

# LAW 7604: 2 CREDIT HOURS

## TAX TIMING

## SYLLABUS

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OFFICE HOURS: Monday 11:00 – 1:00; Tuesday 11:00 – 1:00 and 3:00 to 4:00; WEDNESDAY 11:00 TO 3:00

Email: willis@law.ufl.edu; best way to contact is through Canvas.

### REQUIRED:

- Internal Revenue Code and Regulations.
- TAX TIMING ELECTRONIC MATERIALS, available on Canvas. This includes Professor Willis' text on ERROR CORRECTION, ACCOUNTING, AND THE TIME VALUE OF MONEY, slides for most chapters, edited and full versions of most cases (most annotated), the appropriate code and regulation sections (most of them *annotated*).

Note: If you have *not* studied tax procedure, you should become familiar with the following:

- Subtitle F in general.
- Section 6501.
- Notice of Deficiency.
- Application for Refund.
- Jurisdiction of Tax Court, District Court, and Claims Court.
- Appellate jurisdiction from various courts.
- Sections 1311-14 (Read Chapter 4).
- DOCTRINE OF EQUITABLE RECOUPMENT (Read Chapter 3).

### COURSE OBJECTIVES:

- The Objective of this course is for you to learn the tax law governing affected by timing. This includes accounting methods, error correction for inconsistencies, and the time value of money.
- Student Learning Outcomes:
  - You should learn how:
    - To apply the cash method of accounting, including income, deductions and capitalization.
    - To apply the accrual method of accounting, including income and deductions and the time value consequences of the tax rules.
    - To deal with the change of accounting methods.
    - To apply the DOCTRINE OF EQUITABLE RECOUPMENT.
    - To apply the tax mitigation provisions.
    - To apply section 1341.
    - To apply the DOCTRINE OF THE TAX BENEFIT RULE.
    - To apply sections 7872, 1272-86, and 467.

- To inter-relate the above issues.

**COURSE DESCRIPTION:**

- To learn the fundamentals of timing issues in federal income taxation in order to help prepare students, as tax lawyers, to recognize, appreciate and advise on the tax consequences of timing aspects of transactions and events encountered in tax practice. The course has three main parts: Accounting Methods, Time Value of Money and Error Correction.

**PREPARATION:**

- ABA Standard 310 requires that students devote 120 minutes to out-of-class preparation for every “classroom hour” of in-class instruction. Each weekly class is approximately 2 hours in length, requiring at least 4 hours of preparation outside of class including reading the assigned materials, working problems and quizzes, and listening to lectures.
- As a student, I preferred to spend about one-third of my study time preparing for class, and two-thirds reviewing. I strongly recommend you do the same. If you are under-prepared, for a particular class, please attend anyway.

**PARTICIPATION AND ATTENDANCE:**

- I enjoy questions and try to answer all. Canvas has easy-to-use ways to communicate with me: *please use them*.
- Canvas *may* have DISCUSSION topics. Strong participation can affect your grade.
- Students requesting classroom accommodation must first register with the Office of Disability Resources. The UF Office of Disability Resources will provide documentation to the student who must then provide this documentation to the Law School Office of Student Affairs when requesting accommodation.
- Both the ABA and the College of Law require class attendance. If you miss more than six classes, your semester grade may be adversely affected. If you have a legitimate reason for missing class, you should contact me so that your absence may be excused.

**UF College of Law Standard Syllabus Policies:**

- Other information about UF Levin College of Law policies, including compliance with the UF Honor Code, Grading, Accommodations, Class Recordings, and Course Evaluations can be found at this [link](#).

**Recordings Of Class:**

- All classes will be recorded via Mediasite in case students must miss class for health reasons. The Office of Student Affairs will work with faculty to determine when students may have access to these recordings, and the recordings will be password protected. It is the student’s responsibility to contact the Office of Student Affairs as soon as possible after an absence.

**ACADEMIC HONESTY AND INTEGRITY:**

- Academic honesty and integrity are fundamental values of the University community. Students should understand the **UF Student Honor Code**.
- You may not work with other persons on the exam, quizzes (other than for installation of materials) or assignments to be submitted unless clearly authorized otherwise.

