Introduction, Syllabus, Administrative Details, First Assignments

[All of this will be covered in the first class where you will have the opportunity to ask questions.]

Materials

Required:
  Michael J. Graetz & Deborah H. Schenk, Federal Income Taxation, Principles and Policies (Foundation rev. 4th ed.)

  2004 Supplement to above book

  Abridged edition of Internal Revenue Code and Regulations

Recommended:

  Marvin Chirelstein, Law Student’s Guide to Federal Income Taxation (Foundation 9th ed.)

Exam and Grading

The exam is a 3-hour completely open book essay exam. Past exams and model answers are available on the law school website.

I grade the exam aiming to hit the bottom of the recommended curve and then curve the grades upward for class participation, which I take into account in the following way: Those who participate extensively in a meaningful and helpful way will have their grades bumped up one notch (e.g. B to B+) regardless of the grade received on the final exam. Others who participate less regularly but still in a meaningful way, will have their grades bumped up one notch if they are in the top of half of their grade cohort (e.g. if I have 20 A- papers, any one in the top 10 papers who participated in class will have the grade changed to an A). Exams are graded anonymously and a list of people who receive class participation credit is submitted to the registrar along with the raw exam grades. I will discuss this further in class.

Assignments/Syllabus

I teach using a problem method and there are 15 assignments for the class. Each assignment (except for the first) includes an introductory note, reading assignments, and a set of problems. The problems should be prepared before class. I do not lecture; the classes are a discussion of
the problems. If you have not done the reading or looked at the problems, the class will probably be something of a mystery. The assignments and some handouts are posted on Blackboard. To help those who are class shopping, you will find below the first two assignments, as well as a syllabus that lists the topics that we will cover this semester.

Blackboard Discussion Group

I will maintain and monitor a Blackboard discussion group throughout the semester. I use it (and I hope the class will use it) to post interesting items, to clarify class discussion, to answer or post questions. Class members are not required to post to Blackboard nor is their credit for posting (it’s pure education) but you are responsible for anything that is posted there.

Questions

I have “formal” office hours from 11-12 on Monday and Wednesdays but I am almost always around. Feel free to stop in–430H. You can always e-mail me with questions (including any questions you may have now about the course) at deborah.schenk@nyu.edu.
Syllabus/Units Covered

Unit I: Introduction to the course; why study federal income taxation; basic structure of federal tax law; sources of the law, structure of the administrative and judicial system; tenets of good tax policy

Unit II: What is Income? Compensation and fringe benefits

Unit III: What is Income? Swapped services, imputed income, gifts, government benefits, scholarships, support. Rules vs. standards; the concept of equity

Unit IV: What is Income? Introduction to taxation of capital; concept of basis; recovery of capital; realization rule; time value of money

Unit V: What is Income? Taxation of loan proceeds and discharge of indebtedness; claim of right doctrine; illegal income; windfalls

Unit VI: What is Income? Tax-exempt interest; tax expenditure concept; equity and efficiency

Unit VII: What is Deductible? Ordinary and necessary business expenses

Unit VIII: What is Deductible? Mixed motive expenses: travel, entertainment, meals, clothing, education, child care

Unit IX: When is Capital Accounted for? Timing of capital recovery; normative cost recovery vs. subsidy; expensing; depreciation; amortization

Unit X: What is Deductible? Interest; limitations on deductions; introduction to tax shelters

Unit XI: What is Deductible? Personal expenses; standard deduction; exemptions; personal credits; itemized deductions (charitable contributions, medical expenses)

Unit XII: Acquisition and Disposition of Property: More basis (swaps, gifts, bequests, divorce); effect of debt on basis and amount realized; more on tax shelters

Unit XIII: Acquisition and Disposition of Property: Recognition/nonrecognition of gains and losses; loss limitation rules; like kind exchanges

Unit XIV: Acquisition of Disposition of Property: Capital gains and losses; rate preference; loss limitation; inventory; depreciable property and § 1231 property; hedges; gifts of appreciated property to charity

Unit XV: Tax Accounting: cash and accrual methods of accounting; accounting for interest; OID rules; below market loans; installment sales
After some administrative announcements, I will begin the first class with an overview of my teaching methods, what I hope to accomplish, and what I expect of you. I also will try to convey a sense of why tax is so important and why you should be taking the class. At the end of the first hour, you can disappear if this course or this professor is not for you.

