Preface xxix
Acknowledgments xxxi

CHAPTER 1
INTRODUCTION 1

A. Development of the Income Tax 1
1. Introduction 1
2. Constitutionality of the Income Tax 3
   Hellermann v. Commissioner 7
   Perry v. Commissioner 8

B. The Structure of the Tax Law 11
1. Tax Policy: Equity and Efficiency Goals 11
   Joint Committee on Taxation, Description and analysis of
   Proposals to Replace the Federal Income Tax 13
   Report of the President’s Advisory Panel on Federal
   Tax Reform, Simple, Fair and Pro-Growth: Proposals
   to Fix America’s Tax System 13
2. The Progressive Rate Structure 17
   Pine, Everyone’s a Critic of U.S. Tax System 18
3. Macroeconomic Growth and Income Taxation 20
   Tax Incentive Act of 1981 20

C. Illegality and Ethical Considerations 22
   United States v. Greenberg 23

D. The Taxing formula 24
CHAPTER 2
THE CONCEPT OF GROSS INCOME

A. Introduction

B. Forms of Gross Income
   1. Compensation for Services and Sale of Appreciated Property
      Problem 2-1
      Problem 2-2
   2. Income without Receipt of Cash
      McCann v. United States
      Note on United States v. Gotcher
      Problems 2-3 through 2-6
   3. Barter Transactions
      Rev. Rul. 79-24
      Problem 2-7
   4. Unanticipated Gains
      Cesarini v. United States
      Problems 2-8, 2-9
   5. Prizes and Awards
      Turner v. Commissioner
      Problems 2-10, 2-11

C. The Role of Debt In Gross Income
   1. What is Debt?
   2. Receipts Subject to Claims
      Inductotherm Industries, Inc. v. United States
      Kreimer v. Commissioner
      Problems 2-12 through 2-14
   3. Discharge of Indebtedness
      Zarin v. Commissioner
      Rood v. Commissioner
      Problem 2-15

D. Limitations on Gross Income
   1. Recovery of Capital
      Rev. Rul. 81-277
      Note on Return of Human Capital
      Problems 2-16 through 2-18
   2. Unrealized Gains
      Note, Realizing Appreciation without Sale: Accrual
      Taxation of Capital Gains on Marketable Securities
   3. Imputed Income
      Commissioner v. Daehler
      Problems 2-19, 2-20
   4. Administrative Exceptions to Gross Income
      Announcement 2002-18
      Rev. Rul. 98-19
      Ir-98-56
      Problem 2-21

E. Disposition of Property
   1. Gains on the Disposition of Property
2. The Realization Requirement
   *Cottage Savings association v. Commissioner* 78
   Note 83
   Problem 2-22 84
3. Special Issues in Determining Adjusted Basis 84
   a. Taxable Exchanges of Property 84
      Problems 2-23 through 2-25 86
   b. Debt Incurred in the Acquisition of Property 86
      *Crane v. Commissioner* 88
      Problem 2-26 92
   c. Debt Incurred after Property Acquisition 92
4. Amount Realized from Debt Relief 93
   a. Nonrecourse Indebtedness 94
      *Commissioner v. Tufts* 95
   b. Recourse Indebtedness 102
      Rev. Rul. 90-16 102
      Problems 2-27, 2-28 104
      Problem 2-29 105
5. Discharge of Indebtedness Redux: Reconciling Tufts and Zarin 105
   *Preslar v. Commissioner* 106

**CHAPTER 3**

**ITEMS EXCLUDED FROM GROSS INCOME** 111

A. Overview 111
B. Gifts and Bequests 112
   1. Introduction 112
      *Olk v. United States* 114
      Note on Gift versus Compensation 117
      Problems 3-1 through 3-3 118
      Problems 3-4, 3-5 119
   2. Section 1015—Başış for Property Received as a Gift 119
      Problem 3-6 121
   3. Basis of Property Acquired by Bequest, Inheritance or Devise 121
      Problem 3-7 123
   4. Part Sale/Part Gift Transactions 123
      *Diedrich v. Commissioner* 124
      Problem 3-8 128
C. Employee Benefits 128
   1. Introduction 128
   2. Meals and Lodging 129
      *Commissioner v. Kowalski* 130
      *Adams v. United States* 133
      Problems 3-9 through 3-12 138
      Problem 3-13 139
   3. Reimbursed Employee Expenses 139
   4. Employee Fringe Benefits 140
      a. Introduction 140
b. Section 132 — Statutory Criteria for Excludable Fringe Benefits
   Notice 2011-72 142
   Rev. Rul. 2006-57 149
   Problem 3-14 151
   Problem 3-15 152

