

The Fundamentals of Federal Taxation

*Carolina Academic Press
Law Advisory Board*



Gary J. Simson, Chairman
Dean, Mercer University School of Law

Raj Bhala
University of Kansas School of Law

Davison M. Douglas
Dean, William and Mary Law School

Paul Finkelman
Albany Law School

Robert M. Jarvis
*Shepard Broad Law Center
Nova Southeastern University*

Vincent R. Johnson
St. Mary's University School of Law

Peter Nicolas
University of Washington School of Law

Michael A. Olivas
University of Houston Law Center

Kenneth L. Port
William Mitchell College of Law

H. Jefferson Powell
Duke University School of Law

Michael P. Scharf
Case Western Reserve University School of Law

Peter M. Shane
*Michael E. Moritz College of Law
The Ohio State University*

The Fundamentals of Federal Taxation

Problems and Materials

Third Edition

John A. Miller

WELDON SCHIMKE DISTINGUISHED PROFESSOR OF LAW
& DEAN EMERITUS
UNIVERSITY OF IDAHO COLLEGE OF LAW

Jeffrey A. Maine

PROFESSOR OF LAW
MAINE LAW FOUNDATION
UNIVERSITY OF MAINE SCHOOL OF LAW



CAROLINA ACADEMIC PRESS

Durham, North Carolina

Copyright © 2013
John A. Miller and Jeffrey A. Maine
All Rights Reserved.

ISBN: 978-1-61163-210-1
LCCN: 2013934479

CAROLINA ACADEMIC PRESS
700 Kent Street
Durham, North Carolina 27701
Telephone (919) 489-7486
Fax (919) 493-5668
www.cap-press.com

Printed in the United States of America.

To Maggie, Ben and Alex

- Jack Miller

To My Mother and Father

- Jeff Maine

Summary of Contents

Preface and Acknowledgments	xxv
-----------------------------	-----

Part I: Basic Structure of the Income Tax

Chapter 1	Introduction	3
Chapter 2	Gross Income	17
Chapter 3	Gains and Losses from Dealings in Property	33
Chapter 4	Gifts and Inheritances	49
Chapter 5	Discharge of Indebtedness	63
Chapter 6	Fringe Benefits	77
Chapter 7	Business and Investment Expense Deductions	93
Chapter 8	Capital Expenditures	103
Chapter 9	Depreciation and Amortization	129
Chapter 10	Deductible Personal Expenses: Casualty and Theft Losses	147
Chapter 11	Other Deductible Personal Expenses: Taxes, Interest, Charitable Gifts, Moving Expenses, and Medical Expenses	163
Chapter 12	The Deduction Hierarchy: Adjusted Gross Income, Taxable Income, the Standard Deduction, and the Personal Exemptions	175
Chapter 13	Timing Rules and Related Principles	191
Chapter 14	Ordinary Tax Rates and Taxpayer Classification	209
Chapter 15	Tax Credits	219
Chapter 16	First Review Problem	225

Part II: Characterization of Gains and Losses from Property

Chapter 17	Capital Gains and Losses	227
Chapter 18	Quasi-Capital Assets	247
Chapter 19	Recapture of Depreciation	257
Chapter 20	The Charitable Contribution Deduction	263
Chapter 21	Second Set of Review Problems	283

Part III: Real Estate Taxation

Chapter 22	Residential Real Estate	285
Chapter 23	Hobby Losses	303
Chapter 24	Like Kind Exchanges	315
Chapter 25	Involuntary Conversions	329
Chapter 26	Installment Sales	337
Chapter 27	Limitations on Deductions	347

Part IV: Intellectual Property Taxation

Chapter 28	Intellectual Property Development and Acquisitions	359
Chapter 29	Intellectual Property Sales and Licenses	379

Part V: Family Taxation

Chapter 30	Assignment of Income	395
Chapter 31	Alimony and Support	413
Chapter 32	Transfers of Property Between Spouses or Incident to Divorce	427
Chapter 33	Education Benefits and Costs	441

Part VI: Tax Consequences of Litigation

Chapter 34	Personal Injury Recoveries and Punitive Damages	453
Chapter 35	Attorney's Fees	475

Part VII: Deferred Compensation

Chapter 36	Retirement Resources and Deferred Compensation	493
------------	--	-----

Part VIII: Business Entity Taxation

Chapter 37	Overview of Entity Taxation	507
Chapter 38	Corporate Formations	519
Chapter 39	Partnership Formations	529

