SYLLABUS
INCOME TAX
SPRING 2003
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• BOOK:
  o CD: Willis, Income Tax (Cases, Statutes, & Materials) [available at Wilbert’s].
    ▪ If you only use a MACINTOSH computer, let me know before you purchase the CD.
  o Optional: Printed version of the classroom notes from the CD [available at Wilbert’s].

• SOFTWARE:
  o Adobe Acrobat Reader 5.0. This is available free at www.adobe.com. It may also be provided on your gatorone disk.
    ▪ Version 4.0 is probably fine, but earlier versions will not always work with my materials.
    ▪ If you need to install a new version, be sure to uninstall the old version first, then install the new.
  o As an option, you may want to purchase Adobe Acrobat Exchange 5.0, which is available at an academic rate of $59 to $100 (depending on where you shop). This would allow you to edit and supplement my materials. This is not necessary, however, and I do not expect many, if any, of you to purchase this program.

• Internal Revenue Code and Regulations.
  o A printed edited version in a single volume is sufficient - several publishers make them available. You should have a new copy - one dated 2002, OR
  o Some of you may want to have a complete set, which includes two volumes of Code and six volumes of regulations. It is quite expensive. I require the complete set for my LL.M. classes. Occasionally, in this course, the edited version is not sufficient; however, that is not common and is easily overcome. If you purchase the complete set, keep in mind that you will need to have several volumes with you in class. Also, if you take future tax courses, you may need a new edition, as the Code and Regs change frequently, OR
A copy of my Comprehensive CD ROM, available at Wilbert's. **This includes a copy of the Code and Regs.** For me, the electronic version is best; however, many students prefer a printed. You should have access to a copy in class.

**OPTIONAL:**

Several good treatises are available. I recommend:

- Chirlestein, Federal Income Tax (Foundation Press)
- Bittker & Lokken, Federal Taxation of Income, Estates, and Gifts (Warren, Gorham and Lamont)
- Lind & Hudson, Income Tax (West Blackletter Series)

**PREPARATION:**

Students generally view this as a difficult course, which builds from week to week. Therefore, inadequate preparation may cause you to become hopelessly lost. I do not, however, expect perfection in class. As a student, I preferred to spend about one-third of my study time preparing for class, and two-thirds reviewing. This meant that I was less prepared than many others; however, I continually reviewed. I strongly recommend you do the same. If you are unprepared, or underprepared, for a particular class, please attend anyway.

**PARTICIPATION:**

Much of our time will be spent working problems. This method is conducive to class participation. I like to take many questions, so do not be afraid to ask them.

**OFFICE HOURS:**

*Monday* from 10:00 a.m. until 11:00 a.m. in Office 331 and from 2:00 to 3:00 in Room 190A.

Tuesday and Wednesday from 10:00 a.m. until 11:00 noon in Office 331.

**CLASS DAYS and TIMES:**

Monday 11:00 to 12:50.

Tuesday, Wednesday, 11:00 to 11:50.

**E-MAIL and INTERNET:**

My office e-mail address is: willis@law.ufl.edu.

My Web Site address is: [http://nersp.nerdc.ufl.edu/~acadian](http://nersp.nerdc.ufl.edu/~acadian). On it you will find further information regarding this course, including old exams, announcements, essays, and notes.
In the first class, I will ask you to provide your email address so that I can add you to a listserve.

**COURSE CONTENT:**

This is a fundamental course and text. We will cover some issues in depth and others lightly, if at all. In all events, you should concentrate on the Code mostly, and the regulations secondarily. I want you to read the cases; however, I am much more concerned with your ability and willingness to read the Code and Regulations. Also, in most instances, the problems are important.

**ATTENDANCE:**

I will pass around a seating chart, which I ask that you initial. Attendance, participation, and preparation may have some impact on your final grade.

**ASSIGNMENTS:**

These are fluid, so check the web and your email frequently. Most of the problems on the CD and slides are from the Burke/Friel casebook. I will substitute my own problems during the semester. Although I cannot provide you with written answers to the Burke/Friel problems, I can allow you to view – in my office – a copy of suggested answers.

