? =

Kernan v. Bowers

(p. 177)

Here, y was no sudden inter-
vention of some outside force. So, this
would differ from the watch hypo.
One will not, however, be
compensated for carelessness - gross.

* Even tho' a shipwreck is
never unexpected, it is specifically
provided in the statute, 165(C)(3).

* Past cases have held that an
outside intentional force wh
causes loss, is not deductible. e.g.,
Vandal slits convertible car top. Today,
it is uncertain.

Helvering v. Owens

(p. 181)

Said how much an indiv. could
take for a personal casualty loss.

hypo: Car costs \$3000. X drives it for 10
years, it then being worth \$300. Then
X wrecks it. - Ct in Owens case

said loss would only be \$300.

Under 165 (b), the amt. of loss must be considered on the basis of the adjusted basis.

No depreciation allowed on personal prop. So, how could Ct. here reconcile this? Prob. interpreted this to mean that there was no depreciation, no deduction. Anyway, the loss will never exceed the fair market value.

* Supp. Prob. #2.23

Reg. are no longer governing here.

This was his prop. The amt. of loss was \$4,545 per regulations. Since the ins. recovery was \$5,000 & must be subtracted, the T had a deficit loss, i.e., a gain. $\$4,545 - 5,000 = \455 gain. However, now the biz prop. is equated w/ the per. prop. + the loss would be \$5,000.

* Bad Debts * §166 ('54 Code)

It must be a genuine indebtedness. (In family situations here, look out for gifts.)

An uncollectable judg. debt is w/in the §166.

* Supp. Prob. #2.24

If they are occasional investors,

it would under normal circumstances be deductible. If you are regular investor, no deduction buying good will.

Here, this was nothing more than an investment in advertising. Was this a big bad debt or a non-big bad debt?

S/L [9 is a 7 year S/L on bad debts before you're precluded from deducting the bad debt.

hypo: Suppose debtor misses one int. pymt. Can creditor then deduct a bad debt? i.e.

When is a debt worthless?

When a debt becomes worthless

Must one first sue before the debt can be declared worthless? No. But, a debt can

be considered worthless even tho' you don't get a judg., ~~even~~ must show that if you did get a judg., you would not be able to collect from the debtor. (Share-judg debtor v. debtor here.)

* Personal + Dependency Exemptions * (Sec. 151)

Standard deduction of \$600 for personal deductions.

28 Oct. 59

§§ 151, 152

The \$600 exemption is dated since it is not realistic today re cost of living, etc.

* Minor children - in united home, no prob. Maybe prob. in dis-united. What about minor but mature children?

Supp. Prob. #2.25

Y must 1st be a dependent.
Is son dependent here? 2
requirements:

(1) TP must pay over $\frac{1}{2}$ of support.

(2) Related to TP (per §152)

* If Son had been 18, TP would have deducted. Earnings Test waived if depend. is 19 or under and/or in school.

* 20 yr. old son not deductible due to earnings test w/in §151: deduction not allowed if child's earnings (gross income) is \$600 or more.

Earnings
Test

Y is no age limitation to a student who is under 21. (2)

§151 involves the earnings test.

§152 involves the support test and dependency test.

#2.26

W doesn't come under the earnings test, so she would not qualify as a dependent.

"Support" is actual support?

So son (unmarried) could spend his \$130 at race track and TP could still claim son, since bets at track are not actual support of son. Even true if son keeps car, so one case held.

Quaere: Can you allocate ~~any~~ money contributed for support (e.g., of 3 of 5 kids)? No, a pro rate support is held to be. So father can't claim to have been supporting only 3 of 5 kids w/ w supporting the other 2. The total, aggregate support expended will be pro rated. Maybe ~~on~~ the family is dis-integrated, the Comm. might allow a special agreement.

* Chap. III

The Business Taxpayer *

Subsidy pymts. by a State to a R.R. (e.g.) have been held to be contribution to capital. ~~See~~ ^{see} Cuba R.R. Co case - the RR had to render services wh were actually bene. to the Cuban people as a whole.

3.2

On Mass gave \$9000 to Old Colony RR last year, that was less like Cuba & more like a contribution to the operating revenue since Old Col. was already

operating & was in the red.

30 Oct. 59

Cuba case was one of few cases besides Eisner v. Macomber which used Const. grounds to say that receipts were not income in this case.

Spur line (L.R.) cases & elec. hook-up cases were not income (re receipts) on ground that those receipts were capital construction contributions, and non-taxable. Spur lines were built by private companies or individuals and were then given to the L.R.Co.

Sec. 118(a) 1954 Code - gross income does not include any contributions to the capital of a company. Not applicable to contributions or other pymts. by persons who are direct beneficiaries of the service rendered by the recipient corporation.

Same for elec. hook-ups re elec. companies. TP in these cases could write off the worth of the spur as the worth being the adjusted basis, and y was no deduction in future on basis of depreciation because y was no " "

See Teleservice Case, par. 1163 C.C.H. & Rev. Ser. Ruling 55-580(?).

3.5

Soil Bank pymts. (paying farmer not to work) are taxable. Same for parity. Pymts. under Soil Conservation program to terrace

his land + build dam, etc.,
have been held taxable
because this was not
contribution to construction
capital as TP not only
had to build, but had to
maintain the conser-
vation improvements,
thus rendering services.

Quaere, tho', wasn't the
same thing true in
Cuba? = Cuba case ltd. to its facts.

Wouldn't the building of a
dam be an investment
in prop. rather than
a current expenditure?

Probably. - End of Subsidies.

* Big Expenses and Losses \$162 *

Those deductible are those in-
curred in earning money.

\$212 - altho' referred to as "non-
biz" expenses, they must still be
gainful activity expenses.

Smith v. Comm. (cbk. 195)

TP tried to deduct as biz expense
the salary of babysitter. Ct.
said that it was too personal
and could not be considered
as "ordinary" or usual as the
direct accompaniment of biz pur-
suits.

Supp. Prob. #3.6

W would have to show that the
presence of babysitter permitted

her to sit at sewing machine + sew. Being in the home + working for money would still be a big pursuit, but the matter of proof might be more difficult. — See Sec. 214.
— Here, per §214(b)(2)(B), they would have to deduct $(4700 - 4500) = \$200$ from the deduction of \$600 per Regs. = \$400 deduction.

No class on 11-3+4-59

6 Nov. 59

Prob. 3.7

Re §162. * Question is whether the clothing expenditure is an "ord. and necessary expense" w/in the meaning of §162.? = Could she deduct all or a part of the expenditure? Is this her personal wardrobe? =

The Comm. recog. that clothes might be required by a certain biz, i.e., an excess expenditure for clothing. white shirts and suits for ord. biz are not deductible.

If she can wear the clothing personally, ~~and~~ no deduction, or, at most, an allocation. A street car conductor who wears blue suit w/ permanent brass buttons can deduct. If brass buttons are detachable, no deduction.

Assuming them to be personal, if she

sold them for a loss, it would be a capital loss.

If sold for gain, capital gain would be taxable.

She could save a bit of money by giving the clothes to Good Will Industries and get a 20% deduction: charitable contribution.

If Co. bought the dresses & kept them & later sold them, it could be interpreted as being a depreciable asset. If an acquired asset lasts more than a year, you can't write off the full expense ^{in one year}, but must spread it out over a number of years. You can either expense an item or depreciate it.

If, at the end of the year, the Co. sold the dresses for \$500 (assuming the Co. had expensed the dresses on their tax return), their basis would be reduced to 0. If they were sold for a ~~profit~~ loss, viz loss.

Basis is disregarded in charitable contributions. You deter. amt. by fair market value of item. If, however, you have expensed the item at the beginning of the year, you will not have the char. contri. as a write off because Reg. 1.161-1 says

it shall not be double deductions.

Consider the above discussion assuming that Desi Snore ran a store for the sale of the dresses.

The best way would be for Desi Snore to buy, lend to Dinah, and then ^{Desi} sell them at the end of the year.

Supp. 3.8

Rule of Law

It must be shown a direct relationship between expenditure and biz.

*Country Club dues - if you can show that your biz increased due to the C.C. and for that you got more clients, deductible.

John here, worked for the ~~corp.~~ and was treasurer. He has problems ~~because~~ because he is treas. of a missile co. that has one client - U.S. Govt.

Even assuming that these were biz expenses on account of the biz, it is a problem of the Suttler problem of showing that he did not deduct an excess of things which could not be considered biz expenses. Further, the expenditure must be reas.

Was this expense his or that of the co.? Can a treas.

spend his money on somebody else's biz? See Jergens Case in notes, p. 201, prob. #5. Would an expense acct. help the Jergens prob. See Reg. 1-162-17 re expense acct. reporting.

We'll next discuss implications of a sale.

10 Nov. 59

Quaere: Is John's loss of \$2500 deductible? He must show that the home was for biz use. We are dealing w/ §165(c)(1).

Hypo: Suppose John = corp. and cape prop. = farm. Would y be a stronger case for the corp.? Farm has golf course on it & corp. makes mistakes. Under 165(c)(1), corp. would still have to qualify the farm as being primarily for a trade or business.

Quaere: Under §165(c)(2), would John qualify? Just remember that all losses are not deductible. If John had rented it out before he sold it, y would have been a clear conversion of the prop. to biz prop. ~~and the loss could be deducted~~ The loss basis is the fair market value or basis at the time of conversion. So, you can't capi-

Rental of Private Prop.