Part IX: International Taxation

Chapter 40	Overview of International Income Taxation	543
------------	---	-----

Part X: Estate and Gift Taxation

Chapter 41	Overview of Estate and Gift Taxation	557
------------	--------------------------------------	-----

Part XI: Tax Practice and Procedure

Chapter 42	Tax Practice and Procedure	571
------------	----------------------------	-----

	Table of Internal Revenue Code Sections	595
	Table of Treasury Regulations	605
	Table of Administrative Pronouncements	609
	Table of Cases	611
	Index	619

Contents

Preface and Acknowledgments

xxv

Part I: Basic Structure of the Income Tax

Chapter 1	Introduction	3
A.	Tax Policy	3
1.	Fairness	4
2.	Efficiency	4
3.	Neutrality	4
B.	Structure of Current Income Tax System	5
Computational Overview		6
C.	Tax Reference Resources and Authorities	6
1.	Internal Revenue Code	6
2.	Treasury Regulations	7
3.	IRS Rulings and Procedures	7
4.	Case Law	8
5.	Legislative History	9
Tax Research Caveats		9
D.	The Structure of This Book and How to Use It	10
<i>Mayo Foundation v. United States</i>		11
Chapter 2	Gross Income	17
I.	Assignment	17
II.	Problems	17
III.	Overview	18
A.	The Definition of Gross Income	18
1.	The Realization Requirement	19
2.	Statutory Exclusions from Gross Income	19
3.	Long-Standing Administrative Practices	20
B.	Gross Income May Be Realized in Any Form	21
C.	A Note on “Basis”	23
D.	Impact of Obligations to Repay	23
IV.	Materials	24
<i>Commissioner v. Glenshaw Glass Co.</i>		24
<i>Cesarini v. United States</i>		26
<i>Old Colony Trust Co. v. Commissioner</i>		29
V.	Related Matters	30

Chapter 3	Gains and Losses from Dealings in Property	33
I.	Assignment	33
II.	Problems	33
III.	Overview	34
	A. Sale or Other Disposition	35
	B. Computation of Gain or Loss Realized	35
	Gain Realized	36
	Loss Realized	36
	1. Amount Realized	36
	2. Adjusted Basis	36
	C. “Recognition” of Realized Gain or Loss	37
	D. Impact of Liabilities in Property Transactions	38
	1. General Framework	38
	2. Specialized Aspects of Debt in Property Transactions	39
IV.	Materials	40
	<i>Philadelphia Park Amusement Co. v. United States</i>	40
	<i>Crane v. Commissioner</i>	42
V.	Related Matters	47
Chapter 4	Gifts and Inheritances	49
I.	Assignment	49
II.	Problems	49
III.	Overview	51
	A. General Exclusionary Rule for Gifts and Inheritances — § 102(a)	51
	1. Exclusion for Inter Vivos Gifts	51
	2. Exclusion for Bequests, Devises, and Inheritances	51
	3. Policy Reasons Behind Section 102(a)	51
	B. Statutory Limitations on the Exclusion — § 102(b) and § 102(c)	52
	C. Basis of Property Received by Gift, Bequest, Devise, or Inheritance	53
	1. Property Acquired by Gift	53
	2. Property Acquired by Inheritance	53
	3. Basis and Tax Planning	54
	D. Part Sale, Part Gift Situations	55
IV.	Materials	56
	<i>Commissioner v. Duberstein</i>	56
	<i>Wolder v. Commissioner</i>	59
V.	Related Matters	61
Chapter 5	Discharge of Indebtedness	63
I.	Assignment	63
II.	Problems	63
III.	Overview	64
	A. “Contested Liability” or “Disputed Debt” Exception	64
	B. Bankruptcy and Insolvency Exceptions	65
	C. Debt Discharge Outside the Scope of Debt Discharge Rules	66
	D. Discharge of Recourse Debt in Property Transactions	67
	E. Tax Treatment of the Lender	67
IV.	Materials	68