**EXAM AND EVALUATION:**

- The Final Examination is open book, which includes anything written (printed or electronic). You may *not* work with another person. If you copy something from a source, you must cite or link to it.

- Your grade will be based 90% on the final exam and 10% on class participation and Canvas QUIZZES/ASSIGNMENTS (***these are announced on Canvas and may not be on the Syllabus as I may add new ones***). You are expected to read ANNOUNCEMENTS and to regularly look at Canvas for QUIZZES/ASSIGNMENTS. I expect most students will receive most participation and QUIZ points based on reasonable attempts, as well as responses to my comments. Exceptional participation may result in a half-letter grade bump. You ***must*** pay attention to Canvas deadlines for QUIZZES/ASSIGNMENTS.

## COURSE CONTENT:

**ALWAYS LOOK AT CANVAS MODULES FOR CURRENT CLASS ASSIGNMENTS AND TOPICS. I AM REVISING ALL SLIDES; THUS, THE TITLES MAY CHANGE FOR CLASSES FIVE THROUGH THIRTEEN. SOME, I WILL BREAK INTO MANY SHORTER PIECES. THE CANVAS MODULE WILL ALWAYS LINK TO THE CORRECT SLIDES, CASES, RULINGS, CODE SECTIONS, AND REGULATIONS.**

- **INTRODUCTION:**
  - Introduction to Transactional versus Annual Accounting
  - Section 1341
- **PART I: ACCOUNTING METHODS**
  - Cash Method
  - Accrual Method
  - Other Methods
- **PART II: TIME VALUE OF MONEY**
  - Below Market Loans
  - Original Issue Discount
  - Market Discount
  - Time Value of Money and Deductions
- **PART III: ERROR CORRECTION**
  - TAX BENEFIT RULE
  - Tax Mitigation
  - DOCTRINE OF EQUITABLE RECOUPMENT
  - Review of Section 1341
  - *Res Judicata* and Collateral Estoppel
  - Equitable Estoppel
  - DUTY OF CONSISTENCY
  - Change of Accounting Method
  - DOCTRINES OF OFFSET AND SETOFF
  - *ARROWSMITH* DOCTRINE
  - *SKELLY OIL* DOCTRINE

Notice the course has three main Parts, each of which is distinct and sufficient to support a stand-alone one-hour course. The three are, however, very much inter-related. Consider one scenario: you and I have a contract under which we each must perform either partially or fully in different years. [If, in contrast, we both fully perform in the same

year, accounting for both of us is simple, the time value of money is largely unimportant, and the opportunity for error is small].

Each of us must report – or decide not to report – the agreement and its consequences in year one, but based on incomplete information: will the other ultimately perform or breach? Accounting for each of us can thus be difficult. Also, the one who performs early effectively has loaned value to the other, which raises time value of money issues – regardless whether money is involved (one can loan property, the use of property, or services).

Also, the opportunity for errors increases, as does the opportunity for inconsistencies. Perhaps you report the events of year one assuming I will perform, but ultimately I do not. How will you treat the resulting inconsistency when I must refund value to you, or when I simply breach? That raises the problems of error correction.

Indeed, accounting methods present difficult issues only when a contract involves multiple years. The same is true of the time value of money issues and also error correction. Thus the three seemingly unrelated topics arise only (and arguably always, as we will see) in the same scenario.

## WEEKS ONE AND TWO: TAXABLE YEAR AND RESTORATION OF A CLAIM OF RIGHT

This is a two-week assignment. The first week we will cover Chapter 1 and begin Chapter 2.