Conversion
of Pri. Prop. to
Biz Prop.

taxable on the depreciation of personal prop.

A rental or remodeling with a purpose (e.g. making doctors' offices) is fairly conclusive of an adequate conversion.

One who is in a trade or biz can, under the one head of expenses, deduct for depreciation, loss and other expenses. See §162, 167(c)(1), 165(c)(1) ~~and~~ re trade or biz.

Non-taxable: §212, 167(a)(2) and 165(c)(2). (If not in trade or biz.)

Gen. Rule
re Conversion

So, one who is a conversion of ~~per~~ prop. like a private home into biz prop. (e.g., by renting), ~~it~~ can be deductions for depreciation of the prop., janitorial salaries, maintenance, and the like, but ~~it~~ cannot have ~~be~~ deduction of loss.

* Attorney Fees *

Baer v. Comm.

(S. 208)

Atty. was retained ^{to} protect P's biz prop. The Comm. alleged the fees to be NOT deductible but the Ct. said they were deductible. Ct. held that the fees here and the activities of attys. were directed to the conservation and maintenance of prop. held by their client for income producing.

(§212)

purposes. — This case would not have been so decided in the Tax Ct. and the Lewis Case differed, too.

TEST: What prompts the litigation?? = If the whole proceeding stems out of something personal, fees not deductible.

On wife's side, re Lewis and Baer Cases, wife could deduct fees that are allocable to obtaining alimony. H could not deduct same if he paid W's atty's fees because you can't deduct others' expenses. It would be a gift to the W, and she, if anyone, could deduct.

Factor of Time: Expense or Investment? =

If you buy apt. bldg. \$800 and bldg. will last for 20 years, you will not be allowed full deduction the year of purchase. It would be allocated.

Expense or Investment?

Midland Empire Packing Co. v. Comm. (p. 220)

Quaere: What distinguishes a current benefit from a capital expenditure that must be allocated? The Comm. argued for the latter. P and Ct. classified work as

repair rather than replacement. - Hard to reconcile on the pt. of the increase in value of prop. Increase in value is taxable usually.

13 Nov. 59

If repair = expense
Replacement, betterment,
extension of ord. life of
prop = investment wh.
must be capitalized
§263 (no deduction allow-
ed for capital expendi-
tures).

General Rule
of Thumb

"Expense" in 162 + 212 (non-biz, gainful activity
expense) - you must deter. whether you
mean investment or biz expense.

If you have replacement rather
than repair, investment!, and it
must be capitalized (not current
expense).

In Sulgrave Case in note follow-
ing Midland Empire Case, TP got a
sprinkler system.

If the improvement will last
longer than 1 year, it cannot be
expensed but must be capitalized.

hypo: TP in rental (prop) biz has to pay
lawyer \$3000 defending suit for re-
cission by seller of apt. bldg. (to
TP). - Legal fees generally can be
deducted. These expenses arose out
of biz because TP is in real estate
biz. §212. Could this be part of the
cost of acquiring the prop? If so,
it would be added to the basis
and would have to be capitalized
not expensed. Would be recovered
by depreciation. This would probab-
ly be the result. Have to capitalize

Hochschild v. Comm. (p. 224)

Q. Why was TP's position here better than the position of TP in the hypo.? = TP here was protecting his position & the alleged wrong came out of something of his flavor. If TP had driven over someone w/ a car & defended w/ company funds, not deductible. But, TP here defended that the defense of this suit was protection of an asset and his position. Protection & acquisition of title speak of initial or expenditure rather than current operating expense.

Welch v. Helvering

Q. How long would TP benefit from the expenditure? = Indefinitely, because he acquired good will, and it was non-deductible because of acquisition of his expenditure. § 243.

Supp. Problem # 3.9

Q. Could Roy Rum deduct? If so, for what? The \$5,000 might be called a capital expense. The \$600 is the fee that had to be paid and would be for only one year & could be deducted. The \$4,400 would have to be capitalized because it lasts over a year and is premium. \$1,000 - could be argued by Comm. that this is, rather than cur-

Lobbying
Expenses

3.11

rent expense, an investment in good will. e.g., Ford Co. spends \$X million advertising Falcon? Is this current expense or an investment to create greater public reception? = Latter could be argued as being the same sort of limitation on Roy Rum. Same for a Ford franchise for \$100G. This \$10G could also be called Lobbying expenses, which are not deductible. Even if filtered thru an asso. (e.g., N.A.M.), still probably not deductible (per Sup. Ct. + Proposed Regs.)

* Fines, atty. fees for protecting against penalty for illegal activities and things like that, are not deductible. Are also against public policy. See also §§ 174, 175, 179. permitting write-off of certain expenses wh might otherwise be capitalized.

Even if Roy Rum could prove to a legal certainty that but for the \$1000 expenditure the M.C.A.E. would have the liquor licenses revoked, not deductible because this would still be lobbying, wh altho' not illegal per se, is not deemed to be sanctioned by public policy.

* What is "Ord. and Necessary?" * (5/62)

"Ord + necessary" is a limitation.

Friedman v. Dolan

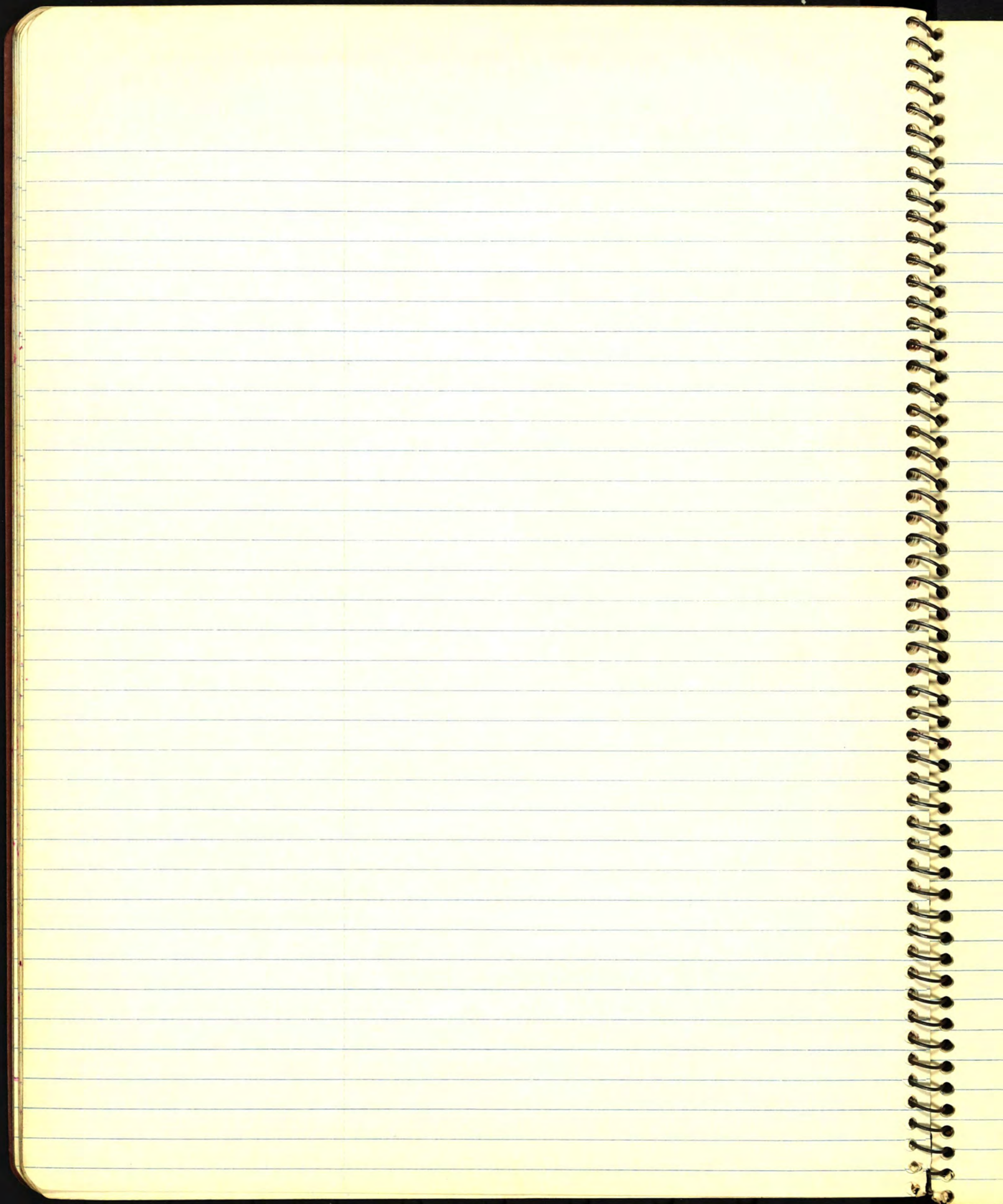
(p. 236)