For the First Class, prepare a very brief statement of what you would like from this course: perhaps you want to concentrate your practice on real estate, or perhaps estate planning, or family law, or tort, or perhaps you want to concentrate in tax. Whatever it is, I would like to know so that, as the opportunity presents itself, I can identify issues that will particularly interest some of you. This will help all of you maintain a perspective of what we are doing and how it relates to other subject. My knowing who is interested in what will help me to help you. Please put your name on this and your prior degrees.

- **Week One:**
  - Read Topic One.
    - Whether you have income or a deduction.
    - When does this occur.
    - How Much income or deduction occurred.
    - Who's income or deduction was it.
    - What is the Character of the income or deduction.
  - Read the cases listed on Slide 17. Compare I.R.C. § 61, defining gross income, to Amendment 16, detailing the extent of Congress’ authority to tax income. You may also want to briefly examine I.R.C. §§ 62 and 63, defining adjusted gross
income and taxable income - two other important terms. *Glenshaw Glass* is important in defining a "realization event." Pay some attention to the cases cited on page 31. *Cesarini* is not a particularly important case, however it illustrates two important issues: treasure trove is income and it becomes so when it is found. *Old Colony* and Rev. Rul. 79-24 are important in showing that income need not be in cash and need not be paid to the taxpayer. *McCann* is interesting both for the *Old Colony* issue and for its approach to the question "How Much." *Pellar* is interesting both for its answer to the *Old Colony* issue (Whether) but also to its effect on the When question (although this aspect of the case is a bit hidden).

- Read Rev. Rul. 91-36, which raises questions similar to those above. I will provide you with a copy; however, I really want you to learn how to find a Revenue Rule. You'll find them in the Cumulative Bulletin, published two or three times per year. I have copies in my office, so stop by to look at them.

- Read Topic Two A and work the problems distributed or on the CD. This chapter presents two landmark cases (North American Oil and Indianapolis Power) and one important one (James). On a surface level, the chapter considers whether question in terms of an obligation of the recipient to repay or restore whatever was received. On a more sophisticated level (to which we will refer later) these cases establish some of the basic framework or tax law. North American Oil created the "claim of right" doctrine (discussed now), and also helped create the "timing" notion that "every year stands alone." This is part of the "When" question and we cover it in chapter 29. *James* reinforces this issue. Indianapolis Power helps elucidate the meaning of a "deposit" as opposed to a "claim of right," which is a critical part of chapters 27.IV.B. (dealing with cash method prepayments) and 28.IV.B. (dealing with accrual method receipt of prepayments).

**Week Two:**

- Continue with above, if not complete.

- Read Topic Two B and work the problems on the CD or as distributed. *Philadelphia Park* (page 79), a seemingly unremarkable case is actually very important for three reasons (be familiar with them).

- Be familiar with the following code sections:
  - section 1012 -- cost basis
  - section 1016(a)(1) -- adjusted basis
  - section 1001 -- gain

- *Philadelphia Park:*
Taxpayer built a bridge in 1889. Taxpayer transferred the bridge to city in 1934 in exchange for a ten year franchise on a passenger railway. In 1946, with three years left on franchise, taxpayer abandoned it.

Taxpayer needs to know its basis in the franchise to determine depreciation and loss.

This famous case stands for three important propositions:

1. "To maintain harmony with the fundamental purpose of these sections [1001, 1011, 1012], it is necessary to consider the fair market value of the property received as the cost basis to the taxpayer."

2. "The failure of taxpayer to properly record the transaction in 1934 and thereafter does not prevent the correction of the error . . .."

3. "[T]he value of the two properties exchanged in an arms-length transaction are either equal in fact, or are presumed to be equal."

The third proposition is the one for which the case is famous: essentially, if you cannot value one side of a transaction, but can value the other, then do so and presume they are equal. This should hold true in an arm's length transaction.

