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Adjective Tax Law: Final Examination (May 1965)

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ADJUTANT GENERAL

Final Examination

May, 1968

On December 1, 1959, X Corporation declared a dividend payable on December 31 to stockholders of record as of December 15. The dividend was to be paid in cash or, at the election of the stockholder, one share of pfd stock equal in value to the cash that otherwise would have been paid on each five shares of com stock held by him. Taxpayer, T, elected to take 100 shares of pfd stock on his 500 com shares and received the pfd shares from X on January 2, 1960. In his income tax return for 1959, filed in April, 1960, T reported all of the facts and in good faith treated the distribution as a non-taxable stock dividend. This return was audited by the IRS in 1961 and the agent contended that it was a taxable dividend in 1959 as T was on the accrual basis and could have elected to take cash. No agreement was reached in conferences and following a timely statutory notice of deficiency, filing of T's petition with the Tax Court and trial of the case, the TC held in May, 1965, that although the dividend was a taxable one, it was income as of T's receipt of the stock and therefore expunged the 1959 deficiency. T's 1960 return had been timely filed in April, 1961, and was otherwise correct but for the omission of the dividend income. Following expiration of the time to appeal from the decision of the TC, the Com sent T a statutory notice of deficiency for the year 1960 in the amount of the unpaid tax on the dividend.

1. May the 1960 deficiency be successfully contested on the grounds of the running of the statutory period for assessments for that year?

In 1961 T sold his 500 X com shares on which the pfd stock dividend had been distributed. In his 1961 return, filed in April, 1962, T had computed the gain on the sale of the com stock on a cost basis reduced by an allocation of a part of that basis to the pfd stock, consistent with his treatment of the distribution of the pfd stock as a non-taxable stock dividend. In June, 1962, T filed his "protest" to the agent's audit report on the 1959 return and set forth therein that if the agent's determination that the dividend was a taxable one should be upheld, his basis for computation of the gain on the 1961 sale of the com stock should have been full cost of the com stock, not reduced by any allocation to the pfd stock, and accordingly he overpaid his 1961 tax.

2. Is there any valid purpose for which T might be permitted to introduce the 1961 overpayment at the TC trial of the Com's alleged 1959 deficiency?

3. Following the TC decision in May, 1965, that the distribution of the pfd stock was a taxable one but not in 1959, would T's filing of a claim for refund of the 1961 overpayment resulting from his improper reduction of the com stock basis be a timely one?

4. If T does file claim for refund of the 1961 overpayment and it is denied by the Com solely on the grounds that it has not been established that the pfd stock distribution to T was a taxable dividend (the Com not yet having been successful in collecting the 1960 deficiency), may T successfully assert the May, 1965, TC decision as being res judicata on that issue?

Assume that T's refund claim for 1961 is denied solely on the grounds that it is not timely; that T files suit in the District Court and the Court sustains the Cmr on this point and dismisses T's suit; that subsequently the Tax Court, on T's petition in response to the Cmr's statutory notice of the 1960 deficiency, denies T's defense of the running of the period for assessments for that year and sustains the Cmr's determination of the deficiency for the tax on the 1960 dividend received by T.

5. May T now re-open the 1961 overpayment issue under any of the provisions of IRB Sec 1312?

6. Assuming that some one of these provisions may be applicable, will the District Court's dismissal of T's prior suit to recover the overpayment be a bar to this one?

7. If instead of petitioning the TC in response to the Cmr's statutory notice of deficiency for 1960, T had paid the asserted deficiency and then filed claim for its refund, following up with suit in the District Court, could he still have raised the issue of the running of the period for assessments for that year, or would he be held to have waived that point by payment of the deficiency with knowledge?

8. Assuming that he had followed this latter course of action, discuss the propriety of his contention before the District Court that he should be permitted to offset his 1960 liability by the amount of his 1961 overpayment.

9. In 1960 T was a small business proprietor. His business books and records were regularly audited by a professional accountant, but T kept his own records of his non-business transactions and prepared his own individual tax returns, and thus the accountant had no part in advising on the treatment to be accorded to the paid stock distribution. Should the 1960 deficiency determination be upheld, discuss T's potential liability for a 5% addition to the tax based on asserted negligence.