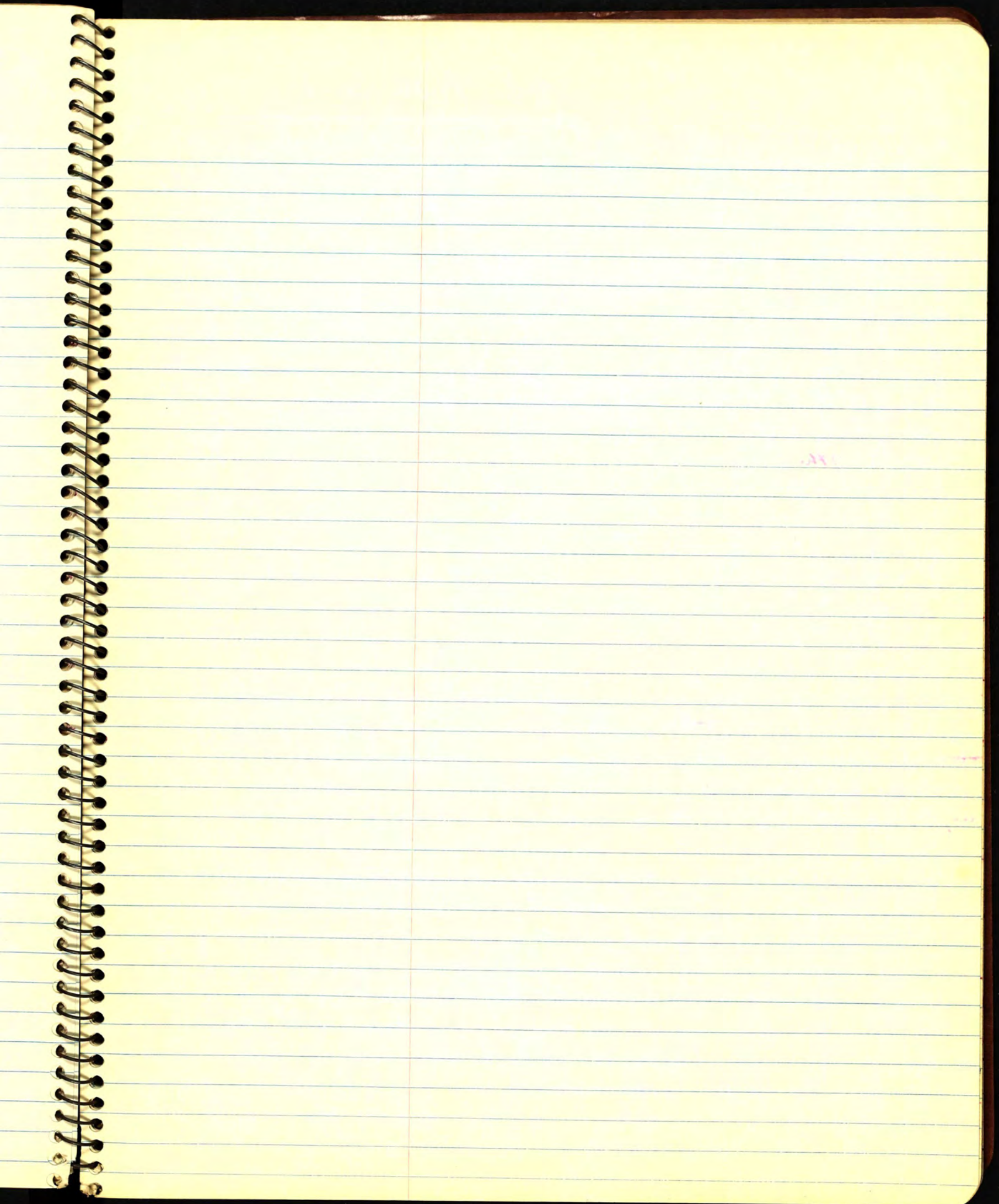
TEST.

P - lawyer payed out of his own pocket for creditor's composition in behalf of client-debtor. Comm. claimed that the expense was not required and was voluntary and more morally-inspired than necessary to P's biz. - Ct. agreed w/ Comm. and applied the above test to show that it was not an "ord. & necessary" biz expense.

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18 Nov. 59

Travelling Expenses

162(a)(2) = meals + lodging

162(a) = travel

Pick-up truck used by carpenter in his biz - deductible: An ord. & necessary expense

Peurifoy v. Comm. -

Generally, a TP is entitled to deduct unreimbursed travel ex- ~~not~~ deductible. Not "away from home."

penses under 162(a) only when they are required by "the exigencies of biz." However, it is an excep- ~~not~~ deductible. But in Peurifoy v.

tion wh. allows a deduction for expenditures of the type made for periods of time. If the

in this case when the TP's transportation expense can be

is "temp." as contrasted w/ "indefinite" or "indeterminate" are also deductible.

It would seem that the exception presupposes the "tax home" to be at Staying away from home

the "biz headquarters" of the TP, so that getting travel status (including

he is away from his "home." If he meals & lodging). Overnight is a cond. precedent to

is so away from "home" "temp." he is entitled to the deduction. But, if ~~his~~ activity is indefinite, then his convention is deductible. If wife goes

"tax home" shifts his post of duty or biz headquarters has shifted. along, not deductible unless it can

was "in pursuit of a trade or biz." Re convention, the TP must

show that his attendance was "in pursuit of a trade or biz."

If ~~minor~~ stockholder went to a stockholders meeting, not deductible

because not in pursuit of biz.

Supp. Prot. 3.13

Not deductible because TP had no home and thus he could not be away from home. So, his travelling

Home place that home deductible when even

expenses could not be deducted.

Supp. Problem 3.14

Is this a move of a permanent nature, a shift of biz home? Is it a biz in Belmont to be away from? Is an empty office a biz? How long do you have to stay away from your biz home? It could be well argued that TP here could deduct. A temporary trip will not shift the biz home. What is temporary?

In Pourifoy, Ct. said that unless the expenses are required by the exigencies of the biz, no deduction.

Supp. Prob. 3.15

Here, "home" = principal place of biz (per I.R.S.) so that TP is not "away from home" while y, but he may deduct his living expenses while at the minor post even if his family is located y.

Same as baseball player who has home in Stillwater, Okla. on he owns bowling alley. Also, because he plays for the White Sox, he lives in Boston for a part of each year. Which is the principal place of biz? Many factors are considered: how much time spent in each place, how much work done in each, comparative incomes, etc. Once that is decided, the expenses in the non-principal place would be deductible.

NOTE: New Case re med-travel expenses = food & lodging deductible.

20 Nov. 59

* Educational Expenses *

Tuition is considered personal or investment expenses, in the sense that it is an investment in one's future. So, 4 years of College + 3 years of law school aren't deductible.

Coughlin v. Comm.

(p. 231)

Ct. said that TP had already reached the plateau of achievement wh. colleges & law students are trying to reach. The tuition was to maintain what he had. Like repairs, not replacement. He was keeping current. Deductible.

Supp. Prob. 3.11

Altho' he may not be able to get trans. (if he's not away from home) under 162(a)(2), but may get it under 162(a). Educational expenses must be required by the job. But, if the education qualifies the TP for a new plateau, not deductible unless the job expressly requires the attaining of that new plateau. So, here the TP could deduct because of the express provision and requirement that he study more & get new degree.

* Bad Debts *

It is a difference between a biz bad debt and a non-biz bad debt (treated as a capital loss).

Comm. v. Smith

(p. 258)

Had to distinguish biz from non-biz bad debts. The latter do not come under 166.

Supp. Prob. 3.16

$\$1/2$ on bad debts =
7 years.

Unless the loan could be directly connected w/ advancing lawyer's biz, this would be a sticky problem and a strong argument could be made that this was personal & not biz.

Debt should have been collected in 1954. The question could be raised as to whether the oral promise by client could be suffi to prevent debt being worthless. Would $\$1/2$ bar the oral promise? Yes, it could if pleaded by the other party. In that case, the debt would be worthless in 1954.

24 Nov. 59

* Depreciation and Obsolescence §167 *

TEST

Another special biz deduction specially carved out. Applies only to prop. used in a trade or biz or gainful activity.

INVENTORY

Quaere:

Is an asset (prop) depreciable?? $\$1/2$ Would inventory be depreciable?? = No. Inventory not used in the biz but only held for sale. So, used cars on a lot are not used in the biz of the dealer, and it is not deductible. Inventory is not

up in 167 and is not depreciable. Inventory depreciation is specially provided for.

The obsolescence of a wasteable asset (shoes) is not sufficient to qualify as a depreciable item as obsolescence and depreciation apply only to prop. used in the trade or biz, or prop. held for the production of income, as the shoe inventory of a shoe store is held for sale.

Good Will * Good will? An intangible asset, but it is prop. which is used in the biz. But, good will not be depreciable because to be an asset must be a wasting asset and you must be able to allocate the depreciation. You can't show depreciation of good will. However, under § 177.4 is an amortization write-off of 60 months of ~~trade~~ trademarks.

Patents How will you take care of patents? ~~depreciable~~ depreciable because they have a set life per fed. law.

Methods of Depreciation:

- (1) Straight line method - equal amt. per each year for asset no. of years.

The other methods (explained in the Reg.) in 167(b) are methods of lumping a big amt. of depreciation in the first year.

Supp. Problem 2.18

~~depreciation~~ depreciation per year = \$2000.
Adjusted basis after two years = \$6500.

$$\frac{\text{COST} - \text{SALVAGE VALUE}}{\text{USEFUL LIFE}}$$

(straight line method)

$$\frac{\$10,500 - 500}{5}$$

$$= \$2,000$$

\$2000 depreciation per year

The Comm. might object because of the useful life of the asset (truck). On the straight line method, after two years, if T.P. sold truck he would recoup more than he should in comparison to the depreciation. So, as the useful life was really two years, ~~the~~ depreciation was too great. ∴ the depreciation was too great. — just what "useful life" means is a sticky problem & the Sup. Ct. has granted certiorari in three cases (Hertz Rent-a-Car, et al) to deter. "useful life."

