

# The Fundamentals of Federal Taxation



# The Fundamentals of Federal Taxation Problems and Materials

FOURTH EDITION

**John A. Miller**

WELDON SCHIMKE DISTINGUISHED PROFESSOR OF LAW  
UNIVERSITY OF IDAHO COLLEGE OF LAW

**Jeffrey A. Maine**

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



CAROLINA ACADEMIC PRESS  
Durham, North Carolina

Copyright © 2017  
John A. Miller and Jeffrey A. Maine  
All Rights Reserved

eISBN 978-1-53100-206-0  
ISBN 978-1-53100-205-3  
LCCN 2017939771

Carolina Academic Press, LLC  
700 Kent Street  
Durham, North Carolina 27701  
Telephone (919) 489-7486  
Fax (919) 493-5668  
[www.cap-press.com](http://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	xxix
<b>Part I: Basic Structure of the Income Tax</b>	
Chapter 1 · Introduction	3
Chapter 2 · Gross Income	19
Chapter 3 · Gains and Losses from Dealings in Property	37
Chapter 4 · Gifts and Inheritances	55
Chapter 5 · Discharge of Indebtedness	71
Chapter 6 · Fringe Benefits	85
Chapter 7 · Business and Investment Expense Deductions	103
Chapter 8 · Capital Expenditures	125
Chapter 9 · Depreciation and Amortization	143
Chapter 10 · Deductible Personal Expenses: Casualty and Theft Losses	163
Chapter 11 · Other Deductible Personal Expenses: Taxes, Interest, Charitable Gifts, Moving Expenses, and Medical Expenses	181
Chapter 12 · The Deduction Hierarchy: Adjusted Gross Income, Taxable Income, the Standard Deduction, and the Personal Exemptions	193
Chapter 13 · Timing Rules and Related Principles	209
Chapter 14 · Ordinary Tax Rates and Taxpayer Classification	229
Chapter 15 · Tax Credits	241
Chapter 16 · First Review Problem	247
<b>Part II: Characterization of Gains and Losses from Property</b>	
Chapter 17 · Capital Gains and Losses	251
Chapter 18 · Quasi-Capital Assets	273
Chapter 19 · Recapture of Depreciation	283
Chapter 20 · The Charitable Contribution Deduction	291
Chapter 21 · Second Set of Review Problems	313
<b>Part III: Real Estate Taxation</b>	
Chapter 22 · Residential Real Estate	315
Chapter 23 · Hobby Losses	335
Chapter 24 · Like Kind Exchanges	347
Chapter 25 · Involuntary Conversions	363

Chapter 26 · Installment Sales	373
Chapter 27 · Limitations on Deductions	385
<b>Part IV: Intellectual Property Taxation</b>	
Chapter 28 · Intellectual Property Development and Acquisitions	399
Chapter 29 · Intellectual Property Sales and Licenses	421
<b>Part V: Family Taxation</b>	
Chapter 30 · Assignment of Income	439
Chapter 31 · Alimony and Support	459
Chapter 32 · Transfers of Property Between Spouses or Incident to Divorce	473
Chapter 33 · Education Benefits and Costs	489
<b>Part VI: Tax Consequences of Litigation</b>	
Chapter 34 · Personal Injury Recoveries and Punitive Damages	501
Chapter 35 · Attorney's Fees	525
<b>Part VII: Deferred Compensation</b>	
Chapter 36 · Retirement Resources and Deferred Compensation	545
<b>Part VIII: Business Entity Taxation</b>	
Chapter 37 · Overview of Entity Taxation	561
Chapter 38 · Corporate Formations	575
Chapter 39 · Partnership Formations	585
<b>Part IX: International Taxation</b>	
Chapter 40 · Overview of International Income Taxation	601
<b>Part X: Estate and Gift Taxation</b>	
Chapter 41 · Overview of Estate and Gift Taxation	615
<b>Part XI: Tax Practice and Procedure</b>	
Chapter 42 · Tax Practice and Procedure	629
Table of Internal Revenue Code Sections	653
Table of Treasury Regulations	663
Table of Administrative Pronouncements	667
Table of Cases	669
Index	677