In the second hour, we will begin the course by exploring various rudimentary, structural elements of the federal income tax system. Each of you comes to this class with a different background in taxation, ranging from no background to filing your own return to sophisticated economics and accounting experience. One purpose of the first class discussion and the assigned readings is to begin to lay the groundwork for the substantive discussion that will occupy the remainder of the semester. Another purpose is give us a common background.

We will not return to some of the material in the assigned readings. Other parts of the readings and the class discussion are crucial building blocks for the remainder of the semester. One of the goals of the first few class hours is to develop a common "language" for use during the course. We also will do a brief overview of the federal income tax system and how to evaluate a tax provision on policy grounds.

The materials for the class include the coursebook—Federal Income Taxation, Principles and Policies (Graetz and Schenk, 4th rev. edition) as well as the 2004 Supplement, the Internal Revenue Code and Regulations (an abridged edition has been ordered and is available in the Bookstore), and the problem sets that will be posted on Blackboard. As an additional source for study or review, I recommend Marvin Chirelstein, Federal Income Taxation, A Law Student's Guide to the Leading Cases and Concepts (9th ed.). This is available in the bookstore.

**Assignment**

G&S: Notes, pp. 1-33, 53-85 and accompanying pages in the Supplement
The primary U.S. federal tax base is income and our first task is to try to define “income.” Despite your probable initial reaction that this will be quite easy, you will find it is an extremely difficult task. We will devote several weeks to trying to understand what is meant by the term. It is clear that it does not have the same definition as given it by Webster's or by economists. As you will discover, many English words become terms of art when used in the Internal Revenue Code and "income" is one of the most important of these.

Curiously, although essential to the calculation of tax liability, neither the Code nor the Regulations defines income. Section 61 comes closest. It says "gross income includes income from whatever source derived," a notoriously egregious example of defining a word by using the word. Section 61, however, does include a list of items constituting gross income and the following sections provide more detail for certain items and exclude others. But the list in Section 61 is nonexclusive--some receipts not listed there are income and some receipts not excluded by a subsequent section are not income. Our approach to exploring the parameters of "income" will be to consider certain categories of receipts to determine if they are "income" under the various statutory rules or under a "common law" definition of income.

We begin our discussion of "what is income" with the tax treatment of compensation and fringe benefits, the largest source of revenue from individuals. Section 61 includes compensation within the definition of "gross income." Compensation is taxed no matter how it is labeled. A basic principle of taxation is that the label does not control; otherwise, wily tax lawyers would instruct their clients to label salary with a nontaxable moniker.
It is not always easy to determine whether a particular item is compensation, or whether it is administratively or politically possible to subject it to tax. Often the problems arise in connection with in kind, work-related benefits conferred on employees, which have a large personal or pleasure element.

Furthermore, Congress has chosen to bless certain kinds of fringe benefits by excluding them from tax even though they are clearly economic "income" (take a look at §§ 79, 101, 104, 105, 106, 119 and 129).

In § 132, Congress has tackled fringe benefits generally. When you read that section, think about the following questions
(1) Did Congress make rational choices in deciding which fringes are included and which fringes are excluded? (2) What kind of behavioral response would you expect § 132 to provoke? (3) How fair is § 132? (Begin to think about how you decide whether a tax provision is "fair.")

In addition, there are choices to be made as to when compensation is to be taxed and at what value, especially when restrictions are imposed. In that regard, pay particular attention to § 83.