Accounting + Inc. Taxation

METHODS

(1) Cash receipts -

Less sophisticated because the time of inclusion is determined by when the income is rec'd. Many businesses use this. Also, expenses are not deductible until paid.

(2) Accrual - payment not determining time. When the obligations to be paid & to pay arise, they are then reported.

CASH RECEIPTS AND DISBURSEMENTS

Under cash receipts & disbursements methods, if you constructively receive the money, income there. If you have a right to get money and it's available, constr. receipt.

Amend V. Comm.

(p. 626)

TP wanted payor to wait to pay him until the next year and same happened. But, TP had rec'd a note for money in the year of the work. TP had actually received something, so the question of constr. receipt is not involved.

Quaere: Was the note pymt. when the note was rec'd. ?? =

25 Nov. 59

* Trademark expenses - initial investment would be a capital expenditure. The 60-month write-off under the code applies not to capital investment (sec 177), but to atty. fees spent by TP in protection of his newly acquired prop. Atty. fees would be capitalized & added to basis.

Sec. 62 is the traffic cop re the standard deduction, telling what TP might lose ~~by~~ by taking the standard deduction.

Timing is not a moot question since TP may either benefit or lose depending on the year in wh the deduction is made.

Quaere: In Amend case, why was not y constructive receipt?

The consistency of TP here was such as to allow the Ct. to see that TP was not doing handturns that year to avoid taxes in that year. Consistency is important.

Annuity Constr. receipt applies on the right to and/or advantage of money as gotten by TP. So, if $\$2$ bought annuity for $\$2$ for $\$500$ per year, the flow of money not to begin until $\$2$'s retirement, it has been receipt the year of purchase as the $\$2$ then rec'd. the advantage of the future annuity. Here, fair market value can be assessed then (even tho' only a promise then) because of a strong & solvent Ins. Co. Could argue against taxation in year of purchase

"Normally, lawyers should be on cash."

on ground that γ is no guar.
the Ins. Co. will re-
main solvent.

Holding in
Amend Case

In Amend, the Ct. held
that a cash basis TP cannot
be deemed to have realized inc.
come at the time a promise to
pay in the future is made.
The obligation to pay being ~~uncertain~~
in the future renders ~~the~~
an element of uncertainty
and contingency, and ~~therefore~~ the
promise has no "market
value," fair or unfair.

Pymt. by
Check

If TP were paid w/ a
check, even post-dated into
the next year, actual receipt
then + taxable then.

Comm. v. Boylston Market Assoc. (p.631)

Ct. analogized to capital
proportion in allowing the
proportion of pre-paid
insurance premiums.

Notice, here too the Ct.
took a close look at the
consistency of bookkeeping
procedure. So, the premium pay-
ments had to be allocated.

ACCRUAL METHOD

Ga. School Book Depository, Inc. v. Comm. (p.633)

TP tried to argue that γ was no
reas. probability that TP would
be paid. In the accrual method,
 γ must be not only the

Assignment: Ch. 8 - pp. 622-639, 639-645 + 663-672, 673-688.

P. 60

Must be a reas. expectancy that pymt. will be made.

Acquisition of an obligation to be paid (or to pay), but must also be a reas. expectancy.

Rule of Law-

The TP need not accrue a debt if later experience, available at the time that the question is adjudged, confirms a belief reasonably held at the time the debt was due, that it will never be paid.

Auto. Club of Mich. v. Comm.

(p. 636)

Assignment:

Ch. 5, Capital Gains

12-2-59 : pp. 366-382

12-4 pp. 382-395

12-8 pp. 395-413

12-9 pp. 413-428

12-11 pp. 428-446

CLAIM OF RIGHT
DOCTRINE

If a TP receives earnings under a claim of right and w/o restriction as to its disposition, it has rec'd. income wh. it is required to return. Thus, since TP here rec'd prepaid dues under a claim of right, w/o restriction as to their disposition, ~~the~~ the entire amt. rec'd in each year should be reported as income. - Dissent here, too, p. 638.

1 DEC. 59

Like a dancing studio wh. receives prepaid tuition. The gen. rule is that a calendar year TP reports income only in the time between Jan. 1 and Jan. 1 of the next year.

The D here argued that he had an ~~an~~ obligation to apply the dues pro rata, and \therefore were not income until they were so applied. However, the Ct.

applied the Claim of Right Doctrine.

Schuessler v. Comm.

(p. 639)

* There are two methods of levelling off a big-income year:

- (1.) Deferral of income over a number of years.
- (2.) Lumping of expenses in the heavy year of income to lower tax liability.

The effect of the reserve fund was to lump the expenses.

When dealing w/ contingent obligations, accrual accounting will not permit a lumping of expenses. However, the Ct. allowed TP to defer his expenses. On the obligation is firm and the expenses are certain to be rendered, a reserve for future expenses will be allowed and lumping of expenses will be allowed. That's the test for accrual of expenses.

TEST FOR
ACCRUAL OF
EXPENSES

* Annual Accounting System *

Sec. 172 - 9 year spread in w/ allocation of net operating loss is allowed: 1 base year, 3 years back and 5 years forward. A refund on already paid tax can be gotten. This is essentially a big

loss. Thus, it is a limited spread-out year.

Secs 381 - 383 limit ability of a purchaser of a corp. to use the purchased corp's loss to spread out.

§1301 - re lawyers

§1302 - artists and inventors

Both of the above deal w/ people who may get a lump sum payment in one year on the work for wh payment is made lasted over a longer period.

§1303 - involuntarily withheld income is the common thread wh runs thru all of these sections.

* Items IN DISPUTE *

N. Amer. Oil Consolidated v. Burnet (p. 678)

If a TP receives earnings under a claim of right & w/o restriction as to its disposition, he has rec'd income wh he is required to return, even tho it may still be claimed that he is not entitled to retain the money, and even tho he may still be adjudged liable to restore its equivalent. Held, profits taxable to the co. as income of 1917, regardless of whether the co.'s returns were made on the cash or the accrual basis.

TP wanted to avoid having to pay the tax in 1917 because the rates were higher. TP argued either for 1916 or 1922. Ct. said that the TP actually got the money in 1917 even tho' the litigation in wh TP was involved did not finally resolve in his favor until 1922. Ct. applied Claim/Right Doctrine.

Sec. 1341 re refund of taxes wh
will allow spread out.

2 DEC. 59

* CAPITAL GAINS AND LOSSES *

§1221 - "For purposes of this Timing very important.

subtle, the term "capital asset" means prop. held by the TP (whether or not connected w/ his trade or biz), but does not include gains at 25% (thus, better than 1) stock in the trade of TP ord. income at 91%).

... wh could ord. be included

in the inventory of the TP if gains and losses here differ. Capital
on hand at the close of the losses are discriminated against.
taxable year, or prop.

held by the Quaere: Why are C.G. preferred? = The asset
TP primarily for sale to has appreciated over a long
customers in the ord. period of time; and to lump the
course of his trade or tax into the one year of
biz; asset disposition would be

2) prop., used in his trade unfair. Further, you don't want
or biz, subject to the to lock in capital. Argument
allowance for depreci- contra: should be taxed like ord.
ation ..., or real prop. income for wh TP had worked.
used in his trade or biz;

3) a copyright, a literary, Requisites to get C.G.:

musical, or artistic com- (1) Dealing w/ capital asset - but not
position, or similar prop. the only way. Can get C.G. w/o
held by dealing w/ cap. assets.

(2) Must dispose of asset in certain
way, sale ~~and~~ or exchange

§1222 implies this

(3) Must have held asset over 6 mos.

The gain must have appreciated over a period of time.

hypo: Suppose you swap stock for an apt. house. — Exchange can be taxable and will be only if it is a C.G. So, exchange is a taxable event. (rare exceptions.)

Quaere: How does the statutory variation affect C.G.?

Supp. Problem 5.1

(a) Taxed just like salary because it was a short term capital gain but in less than six months. Tax liab. $\$3830$.
The first three sections of the ITC show the schedules.

(b) $\$106$ = salary
36 = sh. term gain - just like salary
106 = long term capital gain.

236
- 56 = 50% of long term gain exempt $\$1202$

180 = taxable income.

"Using $\$206$ " = The alternative method would have helped X to save $\$510$ ($\$11,980$ [tax on $\$28,000$ - using $\$206$ here] - $\$11,470$ = $\$510$).

$\$28,000$	$33,000$
8,000	- 5,000
<hr/> 28,000	<hr/> \$28,000
- 5,000 ($\$1202$ deduct.)	
<hr/> 23,000	
10,000	
<hr/> 33,000	

In capital gains, under 1201, the deduction is 50% of ~~gross~~ capital gains not to exceed 25% of gross income. If it is over 50%, the alternative method is better to use.

§1201(b) is the alternative to the tax rate schedule.

[Don't get bogged down in §1222.]

\$ 18,000 - taxable income
- 10,000 - capital loss
\$ 8,000
+ 1,000
\$ 9,000

(c) Taxable income = \$9,000⁰⁰. The capital loss offset the \$3,000 short term gain ~~and~~ and he can add the \$1,000 ~~loss~~ from his income under §1211(b).

(d) You cannot depreciate a personal residence. When talking about gains and losses, you must still think in terms of the ones that are allowable ~~and~~ in conjunction w/ §165.

Supp Problem 5.2.