# Contents

---

Preface and Acknowledgments xxix

## Part I: Basic Structure of the Income Tax

<b>Chapter 1 · Introduction</b>	3
I. Problems	3
II. Overview	4
A. Tax Policy	4
1. Fairness	5
2. Efficiency	5
3. Neutrality	5
B. Tax Expenditures	6
C. Structure of Current Income Tax System	6
Computational Overview	7
D. Tax Reference Resources and Authorities	7
1. Internal Revenue Code	8
2. Treasury Regulations	8
3. IRS Rulings and Procedures	9
4. Case Law	10
5. Legislative History	11
Tax Research Caveats	11
E. The Structure of This Book and How to Use It	12
III. Materials	13
<i>Mayo Foundation v. United States</i>	13
<b>Chapter 2 · Gross Income</b>	19
I. Assignment	19
II. Problems	19
III. Overview	20
A. The Definition of Gross Income	20
1. The Realization Requirement	21
2. Statutory Exclusions from Gross Income	21
3. Long-Standing Administrative Practices	22
B. Gross Income May Be Realized in Any Form	24
C. A Note on “Basis”	26
D. Impact of Obligations to Repay	26
IV. Materials	27
<i>Commissioner v. Glenshaw Glass Co.</i>	27

<i>Cesarini v. United States</i>	30
<i>Old Colony Trust Co. v. Commissioner</i>	33
V. Related Matters	35
<b>Chapter 3 · Gains and Losses from Dealings in Property</b>	<b>37</b>
I. Assignment	37
II. Problems	37
III. Overview	38
A. Sale or Other Disposition	39
B. Computation of Gain or Loss Realized	40
Gain Realized	40
Loss Realized	40
1. Amount Realized	40
2. Adjusted Basis	40
C. “Recognition” of Realized Gain or Loss	42
D. Impact of Liabilities in Property Transactions	43
1. General Framework	43
2. Specialized Aspects of Debt in Property Transactions	44
IV. Materials	45
<i>Philadelphia Park Amusement Co. v. United States</i>	45
<i>Crane v. Commissioner</i>	47
V. Related Matters	52
<b>Chapter 4 · Gifts and Inheritances</b>	<b>55</b>
I. Assignment	55
II. Problems	55
III. Overview	57
A. General Exclusionary Rule for Gifts and Inheritances—§ 102(a)	57
1. Exclusion for Inter Vivos Gifts	57
2. Exclusion for Bequests, Devises, and Inheritances	57
3. Policy Reasons Behind Section 102(a)	58
B. Statutory Limitations on the Exclusion—§ 102(b) and § 102(c)	58
C. Basis of Property Received by Gift, Bequest, Devise, or Inheritance	59
1. Property Acquired by Gift	59
2. Property Acquired by Inheritance	60
3. Basis and Tax Planning	61
D. Part Sale, Part Gift Situations	62
IV. Materials	62
<i>Commissioner v. Duberstein</i>	62
<i>Wolder v. Commissioner</i>	66
V. Related Matters	68
<b>Chapter 5 · Discharge of Indebtedness</b>	<b>71</b>
I. Assignment	71
II. Problems	71

III. Overview	72
A. “Contested Liability” or “Disputed Debt” Exception	73
B. Bankruptcy and Insolvency Exceptions	73
C. Debt Discharge Outside the Scope of Debt Discharge Rules	74
D. Discharge of Recourse Debt in Property Transactions	75
E. Tax Treatment of the Lender	76
IV. Materials	76
<i>United States v. Kirby Lumber Co.</i>	76
<i>Preslar v. Commissioner</i>	77
V. Related Matters	83
<b>Chapter 6 · Fringe Benefits</b>	<b>85</b>
I. Assignment	85
II. Problems	85
III. Overview	86
A. The Major Exclusions Under Section 132	87
1. No Additional Cost Services and Qualified Employee Discounts	88
2. Working Condition and De Minimis Fringe Benefits	88
B. Meals or Lodging for the Employer’s Convenience	89
C. Employment Related Payments from Third Parties	90
D. Employer Provided Health Care Benefits	90
E. The Strange Cases of Frequent Flyer Miles, Free Meals and Other Untaxed Benefits	91
IV. Materials	91
<i>J. Grant Farms, Inc. v. Commissioner</i>	91
<i>Charley v. Commissioner</i>	97
V. Related Matters	100
<b>Chapter 7 · Business and Investment Expense Deductions</b>	<b>103</b>
I. Assignment	103
II. Problems	103
III. Overview	105
A. The Main Provisions	105
B. Some Limitations	106
C. Section 162(a)—General Principles	106
1. Ordinary and Necessary	106
2. What Is an “Expense”?	107
3. Carrying On	107
4. Trade or Business	108
D. Substantiation	108
E. Section 162(a)(1)—Reasonable Salaries	109
F. Section 162(a)(2)—Travel Expenses	109
1. Where Is Home?	110
2. Commuting Expenses	110
3. The Sleep or Rest Rule	111