The problems below are lawyer-related (to keep your interest and possibly to amuse). But you should not be under the impression that compensation questions are limited to attorneys. They are a large and pervasive problem in all industries and often affect how employers and employees structure compensation arrangements. We will not discuss deferred compensation (a huge and expensive tax preference item) at this point because it is so complex and you need a much deeper background to understand the issues. Thus, we will only scratch the surface of the tax treatment of compensation.

Assignment

Code: §§ 61(a)(1); 132(a), (b), (c) [Do not worry about the details of (c)(1) and (2) but note that there is a limit on the amount of the discount], (d), (e), (f) [Do not worry about the details but do notice the difference between the treatment of transit passes and parking], (h), (j)(4); 83(a)-(c)(1), (2), (h); 102(c); 119(a)-(b)(1). Glance at §§ 79(a), 101(a)(1); 104(a);
105(a)-(c); 106; 129(a) [We will look at these in more detail later.]

Regs: §§ 1.61-1; 1.61-2(a)(1), (d)(1), (2)(i); 1.61-21(a)(1)-(3), (b)(1), (2); 1.132-2(a)(1) (2), (5)(c); 1.132-5(a)(1)(v); 1.132-6(a), (c), (d)(2)(i), (e); 1.83-1(a)(1), (b)(2), (f)(Ex 1); 1.83-2(a).


Problems

1. Arlene, a summer associate at a law firm, receives the following. Which are (should be) subject to tax and in what amount?

   a. Her NYC income taxes are paid by the firm. Assume she earns $10,000 and the NYC tax rate is 2%.

   b. On days when she works past 7 p.m., dinner is provided. Suppose in the alternative

      (i) She is given a $20 voucher to use at one of ten neighborhood restaurants.

      (ii) Dinner is catered in the firm dining room by a fancy French restaurant, which costs the employer $50 per person, but is worth only $20 to her.

      (iii) She is given $20 supper money, of which she uses $10 to buy a sandwich to eat at her desk.
What effects are the tax results likely to have? If you had the option (highly unlikely, but play along here) to take either the dinners in the dining room or extra cash compensation, how would the tax treatment affect your decision? What else do you need to know?

c. The option of a free parking space or access to a Dial-A-Car account for travel to and from the firm.

d. Tickets to Mets games when no client or partner wants them.

2. Which of the following is (should be) included in gross income?

a. Bert is a lawyer for Open Skies Airlines and is permitted to fly free on a space-available basis for personal travel.

b. Chris is general counsel for Widgets, Inc. and often "hitchhikes" on the company jet for pleasure trips. (If taxable, how much would you include?)

c. Deidre is a law student whose airfare is paid by a law firm to enable the student to fly to California for an interview.

d. Ed is Deidre’s husband and he too is flown to California by the firm who is super-anxious to hire Deidre.

3. When Fred Flintstone becomes the general counsel of Luxury Living Inc., a developer of luxury apartment buildings, he purchases an apartment from the corporation for $2 million. The price—was calculated with reference to the forgone income stream that would have been produced by a renter, but is substantially under market for similar apartments available for purchase in the neighborhood (say, $2.5 million). His ownership is restricted in that he must resell the apartment to the Luxury Living for $2 million should he resign as general counsel during the next 10 years. Jones consults you to determine if there are any tax
consequences to the purchase of the building. (Since you are new at this, here are some suggested questions that you should think about in deciding how to advise him.)

a. What, if anything, should (or must) Flintstone include in income when he purchases the apartment?

b. What tax results, if any, if Flintstone leaves the corporation in five years?

c. What tax results, if any, if Flintstone remains more than 10 years?

d. What tax results, if any, if Flintstone sells the apartment for $2.5 million in 12 years? What if he sells it for $900,000?

d. What tax results, if any, if alternatively, the corporation simply rents the apartment to Flintstone for $150,000 a year? What if market rent is $200,000 a year?