<i>United States v. Kirby Lumber Co.</i>	68
<i>Preslar v. Commissioner</i>	68
V. Related Matters	74
Chapter 6 Fringe Benefits	77
I. Assignment	77
II. Problems	77
III. Overview	78
A. The Major Exclusions Under Section 132	79
1. No Additional Cost Services and Qualified Employee Discounts	80
2. Working Condition and De Minimis Fringe Benefits	80
B. The Strange Case of Frequent Flyer Miles	81
C. Meals or Lodging for the Employer's Convenience	81
D. Employment Related Payments from Third Parties	81
E. Employer Provided Health Care Benefits	82
IV. Materials	83
<i>J. Grant Farms, Inc. v. Commissioner</i>	83
<i>Charley v. Commissioner</i>	88
V. Related Matters	90
Chapter 7 Business and Investment Expense Deductions	93
I. Assignment	93
II. Problems	93
III. Overview	95
A. The Main Provisions	95
B. Some Limitations	95
C. Section 162(a)—General Principles	96
1. Ordinary and Necessary	96
2. What is an "Expense"?	96
3. Carrying On	97
4. Trade or Business	97
D. Substantiation	98
E. Section 162(a)(1)—Reasonable Salaries	98
F. Section 162(a)(2)—Travel Expenses	99
1. Where is Home?	99
2. Commuting Expenses	99
3. The Sleep or Rest Rule	100
4. Temporary Reassignments	100
G. Section 212—Investment Expenses	100
IV. Materials	101
<i>Welch v. Helvering</i>	101
<i>Jenkins v. Commissioner</i>	103
<i>Henderson v. Commissioner</i>	106
V. Related Matters	110
Chapter 8 Capital Expenditures	103
I. Assignment	113
II. Problems	113
III. Overview	114

A. Section 263(a)	114
1. In General	114
2. Distinguishing Deductible Expenses from Nondeductible Capital Expenditures	115
3. Capitalization Rules Governing Tangible Property	117
4. Capitalization Rules Governing Intangible Assets	120
B. Section 263A	121
IV. Materials	122
<i>Midland Empire Packing Co. v. Commissioner</i>	122
<i>Mt. Morris Drive-In Theatre Co. v. Commissioner</i>	124
V. Related Matters	127
Chapter 9 Depreciation and Amortization	129
I. Assignment	129
II. Problems	129
III. Overview	130
A. Depreciation of Tangible Property	130
1. Applicable Recovery Period	131
2. Applicable Depreciation Method	132
Determining the Straight-Line Percentage	132
3. Applicable Convention	132
4. Example of ACRS Depreciation	133
B. Bonus Depreciation	135
1. Section 179	135
Planning Pointer	135
2. Section 168(k)	136
C. Amortization of Intangible Property	136
IV. Materials	137
<i>Simon v. Commissioner</i>	137
Revenue Procedure 87-56 (Excerpt)	143
Revenue Procedure 87-57 (Excerpt)	144
V. Related Matters	146
Chapter 10 Deductible Personal Expenses: Casualty and Theft Losses	147
I. Assignment	147
II. Problems	147
III. Overview	149
A. A Look at the Tax Treatment of Business, Investment, and Personal Losses	149
B. The Personal Casualty Loss Deduction	149
C. Rationale for the Deduction	150
D. Proof of Causation	150
E. Measuring the Loss	151
1. Effect of Reimbursements	151
2. Examples	151
F. Restrictions on the Deduction	152
1. The \$100 Threshold	152
2. The Ten Percent of Adjusted Gross Income Threshold	152

G. Adjustments to Basis for Casualty Loss Deduction and Reimbursements	153
IV. Materials	153
<i>Chamales v. Commissioner</i>	153
T.C. Memo 2000-33	153
<i>Blackman v. Commissioner</i>	159
88 T.C. 677 (1987)	159
V. Related Matters	162
Chapter 11 Other Deductible Personal Expenses: Taxes, Interest, Charitable Gifts, Moving Expenses, and Medical Expenses	163
I. Assignment	163
II. Problems	163
III. Overview	164
A. Qualified Residence Interest	165
B. State and Local Taxes	166
C. Charitable Contributions	167
D. Moving Expenses	167
E. Medical Expenses	168
IV. Materials	169
Revenue Ruling 87-106	169
Revenue Ruling 2003-57	171
V. Related Matters	172
Chapter 12 The Deduction Hierarchy: Adjusted Gross Income, Taxable Income, the Standard Deduction, and the Personal Exemptions	175
I. Assignment	175
II. Problems	175
III. Overview	177
A. Itemized Deductions Versus the Standard Deduction	177
B. Miscellaneous Itemized Deductions	178
C. Personal and Dependency Exemptions	178
Getting to Taxable Income	178
1. Qualifying Child	179
2. Qualifying Relative	180
3. Phase Out Rules	180
IV. Materials	181
Form 1040	181
Form 8332	187
V. Related Matters	189
Chapter 13 Timing Rules and Related Principles	191
I. Assignment	191
II. Problems	191
III. Overview	192
A. Introduction	192
B. The Cash Method	193
1. Income Under the Cash Method	193
2. Deductions Under the Cash Method	195