D. Cafeteria Plans
   Notice 2005-42 153

E. Life Insurance
   Problem 3-16 157

F. Health Insurance and Other Compensation for Personal Injuries and Sickness
   a. Employer-provided Health Insurance
      Note on Insurance Mandates and Tax Penalties 159
   b. Damages for Physical Injuries and Sickness
      Small Business Job Protection Act of 1996 162
      Problems 3-17, 3-18 163
      Problem 3-19 164

G. Discharge of Indebtedness
   Bankruptcy Tax Act of 1980 165
   Rev. Rul. 92-53 167
   Problem 3-20 169
   Problem 3-21 170

H. Gains from the Sale of a Primary Residence
   Joint Committee on Taxation, General Explanation of Tax Legislation Enacted In 1997 Jcs-23-97 170
   Problem 3-22 172

I. Other Miscellaneous Exclusions
   1. Tax-exempt Interest 173
   2. Social Security
      Goldin v. Baker 174
      Problem 3-23 177

J. Policy Considerations
   1. Temporary versus Permanent Exclusions: the Relationship of Debt, Gross Income, and Basis
      Bailey v. Commissioner 178
   2. Protecting the Tax Base
      Bittker, a "Comprehensive Tax Base" as a Goal of Income Tax Reform 181

C H A P T E R 4
CHOOSING THE PROPER TAXPAYER 191

A. assignment of Income — Services
   1. The Concept of Income Splitting 191
   2. Shifting Income within the Family by Gratuitous Transfer
      Teschner v. Commissioner 195
3. Shifting Income within the Family within the Family by Compensatory Arrangement
   
   *Fritschle v. Commissioner* 199
   *Problems 4-1 through 4-3* 202
   *Problem 4-4* 203

B. Assignment of Income — Property
   1. Appreciated Property Transferred by Gift 203
   2. Transfers of Income from Property
      *Helvering v. Horst* 204
   3. Property and Income Transfers Compared
      *Meisner v. United States* 207
      *Commissioner v. Banks* 208
   4. Substance versus Form Analysis
      *Ferguson v. Commissioner* 212

5. Dividends on Stock 216

   *Problem 4-5* 218
   *Problem 4-6* 219

C. Below-Market and Interest-Free Loans
   1. Interest-free Loans as an Income-shifting Device
      *Joint Committee on Taxation, Explanation of the Tax Reform Act of 1984* 221
   2. The Mechanics of §7872
      *KTA-Tator, Inc. V. Commissioner* 230
      *Problems 4-7 through 4-9* 233

D. Divorce and Alimony
   1. Alimony versus Property Settlements 234
   2. Statutory Requirements 235
   3. Property Transfers between Spouses
      *Rev. Rul. 2002-22* 237
      *Problem 4-10* 239

CHAPTER 5
TIMING OF GROSS INCOME

A. General Principles
   1. Annual Accounting Period
      *Problems 5-1, 5-2* 241
   2. Tax Accounting Method 243
   3. Relief Provisions 244

B. Cash Method of Accounting
   1. Cash Equivalency
      a. Negotiable Instruments as Payment for Services
         *Kahler v. Commissioner* 245
      b. Other Obligations as Payment for Services
         *Cowden v. Commissioner* 247
c. Distinguishing Negotiable Instruments and Other Promises to Pay 248
   Bright v. United States 248
   Problem 5-3 250
2. Actual versus Constructive Receipt 251
   Miele v. Commissioner 252
3. Contractual Agreements Postponing Receipt 254
   Reed v. Commissioner 255
   Problem 5-4 262
   Problem 5-5 263
4. Promises to Pay in the Future: Deferred Compensation 264
   Rev. Rul. 60-31 264
5. Treatment of Nonqualified Deferred Compensation Plans 268
   Joint Committee on Taxation General Explanation of Tax Legislation Enacted in the 108th Congress 268
   Problem 5-6 270
6. Section 83: Property Received for Services Performed 271
   Rev. Rul. 2007-49 273
   Problem 5-7 276
C. Accrual Method of Accounting 276
1. All Events Test 276
2. Fixed Rights to Receipt 277
   Flamingo Resort v. United States 277
3. Timing of Inclusion of Various forms of Income 280
   a. Interest Income 280
   b. Dividend Income 280
   c. Sales in the Course of a Trade or Business 281
   d. Prepayment for Services 281
      RCA v. United States 282
      RCA v. United States 289
      Note 291
      Problem 5-8 292
      Problems 5-9 through 5-12 293
4. Security Deposits 294
   Commissioner v. Indianapolis Power & Light Co. 295
   Note on Prepayments vs. Deposits: the Problem of Volume Discounts 299
   Problems 5-13, 5-14 301
5. Mandatory Accrual Method: Original Issue Discount 302
   a. Introduction 302
   b. The OID Rules 303
      Problem 5-15 305
D. Judicial Exceptions Postponing Inclusion 305
   Kitchin v. Commissioner 306
   Note 308
   Problem 5-16 309
E. Deferred Payment Sales of Property 309
1. Closed Transaction Reporting 310
2. Open Transaction Reporting