The second proposition is a bit beyond this chapter, but is the most profound. We will discuss it in relation to Chapter 29.

The first proposition is the one I find most fascinating: tax cost is the fair market value received in a transaction, not the fair market value given up. This should be counterintuitive to you because you likely think of cost as what you give up rather than what you receive.

If the taxpayer properly reports the transaction, the rule is not important. This is true because most people would describe tax cost as the basis given up plus the gain or loss recognized. This amount will necessarily equal the fair market value received because section 1001(a) provides that gain recognized equals amount realized minus basis. Thus, algebraically, basis plus gain equals amount realized.

Basis is a store of aftertax dollars. Once a taxpayer has been taxed on value (or properly excludes that value), he effectively has basis (although it does not make particular sense to speak of basis in currency).

For example, if your employer pays you $1000 for services, you have $1000 income and $1000 "basis" in the dollars or in whatever you purchase with them. That way, if you sell the item you purchase, you will not again be taxed, unless you receive more than $1000 for it.

If your mother gives you $1000, you will not be taxed on it because of the section 102 exclusion; however, you will nevertheless receive a cost basis in it.
or in whatever you purchase. [section 1015 supports this idea] Otherwise, you’d be taxed when you sold the item and this would frustrate the intent of section 102.

Similarly, if your employer provides you with a permitted employee discount on an item, you will have no income under section 132(b) and will receive a full fair market value basis in the item. For example, you purchase a refrigerator from Sears, where you work, for $1000 but the normal price is $1500. Assuming this is a permitted discount, you will nevertheless have a $1500 basis. Thus, if you sell the refrigerator for $1500, there will be no additional income. Essentially, the tax rate on the extra $500 was zero -- it is thus theoretically aftertax value.

- Read the *Crane* and *Tufts* decisions, which are arguably the most important of all tax cases. This are very difficult, so go slowly. Some of the issues involved will make much more sense later in the course.

- **Week Three:**
  - Read Topic Two C and work the problems on the CD or distributed. The *Duberstein* case is landmark. Often, however, it is cited for the lesser of its two propositions. First, it explains that gifts, which are nontaxable under section 102, arise from "detached and disinterested generosity." Second, and more importantly, it explains how to evaluate a transfer arising from mixed motives - both compensatory and gift. The test it announces is subject to criticism. *Wolder* and *Olk* are interesting illustrations of the *Duberstein* issues.
  - Read Topic Three. I will lecture on this topic. It introduces some important notions, but ones which are not part of the building blocks of tax law.

  The main thing you need to learn here is, in my opinion, the comparison among section 72, 101(c), 101(d), and 104(a)(2).

  Per section 72 -- private annuities -- an annuity purchaser must set up an exclusion ration to be applied to each payment. It will exclude a portion of those payments, with the remainder being included.

  Section 72(b) provides the ratio as the "investment in the contract" divided by the "expected return"

  Section 72(c) defines the investment as essentially the cost basis. The expected return is the sum of expected payments. If it involves a life annuity, the annuitants life expectancy per the estate and gift tax annuity is used to determine expected return.

  The section 72 exclusion ratio ends once the annuitant fully recovers the "investment in the contract". This applies to a life annuity for which the annuitant outlives his life expectancy. Also, if a life annuitant dies early, his final return has
a deduction for the unrecovered investment. Each exclusion of a payment is a "recovery" of investment.

Section 101 excludes life insurance proceeds paid by reason of the death of the insured. Some exceptions apply for policies transferred for consideration. Naturally, if a recipient invests life insurance proceeds, any income earned is taxable -- interest or dividends, etc. -- unless some other code section excludes it (state and local bond interest per section 103, for example).

But, it the recipient leaves the money with the insurance company and receives interest thereon, the interest is fully taxable per section 101(c).