4. Temporary Reassignments	111
G. Section 280E—The Curious Case of Legalized Marijuana	111
H. Section 212—Investment Expenses	112
IV. Materials	112
<i>Welch v. Helvering</i>	112
<i>Jenkins v. Commissioner</i>	114
<i>Henderson v. Commissioner</i>	118
V. Related Matters	123
<b>Chapter 8 · Capital Expenditures</b>	125
I. Assignment	125
II. Problems	125
III. Overview	126
A. Section 263(a)	126
1. In General	126
2. Distinguishing Deductible Expenses from Nondeductible Capital Expenditures	127
a. Case Law	127
b. Administrative Rulings	128
c. Treasury Regulations	128
3. Capitalization Rules Governing Tangible Property	129
a. Amounts Paid to Acquire Tangible Property	129
b. Amounts Paid to Construct Tangible Property	130
c. Amounts Paid to Sell Tangible Property	130
d. Amounts Paid to Defend or Perfect Title to Tangible Property	131
e. Amounts Paid to Improve Tangible Property	131
4. Capitalization Rules Governing Intangible Assets	133
a. Amounts Paid to Acquire Intangible Property	133
b. Amounts Paid to Create Intangible Property	133
c. Transaction Costs	134
B. Section 263A	134
IV. Materials	135
<i>Midland Empire Packing Co. v. Commissioner</i>	135
<i>Mt. Morris Drive-In Theatre Co. v. Commissioner</i>	138
V. Related Matters	140
<b>Chapter 9 · Depreciation and Amortization</b>	143
I. Assignment	143
II. Problems	143
III. Overview	144
A. Depreciation of Tangible Property	144
1. Applicable Recovery Period	145
2. Applicable Depreciation Method	146
Determining the Straight-Line Percentage	146

3. Applicable Convention	147
4. Example of ACRS Depreciation	147
B. Bonus Depreciation	149
1. Section 179	149
Planning Pointer	150
2. Section 168(k)	150
C. Amortization of Intangible Property	151
IV. Materials	152
<i>Simon v. Commissioner</i>	152
Revenue Procedure 87-56 (Excerpt)	159
Revenue Procedure 87-57 (Excerpt)	160
V. Related Matters	162
<b>Chapter 10 · Deductible Personal Expenses: Casualty and Theft Losses</b>	<b>163</b>
I. Assignment	163
II. Problems	163
III. Overview	165
A. A Look at the Tax Treatment of Business, Investment, and Personal Losses	165
B. The Personal Casualty Loss Deduction	165
C. Rationale for the Deduction	166
D. Proof of Causation	166
E. Measuring the Loss	167
1. Effect of Reimbursements	167
2. Examples	168
F. Restrictions on the Deduction	168
1. The \$100 Threshold	168
2. The Ten Percent of Adjusted Gross Income Threshold	169
G. Adjustments to Basis for Casualty Loss Deduction and Reimbursements	169
IV. Materials	170
<i>Chamales v. Commissioner</i>	170
<i>Blackman v. Commissioner</i>	176
V. Related Matters	179
<b>Chapter 11 · Other Deductible Personal Expenses: Taxes, Interest,     Charitable Gifts, Moving Expenses, and Medical Expenses</b>	<b>181</b>
I. Assignment	181
II. Problems	181
III. Overview	182
A. Qualified Residence Interest	183
B. State and Local Taxes	185
C. Charitable Contributions	185
D. Moving Expenses	186
E. Medical Expenses	187