   Burnet v. Logan 312
   Problem 5-17 313

3. Installment Reporting

   Estate of Silverman v. Commissioner 316
   Note 321
   Problem 5-18 321
   Problems 5-19, 5-20 322
   Note on Disposition of Installment Obligations 322
   United Surgical Steel Co. v. Commissioner 323
   Note on Pledges of Installment Obligations 326
   Problem 5-21 327
   Note on Installment Sales of Encumbered Property 327
   Problems 5-22, 5-23 329
   Problem 5-24 330

F. Nonrecognition of Gross Income

1. Like-kind Exchanges

   Moore v. Commissioner 332
   Note on Mixed Investment / Personal Properties 335
   Note on Deferred Multiparty Exchanges 335
   Rev. Rul. 90-34 336
   Note on the Basis of Acquired Property 337
   Rev. Rul. 79-44 340
   Note 342
   Installment Sales Revision Act of 1980 343
   Problems 5-25, 5-26 344
   Problem 5-27 346

2. Involuntary Conversions

   Liant Record v. Commissioner 348
   Rev. Rul. 76-319 349
   Problem 5-28 350

CHAPTER 6

DEDUCTIONS FOR TRADE OR BUSINESS EXPENSES 351

A. Deductions — In General 351
B. Adjusted Gross Income 352
C. Statutory Requirements for Business Deductions 354
   1. Ordinary and Necessary 354
      Mason and Dixon Lines, Inc. v. United States 355
      Trebilcock v. Commissioner 356
      Note 358
      Problems 6-1, 6-2 358
      Problems 6-3, 6-4 359
   2. Defining a Trade or Business
      Commissioner v. Groetzinger 360
      Note 365
      Problem 6-5 366
3. Expenses Incurred in a Trade or Business 367
   *Pevsner v. Commissioner* 368
   Problems 6-6, 6-7 370

4. Current Expense versus Capital Expenditure 370
   *Rev. Rul. 92-80* 371
   Note on Repairs vs. Improvements 372
   *Commissioner v. Idaho Power Co.* 374
   Note on Capitalization of Inventory 378
   Problems 6-8, 6-9 379

D. Statutory Deductions for Mixed Business-Personal Expenses 379

1. Business-related Travel 380
   a. Commuting Expenses 380
      Problems 6-10 through 6-12 382
   b. The Tax Home Doctrine 382
      1. Business vs. Personal 383
      *Hantzis v. Commissioner* 383
      Note 388
      Problem 6-13 389
   2. Temporary vs. indefinite travel 390
      *Rev. Rul. 93-86* 390
   c. Travel Away from Home 393
      *Bissonnette v. Commissioner* 393
   d. Multiple Homes 396
      *Wilbert v. Commissioner* 396
      Problem 6-14 401
   e. Exceptions for Specific Mixed Business/Pleasure Travel 401
      Problem 6-15 404

2. Education Expenses 404
   a. Education versus Personal Expenses 405
      Problem 6-16 406
      Problems 6-17, 6-18 407
   b. Minimum Education Requirements 407
      *Wassenaar v. Commissioner* 407
      Note 410
   c. New Trade or Business Limitation 411
      Problems 6-19 through 6-21 412

3. Entertainment Expenses 412
   a. General Requirements for the Deduction 413
      *Walliser v. Commissioner* 414
   b. Entertainment Facilities 418
   c. Substantiation Requirements and the 50-Percent Limitation 419
      Problems 6-22 through 6-24 421
   d. Business Meals 422
      1. Requirements for the Deduction 422
         *Moss v. Commissioner* 423
      2. Amount of the Deduction 426
         Problem 6-25 426
C H A P T E R 7
CAPITAL GAINS AND LOSSES

