
CONTENTS

Preface

xxiv

PART I

INTRODUCTION

1

CHAPTER 1

Overview of the Revenue System

3

A. Foundational Concepts

3

B. Rates, Burdens, and Distribution

11

C. Tax Policy Concerns

18

D. Procedure and Administration

21

1. The Internal Revenue Service

21

2. Annual Returns

22

3. Investigation, Assessment, and Collection of Deficiencies

22

4. Refund Procedure

22

5. The Tax Court

23

6. Appellate Review

23

7. Statutes of Limitations

24

8. Interest, Penalties, and Costs

24

9. Withholding and Estimated Taxes

25

PART II

SCOPE OF GROSS INCOME

27

CHAPTER 2

Income in Kind

29

A. Noncash Receipts

29

1. In General

29

Old Colony Trust Co. v. Commissioner

29

Arthur Benaglia

34

Reginald Turner

38

Haverly v. United States

40

2. Restricted Property: §83

42

B. Statutory Exclusions

44

1. Meals and Lodging: §119

44

<i>Commissioner v. Kowalski</i>	45
<i>Sibla v. Commissioner</i>	53
2. Certain Other Fringe Benefits: §132	58
Fringe Benefits Provisions [§§132 and 117(d)]	58
C. Imputed Income	62
1. Owner-Occupied Housing	62
2. Other Consumer Durables	63
3. Household Services	63
4. Leisure	64
5. Borderlines	64
D. Alternative Formulations	66
E. Deductions	67
F. Microeconomic Effects	67
G. Taxing Employers in Lieu of Employees	68
1. Withholding	68
2. Other Possibilities	68
H. Other Items	69
CHAPTER 3	
Compensation for Losses	71
A. Damage Payments (In General)	71
<i>Edward H. Clark</i>	71
<i>Raytheon Production Corp. v. Commissioner</i>	74
<i>Commissioner v. Glenshaw Glass Co.</i>	78
B. Personal Injuries	81
1. In General	81
2. Nonphysical Injuries and Nonphysical Sickness	82
Solicitor's Opinion 132	82
Revenue Ruling 74-77	84
<i>Murphy v. Internal Revenue Service</i>	87
3. Punitive Damages	102
C. Insurance	103
1. Medical Insurance	103
2. Deducting Extraordinary Medical Expenses (Self-Insurance)	109
<i>Ochs v. Commissioner</i>	109
3. Disability Insurance	116
4. Life Insurance	117
D. Previously Deducted Losses	121
1. Annual Accounting	121
<i>Burnet v. Sanford & Brooks Co.</i>	121
2. Tax-Benefit Limitations	125
<i>Dobson v. Commissioner</i>	125
3. The Inclusionary Side of the Tax-Benefit Rule	132

PART III	
TIMING OF INCOME	135
<hr/>	
CHAPTER 4	
Return of Capital and Timing Issues	137
A. Return of Capital	137
1. Timing Alternatives	137
<i>Fairfield Plaza, Inc. v. Commissioner</i>	140
<i>Inaja Land Company, Ltd. v. Commissioner</i>	142
Revenue Ruling 70-510	147
2. Capital Expenditures, Depreciation, and Loss Deductions	149
B. Annuity Contracts	152
1. Life Annuities	152
2. Deferred Annuities	155
Deferred Annuities [§72]	155
C. Cash Method Accounting and Its Limits	157
1. Constructive Receipt	157
Revenue Ruling 60-31	157
2. Inclusion in Advance of Receipt: Debt Instruments	167
D. Accrual Method Accounting and Its Limits	171
1. Prepaid Income	172
<i>American Automobile Ass'n v. United States</i>	172
2. Security Deposits	181
<i>Commissioner v. Indianapolis Power & Light Co.</i>	181
3. Inventories	185
<i>Thor Power Tool Co. v. Commissioner</i>	187
4. Accruing Future Expenses	195
<i>United States v. General Dynamics Corp.</i>	195
Premature Accruals [§461(h)]	200
E. Consistency and Matching	206
1. Change of Accounting Method	206
2. Mitigation of the Statute of Limitations	207
Revenue Act of 1938	208
3. Matching	208
Treatment of Certain Related Party Transactions [§267]	208
CHAPTER 5	
Capital Appreciation	211
A. Unrealized Gains	211
<i>Eisner v. Macomber</i>	211
B. Time Value of Money	233
1. Interest	233
2. Present Discounted Value	234
3. After-Tax Returns	234
4. Effective Tax Rates	235
5. Tax Deferral as a Source of Capital	235
6. Fruits and Trees	237
7. The Equivalence of Tax Deferral and Yield Exemption	237