Or, if the recipient leaves the money with the insurance company and receives an annuity in exchange -- but not specifically interest -- then section 101(d) provides a "proration" of the amount left with the company. This is effectively the same as the section 72 "exclusion ratio", although it is termed a proration. The amount left with the company is essentially the same as the section 72 "investment in the contract", although it can be the result of a present value formula. The difference between this section and section 72 involves a recipient who accepts a life annuity from the insurance company in lieu of the proceeds. The "proration" amount [which is excluded as each payment is received] continues even if the annuitant outlives his life expectancy. And, the annuitant does not receive a deduction for unrecovered proration, if he dies early (neither does his final return).

Section 104(a)(2) excludes personal injury awards -- which is a very broad concept. This is true, even if the award or settlement is structured to be paid over a period of years or someone's life. Economically, such a structured series of payments is an annuity and includes a substantial interest component; nevertheless, the government conceded that none of the payments are taxable if the award is for personal injury.

If, instead, the injured person accepts the lump sum and invests it, the income will be taxable. If he purchases an annuity, he must use section 72 to compute an exclusion ratio, which will result in substantial amounts being taxed. Thus this provides a huge loophole for sheltering income. It comes at the risk of violating the sage advice "don't put all your eggs in one basket."

• **Week Four:**
  - Read Topic Four regarding Discharge of Indebtedness and work the problems on the CD or distributed. The code provisions are intricate and will take some time deciphering. *Kirby Lumber* is a landmark case. *Zarin* is a fascinating case and has been subject to considerable criticism. It is also relevant to some important notions covered in a later chapter. Read *Gehl* carefully, particularly for the notion of how this compares to the *Tufts* decision (above).
• Be familiar with sections 108 and 1017. Most classes find this to be a difficult chapter; however, it is important, so we must cover it.

  o Read Topic Four B regarding Fringe Benefits. This is an interesting but not particularly important area, in my opinion. We will go through the Code sections and the problems; however, we may do so quickly. You need to understand the general idea of how fringe benefits are taxed; however, I do not care about the details of section 132.

• Week Five:

  o Read Topic Five, dealing with business expenses. and work the problems on the CD or as distributed. The Welch decision is important both for its discussion of "ordinary and necessary" and also for Cardozo's poetic description of the test. Higgins is also an important building block for its discussion of what constitutes a trade or business. Groetzinger is interesting in its general continuation of the Higgens facts and circumstances test. Rockefeller and Rev. Rul. 75-120 are helpful in understanding the deductibility of job hunting expenses.

  o Be familiar with section 162 and 212.

  o This topic may not take the entire week, so be prepared to move ahead.

• Week Six:

  o Read Topic Six, dealing with capitalization and depreciation and work the problems on the CD or as distributed. Idaho Power and Boylston Market are very important cases dealing with capitalization. We will revisit Boylston Market in relation to Topic twelve. The other cases are interesting. You should spend time contemplating the differences between Midland Empire and Mt. Morris. Be familiar with the depreciation calculator.

  o Read the portion of Topic Seven, dealing with losses and bad debts. Be familiar with section 165 and 166.

  o Read the portion of Topic Seven, dealing with Travel Expenses concentrating on the code sections and the Generes case. This is an important topic. Part of its importance, however, involves Character issues, which we will not fully discuss until later.

  o Glance at the portion of Topic Seven dealing with Entertainment and Business Meals and the Code sections listed. I will discuss them quickly. Glance at the portions of Topic Seven dealing with Education Expenses, Moving Expenses, Legal Expenses, and Clothing.

  o Generally read sections 163,164, 280A, and 280F.
• **Week Seven:**
  - Read Topic Eight and work the problems on the CD or distributed. Each of the cases is important. Section 1231 is an intricate but highly important code section. The *International Shoe* case is quite important, as is the *Malat v. Riddell* decision cited therein. Be familiar with the use of the calculator for this.
  - Be sure to read the text accompanying this Topic.

• **Week Eight:**
  - Read Topic Ten dealing with Family Tax Issues and work the problems distributed.
    - Concentrate on sections 72, 215, and 1041.
    - The presentation contains much more material than we can cover in a single week, so expect to skip much of this during class (although you should read through all of it).
  - I am in the process of revising this chapter for a presentation to the Florida Bar in January. I hope to have the revised version available before this week (or at least a draft).