4 DEC. 59

Basis for Inheritance

Basis deter., when acquisition is by purchase, by cost thereof per §1012. Q. But, what about inheritance? §1014: fair m.v. at death, regardless of the decedent's basis. If it is an appreciation in the basis from time decedent acquired

Basis for Gift

- 1) For gain - Donor's basis
- 2) For loss - F.M.V. at time of giving

it and death, the appreciation is not taxed. Stepped-up basis

* Gift: \$1015(?) - a substituted basis will be the basis of the donor at the time of acquisition by donor. On this gift tax substituted basis, assume donor paid \$75 for stock and at time he gives it to X, it is worth \$50. 6 mos. later, X sells it for \$50. Is the loss recognized? No. The basis of donee for ~~loss~~ purposes is F.M.V. (\$50). (Shifting of basis for tax purposes held constitutional by Sup. Ct.) But, for gain purposes, the donee's basis is the cost to the donor at time of acquisition.

Under §1094 - a termination for a short break for 30 days either way from date of sale will prevent claim of loss, if any.

No loss allowed from sale of items to tax relatives (bro., sisters, lineal descendants). (around §1067).

How do you deter. basis of an income item (e.g., exer. of option offered by employer for stock)? If paid \$50 for share

of stock worth \$100. What's the basis? §421 - special allowance. Basis = fair market value at time of purchase + the amt. you must include as ord. income in your return (i.e., \$80 + \$20 = \$100 basis).

Build your own house - labor has no basis. Basis would be the out-of-pocket cost only.

Basis of real prop. must be adjusted (lessened) by depreciation.

An addition to house could not be currently expensed, but would be (capitalized) added to basis of house.

Supp. Prob. 5.2

Gain of \$256 realized on the swap. Is that gain recog.? Under §1001, if must be a sale for income to be realized, so actually it was no realization here. Under §1031, due to a swap of like prop., the gain would be postponed. The gain was not immediately recog. under §1031 because of a specific provision - if can be a tax on a swap of prop. because gain there

§1031 - does not include stock in trade or other prop. held primarily for sale, nor stocks, bonds, notes, shares in action, certs. of trust or beneficial interest, or other securities or evidences of indebtedness or interest.

Exchange of
Like Property

is realized. But, on like prop is swapped, §1031 defers the recog. of that tax due to policy considerations (just as tho' it has been no disposition of the prop.)

(Under §1031, the non-recognition is extended only on there is exchanged prop. solely for like prop.)

Suppose TP got cash in addition: e.g., \$50,000 in cash + prop. w/ F.M.V. = \$125,000. \$125,000 would be taxed since that's the difference between \$125,000 and \$100,000 (the basis of the old prop. exchanged - money rec'd + amt. gained - 1031(d)).

Securities don't come under §1031(d).

§1221 = Capital gains don't apply to the exceptions here listed. *Trade or sale of stock in trade = income. Would apply to cars held for sale and to bonds except on bonds are dealt in in great quantity. In latter, gain would be C.G. and loss = C.L.

BONDS

What Const. Capital Assets

Van Suetendael v. Comm. (p. 382)

Dealer
v.
Trader
in
Securities

A mere trader in securities (not a dealer), regardless of volume, selling to customers, who gets a gain has a capital gain and loss from sale to a customer = C.L. * If the sale is

to a dealer, neither C.G. nor C.D. - Merrill Lynch is a dealer and keeps a stock of securities and they are treated like regular inventories, eg. stock, bonds, cars, and they would be treated as ord. income.

It is preferable to have C.G. and C.D. because of the greater deduction allowed than ord. income. That's why P here (TP) was trying to get a refund from the govt.

8 Dec. 59

1221 - Capital asset defined.

In Bagley, rather loose reading of §1221.

In Suetindael, very strict reading of "capital asset" in §1221.

Corn Products - another loose reading.

In Bagley, bonds called a "biz asset" (not capital asset), hence y was ord. biz loss on resale. Still doesn't say that the bonds were part of inventory.

Ct. seems to have relaxed view on reading of 1221.

162 - Trade or Biz Expenses

Often Ct. will also resort to §162 to say that an "asset" is procured in the course of biz and hence is not a "capital asset," therefore a.

loss thereon is an "ord. loss."

Sale or Exchange - problems arise as to what this is.

Supp. Problem 5.3

p. 367 - Read at top.

Trustee required to give \$1,000,000 to legatee per will. Trustee then gave ~~\$500~~ \$500,000 worth of stock which had appreciated to \$1,000,000.

Questions were:

- (1.) Is the \$500,000 taxable?
- (2.) If so, to whom?

— Estate is taxable entity. Does pay an income tax while in existence.

— § 1001 says that there shall be a "taxable event" on "sale or other disposition of prop. or exchange of prop."

— If this had been a specific bequest, y would have been a "taxable event to the estate (Reason: X, against estate, has an ^{enforceable} claim). If, however, as here, the bequest given renders direction to the trustee, then this is not a "taxable event" "sale or exchange" w/in 1222.

W/ this result, y would be "ord. income" to legatee.

What legatee prefers is "sale or exchange" so that he will be taxed on capital gain.

— Could avoid this taxable event by giving trustee option to give \$1,000,000 or F.M.V. of stocks. Then X would not have a "claim" against estate, and, ∴, y would be no taxable event (income-wise).

How to Avoid Brand here.

when the prop. passed to him.

Pledge to a
Charitable Institution

Satisfaction of a pledge to a charitable institution is but a taxable event. Thus, if TP pledged \$1G + satis. by giving stock purchased for \$500⁰⁰, not a taxable event. TP would pay no tax on appreciation.

Redemption of Securities - held not to be a "sale or exchange."

§1232 equates retirement at maturity w/ C.G.

Sale or Exchange of Real Property

(Mauldin)

Malden Case ^(Sic) ^(p. 395) TP bought large piece of land. Subdivided and sold land in lots.

Was held that TP ~~was in the~~ ^{had} "ord. income" on the sale.

Ct. felt that TP was in the "biz" of selling prop., hence "pieces of property" comparable to inventory, ∴ "ord. income."

Must look to the facts of each case to deter. whether TP engaged in enough activity to put him in "business."

TEST

Case said the ultimate query is: the purpose for wh prop. is held.

§1237 - helps TP who has subdivided prop. for sale. Says that TP who must divide prop. to sell would ~~be~~ not be considered to be in the "trade or biz" of selling prop. Someone in really biz excluded even tho' he may allege that this particular parcel was not for his biz.

Requirements:

- (1) Hold for five years ^(except in case of device or insurance)
- (2) Disposing of inventory.

In Madden, "trader" in prop. had to pay on "ord. income" and in Van Sustendael, trader in securities had to pay only on C.G.

Supp. Problem 5.4:

1231 - creates an exception to §1231 - very complicated. Covers "depreciable prop. used in the biz." and ~~used in a trade or biz~~ "realty used in the biz."

to be w/in C.G. and C.G. provisions. (See Regs.)

Total gain from invol. conversion must exceed total losses for this sale or exchange; hence gain = ord. income. § to apply. If gains don't exceed losses, then the invol. cases of invol. conversion. (This was case of even a capital asset will be treated as an ord. loss. i.e., Capital assets

subject to treatment herein. Problem w/ 1231 is that it cannot include only capital assets in volun. converted. thereunder will be "capital" or "ord. inc."

The non-capital assets subject hereto are: (1) depreciable biz prop. Hodge-Podge and biz realprop. held for more than 6 months, other than stock in trade & certain copyrights & artistic property; (2) timber & coal; (3) certain livestock & unharvested crops.

Must be "netting" under 1231:
- If more gains than losses, then gains and losses are "capital."
- If more losses than gains, then both treated as "ord."

Rule of thumb under §1231: always try to keep the types of transactions in one yr. (Keep all gains in some year, and all losses in some year.)

Gain under 1231 will be "capital"

and loss thereunder will be "ord."
unless TP is caught in hodge-podge.
Must see relationship of 1231 + 1231.

9 Dec. 59

Pick up miscellaneous
problems at Roemele's
office.

Depreciable + real prop. used in biz are
not capital assets, under even 1231.

1231 used to provide against:
Here: warehouse cost \$506, insured for
\$1000. Burns down. \$506 gain.

Cts. have said this was no sale
or exchange of a capital asset. —

INSURANCE GAIN
ON PRIVATE RESIDENCE
(Involut. conver.
thereof).
Since home is not depreciable, it
is a capital asset and the gain from
insurance would be a capital
gain. — Due to Congress's

desire to protect against the
warehouse bit (not a sale or
exchange), 1231 brings that
situation under its wing. The
warehouse comes under the
"invol. conversion" provision.

Q. Suppose personal residence
burns down at a loss. Is that
a §1231 loss? Under 65, that would
be a casualty loss. Q. But, can you
have a capital casualty loss (ie,
not emp. insurance money to re-
coup your basis)? = Yes, both.
This would be under 1231.

Q. Netting principle of 1231 —

If you have an excess of 1231

Functions of 1231:

- 1) Taking care of "sale or exchanges"
- 2) Taking care of things like livestock
- 3) Taking care of the invol. conversion situations on a capital asset was not converted.

for the year
loss, over 1231 gain, each & every transaction in the taxable yr. is treated as ord. income. But, if the 1231 gains exceed the 1231 loss, other things being equal, it would be a capital gain.