C. The Accrual Method	196
1. Income Under the Accrual Method	196
2. Deductions Under the Accrual Method	197
D. Principles Applicable to Both the Cash Method and the Accrual Method	199
1. The Claim of Right Doctrine	199
2. The Tax Benefit Rule	199
3. The Ancillary Effects of Paying Expenses with Services or Appreciated Property	200
IV. Materials	200
<i>Ames v. Commissioner</i>	200
<i>Schlude v. Commissioner</i>	204
V. Related Matters	208
Chapter 14 Ordinary Tax Rates and Taxpayer Classification	209
I. Assignment	209
II. Problems	209
III. Overview	210
A. Introduction	210
Computing a Final Tax Liability	211
B. The Rate Structure for Ordinary Income	211
1. The Basic Rates	211
2. The Principle of Progressivity	211
C. Taxpayer Classifications	212
1. Marital Status	213
2. Surviving Spouse	214
3. Head of Household	214
D. Alternative Minimum Tax	215
IV. Materials	216
Revenue Procedure 2013-15 (Excerpt)	216
V. Related Matters	218
Chapter 15 Tax Credits	219
I. Assignment	219
II. Problems	219
III. Overview	220
Computing a Final Tax Liability	220
A. Non-Refundable Credits	221
1. The Dependent Care Credit	221
2. The Child Tax Credit	221
3. The Hope Scholarship Credit and the Lifetime Learning Credit	221
B. Refundable Credits	222
1. The Credit for Withholding on Wages	222
2. The Earned Income Credit	223
C. Ordering Rules	223
IV. Related Matters	224
Chapter 16 First Review Problem	225

Part II: Characterization of Gains and Losses from Property

Chapter 17 Capital Gains and Losses	227
I. Assignment	227
II. Problems	227
III. Overview	229
A. The Mechanics of Capital Gains	229
Net Capital Gain	230
Net Long Term Capital Gain	230
Net Short Term Capital Loss	230
1. The Sale or Exchange Requirement	230
2. The Capital Asset Requirement	231
3. The Holding Period Requirement	233
4. Special Characterization Provisions	233
5. Determining the Appropriate Capital Gains Rate on “Net Capital Gain”	234
B. The Mechanics of Capital Losses	236
IV. Materials	237
<i>Bynum v. Commissioner</i>	237
<i>Williams v. McGowan</i>	242
V. Related Matters	244
Chapter 18 Quasi-Capital Assets	247
I. Assignment	247
II. Problems	247
III. Overview	248
A. Transactions to Which Section 1231 Applies	248
B. The Mechanics of Section 1231	249
C. Recapture of “Net Ordinary Loss”	251
D. Summary	251
Section 1231 Checklist	252
IV. Materials	252
<i>Wasnok v. Commissioner</i>	252
V. Related Matters	254
Chapter 19 Recapture of Depreciation	257
I. Assignment	257
II. Problems	257
III. Overview	258
A. Recapture Under Section 1245 for Tangible Personal Property	258
1. An Overview	258
2. The Statutory Mechanics	258
B. Recapture Under Section 1250 for Real Property	260
C. Characterization Under Section 1239	261
IV. Materials	261
Revenue Ruling 69-487	261
V. Related Matters	262

Chapter 20 The Charitable Contribution Deduction	263
I. Assignment	263
II. Problems	263
III. Overview	264
A. Introduction	264
B. The Structure of the Code: Sluices and Gates	265
1. Defining Terms	265
2. Section 170(e)	266
3. Sections 170(b)(1)(A) & (B)	267
4. Section 170(b)(1)(C)	267
5. Section 170(b)(1)(D)	267
The Charitable Deduction Summarized	268
C. Gifts of Intellectual Property: Section 170(m)	268
D. Bargain Sales to Charities	269
E. Substantiation	270
F. Tax Policy and the Charitable Deduction	270
G. Tax Planning and the Charitable Deduction	271
IV. Materials	271
<i>Sklar v. Commissioner</i>	271
V. Related Matters	281
Chapter 21 Second Set of Review Problems	283

