1971

Tax Administration and Procedure: Final Examination (May 1971)

William & Mary Law School
I. (40 points)

In 1957 the taxpayer (T) purchased 100 of the outstanding shares of stock in X Company, paying $100 per share which was its fair market value at that time. From that date to the present, T's father (F) has owned 800 shares and the remaining 100 shares have been owned by T's brother (B). During the years 1962-1963, T was the General Manager of X Company and received a regular salary of $20,000 per year. F was the President and B was an officer of the Company.

Late in December of 1962, T was married to W. On that occasion, F wanted to do something for his son. Accordingly, pursuant to appropriate corporate resolutions adopted in that month, F then caused X Company to set aside for T's benefit 120 shares of Y stock which X Company had acquired as an investment. However, the Y stock certificates were not delivered to T until January of 1963. At that time and in the proceeding month, the fair market value of the 120 shares of Y stock was $6,000 ($50 per share). Under identical circumstances, an equivalent amount of Y stock had been set aside for B late in 1960 and delivered to him in 1961. In his 1960 return, B reported the full value of all of the Y shares set aside for him in that year.

T filed timely income tax returns for years 1962 and 1963, reporting his $20,000 salary in each year. In his 1962 return, he also reported a short term capital gain of $4,000 realized from the sale of some bonds in that year. In his 1963 return, in addition to his salary, he included as additional compensation the value of 24 shares of the Y stock. However, proceeding on the theory that the remaining 96 shares represented in effect a tax-free wedding gift from F, he did not report their value as income. The tax liability shown in the returns for the two years was promptly paid.

In January of 1967, the Commissioner mailed a 90 day letter to T asserting a deficiency for the year 1963 as a result of adding the value of the 96 Y shares to taxable income for that year. On March 10, 1967, T filed a petition in the Tax Court in which, in addition to contesting the deficiency, he claimed a refund of tax attributable to the value of the 24 shares he had originally included as taxable income in 1963 return. At a subsequent hearing and in his briefs, T contended (1) that nothing was properly taxable in 1963, because whatever income he had from the Y stock was realized in 1962, or in the alternative, (2) that not more than $1,200 was taxable in 1963, the remaining $4,800 being exempt under Section 102(a) of the Code. In the event that the first of the foregoing contentions should be accepted, T requested a finding that he had overpaid his 1963 tax.

The Tax Court agreed with T's second contention, but rejected his first one. Consequently, on March 10, 1969, it entered in order expunging the deficiency, but refusing to find an overpayment. The Commissioner filed a notice of non-acquiescence as to the exemption issue, but then believing that the correct year was 1962 rather than 1963, he decided not to appeal. Nor did T appeal from the decision relating to the claimed overpayment.
Question I (continued)

In the meantime, B had been litigating in a refund suit the question whether any part of the Y stock received by him was exempt as a gift, and if not, whether 1960 or 1961 was the correct year. In January of 1970, the U.S. Court of Appeals held that the entire value of B's Y stock was taxable as compensation in the year 1960, as he had originally reported it. Hereafter, that decision should be assumed to be correct.

On February 20, 1970 the Commissioner mailed a 90 day letter to T asserting a deficiency for the year 1962 as a result of adding the entire value of the 120 Y shares ($6,000) to his taxable income for that year. T did not file a petition in the Tax Court. Instead he filed an ordinary form 870 on February 25, 1970 and the deficiency was assessed and paid on March 9, 1970. On May 22, T will file a claim for refund of the amount so paid.

(A) In your opinion should the claim be allowed or rejected, either in whole or in part? Discuss all theories which support your answer.

(B) Same questions and directions as in part A though repetition should be avoided. For purposes of this part B, assume all of the facts stated above except that the following should be substituted for the 5th paragraph of this question. The Tax Court agreed with T's first contention, and therefore found it unnecessary to pass on the second one. Consequently, on March 10, 1969 it entered an order expunging the deficiency for 1963, and finding an overpayment in the amount requested by T which was duly refunded. Being then persuaded that the correct year was 1962, rather than 1963, the Commissioner acquiesced in the decision of the Tax Court and did not appeal.

(C) For the purpose of this part, disregard the modifications stated in the preceding paragraph B. Assume all the facts stated in the first six paragraphs of this question with the following exception: In 1962, T received a salary of $12,000 (not $20,000), and reported the $12,000 in his return for that year, together with the $4,000 capital gain referred to in the 3rd paragraph of this question.

The Commissioner today (May 22, 1964) mailed the 90 day letter to T asserting a deficiency for the year 1962 as a result of adding the entire value of the 120 Y shares to his taxable income for that year. T will file a timely petition. As a law clerk for the Tax Court Judge who will hear and decide the case, state precisely what conclusions you think he should reach and give your reasons.