IV. Materials	187
Revenue Ruling 87-106	187
Revenue Ruling 2003-57	190
V. Related Matters	191
<b>Chapter 12 · The Deduction Hierarchy: Adjusted Gross Income, Taxable Income, the Standard Deduction, and the Personal Exemptions</b>	193
I. Assignment	193
II. Problems	193
III. Overview	195
A. Itemized Deductions versus the Standard Deduction	195
B. Miscellaneous Itemized Deductions Getting to Taxable Income	196 196
C. Personal and Dependency Exemptions	197
1. Qualifying Child	197
a. Tie Breakers	197
b. Children of Divorced Parents	198
2. Qualifying Relative	198
3. Phase Out Rules	199
IV. Materials	200
Form 1040	200
Form 8332	206
V. Related Matters	208
<b>Chapter 13 · Timing Rules and Related Principles</b>	209
I. Assignment	209
II. Problems	209
III. Overview	210
A. Introduction	210
B. The Cash Method	211
1. Income under the Cash Method	211
a. The Doctrine of Cash Equivalence and the Related Principle of Economic Benefit	212 212
b. The Doctrine of Constructive Receipt	212
2. Deductions under the Cash Method	214
a. Prepayment of Expenses	214
b. The Special Rule for Interest Expenses	215
C. The Accrual Method	215
1. Income under the Accrual Method	215
a. Prepayments	215
2. Deductions under the Accrual Method	215
a. Inventory Accounting	216
D. Principles Applicable to Both the Cash Method and the Accrual Method	217 217

1. The Claim of Right Doctrine	217
2. The Tax Benefit Rule	218
3. The Ancillary Effects of Paying Expenses with Services or Appreciated Property	219
IV. Materials	219
<i>Ames v. Commissioner</i>	219
<i>Schlude v. Commissioner</i>	223
V. Related Matters	227
<b>Chapter 14 · Ordinary Tax Rates and Taxpayer Classification</b>	<b>229</b>
I. Assignment	229
II. Problems	229
III. Overview	230
A. Introduction	230
Computing a Final Tax Liability	231
B. The Rate Structure for Ordinary Income	231
1. The Basic Rates	231
2. The Principle of Progressivity	231
C. Taxpayer Classifications	232
1. Marital Status	233
2. Surviving Spouse	235
3. Head of Household	235
D. Alternative Minimum Tax	236
IV. Materials	237
Revenue Procedure 2015-53 (Excerpt)	237
V. Related Matters	239
<b>Chapter 15 · Tax Credits</b>	<b>241</b>
I. Assignment	241
II. Problems	241
III. Overview	242
Computing a Final Tax Liability	242
A. Non-Refundable Credits	243
1. The Dependent Care Credit	243
2. The Child Tax Credit	243
3. The Hope Scholarship Credit and the Lifetime Learning Credit	244
B. Refundable Credits	245
1. The Credit for Withholding on Wages	245
2. The Earned Income Credit	245
C. Ordering Rules	246
IV. Related Matters	246
<b>Chapter 16 · First Review Problem</b>	<b>247</b>

<b>Part II: Characterization of Gains and Losses from Property</b>	
<b>Chapter 17 · Capital Gains and Losses</b>	<b>251</b>
I. Assignment	251
II. Problems	251
III. Overview	253
A. The Mechanics of Capital Gains	254
Net Capital Gain	254
Net Long Term Capital Gain	254
Net Short Term Capital Loss	254
1. The Sale or Exchange Requirement	255
2. The Capital Asset Requirement	255
a. Inventory and Inventory-Like Property—Section 1221(a)(1)	255
b. Trade or Business Property—Section 1221(a)(2)	256
c. Self-Created Copyrights and Similar Property—Section 1221(a)(3)	256
d. Accounts Receivable for Service or Inventory—Section 1221(a)(4)	257
e. Federal Publications—Section 1221(a)(5)	257
f. Hedging Transactions—Section 1221(a)(7)	257
g. Supplies Used in a Trade or Business—Section 1221(a)(8)	258
3. The Holding Period Requirement	258
4. Special Characterization Provisions	258
5. Determining the Appropriate Capital Gains Rate on “Net Capital Gain”	259
B. The Mechanics of Capital Losses	261
IV. Materials	262
<i>Bynum v. Commissioner</i>	262
<i>Williams v. McGowan</i>	268
V. Related Matters	270
<b>Chapter 18 · Quasi-Capital Assets</b>	<b>273</b>
I. Assignment	273
II. Problems	273
III. Overview	274
A. Transactions to Which Section 1231 Applies	274
B. The Mechanics of Section 1231	275
C. Recapture of “Net Ordinary Loss”	277
D. Summary	278
Section 1231 Checklist	278
IV. Materials	278
<i>Wasnok v. Commissioner</i>	278
V. Related Matters	281