C. Realization	238
1. Leasehold Improvements	238
<i>Helvering v. Bruun</i>	238
2. Mortgage Participation Exchanges	241
<i>Cottage Savings Ass'n v. Commissioner</i>	241
3. Short Sales and Constructive Sales	248
D. Nonrecognition Exchanges	250
1. Like-Kind Exchanges	250
<i>Alderson v. Commissioner</i>	250
2. Nonrecognition on Dispositions for Cash	255
E. Deferred and Contingent Payment Sales	258
<i>Bernice Patton Testamentary Trust v. United States</i>	258
F. Capital Gains	264
G. Inflation	266
1. Bracket Creep	266
2. Income Mismeasurement	267
H. Taxing Consumption Instead of Total Accretion	267
CHAPTER 6	
Receipts Subject to Offsetting Liabilities	271
A. Cancellation of Indebtedness	271
<i>United States v. Kirby Lumber Co.</i>	271
Bankruptcy Tax Act of 1980	272
<i>David Zarin</i>	275
<i>Zarin v. Commissioner</i>	281
B. Claim of Right	283
<i>North American Oil Consolidated v. Burnet</i>	283
<i>United States v. Lewis</i>	285
<i>Alcoa, Inc. v. United States</i>	287
C. Embezzled Funds	294
<i>James v. United States</i>	294
<i>McKinney v. United States</i>	299
D. Nonrecourse Borrowing	302
<i>Crane v. Commissioner</i>	302
<i>Parker v. Delaney</i>	307
1. Inadequately Secured Nonrecourse Debt	311
<i>Commissioner v. Tufts</i>	311
Revenue Ruling 91-31	318
2. Mortgaging Out	320
<i>Woodsam Associates, Inc. v. Commissioner</i>	321
3. Gifts of Encumbered Property	323
<i>Estate of Levine v. Commissioner</i>	323
<i>Diedrich v. Commissioner</i>	328

PART IV	
THE PROPER TAXPAYER	333
<hr/>	
CHAPTER 7	
Gifts and Kindred Items	335
A. Policy Considerations	335
B. Income Interests	337
<i>Irwin v. Gavit</i>	337
<i>Commissioner v. Early</i>	339
B. Appreciated Property	343
1. Inter Vivos Gifts: §1015	343
<i>Taft v. Bowers</i>	343
2. Property Acquired from Decedents: §§1014 & 691	346
C. Gratuitous Transfers Outside the Family	349
1. Prizes and Awards	349
<i>Pauline C. Washburn</i>	349
<i>Paul V. Hornung</i>	351
2. Scholarships	352
3. Commercial and Compensatory Gifts	353
<i>Commissioner v. Duberstein</i>	353
<i>Stanton v. United States</i>	360
<i>United States v. Kaiser</i>	362
Revenue Ruling 61-136	364
<i>Estate of Sydney Carter v. Commissioner</i>	369
4. Social Insurance, Welfare, and Disaster Relief Payments	373
Revenue Ruling 2003-12	374
CHAPTER 8	
Taxation and the Family	379
A. Interspousal Income Attribution	379
1. First Principles	379
<i>Lucas v. Earl</i>	379
<i>Poe v. Seaborn</i>	380
2. Split Income and Joint Returns	384
3. Determination of Marital Status	385
B. The Marriage Bonus and the Marriage Penalty	386
C. Support, Gift, or Compensation?	391
<i>United States v. Harris</i>	391
D. Children and Dependents	395
Adjust Tax Rate on Unearned Income of Minor Children	396
E. Separation and Divorce	399
1. Support Payments	399
2. Property Transfers	402

<i>United States v. Davis</i>	402
<i>Farid-es-Sultaneh v. Commissioner</i>	405
Transfer of Property Between Spouses or Incident to Divorce [§1041]	409
CHAPTER 9	
Investment Income	413
A. The Basic Supreme Court Cases	413
<i>Corliss v. Bowers</i>	413
<i>Douglas v. Willcuts</i>	415
<i>Burnet v. Wells</i>	418
<i>Blair v. Commissioner</i>	422
<i>Helvering v. Clifford</i>	426
<i>Helvering v. Horst</i>	431
<i>Helvering v. Eubank</i>	435
B. Statutory Rules for Nongrantor Trusts	437
1. Simple Trusts and Distributable Net Income	438
2. Complex Trusts and the Tier System	438
3. Accumulation Distributions	439
4. Fiscal Years	439
C. Grantor Trusts	439
D. Interest-Free Loans	441
Below-Market and Interest-Free Loans [§7872]	442
PART V	
COSTS OF PRODUCING INCOME	447
CHAPTER 10	
Deductions, Credits, and Tax Computation	449
A. Adjusted Gross Income	450
1. Costs Incurred in Carrying on a Business (Other than Employment)	450
2. Other Nonitemized (Above-the-Line) Deductions	451
B. Personal Exemptions and the Standard Deduction	452
C. Itemized Deductions	454
D. Miscellaneous Itemized Deductions	455
Revenue Ruling 2012–25	457
E. Applying the Rate Schedules	464
F. Credits	464
G. Additional Taxes	466
CHAPTER 11	
Business and Investment Expenses	467
A. Ordinary and Necessary	467
<i>Welch v. Helvering</i>	467

