1962

Adjective Tax Law: Final Examination (May 1962)

William & Mary Law School

ADJECTIVE TAX LAW

Final Examination

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I

In 1950 T purchased a tract of land for $50,000. Subsequently, he divided the tract into 50 lots of equal size and contour, and in 1956 he sold 20 of the lots for $40,000. In his return for that year, filed in April, 1957, he reported $25,000 gross income from his insurance business but did not report the sale of the lots, having been advised by his bookkeeper who regularly prepared his tax returns and believing in good faith that he would have no income therefrom until he had recovered his $50,000 cost.

In 1957 he sold the balance of 30 lots for $60,000, reporting capital gain of $50,000 in his return for that year, filed April, 1958, consistent with his view that all amounts received in excess of the $50,000 cost should be treated as income.

T's 1957 return was audited and in June, 1960, he received the agent's notice of proposed adjustments, asserting that the $50,000 reported gain should be treated as ordinary income from the sale of property held for sale to customers in the ordinary course of business and not as capital gain. A formal protest was immediately filed by T's attorney which set forth in substance the following position: that $1,000 of T's $50,000 cost should have been allocated to each of the 50 lots; that consequently T's basis for the 30 sold in 1957 was $30,000, resulting in gain on the sale of only $30,000 and not $50,000 as reported; however, in view of T's 1956 underpayment, he was willing to let sleeping dogs lie providing that the Commissioner did not persist in and pursue the ordinary income contention.

Having no use for sleeping dogs, immediately upon receiving this protest the Commissioner discontinued audit of the 1957 return and issued a statutory notice of deficiency letter for the year 1956, grounded upon T's omission of $20,000 ordinary income upon the sale of the 20 lots in that year and adding a 5% negligence addition. T paid the determined tax deficiency, penalty and interest, and thereupon filed claim for refund for 1956 for the full amount so paid. The refund claim was denied in May, 1961, and T commenced action in the District Court for recovery of the alleged 1956 overpayment.

In addition to contesting the issue of capital gain vs ordinary income on its merits, T also made the following contentions:

(a) That at the time of issuance of the statutory notice for 1956 the statute of limitations for assessment of deficiencies for that year had run and T's payment was therefore an overpayment which should be refunded.

(b) That in any event, imposition of the negligence addition was erroneous in the circumstances and should be refunded.

(c) That in any event, equitable recoupment is appropriate so as to permit offset of the 1956 deficiency by the 1957 overpayment resulting from his having erroneously paid a tax on $50,000 instead of $30,000 gain in that year.

Discuss the merits of each of the above (a), (b) and (c) contentions.

Following trial in the District Court, judgment was rendered in February, 1962, for the Government and against T on all issues, the Court holding that $1,000 of the $50,000 cost was fairly allocable to each of the 50 lots and that consequently T realized gain of $20,000 upon the sale of 20 of them for $40,000; further, that by reason of the number of sales of lots made by T in 1956, he was in the business of selling them and his gain should be treated as ordinary income. T took no appeal but filed a formal refund claim for 1957, grounded upon realizing capital gain of only $30,000 on the sale of the 30 lots in that year instead of $50,000 as reported, and further asserting:

(d) That the claim constituted a permissible amendment of the timely informal claim filed by way of protest in June, 1960.

(e) That in any event the claim was timely by force of the mitigation provisions, IRC Secs 1311 and either or both 1312(1) and 1312(7).

(f) That the District Court judgment was res judicata that his basis was $1,000 for each of the 30 lots sold, but not on the issue of capital gain vs ordinary income upon the 1957 sales.

II

T entered into a contract of sale of some real property which he owned late in the year 1956, pursuant to the terms of which a substantial down payment was made to him with deed to be given and balance of payment to be made early in 1957. He included the total gain on the sale in his 1956 return, filed in April, 1957.

T's return for the year 1957, filed in April, 1958, was audited and in July, 1959, a deficiency was proposed in the total amount of $8,000, of which $5,000 was attributable to his failure to include the gain on the sale in 1957, and $3,000 to over-depreciation on equipment resulting from T's failure to accord proper salvage value. Conferences followed to the level of the Appellate Division, where an agreement was reached that T would be allowed a refund for 1956 of $3,500 by reason of eliminating the gain on the sale from that year of lower tax bracket; pay the deficiency of $5,000 for 1957 resulting from including the gain on the sale in that year; and the 1957 over-depreciation claim to be withdrawn. In December, 1959, a Form 870 A.D. was executed on that basis and stipulating that T agreed not to bring any subsequent claim for refund and the Commissioner agreed not to assert any further deficiency with regard to the year 1957. Simultaneously T paid $1,500 and was allowed a credit for the $3,500 1956 overpayment in satisfaction of the balance.

In May, 1961, the Supreme Court of the United States decided an analygous case, holding that if the purchaser was given the right to possession in the contract year, the sale was concluded for tax purposes in that year and not in the later deed year. T immediately filed claim for refund in the amount of $5,000 for 1957, grounded upon the gain on the sale having been taxed in that year. The claim was forthwith denied.

In October, 1961, he commenced action against the United States in the District Court, asking for judgment for $5,000, and alleging: (1) overpayment of tax in the amount of $5,000 by reason of the erroneous inclusion of the gain on the sale of the realty in 1957; and (2) loss on the sale of securities to his brother-in-law in that year which, if claimed and allowed would have reduced his tax liability for that year by $2,000, not previously claimed because T had erroneously supposed the loss to be non-deductible by reason of the relationship.

The Government contended:

(a) The Form 870 A.D. was binding upon the parties, having been entered into on a give and take basis with that intent.

(b) That T is estopped from claiming any refund on issue (1) above since the refund for 1956 was allowed to him conditionally upon his acceding to pay the tax on the gain for 1957, and his acceptance thereof misled the Government to its detriment.

(c) That in no event can T recover more than the $1,500 actually paid in December, 1959, the statute of limitations having run with respect to any excess.

(d) That the statute of limitations had run with respect to basing any claim upon item (2) above.

(e) That in any event the claim based upon item (2) should be stricken as no refund claim had been timely filed with respect thereto.

(f) That if either the Government's (d) or (e) contention is correct, then even though all of the others may be held against it, in no event can T recover more than $2,000 if the Court should find that T did over-depreciate his equipment in the amount of $3,000 in tax liability.

Discuss the merits of each of the Government's (a) through (f) contentions in the circumstances.

III

What is the primary issue to be resolved in the determination of the controversy as to whether the books and records of an individual taxpayer are within the privilege accorded by the 5th Amendment? (You are asked only to pin-point the issue and not to discuss it at length).