<b>Chapter 19 · Recapture of Depreciation</b>	283
I. Assignment	283
II. Problems	283
III. Overview	284
A. Recapture under Section 1245 for Certain Depreciable Property	284
1. An Overview	284
2. The Statutory Mechanics	284
a. Amount Recaptured as Ordinary Income	284
b. Meaning of “Section 1245 Property”	285
c. Meaning of “Disposed Of”	285
B. Recapture under Section 1250 for Certain Depreciable Realty	286
C. Characterization under Section 1239	287
IV. Materials	288
Revenue Ruling 69-487	288
V. Related Matters	288
<b>Chapter 20 · The Charitable Contribution Deduction</b>	291
I. Assignment	291
II. Problems	291
III. Overview	292
A. Introduction	292
B. The Structure of the Code: Sluices and Gates	294
1. Defining Terms	294
2. Section 170(e)	294
3. Sections 170(b)(1)(A) & (B)	295
4. Section 170(b)(1)(C)	295
5. Section 170(b)(1)(D)	296
The Charitable Deduction Summarized	296
C. Gifts of Intellectual Property: Section 170(m)	297
D. Bargain Sales to Charities	297
E. Substantiation	298
F. Tax Policy and the Charitable Deduction	299
G. Tax Planning and the Charitable Deduction	299
IV. Materials	300
<i>Sklar v. Commissioner</i>	300
V. Related Matters	311
<b>Chapter 21 · Second Set of Review Problems</b>	313
<b>Part III: Real Estate Taxation</b>	
<b>Chapter 22 · Residential Real Estate</b>	315
I. Assignment	315
II. Problems	315
III. Overview	317
A. Home Office Deductions	317

B. Vacation Home Deductions	320
1. Use as a Residence	320
2. Deductible Expenses and Their Limits	320
C. Exclusion of Gain on Sale of Residence	322
1. Ownership and Use Requirements	323
2. One Sale Every Two Years Limitation	323
3. Amount of Exclusion	324
4. Principal Residence	325
5. Tax Planning	326
IV. Materials	326
<i>Popov v. Commissioner</i>	326
<i>Guinan v. United States</i>	329
V. Related Matters	331
<b>Chapter 23 · Hobby Losses</b>	<b>335</b>
I. Assignment	335
II. Problems	335
III. Overview	336
A. Distinguishing Hobbies from Business or Profit-Seeking Activities	337
B. Allowable Deductions	338
Section 183 Checklist	339
IV. Materials	340
<i>Nickerson v. Commissioner</i>	340
V. Related Matters	346
<b>Chapter 24 · Like Kind Exchanges</b>	<b>347</b>
I. Assignment	347
II. Problems	347
III. Overview	349
A. Introduction	349
B. Determining Like Kindness	349
C. Planning the Exchange	350
D. The Mechanics of Section 1031	351
1. Exceptions and Timing	351
2. Boot and Recognition of Gains and Losses	352
3. Basis in New Property and in Boot Received	352
Aggregate Basis under § 1031(d)	352
Basis of Like Kind Property Received	353
4. Holding Period	353
E. Assumptions of Liability	353
F. Illustrations	353
G. Depreciation Recapture	355
H. Mixed-Use Property	356
IV. Materials	356

Revenue Ruling 77-297	356
Revenue Procedure 2008-16	358
V. Related Matters	361
<b>Chapter 25 · Involuntary Conversions</b>	<b>363</b>
I. Assignment	363
II. Problems	363
III. Overview	364
A. Involuntary Conversions	364
B. Similar or Related in Service or Use	365
C. When Replacement Must Occur	366
D. Basis and Holding Period of Replacement Property	367
IV. Materials	367
<i>Clifton Inv. Co. v. Commissioner</i>	367
Revenue Ruling 64-237	370
V. Related Matters	371
<b>Chapter 26 · Installment Sales</b>	<b>373</b>
I. Assignment	373
II. Problems	373
III. Overview	374
A. Introduction	374
B. The Mechanics of Section 453 and the Defined Terms	375
Gross Profit Ratio Formula	375
C. Dispositions of Installment Notes: Section 453B	378
D. Contingent Payment Sales	379
E. Installment Sales with Unstated or Understated Interest	380
IV. Materials	381
Revenue Ruling 79-371	381
V. Related Matters	383
<b>Chapter 27 · Limitations on Deductions</b>	<b>385</b>
I. Assignment	385
II. Problems	385
III. Overview	387
A. Introduction	387
B. The At Risk Rules	388
1. The At Risk Limitation	388
2. The Effect of Losses and Distributions on the At Risk Amount	388
3. Qualified Non-Recourse Financing Exception	389
4. Recapture of Prior Deductions under Section 465(e)	389
5. Examples	389
C. The Passive Loss Rules	390
1. In General	390
2. The Statutory Framework	390