SECTION 1034

Non-recog. of exchange of type A prop. (e.g., bldg. like home) for type B (e.g., stock). A split of prop. A for a part of prop. B ~~not~~ recog. either due to statute. 1034. e.g., Buy house for \$106 & sell for \$206. Then flow that \$206 back into another house. = Insulation provided here by 1034. = If you had bought a new house for \$156 instead of \$206, \$56 would not be insulated.

1034 applies only to primary homes (not to summer cottage).

Some of these sections apply only to gain and not to loss, so look carefully at these sections.

Century Electric Case

(p. 409)

Deals w/ sale and lease-back method: corp. doesn't want to tie up all of its funds at one time. So, it purchases bldg., sells to someone (maybe a charity) and that someone in turn leases back to the corp. - This was thought to be

a cure-all. Usually, a long-term lease is y, and the corp. pays yearly lease amt. i. not tying up all of its ^{at one time} ~~loot~~ ^{here}, y was a 95 year lease. TP sold for a fee ^{simple} and took the lease-back at a loss. But y is not a recog. of loss here!

Supp. Problem 5.5

The loss was recog. See Jordan Marsh Case at par. 1180 of C.C.H.
Q. Why is this different from the Century Elec. Case? = Sale here was for the FMV. In Century, sale was for less than the fair market value, and that amt. was cash rec'd in hand.

Q. If lease is less than 30 years? = Sale can be for FMV or fee, but not w/in protection of the Comm. if for less than 30 years.

Supp. Problem 5.6

§1231 - Q. would that section apply here?? = Regulations say it must be held for more than 12 months before §1231 would apply. The problem here is that the skins are being sold and not the animal itself. - Ct. said

TP/TP: This was a capital transaction. But, livestock culled Animals held exclusively for breeding purposes are out of herd x slaughtered x meat depreciable prop. used in sold, not capital gain, even tho

the trade or biz and even tho' sold when their usefulness for breeding is exhausted are not held for sale.

Hence they have always the livestock may have been un-
qualified under 1231. der 1031 at first.

Authors, Artists + Inventors - 1221

Artistic products, writings, music
not capital ~~assets~~. Distinguished from
inventions, patents.

If the invention is under the "in-
ventory" provision, not Capital asset.

110 Dec. 59

Royalties will be
treated as ord.
income.

PATENTS, INVENTIONS, COPY-
RIGHTS, MANUSCRIPTS and
Similar Prop.

(1) REQUIREMENT THAT
IT BE A CAPITAL ASSET

(2) REQUIREMENT THAT THE CAPITAL
ASSET BE SOLD OR EXCHANGED

Re patents, inventions, copyrights, man-
uscripts, and similar prop., capital
gains and losses would be realized
only if, under the gen. provisions of
the stat., the patent, copyright or
other ~~thing~~ item was a "capital
asset" and was "sold or exchanged."

To meet the first require-
ment — that the prop. be a capital
asset — the TP had to show that
it was neither held for sale to
customers in the regular course of
trade or biz nor depreciable prop.
used in the trade or biz.

Meeting the second requirement
— that the capital asset be
"sold" or "exchanged" — was easy
if the patent or invention was sold
for a specified sum. However, even
on the consideration for the sale
of a capital asset, ^{was not all rec'd.} during the year,
the taxpayer was entitled to a capital
gains limitation on the sums rec'd. in each year.

* Capital gains are better for TP than ordinary gains re less tax liability.
Rhodes' Estate v. Comm. (p. 419)

The dividend was sold. Dividend = prop., ~~but~~ and it was not w/in any of the exclusion of 1221, thus it was not thrown out of 1221. (good will is a non-depreciable asset = nondepreciable because π could be no apportionment of basis) If can be intangible capital assets.

Intangible Capital Assets
(e.g., Good Will)

If owner sold dividend after its declaration, the owner would have to pay tax himself, and not the purchaser. It was a debt past-due owed to owner; ~~and~~ he can't shift the tax liab to someone else.

TP here was trying to convert ord. to capital gains. When TP sells ^{right to} dividends before they are declared, owner will not pay but the purchaser will pay.

hypoi A. T. and T. has for 99 years paid a Dividend yearly. In 1959, before the 1959 dividend was declared, O \rightarrow Purchaser (TP). — This dividend, altho' made regularly for many years, is still contingent before its declaration. So, this would differ from Rhodes as when that dividend was sold, it has already been declared.

TIME

[The crucial time is the date of record (12-26, here).

Hort v. Comm.

(p. 421)

All TP had done was anticipate future rental income and deducted the difference between the balance of \$140,000 (given for discharge of lease by lessee from TP) minus $\$25,000 \times 15$ years, ~~and~~ and then fair rental value of the leased premises.

Ct. held that this could not be capital loss, and further that it was ord. income to TP.

McAllister v. Comm.

(p. 423)

TP won the case and was entitled to capital gains treatment. ~~Donor~~ Donor had relinquished her right to an estate per equity decree and TP got the estate (a remainder). The remainderman paid a lump sum to TP instead of conveying the prop. Ct. here held that the party receiving that \$50,000 (T.P.) had a capital gain and not ord. income. So, the proceeds were treated as income from the disposition of a capital asset. It illustrates a pretty good way to take capital gains and/or losses if you're a life tenant.

⊗ Hort was not allowed this way. ⊗ Why not? = Basically, the

McAllister
"right theory" of ~~that~~ was the difference. Greater contingency in ~~Hort~~.

Comm. v. Lake (p. 428)

Right to oil payments so much like ord. income that it will be treated as ord. income, even tho' dealing w/ capital asset.

Pittston v. Comm.

Sale of ~~the right to all~~ the right to all of the coal of X. Ct. held that this was an anticipation of ord. income, and would be treated as ord. income.

GENERAL
PROBLEM

In this section, the prob. of what kind of income you're getting arises because it is an instant sale of prop. (K itself) wch gives rise to right to the pymts. of the K.

Was unsuccessfully argued that this was a sale of a capital asset because the biz in tota was sold as one entity, and as such was not "held for sale to customers."

Is the sale of a going biz a sale of a capital asset?? = Each and every asset has to be looked at: bldg. may be cap. asset, but inventory may not be. If y is a sale of a corp. (except maybe a collapsible corp.), the sale of the ^{share of} stock is definitely a sale of capital assets.

Assignment:

12/15 - pp. 277 - 288
12/16 - pp. 288 - 301
12/18 - pp. 301 - 319

1/5/60 pp. 319 - 330
1/6/60 pp. 330 - 346
1/8/60 - pp. 346 - 365

15 DEC. 59

* CHAP. 4

SPLITTING OF INCOME *

Quaere: Who pays the tax on the income?
We have already handled what income is, and when the income is taxed.

* Here, we are trying to lessen the net tax by taking the money out of one high rate pocket and spread it among several low rate pockets.

You can't give away salaries, ~~and~~ rights to income, when assigned or sold, will usually still result in tax liability on the assignor or vendor.
But, the disposition of income producing prop. ~~must be~~ must be differentiated. When the income producing prop. is given away the new owner (donee) is the one on whom tax liab. thereafter falls.

PATENTS: is the income producing prop. the patent (or copyright) or the K for royalty rights?? =

Prop. in General On the prop. is shifted, the right to the income and the tax liab. thereon also shift.

In the patent situation, the K of royalties is a lesser included right.
The assignment of both creates the problem re whether y has been an asset of prop. or a right to

income.

Anticipatory ass^{mts} (e.g., of dividends on stocks on the right thereto has not yet firmed up) usually don't help deflect tax liability.

In the 1930s, family partnerships became popular (before joint returns allowed in 1948). This was often done by making your wife a partner, thereby splitting the income in half. ^{Is} any difference between this and the bare ass^{mt} of salary and salary rights (the latter being not allowed)? = If y were prop. in the partnership, y may be a difference and the income splitting may be allowed. Even on no services are required, y still may be allowed a pthrsip. and a splitting of income. See 704(c). But, you can't shift off income earned by your own personal services. Thus, law partnership probably could not be effectively used w/ wife to split income because the "prop." of a law partnership is services and wife would not, further, be contributing anything.

If you transfer prop., the tax is dragged w/ it so long as you

704(c)

really transfer the prop.; and, to the extent that strings are attached, the presumption of the shifting of tax liab. is lessened. Holds true for trusts.

16 DEC. 59

Lucas v. Earl

TP had to pay tax on his wages (income) even tho he had tried to assign his salary to another. Ct. held that he could not escape tax liab. by anticipatorily assigning his salary. Ct. didn't say this was not a valid ass^{mt}, but for tax purposes it failed to deflect tax.

Substantial Ownership - on the donor gives away some prop. and retains many strings of control. Have to read cases to see what retention of strings are O.K.

Congress enacted a provision allowing the Joint Return, thus putting married people on a par w/ those in states having Community Prop.

Supp. Prob. 4.1

\$20,000

-1,000 - stand. deduction

-1,200 - \$600 apiece personal deductions.

17,800 = \$6,100 in taxes w/o \$2.

= \$4,532 in taxes w/ \$2.

\$1,568 - difference.

* GIFTS *

H+W ked to have his salary, Lucas v. Earl (p. 289)
as community prop. - Ct. taxed it, Husband was taxed on it. As to her,
saying, "...the stat. taxes sal - it was a gift.

aries to those who earned them,
and provide that the tax could Declining of salary still might
not be escaped by anticipatory lead to taxation thereof. e.g.,
arrangements + Ks however On execution reaches the point
skillfully devised to prevent that he's getting only \$.09 on
the salary when paid from the dollar and announces
vesting even for a second in the that he will continue to
man who earned it. work, but does not want
salary.

