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Tax Litigation: Final Examination (June 2, 1960)

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TAX LITIGATION

FINAL EXAMINATION

JUNE 2, 1960

I.

T sold one of two parts of a block of stock in each of the years 1955 and 1956, reporting gain on the sales in each of the two years. In 1958 he filed claim for refund for 1956 on the grounds that he used too low a basis in reporting his gain on the sale in that year and consequently had less gain than that shown on the return. Investigating T's claim, the agent learned of the '55 sale, and as the total basis for the block of stock was to be apportioned between the two parts, increasing the 1956 basis would necessarily decrease that for 1955 and result in greater amount of gain for that year. Consequently the agent proposed that T should have his refund for 1956 providing that he would consent to a deficiency for 1955. The 1955 deficiency was less than the 1956 refund and T agreed.

Accordingly, in October 1958 he received a refund of \$1,200 for 1956 and he signed a Form 870AD permitting an assessment against him of \$700 for 1955, which he thereupon paid. The Form which he signed and which was accepted for the Commissioner recited that T agreed not to file or prosecute any claim for refund of income taxes for the year 1955 and that the Commissioner would not assert any further deficiency or otherwise reopen the income tax liability for that year, and all printed matter inconsistent with these added provisions was stricken out.

In May 1960 T decided that his original treatment had been correct. He filed claim for refund of the \$700 paid in October 1958 on the 1955 deficiency. The Commissioner rejected the claim on grounds of estoppel. Discuss the merits of the Commissioner's contention.

II.

Corporation dissolved in 1956 distributing its assets in final liquidation to T, sole stockholder, and T properly reporting capital gain on the excess of value of assets received over basis of stock cancelled. In 1958 the Commissioner timely determined an income tax deficiency for the year 1955 against the Corporation in the amount of \$5,000, charging T liable therefor as transferee of the Corporation's assets. T paid the deficiency and claimed the \$5,000 as an ordinary deduction upon his individual return filed for 1958. The Commissioner conceded the deductibility of the item by T but maintained that it must be treated as capital, rather than ordinary, loss in the view that had the Corporation properly paid its tax liability before dissolution T would have had \$5,000 less capital gain; that he had received the benefit of reporting the excess \$5,000 as capital gain; and therefore should have the commensurate disadvantage of now taking the deduction as a capital loss. T paid the deficiency determined by the Commissioner on the difference in tax between treatment of the \$5,000 as capital rather than ordinary loss, and then brought suit for refund, asserting that the \$5,000 payment was properly an ordinary loss deduction as there was no "sale or exchange" in 1958, the year of its payment by T. Upon litigation, the Commissioner raised the defense of equitable recoupment, asserting that T should be no better off tax-wise than if the Corporation had paid its tax liability before dissolution. What is your analysis as to the applicability of equitable recoupment in the circumstances?

III.

Bonds issued by a Corporation in 1957 were held to be stocks by the Tax Court in passing upon the Commissioner's disallowance of an interest deduction for 1957. The Court rested its determination upon findings that the so-called bonds had no fixed maturity date; that the interest was payable dependent upon earnings; and that restrictions upon sale of the bonds prevented their passing into the hands of non-stockholders. In 1958 a State Court, passing upon a creditor's action against the Corporation, held that the bondholders with respect to their bonds, unlike stockholders, were on a parity with general creditors. This point had not been raised by the Corporation in the Tax Court action. In 1959, with the additional support of the State Court decision, the Corporation is considering filing refund claims based upon claiming deductions (1) for the 1957 interest paid on the 1957 issued bonds; (2) for 1958 interest paid upon the 1957 issued bonds; and (3) for 1958 interest paid upon 1958 issued bonds identical in all respects with the bonds issued in 1957. Discuss the applicability of the doctrine of res judicata to the Corporation's proposed action.

IV.