(D) Disregard all of the facts stated above except those appearing in the first paragraph and in the first sentence of the second paragraph of this question. In 1964, X Company made a distribution to its stockholders of $30 per share. T thus received $3,000 which he reported as a dividend in his 1964 return. In 1966 when the X stock was worth $140 per share, he made a gift of his 100 shares to his wife (W). She sold those shares to B in 1960 for $15,000. In her separate return for that year, she reported a profit of $5,000, using as required by Section 1015, what she thought was T's basis ($10,000). After a deficiency was asserted, a final determination resulted in December of 1963 fixing her basis at $7,000 thus increasing her profit to $8,000 ($15,000 less $7,000). The Commissioner's contention, and the ground of the determination had been that the 1964 distribution to T was not made out of X Company's earnings and profits and therefore it must be applied in reduction of the basis of the stock. Can T now get a refund for 1957?
II. (15 points)

Taxpayer timely filed his tax return for calendar year 1969 on which he included, as income, $4,000 he received from his aunt which increased his tax liability by $1,500. In 1971, during a conversation with his aunt, taxpayer was reminded that the $4,000 was a gift and was for that reason tax free.

Accordingly, the taxpayer filed a claim for refund in January 1970. However, the Commissioner promptly disallowed the claim on the theory that the $4,000 was actually compensation to taxpayer for his work in caring for his aunt's business transactions. Taxpayer then filed a suit for refund in the Court for Claims.

In the course of his investigation, the Commissioner finds that taxpayer erroneously treated certain transactions as long term capital gains when, in reality, they should have been treated as short term capital gains. This caused the Commissioner to send taxpayer a 90 day letter asserting a deficiency of $1,000. A 90 day letter was received while the Court for Claims suit was in progress.

As his counsel, advise taxpayer as to what courses of action are open to him and what results will flow therefrom. Discuss thoroughly.

III. (15 points)

A Revenue Agent, during a field audit of taxpayer's 1969 calendar year tax return, determined that taxpayer had failed to report all his income. A special agent was called in to investigate.

The Special Agent decided to make a net worth investigation for 1969 and 1970. He had the following information:

(1) In 1967 taxpayer purchased 1,000 shares of X Co. stock for $40,000 and 2,000 shares of Y Co. stock for $10,000.

(2) In 1968 he inherited $20,000 from his father.


(4) Taxpayer spent approximately $20,000 per year in living expenses.

(5) Taxpayer's bank balance was $40,000 at the end of 1968. He increased it by $2,000 deposits in each year, (1969 & 1970).

(6) Taxpayer sold his X and Y stock in 1969 for $60,000 and $5,000 respectively.

(7) In 1968 his aunt gave him $10,000.00
Question III (continued)

(8) Taxpayer spent $5,000 in 1969 and
1970 to send his daughter to college.

(9) Taxpayer's tax liability in 1967,
1968, 1969 & 1970 was $5,000, $10,000,
$15,000, and $25,000, respectively.

(10) Taxpayer borrowed $20,000 from A in
1970.

(11) Taxpayer's tax returns show taxable
income of $15,000, $25,000, and
$30,000 respectively for 1968, 1969,
and 1970.

The Special Agent asks you to make a net worth statement. Explain any
inferences you make, if any.

IV. (30 points)

(A) On May 7, 1969, the Commissioner sent a 90 day letter to taxpayer
stating that certain Business Expense deductions were disallowed for cal-
endar year 1967. Taxpayer paid the deficiency on July 17, 1969. On October
1, 1969, he brought a petition in the Tax Court based on the deficiency. In
his petition the taxpayer argues that the Business Expense deductions were
improperly disallowed and that he, in fact, understated his expenses for
1967.

The Commissioner answered under 14(b) denying each material allegation
of fact.

During the trial the Commissioner, perceiving that he was losing the
case, made a motion that the case be dismissed for lack of Jurisdiction.

How should the court rule?

(B) Suppose in Part A above that the taxpayer paid the deficiency on
July 17, 1969 but brought a claim for refund in District Court on October
1, 1969.

The Commissioner makes a motion to dismiss for lack of Jurisdiction.

How should the court rule?

(C) Sam and Mary Jones filed a joint tax return for calendar year 1968
on which they reported certain miscellaneous deductions. The Commissioner,
because the deductions could not be substantiated, sent to Sam & Mary a 90
day letter on January 17, 1970.

On January 18, 1970, Sam files a petition in the Tax Court alleging
error in the Commissioners determination.

The Commissioner moves for lack of Jurisdiction.

How should the court rule?