A. Introduction
Joint Committee on Taxation, Tax Treatment of Capital Gains and Losses

B. Mechanics of Capital Gain and Loss
1. Background
2. Overview of Capital Gain and Loss analysis
3. Definitions and Netting Rules
4. Capital Loss Deduction
5. Carryover of Capital Losses
6. Capital Gain Exclusion
Problems 7-1 through 7-3

C. Definition of a Capital asset
1. Statutory analysis
   Corn Products Refining Co. v. Commissioner
   Arkansas Best Corp. v. Commissioner
Problems 7-4, 7-5
2. Special Issues in Capital Gains: Property Held Primarily for Sale
   
   United States v. Winthrop 483
   
   Note on Liquidation of Investment Doctrine 487
   
   Suburban Realty Co. v. United States 488
   
   Problem 7-6 497

D. Sale or Exchange Requirement 497
   
   Rendall v. Commissioner 499
   
   Problem 7-7 501

E. Holding Period 502
   
   1. Computing the Holding Period 502
   
   2. Tacked and Split Holding Periods 503
      
      Citizen's National Bank of Waco v. United States 504
      
      Problems 7-8, 7-9 507
      
      Problems 7-10 through 7-13 508

F. Section 1231 — Property Used In a Trade or Business 508
   
   International Shoe Machine Corp. v. United States 511
   
   Problems 7-14 through 7-16 514

G. Assignment of Income 514
   
   Lattera v. Commissioner 519
   
   Problem 7-17 522

H. Recapture of Depreciation 523
   
   1. General Principles 523
      
      Legislative History of §1245 (Gain from the Disposition of Certain Depreciable Property) 525
      
   2. Installment Sales 526
      
      Problem 7-18 527
      
      Problem 7-19 528

I. Sale of Business 528
   
   Williams v. Mcgowan 529
   
   Problem 7-20 531

J. Section 1237 — Statutory Immunity for Subdivided Real Property 531
   
   Pointer v. Commissioner 532
   
   Problem 7-21 534

K. Original Issue Discount and Imputed Interest 535
   
   1. Statutory Framework 536
      
      Joint Committee on Taxation, Staff Pamphlet Describing Tax Treatment of Imputed Interest on Deferred Payment Sales of Property 537
      
   2. Applying the New Regime 540
      
      Problems 7-22 through 7-25 541

L. Policy Considerations 541
   
   Joint Committee on Taxation, Tax Treatment of Capital Gains and Losses 542
A. Introduction 547

B. Investment Activity 550
   1. Production of Income Expenses 550
      Rev. Rul. 84-113 551
      Note 553
   2. Personal versus Investment Expense 551
      Rev. Rul. 86-71 551
      Note on Legal Expenses and Pre-opening Costs 556
      Problems 8-1, 8-2 558
   3. Capital Expenditure Limitation 554
      Rev. Rul. 86-71 555

C. Hobby Losses 558
   1. Mechanics 559
   2. Profit Motive Defined 560
      Dreicer v. Commissioner, 665 F.2d 1292 (D.C. Cir. 1981) 562
      Dreicer v. Commissioner, 78 T.C. 642 (1982) 564
      Problems 8-3, 8-4 566
   3. Vacation Home Rentals 567
      Bolton v. Commissioner 570
      Note 577
      Problems 8-5, 8-6 577
      Problem 8-7 578

D. Investment-Personal Deductions 578
   1. Bad Debts 578
      United States v. Generes 579
      Problems 8-8, 8-9 583
      Problems 8-10, 8-11 584
   2. Home Mortgage Interest 584
      Rev. Rul. 2010-25 584
      Sophy v. Commissioner 586
   3. Other Interest Expenses 589
      Problems 8-12, 8-13 591
   4. Taxes 591
      Rev. Rul. 79-180 593
      Problems 8-14, 8-15 595

E. Personal Deductions 595
   1. Casualty Losses 595
      Rev. Rul. 72-592 596
      Rev. Rul. 79-174 598
      Popa v. Commissioner 599
      Note on Other aspects of Casualty Loss Deduction 602
      Problems 8-16 through 8-19 604
   2. Charitable Contributions 605
      Hernandez v. Commissioner 606
      Sklar v. Commissioner 609
### Contents

Note on Mechanics and Limitations 616
Problems 8-20 through 8-22 617
Problems 8-23, 8-24 618