Supp. Prof. 4.2.

(a) In the ~~second~~ first situation,
Compensation derived from Rooney would not be in good
personal services is taxable shape. On he donates before
to the one who performs the the show, just like Lucas
service whether or not he v. Earl; taxable to Rooney. The last
actually receives the comp. part, Rooney would not be
or trans the right to receive taxed because he has no control
it before it is earned. over on the money will go.
Lucas v. Earl, Same holds true The Bureau of Int. Rev. was worried
re the as ^{note} of comp. due in the here about an exceeding of the
future for personal services charitable contribution maximum
performed in the past. of \$ 30% of the adjusted gross in-
come. All of the facts of
each case must be con-
sidered.

Blair v. Comm.

(p. 292)
Here, the result differed from Lucas
v. Earl because an equitable interest
was given (part of a life estate)
and this was like the McAllis-
ter Case.

Helvering v. Horst

(p. 294)

Coupons of bond were given away and Ct. found that this was still taxable. TP had given away these coupons to his son. The Ct. did not accept the argument of TP that he was giving away the prop. and not the right to the income. Here, the coupon was one of many and was the one due to mature for the payment of interest that year.

* If all the interest coupons were given away, this would be like the Blair Case and the giving away of a life estate because the holder of the coupons has the right to receive interest for the life of the bond.

5 JAN. 60

* TRUSTS *

A trust is a taxable entity. Pays tax just like an indiv. would pay tax.

PARTNERSHIPS

Partnerships are not taxable entities, and a partnership is never taxed: - the pturs. are taxed individually.

To the extent possible, a trust (simple or complex) will pay no tax, but will act

as a conduit.

4.3

(a) Here, trust will have to file a return, but will pay no tax because it acts as a conduit and pays out all income. It has a distribution deduction, the bene. would pay the tax.
Sec. 651

(b) In a complex trust, the tax significance of it becomes more apparent and is more likely to be taxed. Assume \$3000 gross income. \$1500⁰⁰ would be the distribution deduction if the bene. (S) is paid only \$1500⁰⁰ annually. \$661 deals w/ complex trusts. S = \$1500⁰⁰ taxable. Trust = \$1500⁰⁰ taxable.

every trust w/ income of over \$600⁰⁰ must file return on or before 4-1.

Simple v. Complex trust - the " pays no tax under the conduit theory. The residual income that remains w/ the trust (complex) is taxable. - So, the simple trust is usually better if you want to avoid taxing the trust. Further, Simple has \$300⁰⁰ deduction. Complex has \$100⁰⁰ deduction.

Simple trust is taxed when

"THROWBACK" RULE

are capital gains added to the corpus. Capital gains must be added to corpus on state law so provides. ~~the~~ The complex or accumulation trust is limited by the 5 yr. throwback rule which limits the shifting of income into a low bracket trust from a high bracket bene.

(4.3(c))

The bene. would be taxed on \$2400⁰⁰ and the \$600⁰⁰ ~~would~~ be capital income added to the corpus, thus being taxable income w/ a \$300 deduction if a simple trust, \$100⁰⁰ if a complex trust.

Cortiss v. Bowers

(p. 307)

The language here sounds a lot like Lucas v. Earl. Ct. here held that the attempt to shift the taxability to the trust was ineffective. The grantor held too much control for this to be called an irrevocable trust.

POWER OF REVOCATION

So long as someone is adverse to the interests of the grantor, that adverse party could have control and ~~power to revoke~~ could be wife if she is economically adverse to grantor (e.g., wife = bene.).

RULE OF LAW RE
REVOCABLE TRUSTS

Adversity = substantial adverse econ. interest wh would be cut off if the trust were ended. e.g., a bene. can hold the power to revoke.

A revocable trust is not effective to shift the tax from the grantor to the trust.

If grantor retains power to revoke and son of grantor is bene. who gets \$2000 annually from the trust, the son would not be taxed because it would be a gift.

4.4

The trust is discharging his ^(grantor's) own duty to support the children. And, this would not shift or avoid tax. So the trust would be taxed on the full \$6000.

If the kids got the income and spent it on necessities or what have you the trust will not be taxed on that amt.

Suppose the trustee accumulated the full \$6000 one year and paid out nothing to the children? - Trust is taxed.

If grantor tells trust to

"accumulate the income for the children, but if I fall short, you (the trust) pay for their education. - Due to this string retained by the grantor, he would probably be taxed.

§677(b) - obligations of support. This would seem to allow the sort of phrase in prot. 4.4. However, the phrase "in the discretion of" would pose some doubt as to the allowability of that sort of phrase. To the extent that the money is actually used, under 677(b), that is taxed.

Hsloering v. Clifford (p. 312)
Here, the grantor was taxed and the trust was irrevocable for five years.

6 JAN. 60

NOTES: \$600 casualty loss = long term capital loss.
§1231 justifies this. This could be applied to the car in the problem that we had, if could be an invol. conversion of a capital asset (line 6 of 1231 Reg. 1.1231-1 (e) [as (d) ~~applied~~]).
When dealing w/ losses, §165 is the first hurdle regardless of what kind of loss it is.

In Clifford Case, it becomes apparent

that you can shift off income of ~~the~~ ~~income~~ producing prop. by transferring the prop. But, ^{NOT} on the transferor retains strings which would allow him to get back the ~~of~~ corpus. For tax purposes, this trust was not a suffi transfer to shift tax liab. from the transferor. This was a family trust and I was a close family rel. It retained almost every power of admin. wh made him trustee, and the trust was to last only for five years. All of these factors would convince the Sup. Ct. that the trust was perfunctory. The mere transfer of legal title is not suffi of itself to make the transfer effective for tax purposes.

Quaere: Why would the length of ~~time~~ of trust's duration be important? = TP has not really given away anything. It amounted to no more than a mere loan and a loan is not suffi to shift tax.

All of the factors surrounding a transfer in trust must and will be judicially considered.

If a trust lasts for ^{less than} 10 yrs,
it is not effective as a trust
for tax purposes.
Clifford codified in §673,
674 and 675.

4.5

Grantor has reversion and
power of reallocation of in-
come from stock among
the kids.

The trust does not fail
~~due~~ due to reversion be-
cause the limitation is
10 years under §673. A
trust for less than 10 years
will fail solely by vir-
tue of insuffi length.

Power to re-allocate
income as between A, B & C
(X can't get anything
until 20 years later) =
under §674, this factor does ~~not~~
disturb the trust because
X did ~~not~~ have "beneficial
enjoyment" — even tho' not
economic — by being able to
control which of the kids
would get how much. So,
§674 would step in here
and say that X has re-
tained too much power over
the corpus, so that X would
be taxed.

Comm. v. Clark

(p. 319)

Held, it was unconstitutional to

to set an arbitrary date line of 10 years as being a deprivation of due process. The effect of this holding was to void the "Clifford reg."

A reg. would not be unconstitutional but would be void. If it properly interprets the statute, the stat. is unconst., not the reg. However, §673 is not unconstitutional since Clark was ltd. to its facts.

In 4.5, the power to repurchase at his orig. cost basis is had and would hurt the argument in favor of a good trust.

8 JAN. 60

Read §673, 674 and 675 to learn criteria for deter. validity of short term trusts.

Person ~~is~~ other than grantor treated as substantial owner. §678.

Funk v. Comm.

This did not come under (p. 323) §678 because P did not have substantial underlying control over the trust so as to allow govt. to treat her as the owner.

Family Partnerships

The pturshp. is not a taxable entity. It does file a return, but it's only an informational return. The pturs. are taxed in their own indiv. capacity on the share each receives from the pturship. Taxed per degree of pturship. e.g., 60-40 pturship, or 50-50.

Family pturship offered chance to shift income from earner to non-earner.

4.6

- Y is taxable because he owns the income producing prop.
- Son would be taxed on his share because he owns that share.
- X would still be taxed because mother's interest was not owned "in which capital is a material income producing factor." This was a circuitous attempt to deflect income in the Lucas v. Earl fashion on TP attempted to assign his income paid for personal services.

Does the asserted ptur. render vital services to the pturship. If so, this aids recog. of that person

as ptur. Did that person render capital? If so, pturship more probable

Main Test: did the parties intend to create a pturship?

What kind of pturships could come under 704(e)? Law pturship. would not be - cause an interest therein would not be an income producing factor (unless the new "ptur." was a lawyer).

The tests of orig. ~~capital~~ capital paid into pturship. and/or vital services, are no longer particularly applicable.

4.6

- d. The three took $\frac{1}{3}$ each of the income of the pturship. - \$16 $\frac{2}{3}$ G ($\frac{1}{3}$ of \$50 G). But, the question must be asked whether it was income producing capital; And, the ans. is yes: the \$1000 produced income of \$500. X could give away whatever share he wanted same as giving away 50% of A.T. & F. stock and thereby making the donee(s) thereof liable for the tax on the income from that stock. That split w/ the two

Sons could be even tho' the sons are out of the country.

Here, if was income producing capital and \therefore any amt could be given away and create a plurship. for tax purposes. The test is whether capital is a material income producing factor.

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Sec. 704(c) - Congressional attempt to define when partner will be recog. in a donated share situation.