Part III: Real Estate Taxation

Chapter 22 Residential Real Estate	285
I. Assignment	285
II. Problems	285
III. Overview	287
A. Home Office Deductions	287
B. Vacation Home Deductions	289
1. Use as a Residence	289
2. Deductible Expenses and Their Limits	290
C. Exclusion of Gain on Sale of Residence	291
1. Ownership and Use Requirements	292
2. One Sale Every Two Years Limitation	293
3. Amount of Exclusion	293
4. Principal Residence	294
5. Tax Planning	295
IV. Materials	295
<i>Popov v. Commissioner</i>	295
<i>Guinan v. United States</i>	298
V. Related Matters	300
Chapter 23 Hobby Losses	303
I. Assignment	303
II. Problems	303
III. Overview	304
A. Distinguishing Hobbies from Business or Profit-Seeking Activities	305

B. Allowable Deductions	306
Section 183 Checklist	307
IV. Materials	307
<i>Nickerson v. Commissioner</i>	307
V. Related Matters	313
Chapter 24 Like Kind Exchanges	315
I. Assignment	315
II. Problems	315
III. Overview	316
A. Introduction	316
B. Determining Like Kindness	317
C. Planning the Exchange	318
D. The Mechanics of Section 1031	319
1. Exceptions and Timing	319
2. Boot and Recognition of Gains and Losses	319
3. Basis in New Property and in Boot Received	320
Aggregate Basis Under § 1031(d)	320
Basis of Like Kind Property Received	320
4. Holding Period	320
E. Assumptions of Liability	320
F. Illustrations	321
G. Depreciation Recapture	323
H. Mixed-Use Property	323
IV. Materials	324
Revenue Ruling 77-297	324
Revenue Procedure 2008-16	325
V. Related Matters	327
Chapter 25 Involuntary Conversions	329
I. Assignment	329
II. Problems	329
III. Overview	330
A. Involuntary Conversions	330
B. Similar or Related in Service or Use	331
C. When Replacement Must Occur	332
D. Basis and Holding Period of Replacement Property	332
IV. Materials	333
<i>Clifton Inv. Co. v. Commissioner</i>	333
Revenue Ruling 64-237	335
V. Related Matters	336
Chapter 26 Installment Sales	337
I. Assignment	337
II. Problems	337
III. Overview	338
A. Introduction	338
B. The Mechanics of Section 453 and the Defined Terms	339
Gross Profit Ratio Formula	339

C. Dispositions of Installment Notes: Section 453B	341
D. Contingent Payment Sales	343
E. Installment Sales with Unstated or Understated Interest	343
IV. Materials	344
Revenue Ruling 79-371	344
V. Related Matters	345
Chapter 27 Limitations on Deductions	347
I. Assignment	347
II. Problems	347
III. Overview	349
A. Introduction	349
B. The At Risk Rules	350
1. The At Risk Limitation	350
2. The Effect of Losses and Distributions on the At Risk Amount	350
3. Qualified Non-Recourse Financing Exception	350
4. Recapture of Prior Deductions under Section 465(e)	351
5. Examples	351
C. The Passive Loss Rules	352
1. In General	352
2. The Statutory Framework	352
3. Special Exception for Mom and Pop Rental Real Estate Activities	353
4. The Effects of Dispositions of Passive Activities	353
5. The Definition of “Activity”	353
6. Coordination Between Sections 465 and 469	354
D. Why Does the Tax Law Use These “Basket” Approaches?	354
IV. Materials	355
Excerpt From Senate Report 99-313	355
V. Related Matters	358
 Part IV: Intellectual Property Taxation	
Chapter 28 Intellectual Property Development and Acquisitions	359
I. Assignment	359
II. Problems	359
III. Overview	360
A. Intellectual Property Development	361
1. Deductibility under Section 162—Ordinary and Necessary Business Expenses	361
2. Deductibility under Section 174—Research and Experimental Expenditures	363
3. Section 41 Research Credit for Increasing Research Activities	364
B. Intellectual Property Acquisitions	365
1. Purchase Costs	365
2. Licensing of Intellectual Property	369
IV. Materials	370
Field Service Advice 200125019	370
Revenue Procedure 2000-50	376
V. Related Matters	378