B. Public Policy Limitations	470
<i>Commissioner v. Tellier</i>	470
<i>Raymond Mazzei</i>	472
C. Capital Expenditures	479
<i>Mt. Morris Drive-in Theatre Co.</i>	479
<i>Mt. Morris Drive-In Theatre Co. v. Commissioner</i>	481
<i>Commissioner v. Idaho Power Co.</i>	482
<i>INDOPCO, Inc. v. Commissioner</i>	490
D. A Reasonable Allowance for Salaries	496
<i>Patton v. Commissioner</i>	496
E. Carrying On Any Trade or Business	499
<i>Estate of Rockefeller v. Commissioner</i>	499
F. Expenses for Production of Income, §212	506
<i>United States v. Gilmore</i>	506
<i>United States v. Patrick</i>	510
<i>Hunter v. United States</i>	512
<i>Ruth K. Wild</i>	512
CHAPTER 12	
Capital Cost Recovery	519
A. What Is Depreciable	519
1. Antique Musical Instruments	520
<i>Richard L. Simon</i>	520
2. Land and Improvements	526
<i>World Publishing Co. v. Commissioner</i>	526
3. Goodwill and Other Intangibles	531
<i>Newark Morning Ledger Co. v. United States</i>	531
4. Section 197	541
<i>Amortization of Goodwill and Certain Other Intangibles</i>	541
B. Rates and Methods	544
1. The Straight-Line Method	544
2. Declining Balance Methods	544
3. Useful Lives	545
4. Additional First Year (Bonus) Depreciation	546
5. Optional Expensing	547
6. Alternative Depreciation — §168(g)	547
7. Purposes for Setting Rates and Methods	547
C. The Economics of Capital Cost Allowances	548
1. Complete Acceleration, or Expensing	549
2. No Acceleration — Economic Depreciation	550
3. Other Cases	553
D. Other Investment Stimuli	553
E. Disposition of Depreciable Property: Recapture or Conversion	554
F. Depletion of Mineral Deposits	556

CHAPTER 13	
Losses and Tax Shelter Limitations	559
A. In General: §165	559
<i>United States v. S.S. White Dental Manufacturing Co.</i>	559
Revenue Ruling 2009-9	562
B. Wash Sales and Transactions Among Related Parties	567
<i>McWilliams v. Commissioner</i>	567
C. Capital Losses: §1211	572
<i>O. L. Burnett</i>	573
D. Section 1231	574
1. Property Used in a Trade or Business	574
2. Involuntary Conversions	575
3. Statutory Structure and Interpretation	576
E. Bad Debts	576
<i>Whipple v. Commissioner</i>	576
F. Tax Shelter Limitations	584
1. Leverage and Overvaluation	584
<i>Estate of Franklin v. Commissioner</i>	584
2. At-Risk Limitation, §465	588
3. The Economics of Leverage and Taxes	588
4. Passive Activity Losses, §469	591
a. Passive Activities	591
b. Disposition of Interests	592
c. Activities	592
d. Portfolio and Earned Income	592
e. Rental and Oil and Gas Activities	593
5. The Alternative Minimum Tax, §55	594
Present Law and Background Relating to the Individual Alternative Minimum Tax	595
 PART VI	
EXPENSES NOT PRODUCTIVE OF INCOME	607
<hr/>	
CHAPTER 14	
Personal, Living, or Family Expenses	609
A. Childcare	609
<i>Henry C. Smith</i>	609
B. Clothing	612
<i>Pevsner v. Commissioner</i>	612
C. Traveling: §162(a)(2)	614
1. Away	614
<i>United States v. Correll</i>	614
2. From Home	618
<i>Commissioner v. Flowers</i>	618
<i>Hantzis v. Commissioner</i>	621
D. Travel and Entertainment	626
<i>Moss v. Commissioner</i>	626
<i>Cohan v. Commissioner</i>	629