A plur. can, in some scts., be taxed even tho' he contributed neither services nor money, e.g., in an apt. house or shares of stock. Capital must be a material income-producing factor. So, there can be a donee plur. or you give away the prop. wh produces the income.

4.6(d)

Capital here is a material income-producing factor.

Will the ~~plur.~~ be taxed $\frac{1}{3}$ each? No, because of father's services contributed quite a bit to the income. So, must place something akin to salary to father.

\$306 was the amt. earned by services of father. That left \$156 as the amt. to be equally distributed between the three: \$52 each.
Re services of donor - 704(e)(2).
—\$306 was arbitrarily picked as the going rate for father's services on the market.

- (2) Here, X retained many strings. Income will be taxed to the owner of the income-producing prop. Was X the owner? One feature would be complete management, power to deter. how the money will be spent, et al. (see Regs. for list of factors). What will be patris or X has all of the determinative factors on his side. An accumulation of the factors = X paying the tax. On title is retained, presumptively he will be taxed. But, that's not necessarily true if other factors showing valid partnership are y.

FAMILY CORPORATIONS

No deduction on dividends paid out of corp.
Corp. (not partnership) is a taxable

entity,
Doerston v. Comm.
Oliphant v. Comm.

p. 341

The kind of stock given away was not on a plane with the kind of stock retained. Result was the retention of control in TP and shifted some income to TP's wife.

Corp. = separate taxable entity even under a diff. rate schedule or structure. Because it is a taxable "person," income can be shifted to it.

Comm. v. Laughton

p. 342

TP farmed his services out to Corp. for \$1,000 and corp. sold the services for \$500. The result was that \$400 was deflected. (Chas. Laughton). But, Ct's. will look to see if the Corp. is only a sham. Laughton Corp. here.

Other Intra-Family Arrangements and Transactions

Henson v. Comm.

p. 346

T/TP. Why did this differ from Oliphant case? TP kept on doing same job but transferred biz to wife and he drew a salary from the corp. TP tried to tax W as being TP's (H's) income. The salary meant that he was getting paid for his

services. If he had no salary & worked w/ one part of the money rec'd by wife would be allocated to services of TP - the going rate for such services.

Look to see if it has been an effectual transfer. Did the Transferee have substantial ownership? If so, effective trans. If not, transferor still taxable.

13 JAN. 60

Shareholder not taxed until he draws his money from (i.e., out of) corp.

Share = capital asset.

But, if you sell your stock back to the corp. - stock redemption - in some cases it will be taxed as ord. income. §302.

It is a stepped-up basis to the stock when the holder dies w/ it.

Accumulated Earnings Tax - "old 102" (1939) tax. Tries to prevent TP from accumulating dividends in corp. unless the dividends are needed by

the corp. Stepped up tax. Anticipated needs of corp. suff.
If less than \$100 & accumulated, can't be touched by tax.

Incorporated ^{personal} Holding Co. - if the corp. has no real purpose except that of retaining dividends, 85% tax. - Never good to use this.

In some situations, it's good to use the "accumulated earnings" measure: \$100 & minimum; corp. may have needs. Way up in the figures, maybe better to pay the penalty tax rather than withdraw the accumulated stock earnings.

You never have dividends unless the corp. accumulates a surplus from which the dividend can be declared.

Selling back to corp.:

1. If complete liquidation by TP = capital gains rate.
2. If partial liquidation by TP = may or may not be capital gains rate.

Chamberlain Case p. 551

(NOT RESPONSIBLE FOR CHAP. 6: THE CORP. AND ITS STOCKHOLDERS.)

Must satis. §302,

Seems like double tax: against corp. and TP (stockholder) when he gets dividend.

Why can't stockholder claim it is a loan to the corp.? This has been & still is hotly litigated, esp. since this is risk capital.

Deduction for interest - must be interest on indebtedness. §163
Forms ~~of~~ Doing Biz

On γ is a hybrid - for biz purposes = corp.; for tax purposes = almost partnership (subchapter S of Code [1958]). Must be small (10 shareholders or less and only one class of stock outstanding, regardless of worth of corp. - may be worth billions). Treated as ptshp. for tax purposes. TP can switch back & forth, so long as you don't do so too often (5 years).

Corp. has ltd. liability.

If you anticipate losses in beginning years of biz, better to have ptshp. because losses will

1,100

be, ord. and can be deducted from
ord. income; and, ~~if~~ is no
year - limitation (on capital gains,
5 forward + 3 back -?).

Suppose employees of corp. = share-
holders? Corp. may be allowed to
deduct social security and
workmen's comp. taxes wh the
Emps pay.



21

g

1959 (Jan.) EXAM

Question #1 ① TP must pay, but when: 59 or 60 (prob. 60)

② S/L

③ Gift to hospital (20% + \$10,000) or to the organ, for the hospital (20% of income only allowed, thus γ would be \$20 deduction more than allowed. 20% of \$180,000 = \$36,000

④ Maybe he could get comm. to pro rate the dividend on analogy of trust (but doubtful). This is stock, and the only real code provision re amortization is on bond ~~profits~~ income.

Question #2

Basis (10/14) = value ^{at death of testator} ~~to be paid~~ - i.e., \$39,000.

Re 50% loss, γ can be fair market value ~~not to exceed~~ of loss not to exceed basis. Basis of prop. lost = \$5,000

Fair M.V. = \$750 ($\frac{1}{2}$ of \$1,500 ^{deduction})

Capital loss? Not if the bushes were inventory or held for sale. Every roses or bushes held for sale. If capital loss, under 1013 - invol. conversion.

Sale of lots

Basis = \$4,000

+ 2,000 - capitalize the roads & sewerage.
\$6,000

10,000

16

16,000

- 6,000

10,000

Under 1237(a) - gain - what kind of gain.

5% = ord gain

95% = capital gain.

Flower Shop & Greenhouse

Basis = 35,000

Basis of Apt. = 20,000

FMV of Apt. = 35,000

Sale of Flower Shop & Greenhouse = 40,000

Exchange of unlike prop. results in recognition. This is not like prop. (Query this) therefore there is 5,000 gain (capital).

Deluxe? If unlike prop., 20,000 gain (capital).

Basis under 1031 if the gain is recog.

Deluxe's Basis = 20,000

Ronald's Basis = 35,000

} If under 1031 (see also 1012)

On gain isn't recog.
under 1012

Improvements = capitalize it + add to the basis of 40,000 (will last more than one year). $40,000 + 1,500 = 41,500$

when was offer accepted? 1-1-58 or in 1957? Prob. 1957.

Basis 41,500

- 1,000 depreciation

40,500

50,000 sale price

- 40,500

9,500

40,500

- 20,000

20,500

+ 9,500

30,000

This was exchange of like prop.
It was held for more than 6 mos.

Note: on boot accompanies exchange, a short cut is the FMV of the prop. rec'd.

Could this be inventory? No, it's being used,
Corp. - See §351

Basis to Corp. = \$306 (basis of apt. bldg.)

Basis of stock to Renaldo = \$35,000

Basis to corp. = \$306

+ \$56

352 basis to corp. if money = prop.

Sec. 362 - Basis to Corp.

If money (\$56) not prop., basis would be ~~\$351~~ applies to "prop." Does it apply to money + prop.?

Cost of prop. was \$60,000. So, Renaldo has basis of \$60,000.

If he had to pay the mtge., contribution to capital of corp. = \$606.

If ~~he did~~ corp. has to pay the mtge., contrib. to capital = \$156.

Being a corp., this was a good gift.

Is the \$156 dividend or return of capital? Dividend; paid out of earnings of profit.

Basis of stock of Renaldo = \$35,000

Gave away 25 shares, so 25% of \$35,000 = basis to Genovino. (= \$8,750)

\$15,000

- 8,750

\$6,250

- ~~did income + shares sold back to corp.~~
Capital gain because of §302

PROBLEM #3

\$900 - lobbying expenses - not deduct.

\$4400 - ~~capitalized~~

Good will ^{query} raised re Care gift.

Is the decrease in value of Roy's biz due to increase in licenses deduct?
Is it ord. & necessary as biz expense? Can't expense it (the \$2000 difference).
Can't get ord. loss. But, when he sells he can take it as a capital loss. His only recourse here.

Sending liquor to members? Is it an investment for good will? If so, can capitalize it.

If other liquor works it, would this be "ord. & necessary" biz expense?
Query?

Care gift - gift to charity, can take the full \$600 as deduction.

\$1200 (fines/penal) - against public policy so not deductible. *Tonk Truck Rentals Case.*

Problem #4

(a) The \$1000 per mo. ~~is not income~~ (but ~~right~~ certain death benefits to widow, \$5000 limit on exclusion to widow, so, \$36,000 - 5000 = \$31,000. Must be "by reason of death."

- (b.) Would ~~the~~ ^{it} be capital gains or loss of \$3000.

Did she have a right to the income?

Was it even a prop. right?

Probably ordinary loss because she's not selling capital investment but merely sale of a right to income (if this is a right = only custom of Co. to pay this; no K or legally enforceable right).

- (c.) See §677 wh rebuts, for this purpose, 676

- (d.) If he's in biz of loaning money, would this be a biz loss? Probably ord. biz loss of \$10,000

She gave, but how much & when?

If she's accrued TP, she has given (dealing w/ note). If cash receipts + disburse TP has not given anything and can't deduct it then. (No impact when returned by ABC.) When given back by ABC, if she accrued she may be able to get the gift tax she paid back.

Either gift or contribution to capital, no tax impact to company.

V.