3. Medical Expenses 618
   Rev. Rul. 75-187 619
   Rev. Rul. 75-319 620
   Rev. Rul. 97-9 620
   Rev. Rul. 2007-72 621
   Announcement 2011-14 623
   *Magdalin v. Commissioner* 623
   Note on Cosmetic Surgery 625
   Rev. Rul. 2003-57 626
   Problem 8-25 628

F. Floor on Miscellaneous Deductions and Overall Limitation on Itemized Deductions 628
   Problems 8-26, 8-27 630

G. The Standard Deduction 630
   Problems 8-28, 8-29 631

H. Policy Issues 631
   Surrey, Tax Incentives as a Device for Implementing Government Policy: a Comparison with Direct Government Expenditures 632

---

### CHAPTER 9

#### TIMING OF DEDUCTIONS AND TAX SHELTERS 641

A. Introduction 641

B. Cash Method Accounting 642
   1. Payment versus Promise to Pay 642
      *Chapman v. United States* 644
      Rev. Rul. 78-38 646
   2. The Capital Expenditure Limitation 647
      Problem 9-1 648
      Problems 9-2, 9-3 649

C. Accrual Method Accounting 649
   1. Reasonable Accuracy Test 650
   2. All Events Test 650
      *Chrysler Corporation v. Commissioner* 651
   3. Economic Performance Requirement 654
      Rev. Rul. 2007-3 654
      Problem 9-4 656
   4. Contested Liabilities 657
      Problem 9-5 657
      Problems 9-6 through 9-8 658

D. Repayments of Items Previously Included In Income 658
   1. Claim of Right Doctrine 658
      *United States v. Lewis* 659
2. Application of §1341 660
3. The Arrowsmith Doctrine 661
   Arrowsmith v. Commissioner 662
   Problems 9-9, 9-10 663
   Problem 9-11 664

E. Tax Shelters 664
1. Overview 664
   Staff of Joint Committee on Taxation, Background on Tax Shelters 664
2. Judicial Restrictions on Tax Shelters 667
   Knetsch v. United States 667
   Estate of Franklin v. Commissioner 670
   Rice's Toyota World v. Commissioner 672
   Note 678
3. Retail Tax Shelters: Statutory Responses 678
   a. “At Risk” Limitations 679
   b. Application of §465 to Real Estate Transactions 681
   c. Passive Activity Limitations 682
   d. Determination of Activity Income 687
   e. Treatment of Passive Activity Losses 688
   f. Dispositions of Passive Activities 690
      Problem 9-12 690
      Problems 9-13, 9-14 691
4. Other Statutory Provisions 691
   a. Sales or Exchanges between Related Parties 691
      McWilliams v. Commissioner 693
      Note 696
   b. Wash Sales of Stock 697
      Estate of Estroff v. Commissioner 697
      Note 700
      Problems 9-15, 9-16 701
   c. Investment Interest Limitations 701
      Problem 9-17 702
F. Ethical Issues 702
   Joint Committee on Taxation, Background and Present Law Relating to Tax Shelters 703
   Treasury Department Circular No. 230 707
   Judisch v. United States 709

CHAPTER 10
COMPUTING TAX LIABILITY 715

A. Overview 715
B. Personal Exemptions 716
   1. The Taxpayer Exemption 716
   2. The Spousal Exemption 717
3. Dependency Exemptions 717
   Shapiro v. Commissioner 719
   Rev. Rul. 76-184 720
   Note on Support Requirements in Specified Settings 721
   Problems 10-1, 10-2 722
   Problems 10-3, 10-4 723

C. Rates and Returns 724
   1. Introduction 724
   2. Filing Status 725
      Problems 10-5, 10-6 728
   3. The Marriage Penalty 728
      Druker v. Commissioner 730
      Boyter v. Commissioner 733
   4. Net Capital Gain Rate Differential 736
      Weiss v. Commissioner 737
      Problem 10-7 738
   5. Policy Issues 738
      Joint Committee on Taxation, analysis of Proposals Relating to Comprehensive Tax Reform 738
      Bittker, Effective Tax Rates: Fact or Fancy? 744

D. Tax Credits 752
   1. Introduction 752
   2. Dependent Care Credit 753
      Problem 10-8 754
   3. Child Tax Credit 754
      Problem 10-9 755
   4. Earned Income Credit 755
      Problem 10-10 757

E. Alternative Minimum Tax 757
   National Taxpayer Advocate 2006 annual Report to Congress 758
   Klaasen v. Commissioner 759

F. The Future? 762
   National Taxpayer Advocate 2011 annual Report to Congress 763

Table of Cases 767
Table of Revenue Rulings and Procedures 773
Index 775