E, acting as executor of an estate, was adjudged by the Probate Court to be entitled to a commission for services performed to date of \$5,000 in 1955. He did not, however, draw upon the estate assets for his commission, preferring to preserve the assets until the final distribution and his release. Upon the closing out of the estate in 1959 he was adjudged an additional \$5,000, and in that year drew the entire \$10,000 in satisfaction of his full commissions. He was advised by the one who prepared his individual tax return that the \$5,000 amount allowed him in 1955 was constructively received by him in that year, even though not having been reported by him as such, and that his only 1959 income tax liability was for the second \$5,000 allowed him in 1959. E submitted his 1959 return accordingly. Following audit in 1960 the Commissioner determined that the entire \$10,000 commissions were taxable in 1959, the year of actual receipt, and proposed a deficiency of the tax on the omitted \$5,000. As E's counsel you are convinced that either the Tax Court or a District Court will hold that the circumstances warrant a finding of constructive receipt of the \$5,000 in 1955. Will it be of any consequence in the applicability of Section 1312 to the situation whether E contests the payment of the deficiency in the Tax Court, or pays the deficiency and seeks refund in the District Court? Would your answer be any different if the \$5,000 omission in 1955 constituted more than 25% of the gross income shown on the 1955 return, but by the time the case could be concluded in either court, the 6 year statute would have expired?

V.

Concerning a corporate reorganization which had been concluded T Corporation requested a ruling as to its tax status, submitting a memorandum of law as to why it felt the requirements for tax free exchange had been satisfied in its case. The IRS rejected the arguments advanced by T and ruled that the transactions resulted in the recognition of gain. T replied that it did not "accept" the Ruling. However, knowing that the Ruling would be communicated to the local Director's office, and not wishing to face controversy at this time, the Corporation reported the exchange as a taxable one in its return for 1956 and paid the tax on the recognized gain. In 1960 a Supreme Court decision was published in which the Court held that the exchange was a non-taxable one in circumstances identical with those of T Corporation. Your advice is sought as to whether a refund claim for 1956, filed in May, 1960, might be considered timely in the circumstances. What is your analysis?

VI.

Disregarding the differing views that the respective courts may observe as to particular issue, what are the primary considerations in the choice between litigating a tax matter in (a) the Tax Court or the U.S. District Court? (b) the U.S. District Court or the Court of Claims?

VII.

- 1) venue
- 2) right of review
- 3) costs
- 4) jury trial
- 5) ~~time of decision~~ x

In 1958 a debt in the amount of \$3,000 became due and owing by Debtor to Creditor. D, unable to pay in full, agreed to pay C 10% of the amount of his \$6,000 annual salary payable to him by Employer until the debt was fully satisfied. D duly assigned to C such percentage of his salary, which assignment was a valid one under local law, and Employer was notified accordingly. D failed to pay his 1959 income tax liability of \$700 assessed against him in April, 1960. State law provides that one's salary may not be assigned, attached, nor otherwise subjected to execution of judgment or process of garnishment in excess of 15% of the total amount thereof. The Treasury notified Employer of D's tax liability, but did not otherwise file general notice of its claim, and demanded of Employer surrender to it of \$700 of D's 1960 salary. Employer seeks your advice as to what amounts of D's salary he must pay and to whom. What is your analysis?

VIII.

- Answer True (T) or False (F), and if False, briefly note in what respects:
- (a) One may, without fear of penalty, give himself the benefit of what to him is a reasonable doubt without further inquiry regarding the proper tax treatment of a transaction. F *am*
 - (b) One may, without fear of penalty, rely upon the advice of his tax advisor, whether attorney or accountant, so long as he is prudent in placing his confidence in the competence of such advisor. T
 - (c) The 5th Amendment privilege of refusing to produce tax books and records is not available to a taxpayer so long as the Revenue Service is seeking only to establish civil liability. T
 - (d) One who deliberately fails to file a tax return with the motive of thereby hoping to evade payment of his tax liability is guilty of a felony, whereas one who deliberately fails to file a return out of mere indifference to his obligation in that respect but knowing that he should file a return is guilty of a misdemeanor. T