Chapter 29 Intellectual Property Sales and Licenses	379
I. Assignment	379
II. Problems	379
III. Overview	380
A. Sales and Exclusive Licenses of Intellectual Property	381
1. General Characterization Provisions	381
2. Special Characterization Provisions	383
3. Treatment of Deferred Payment Sales and Contingent Payments	385
B. Nonexclusive Licenses of Intellectual Property	386
IV. Materials	387
<i>Watson v. Commissioner</i>	387
<i>Stern v. United States</i>	389
V. Related Matters	393

Part V: Family Taxation

Chapter 30 Assignment of Income	395
I. Assignment	395
II. Problems	395
III. Overview	397
A. Introduction	397
B. Assignments of Earned Income	398
1. The Basic Rule and the Community Property Twist	398
Practice Pointer	399
2. More on Principals and Agents and a Note About Disclaimers	399
3. The Teschner Twist	399
C. Assignments of Income from Property	400
1. Gratuitous Assignments	400
2. Grantor Trusts, the Kiddie Tax, and the Rate Structure for Entities	400
3. Assignments After Realization or Accrual	401
4. Allocations of Basis for Gratuitous Assignments in Trust	401
5. Anticipatory Assignments for Value	402
D. Assignments Designed to Transmute Ordinary Income into Capital Gains	402
E. The Special Case of Gift Loans	404
IV. Materials	404
<i>Lucas v. Earl</i>	404
<i>Helvering v. Horst</i>	405
<i>Estate of Stranahan v. Commissioner</i>	408
V. Related Matters	411

Chapter 31 Alimony and Support	413
I. Assignment	413
II. Problems	413
III. Overview	414
A. Introduction	414
B. Alimony	414
1. Alimony Requirements	415

2. Disguised Property Settlements: Section 71(f)	415
Second Year Excess Payments (E.P.) Formula: IRC § 71(f)(4)	416
First Year Excess Payments Formula: IRC § 71(f)(3)	416
3. Indirect Payments	416
4. Expenses to Obtain Alimony and to Defend Against Those Claims	417
C. Child Support	417
1. Failure to Pay	417
2. Expenses to Obtain Child Support	418
IV. Materials	418
<i>Berry v. Commissioner</i>	418
T.C. Memo 2005-91	418
V. Related Matters	424
 Chapter 32 Transfers of Property Between Spouses or Incident to Divorce	 427
I. Assignment	427
II. Problems	427
III. Overview	428
A. Property Settlements	428
B. Transfers Incident to Divorce	429
C. Transfers to Third Parties	429
D. Incorporated Family Businesses	429
E. Assignment of Income Doctrine and Division of Pensions and Other Ordinary Income Rights	431
F. Policies Supporting Section 1041	431
IV. Materials	432
<i>Craven v. United States</i>	432
Revenue Ruling 2002-22	436
V. Related Matters	440
 Chapter 33 Education Benefits and Costs	 441
I. Assignment	441
II. Problems	441
III. Overview	443
A. Business Education	443
B. Scholarships and Fellowships	444
C. Employer-Provided Educational Assistance	444
1. Qualified Tuition Reductions	444
2. Educational Assistance Programs	445
3. Working Condition Fringe Benefits	445
D. Education Loans	445
1. Deductibility of Interest	445
2. Forgiveness of Student Loans	446
E. Special Credits and Deduction for Qualified Tuition and Related Expenses	446
F. Charitable Deduction for Tuition Payments to a Church School	447
G. Saving for Higher Education	447
1. Section 135: Income from U.S. Savings Bonds to Pay Higher Education Costs	447

2. Section 529: Qualified Tuition Programs	448
3. Section 530: Coverdell Educational Savings Accounts	448
H. Coordination Rules	448
IV. Materials	449
Revenue Ruling 2008-34	449
V. Related Matters	451

Part VI: Tax Consequences of Litigation

Chapter 34 Personal Injury Recoveries and Punitive Damages	453
I. Assignment	453
II. Problems	453
III. Overview	454
A. Damages Received on Account of Personal Injuries or Sickness	455
Planning Note	457
B. Punitive Damages	457
Planning Note	457
C. Structured Settlements	457
D. Accident or Health Insurance Proceeds	458
IV. Materials	459
Private Letter Ruling 200041022	459
<i>Amos v. Commissioner</i>	463
<i>Stadnyk v. Commissioner</i>	469
Chief Counsel Advice Memoranda 201045023	472
V. Related Matters	473
 Chapter 35 Attorney's Fees	 475
I. Assignment	475
II. Problems	475
III. Overview	476
A. Deductibility of Attorney's Fees and Other Litigation Costs	476
B. Above or Below the Line Determination	478
C. Contingent Fees	479
IV. Materials	480
<i>Fleischman v. Commissioner</i>	480
<i>Commissioner v. Banks</i>	486
V. Related Matters	491