• **Week Nine:**
  - Read Topic Eleven, dealing with Charitable Contributions. I will likely provide a much simpler version of this; otherwise, we would need to spend much more than the two hours I have allotted.
  - Read Topic Sixteen, dealing with Related Party Transactions. This is likely too long to cover completely, but you should be familiar with the sections involved and how they generally work.

• **Week Ten:**
  - Read Topic 12, dealing with the Cash Method of Accounting. Work the problems on the CD or as distributed. You should read Chapter Seven of my book on this subject. You should be familiar with the inclusion doctrines of constructive receipt, cash equivalence, and economic benefit (including the controversy involving application of this doctrine). You should also be familiar with the deduction rules, particularly those involving the *Zaninovich/Grynberg* controversy and the *Burgess/Battlestein* controversy.

• **Week Eleven:**
  - Read Topic 13 and work the problems on the CD or as distributed. You should read Chapter Eight of my book on this subject. [I hope to have a much shorter version available for you].
• Read Section 453.

**Week Twelve:**

• Read Topic 9, dealing with non-recognition transaction (to be distributed). In particular, be familiar with sections 1031 and 1033.

**Week Thirteen**

• Read Topic 15 (to be distributed) dealing with Assignment of Income. The first three cases, *Earl, Horst*, and *Eubank*, are landmark decisions. *Salvatore* is an interesting illustration of the *Court Holding Company* (cited therein) doctrine. *Stranahan* is a fascinating case which illustrates the acceleration of income doctrine (as distinguished from the assignment of income doctrine).

• If time permits, glance at sections 7872, 483, and 1272-86. I will cite you to appropriate supplementary material (available on the CD, but quite complicated, so I’ll prepare a simpler version.)

**Week Fourteen:**

• Read Topics Seventeen and Eighteen and work the problems on the CD. For those who are interested, read Chapters 1, 2, and 5 of my book, which cover the same topic. As they comprise a couple hundred pages, however, they are generally beyond this basic course. Nevertheless, I’d be quite pleased if you chose to read them.

• I may choose to eliminate this topic and use the time for a slower pace.

**Week Fifteen:**

• Review.

• I have made several old exams available. We can work them in class if demand exists for me to do so.

**Exam (open book and four hours)**

• You may take the exam either in person or electronically.

• You may use the CD (and any other written or electronic materials) for either an in person or electronic exam.

• **Electronic Exam:**

  - I will post the exam on my web site approximately five minutes prior to the scheduled time. If you cannot locate the current exam on my web site by the scheduled begin time, it will be because you are viewing a prior version of the page from your cache. You should press the re-fresh or re-load button on your web browser. You may also want to dump your cache and re-boot. If this does not work, email me immediately.
During the Spring 2000 exam, several students using AOL had problems downloading the test. Thus, if you plan to use AOL, let me know in advance and I will explain the prior problem and the solution.

- It will be available in PDF, Word, and WordPerfect formats. If you require a different format, please let me know well in advance. Please do not use Microsoft Works.

- You should download the exam, answer the questions in the space provided or as indicated and then email it to willis@law.ufl.edu by the scheduled due time. **DO NOT USE ANY OTHER EMAIL ADDRESS.**

  - I will send you a confirmation of my receipt. Keep this along with a digital copy of your answers.

  - In the past, some students have sent their answers to the wrong address and then left town, neglecting to inquire as to the consequent lack of a receipt confirmation from me. I cannot grade something I do not receive.

- Be sure to save your file frequently, as some students have had computers crashes during prior exams.

- Name your answers using your exam number. For example, if your exam number is 1234 and you use Word, call it 1234.doc. Do not include any other letters or digits in the name of the file (this makes my records simpler and grading faster).

- On the subject line of your email returning the exam, identify your exam by your exam number, using only the digits. This will help me quickly locate all the exams through my email program.