3. Special Exception for Mom and Pop Rental Real Estate Activities	391
4. The Effects of Dispositions of Passive Activities	391
5. The Definition of “Activity”	392
6. Coordination between Sections 465 and 469	392
D. Why Does the Tax Law Use These “Basket” Approaches?	392
IV. Materials	393
Excerpt From Senate Report 99-313	393
V. Related Matters	397
<b>Part IV: Intellectual Property Taxation</b>	
<b>Chapter 28 · Intellectual Property Development and Acquisitions</b>	<b>399</b>
I. Assignment	399
II. Problems	399
III. Overview	400
A. Intellectual Property Development	401
1. Deductibility under Section 162—Ordinary and Necessary Business Expenses	401
a. Section 263 Override	401
b. Section 263A Override	402
2. Deductibility under Section 174—Research and Experimental Expenditures	403
a. Research and Experimental Expenditures	403
b. In Connection With a Trade or Business	404
3. Section 41 Research Credit for Increasing Research Activities	405
B. Intellectual Property Acquisitions	405
1. Purchase Costs	406
a. Amortization under Section 197	406
b. Amortization under Section 167	408
2. Licensing of Intellectual Property	410
IV. Materials	410
Field Service Advice 200125019	410
Revenue Procedure 2000-50	417
V. Related Matters	420
<b>Chapter 29 · Intellectual Property Sales and Licenses</b>	<b>421</b>
I. Assignment	421
II. Problems	421
III. Overview	422
A. Sales and Exclusive Licenses of Intellectual Property	423
1. General Characterization Provisions	423
2. Special Characterization Provisions	425
a. Section 1235: Transfers of All Substantial Rights to Patents	425
b. Section 1253: Transfers of Trademarks and Trade Names	427
3. Treatment of Deferred Payment Sales and Contingent Payments	428

B. Nonexclusive Licenses of Intellectual Property	429
IV. Materials	430
<i>Watson v. Commissioner</i>	430
<i>Stern v. United States</i>	433
V. Related Matters	437
<b>Part V: Family Taxation</b>	
<b>Chapter 30 · Assignment of Income</b>	439
I. Assignment	439
II. Problems	439
III. Overview	441
A. Introduction	441
B. Assignments of Earned Income	442
1. The Basic Rule and the Community Property Twist	442
Practice Pointer	443
2. More on Principals and Agents and a Note About Disclaimers	443
3. The <i>Teschner</i> Twist	444
C. Assignments of Income from Property	444
1. Gratuitous Assignments	444
2. Grantor Trusts, the Kiddie Tax, and the Rate Structure for Entities	445
3. Assignments After Realization or Accrual	445
4. Allocations of Basis for Gratuitous Assignments in Trust	446
5. Anticipatory Assignments for Value	446
D. Assignments Designed to Transmute Ordinary Income into Capital Gains	447
E. The Special Case of Gift Loans	449
IV. Materials	449
<i>Lucas v. Earl</i>	449
<i>Helvering v. Horst</i>	450
<i>Estate of Stranahan v. Commissioner</i>	454
V. Related Matters	457
<b>Chapter 31 · Alimony and Support</b>	459
I. Assignment	459
II. Problems	459
III. Overview	460
A. Introduction	460
B. Alimony	460
1. Alimony Requirements	461
2. Disguised Property Settlements: Section 71(f)	461
Second Year Excess Payments (E.P.) Formula: IRC § 71(f)(4)	462
First Year Excess Payments Formula: IRC § 71(f)(3)	462
3. Indirect Payments	463
4. Expenses to Obtain Alimony and to Defend against Those Claims	463
C. Child Support	463