Part VII: Deferred Compensation

Chapter 36 Retirement Resources and Deferred Compensation	493
I. Assignment	493
II. Problems	493
III. Overview	494
A. Savings	495
1. Annuities	495
Exclusion Ratio	495
Return of Investment in Each Payment	495

2. Reverse Mortgages	496
B. Retirement Plans	496
1. Employer Funded Retirement Plans	496
2. Individual Funded Retirement Accounts	498
3. Retirement Planning and Time Value of Money	499
C. Social Security	500
1. Eligibility	500
2. Income Tax Treatment of Benefits	501
3. Pressures for Reform and Policy Choices Implicated	501
IV. Materials	502
Revenue Ruling 80-248	502
<i>Gee v. Commissioner</i>	503
V. Related Matters	505

Part VIII: Business Entity Taxation

Chapter 37 Overview of Entity Taxation	507
I. Assignment	507
II. Problems	507
III. Overview	508
A. Corporations	508
1. C Corporations	508
2. S Corporations	509
B. Unincorporated Businesses	510
1. General Partnerships, Limited Partnerships, Limited Liability Partnerships, and Limited Liability Companies	510
2. Tax Classification of Unincorporated Businesses	511
3. Tax Treatment of Partnership Income	511
Maintaining a Partner's Capital Account	512
Maintaining a Partner's Outside Basis	512
C. Trusts	514
1. Divided Ownership	514
2. The Tax Treatment of Trust Income	514
D. Business Planning with Entities	515
E. Estate Planning with Entities	516
1. Trusts	516
2. Closely Held Corporations	517
3. Family Limited Partnerships	517
Chapter 38 Corporate Formations	519
I. Assignment	519
II. Problems	519
III. Overview	520
A. A Cautionary Note and a Statement of Relevance	520
B. The Fundamental Rules	521
C. Some of the Nuances	521
1. Who is a "Person"?	521
2. What Does "Control" Mean, and How is "Immediately After" Measured?	522

3. What Happens if Stock is Received for Services?	522
D. Receipt of Boot	522
E. Transfers of Liabilities	523
F. Conclusion	524
IV. Materials	524
Revenue Ruling 64-56	524
Revenue Ruling 74-477	527
V. Related Matters	527
Chapter 39 Partnership Formations	529
I. Assignment	529
II. Problems	529
III. Overview	530
A. The Fundamental Rules	531
B. Some of the Nuances	532
1. What Happens if a Partnership Interest is Received for Services?	532
2. What Happens if a Partnership Later Sells Contributed Property?	532
C. Receipt of Boot	533
D. Transfers of Liabilities	534
E. Capital Accounts	535
IV. Materials	535
<i>McDougal v. Commissioner</i>	535
<i>United States v. Frazell</i>	539
V. Related Matters	541

Part IX: International Taxation

Chapter 40 Overview of International Income Taxation	543
I. Assignment	543
II. Problems	543
III. Overview	544
A. Taxation of Foreign Income of U.S. Persons	545
1. General Taxing Rules	545
2. The Foreign Tax Credit	546
Foreign Tax Credit Limit Formula	546
3. Foreign Earned Income Exclusion	547
B. Taxation of U.S. Income of Foreign Persons	547
1. Taxation of Business Income	547
2. Taxation of Non-Business Income from U.S. Sources	548
C. Source Rules	549
1. Income Source Rules	549
2. Deduction Allocation and Apportionment Rules	550
D. The Role of Treaties	550
E. Section 482: Transactions Between Related Parties	551
IV. Materials	552
<i>Boulez v. Commissioner</i>	552
V. Related Matters	554