	<i>Rudolph v. United States</i>	630
	<i>Sanitary Farms Dairy, Inc.</i>	633
	<i>Percentage Reduction for Meal Expenses</i>	638
E. Activities Not for Profit (Hobbies)		640
	<i>Bessenyei v. Commissioner</i>	640
F. Housing		646
1. Loss on Sale		646
	<i>Weir v. Commissioner</i>	646
2. Rental Losses		649
3. Home Offices		651
	<i>Drucker v. Commissioner</i>	651
	<i>Commissioner v. Soliman</i>	653
G. Education and Training		660
1. Business Expense Deduction		660
	<i>Jorgensen v. Commissioner</i>	660
2. Tax Benefits for Education		671
CHAPTER 15		
Interest, Taxes, and Casualty Losses		677
A. Interest		677
1. What Is Interest? §163(a)		678
	<i>Knetsch v. United States</i>	678
	<i>Goldstein v. Commissioner</i>	682
2. Debt to Purchase or Carry Tax-Exempt Obligations: §265(a)(2)		687
	Revenue Procedure 72-18	687
3. Investment Interest		690
	<i>Estate of Yaeger v. Commissioner</i>	690
4. Home Mortgage and Other Personal Interest		695
	Melvin I. White, Proper Income Tax Treatment of Deductions for Personal Expense	696
B. Taxes		698
	Tax Policy Center, Briefing Book	
	The State of State (and Local) Tax Policy	698
	Revenue Ruling 79-180	703
C. Homeowners		705
1. Distortion Produced by the Deductions		705
2. Exclusion of Imputed Rental Value		706
	Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2007	707
	President's Advisory Panel on Federal Tax Reform, Simple, Fair and Pro-Growth: Proposals to Fix America's Tax System	708
D. Casualty Losses		713
	<i>William H. Carpenter</i>	714
CHAPTER 16		
Charitable Contributions and Tax Exemption		717
A. Qualified Organizations		717
	<i>Regan v. Taxation with Representation of Washington</i>	717

	<i>Bob Jones University v. United States</i>	722
B. Unrelated Business Income		735
	<i>United States v. American Bar Endowment</i>	735
C. What Is a Contribution?		742
	<i>Dowell v. United States</i>	742
D. Appreciated Property		747
	<i>Hilla Rebay</i>	747

PART VII

CAPITAL GAINS AND LOSSES 753

CHAPTER 17

Capital Gains 755

A. The Statutory Scheme		756
1. The Deduction for Capital Gains		756
2. Maximum Rates for Capital Gains		757
3. Capital Losses		758
4. Short-Term Capital Gains (and Losses)		759
5. Section 1231		760
6. Definitional Problems — Sale or Exchange		760
7. Definitional Problems — Capital Assets		761
8. Depreciation Recapture		761
9. Qualified Dividends		761
10. The Multiple Rate Ceilings in §1(h)		762
B. The Quest for a Concept		764
1. Sale of a Business		764
	<i>Williams v. McGowan</i>	764
2. A Temporary Taking		768
	<i>Commissioner v. Gillette Motor Transport, Inc.</i>	768
3. Discounted Notes and Bonds		772
	<i>United States v. Midland-Ross Corp.</i>	772
4. Purchased Remainder Interests		776
	<i>Jones v. Commissioner</i>	776
C. Property Held Primarily for Sale to Customers		776
	<i>Curtis Co. v. Commissioner</i>	776
	<i>Malat v. Riddell</i>	779
D. Reasons For Preferential Treatment of Capital Gains		782
	Martin A. Sullivan, Are the Superrich More Burdened and Paying the Highest Rates?	784

CHAPTER 18

Capital Losses 789

A. The Arrowsmith Doctrine		789
	<i>Arrowsmith v. Commissioner</i>	789
B. The Corn Products Doctrine and Its Demise		791
	<i>Corn Products Refining Co. v. Commissioner</i>	791
	<i>Arkansas Best Corporation v. Commissioner</i>	795

CHAPTER 19

Future Income Streams 801

- A. Receipt of a Lump-Sum Payment for a Future Income Stream 801
 - Hort v. Commissioner* 801
 - McAllister v. Commissioner* 803
 - Commissioner v. P.G. Lake, Inc.* 807
- B. Receipt of Payments Out of a Future Income Stream 815
 - Commissioner v. Carter* 815
 - Commissioner v. Brown* 818
 - Stern v. United States* 828
 - Busse v. Commissioner* 832
 - Commissioner v. Ferrer* 834

PART VIII

TAX EXPENDITURES 845

CHAPTER 20

Tax Expenditures and §103 Case Study 847

- A. The Exclusion of Interest on State and Local Obligations 847
 - 1. Constitutional Considerations 848
 - South Carolina v. Baker* 848
 - 2. The Subsidy to Issuers of Tax-Exempt Obligations 850
 - Municipal Taxable Bond Alternative Bill of 1976 850
 - 3. Tax-Exempt Borrowing to Finance Private Activities 853
 - Tax-Exempt Bonds 853
- B. Tax Expenditures in General 856
 - Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2024 857
 - Rethinking Tax Expenditures 865
- C. Concepts of Income 874

APPENDIX

Rates of Return and Effective Rates of Tax on Investments 877

- Table of Cases* 887
- Table of Statutes* 899
- Table of Treasury Regulations, Revenue Rulings and Procedures,
and Miscellaneous IRS Pronouncements* 915
- Index* 919