1. Failure to Pay	464
2. Expenses to Obtain Child Support	464
IV. Materials	464
<i>Berry v. Commissioner</i>	464
V. Related Matters	471
<b>Chapter 32 · Transfers of Property Between Spouses or Incident                   to Divorce</b>	<b>473</b>
I. Assignment	473
II. Problems	473
III. Overview	474
A. Property Settlements	474
B. Transfers Incident to Divorce	475
C. Transfers to Third Parties	475
D. Incorporated Family Businesses	476
E. Assignment of Income Doctrine and Division of Pensions and Other Ordinary Income Rights	477
F. Policies Supporting Section 1041	478
IV. Materials	478
<i>Craven v. United States</i>	478
Revenue Ruling 2002-22	483
V. Related Matters	487
<b>Chapter 33 · Education Benefits and Costs</b>	<b>489</b>
I. Assignment	489
II. Problems	489
III. Overview	491
A. Business Education	491
B. Scholarships and Fellowships	492
C. Employer-Provided Educational Assistance	492
1. Qualified Tuition Reductions	492
2. Educational Assistance Programs	493
3. Working Condition Fringe Benefits	493
D. Education Loans	493
1. Deductibility of Interest	493
2. Forgiveness of Student Loans	494
E. Special Credits and Deduction for Qualified Tuition and Related Expenses	495
F. Charitable Deduction for Tuition Payments to a Church School	496
G. Saving for Higher Education	496
1. Section 135: Income from U.S. Savings Bonds to Pay Higher Education Costs	496
2. Section 529: Qualified Tuition Programs	496
3. Section 530: Coverdell Educational Savings Accounts	497
H. Coordination Rules	497

IV. Materials	498
Revenue Ruling 2008-34	498
V. Related Matters	500
<b>Part VI: Tax Consequences of Litigation</b>	
<b>Chapter 34 · Personal Injury Recoveries and Punitive Damages</b>	501
I. Assignment	501
II. Problems	501
III. Overview	502
A. Damages Received on Account of Personal Injuries or Sickness	503
Planning Note	505
B. Punitive Damages	505
Planning Note	506
C. Structured Settlements	506
D. Accident or Health Insurance Proceeds	507
IV. Materials	507
Private Letter Ruling 200041022	507
<i>Amos v. Commissioner</i>	512
<i>Stadnyk v. Commissioner</i>	518
V. Related Matters	522
<b>Chapter 35 · Attorney's Fees</b>	525
I. Assignment	525
II. Problems	525
III. Overview	526
A. Deductibility of Attorney's Fees and Other Litigation Costs	526
B. Above or Below the Line Determination	529
C. Contingent Fees	530
IV. Materials	531
<i>Fleischman v. Commissioner</i>	531
<i>Commissioner v. Banks</i>	538
V. Related Matters	543
<b>Part VII: Deferred Compensation</b>	
<b>Chapter 36 · Retirement Resources and Deferred Compensation</b>	545
I. Assignment	545
II. Problems	545
III. Overview	546
A. Savings	547
1. Annuities	547
Exclusion Ratio	548
Return of Investment in Each Payment	548
2. Reverse Mortgages	548
B. Retirement Plans	549
1. Employer Funded Retirement Plans	549

a. Defined Benefit and Defined Contribution Qualified Plans	549
b. Payout	550
c. Relative Merits of the Two Approaches	550
2. Individual Funded Retirement Accounts	551
a. Pre-Tax Contribution Accounts	551
b. Post-Tax Contribution Accounts	552
3. Retirement Planning and Time Value of Money	552
C. Social Security	553
1. Eligibility	553
2. Income Tax Treatment of Benefits	554
3. Pressures for Reform and Policy Choices Implicated	554
IV. Materials	554
Revenue Ruling 80-248	554
<i>Gee v. Commissioner</i>	556
V. Related Matters	558
<b>Part VIII: Business Entity Taxation</b>	
<b>Chapter 37 · Overview of Entity Taxation</b>	561
I. Assignment	561
II. Problems	561
III. Overview	562
A. Corporations	562
1. C Corporations	563
2. S Corporations	564
B. Unincorporated Businesses	565
1. General Partnerships, Limited Partnerships, Limited Liability Partnerships, and Limited Liability Companies	565
2. Tax Classification of Unincorporated Businesses	565
3. Tax Treatment of Partnership Income	566
Maintaining a Partner's Capital Account	566
Maintaining a Partner's Outside Basis	567
C. Trusts	568
1. Divided Ownership	568
2. The Tax Treatment of Trust Income	569
D. Business Planning with Entities	570
E. Estate Planning with Entities	571
1. Trusts	571
2. Closely Held Corporations	572
3. Family Limited Partnerships	572
<b>Chapter 38 · Corporate Formations</b>	575
I. Assignment	575
II. Problems	575
III. Overview	576
A. A Cautionary Note and a Statement of Relevance	576