Part X: Estate and Gift Taxation

Chapter 41 Overview of Estate and Gift Taxation	557
I. Assignment	557
II. Problems	557
III. Overview	558
A. Introduction	558
1. Why Have Such Taxes?	558
2. Who Pays the Transfer Taxes?	559
B. Transfer Tax Theory	559
C. The Estate Tax in Outline	559
The Conceptual Structure of the Estate Tax	560
1. The Gross Estate	560
2. The Taxable Estate	560
3. The Rate Structure	561
4. The Unified Credit	561
D. The Gift Tax in Outline	561
1. The Annual Exclusion	562
2. Special Valuation Rules	562
E. Computing the Estate and Gift Taxes	563
1. The Estate Tax Computation	563
Estate Tax Computation Worksheet with	
Statutory Cross-References	564
2. The Gift Tax Computation	564
Gift Tax Computation Worksheet with Statutory Cross-References	565
F. The Generation Skipping Transfer Tax (GSTT)	565
1. The Triggering Event	566
2. Generation Assignment	566
3. Deceased Parent Rule	566
4. The Taxable Amount and Tax Liability	566
5. The Exemption	567
6. The Annual Exclusion	567
7. The Tax Computation	567
8. Illustration of the GSTT's Application	568
9. Conclusion	569
IV. Materials	569
V. Related Matters	569

Part XI: Tax Practice and Procedure

Chapter 42 Tax Practice and Procedure	571
I. Assignment	571
II. Problems	571
III. Overview	572
A. Tax Returns	572
B. The Examination Process and Settlements	573
C. Tax Litigation	574
D. Assessment Process	574
E. Tax Collection Process	575

F. Professional Responsibility Issues	576
1. Tax Return Positions	576
2. Tax Opinions	577
3. Tax Return Preparer Penalties	578
IV. Materials	579
V. Related Matters	592
 Table of Internal Revenue Code Sections	 595
Table of Treasury Regulations	605
Table of Administrative Pronouncements	609
Table of Cases	611
 Index	 619

Preface and Acknowledgments

This edition brings the text current to January 2013 and reflects changes made by recent tax acts, including The American Taxpayer Relief Act of 2012.

It has been said that the hardest thing about writing a good book is knowing what to leave out. That is certainly true of a book about the law of taxation. The Internal Revenue Code and the regulations interpreting it extend for many thousands of pages. An introduction to its labyrinthian nature must necessarily leave a great deal out. In the materials that follow, we have sought to highlight those parts of federal tax law that are most relevant to the every day experiences of life in the United States. The level of coverage is not entirely uniform because part of appreciating the law of taxation is seeing its varying depths. Though our approach has been far from encyclopedic, we have tried to make the study of taxation engaging, concrete and specific through examples and problems. By the same token, we have made a consistent effort to delineate the policies that underlie our tax system and to note deviations from generally accepted principles of sound tax policy. Because most people who study taxation do so in order to serve a client, we have also emphasized planning principles.

We have broken the subject matter of this book into many more chapters than is typical of law casebooks. The purpose for this approach is simply to make the book easier for teachers to assign and for students to read. The typical chapter can be covered in one or two class periods. If the instructor chooses to omit a topic, she or he need only direct the student to skip the appropriate chapter. The assignments are structured to make efficient and effective use of student preparation time by segmenting and prioritizing the material.

As is typical of tax law casebooks, this book is intended to be used in conjunction with selected sections of the Internal Revenue Code and the federal tax regulations. Several publishers produce one volume editions that well serve that purpose.

Jack Miller would like to thank his teachers, friends and colleagues at the University of Florida who opened the world of teaching to him. In particular he would like to thank Mike Oberst and Steve Lind, two of the best classroom teachers he's ever seen. Though quite different in style, Oberst so brusque and exacting and Lind so genial and deft, these two men are both remarkable exemplars of how to use socratic dialogue to teach tax. He would also like to thank the late, great Jack Freeland who possessed a wonderful knack for making a single word or phrase speak volumes of meaning. Jack Miller would also like to thank Douglas Miller and George Yin for modeling how to think about planning and policy. He would like to thank David Hudson for his early counsel on scholarship. He would like to thank Steven Willis for teaching a political science major about accounting and Dennis Calfee, David Richardson and Mike Friel for taking a fatherly interest in a fledgling professor. He would like to thank Dean Donald

Burnett for his generous support for this project. Lastly, he is deeply grateful for the research assistance of Brian Peterson and Jennifer Hedlund and the editorial assistance of Reuben Ayres.

Jeff Maine would like to thank Jack Miller, Richard Gershon, and John Cooper for their constant support and guidance, and for all they have taught him about taxation and, more importantly, life. He would like to thank Julie Welch for her research assistance, and Corinne Gagnon and Nathan Brown for their superb editorial assistance. Jeff Maine would also like to thank Dean Peter Pitegoff for supporting this project. Finally, he would like to thank Beth, who is by far the dearest member of his karass.

The Fundamentals of Federal Taxation