B. The Fundamental Rules	577
C. Some of the Nuances	578
1. Who Is a “Person”?	578
2. What Does “Control” Mean, and How Is “Immediately After” Measured?	578
3. What Happens if Stock Is Received for Services?	578
D. Receipt of Boot	579
E. Transfers of Liabilities	579
F. Conclusion	580
IV. Materials	581
Revenue Ruling 64-56	581
Revenue Ruling 74-477	583
V. Related Matters	584
<b>Chapter 39 · Partnership Formations</b>	<b>585</b>
I. Assignment	585
II. Problems	585
III. Overview	586
A. The Fundamental Rules	587
B. Some of the Nuances	588
1. What Happens if a Partnership Interest Is Received for Services?	588
2. What Happens if a Partnership Later Sells Contributed Property?	589
C. Receipt of Boot	589
D. Transfers of Liabilities	590
E. Capital Accounts	591
IV. Materials	592
<i>McDougal v. Commissioner</i>	592
<i>United States v. Frazell</i>	596
V. Related Matters	599
<b>Part IX: International Taxation</b>	
<b>Chapter 40 · Overview of International Income Taxation</b>	<b>601</b>
I. Assignment	601
II. Problems	601
III. Overview	602
A. Taxation of Foreign Income of U.S. Persons	603
1. General Taxing Rules	603
2. The Foreign Tax Credit	604
Foreign Tax Credit Limit Formula	605
3. Foreign Earned Income Exclusion	605
B. Taxation of U.S. Income of Foreign Persons	605
1. Taxation of Business Income	606
a. In General	606
b. Treaty Exceptions	606
2. Taxation of Non-Business Income from U.S. Sources	606

a. “Fixed or Determinable, Annual or Periodical” (FDAP)	
Income	606
b. Treaty Exceptions	607
C. Source Rules	607
1. Income Source Rules	607
2. Deduction Allocation and Apportionment Rules	609
D. The Role of Treaties	609
E. Section 482: Transactions between Related Parties	610
IV. Materials	611
<i>Boulez v. Commissioner</i>	611
V. Related Matters	614

### Part X: Estate and Gift Taxation

<b>Chapter 41 · Overview of Estate and Gift Taxation</b>	615
I. Assignment	615
II. Problems	615
III. Overview	616
A. Introduction	616
1. Why Have Such Taxes?	616
2. Who Pays the Transfer Taxes?	617
B. Transfer Tax Theory	617
C. The Estate Tax in Outline	617
The Conceptual Structure of the Estate Tax	618
1. The Gross Estate	618
2. The Taxable Estate	619
3. The Rate Structure	619
4. The Unified Credit	619
D. The Gift Tax in Outline	620
1. The Annual Exclusion	620
2. Special Valuation Rules	621
E. Computing the Estate and Gift Taxes	621
1. The Estate Tax Computation	621
Estate Tax Computation Worksheet with Statutory Cross-References	622
2. The Gift Tax Computation	623
Gift Tax Computation Worksheet with Statutory Cross-References	623
F. The Generation Skipping Transfer Tax (GSTT)	623
1. The Triggering Event	624
2. Generation Assignment	624
3. Deceased Parent Rule	624
4. The Taxable Amount and Tax Liability	625
5. The Exemption	625
6. The Annual Exclusion	625
7. The Tax Computation	626
8. Illustration of the GSTT’s Application	626

9. Conclusion	627
IV. Materials	627
V. Related Matters	627
<b>Part XI: Tax Practice and Procedure</b>	
<b>Chapter 42 · Tax Practice and Procedure</b>	<b>629</b>
I. Assignment	629
II. Problems	629
III. Overview	630
A. Tax Returns	630
B. The Examination Process and Settlements	631
C. Tax Litigation	632
D. Assessment Process	633
E. Tax Collection Process	634
F. Providing Tax Advice and Opinions	635
1. General Professional Ethics Rules	635
2. Circular 230	635
3. Code and Regulations (Statutory Penalties)	636
IV. Materials	637
V. Related Matters	650
Table of Internal Revenue Code Sections	653
Table of Treasury Regulations	663
Table of Administrative Pronouncements	667
Table of Cases	669
Index	677



# Preface and Acknowledgments

---

This edition brings the text current to March 2017 and reflects changes made by recent tax acts, including The Protecting Americans from Tax Hikes (PATH) Act of 2015.

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 Dean Mark Adams for his generous support for this project. He is deeply grateful for the excellent research assistance of Brian Peterson, Jennifer Hedlund, and Jamie Bjorklund.

Jeff Maine would like to thank Dean Danielle Conway for supporting this project. He would also like to thank Corinne Gagnon, Nathan Brown, Ryan Almy, Heidi Gage, Frances Smith, and Deborah Lorenzen for their superb editorial assistance.