- **Text:**
  - Chapter 1: Taxable Year (we will not cover pages 1-8 in class)
  - Chapter 2: Restoration of a Claim of Right
- **Slides:**
  - TaxTimingIntroduction.pdf
  - TaxYearIntroduction.pdf
  - 1341slides.pdf (we start these in Class One and complete in Class Two).
- **Cases:** Each of these is a vocabulary case: one you should know by name. Each is on my list of TOP 100 TAX CASES. Be familiar with the holding. If you have time, read the edited version.
  - *Burnet v. Sanford & Brooks*, 282 U.S. 359 (1931)
  - *North American Oil v. Burnet*, 286 U.S. 417 (1932)
  - *U. S. v. Lewis*, 340 U.S. 590 (1951)
  - *U. S. v. Skelly Oil*, 394 U.S. 678 (1969) (this fits in later in the course, but you are well-advised to read it now)
  - *Arrowsmith v. Comm’r*, 344 U.S. 6 (1952) (this fits in later in the course, but you are well-advised to read it now)
  - *Comm’r v. Sunnen*, 333 U.S. 591 (1948).
  - *Bull v. United States*, 295 U.S. 247 (1935). (mostly for a later class, but important. At least glance at it).
  - *Stone v. White*, 301 U.S. 532 (1937). (mostly for a later class, but important. At least glance at it).
- **Ruling:**
  - Rev. Rul. 68-153
- **Code:**
  - 441-42; 444 (very briefly, if at all, in class)
  - 706; 1378 (very briefly, if at all, in class)
  - 7701(a)(23) (very briefly, if at all, in class)
  - 1341
- **Doctrines:** see, TOP 50 TAX DOCTRINES
  - SKELLY OIL DOCTRINE
  - DUTY OF CONSISTENCY
  - CLAIM OF RIGHT DOCTRINE

In relation to *Sanford & Brooks*, *NAO*, and *Lewis*, I will discuss briefly the mitigation provisions and how they would apply to such situations today. You may want to review Chapter 4 and sections 1311-14.

I have usually tested section 1341. It is brief, but complicated. Most students view this as difficult. Read the section *very slowly* and carefully. The problems on the slides and in the Willis text will take you through many problems, from very simple to very complex.

This section largely moots the harshness of the *Lewis* decision. It is an important exception to the rule “Every year stands alone.” We will ***not*** cover all the problems in class.

***Later*** in the course, we will cover the TAX BENEFIT RULE in depth. It applies generally to the other party to a section 1341 event. For example, suppose A pays B in year 1 and B restores the funds in year two. ***If*** the restoration triggers the various requirements of section 1341, B must use section 1341 to determine his tax consequences. A, however, must use the Tax Benefit Rule (which arguably does not appear in the Code and which is, instead, arguably a creation of the Courts). Although the two correction devices apply to the same transaction (to opposite parties), they operate very differently with very different effects. You should ponder the wisdom of a system that is so inconsistent.

## **PART I: METHODS OF ACCOUNTING**

### **WEEKS THREE AND FOUR: CASH METHOD OF ACCOUNTING**

This should be a review for most of you.

- **Text:**
  - Chapter 7: Cash Method (we will not cover pages 72-77, which are mostly mooted by the section 263 regulations)
- **Slides:**
  - cash part1.pdf
  - cash part2.pdf
  - cash part3 CR.pdf
  - cashequivpart4.pdf
  - Cashpart5ecobenefit.pdf
  - cashdeductpart6.pdf
- **Cases:** This is a ridiculously long list of cases; however, with the exception of *Hornung* and *Davis*, they are all vocabulary cases: ones you should know by name. Each is on my list of TOP 100 TAX CASES. Be familiar with the holdings. If you have time, read the edited versions. **Canvas Modules groups these by topic: look at the modules.**
  - *Kahler v. Comm’r*, 18 T.C. 31 (1952)
  - *Hornung v. Comm’r*, 47 T.C. 428 (1967)
  - *Beatrice Davis v. Comm’r*, 37 T.C.M. (CCH) 42 (1978)
  - *Cowden v. Comm’r*, 289 F. 2d 20 (5th Cir. 1961)
  - *Veit v. Comm’r*, 8 T.C. 809 (1947)
  - *Martin v. Comm’r*, 96 T.C. 814 (1991)
  - *Sproull v. Comm’r*, 16 T.C. 244 (1950)
  - *Reed v. Comm’r*, 723 F.2d 138 (5<sup>th</sup> Cir. 1983)
  - *Vander Poel v. Comm’r*, 8 T.C. 407 (1947)
  - *Comm’r v. Idaho Power Co.*, 418 U.S. 1 (1974)
  - *INDOPCO v. Comm’r*, 503 U.S. 79 (1992)
  - *Comm’r v. Boylston Market*, 131 F.2d 966 (1st Cir. 1942)
  - *Indianapolis Power & Light Co. v. Comm’r*, 493 U.S. 203 (1990)

- *Burgess v. Comm’r*, 8 T.C. 47 (1947)
- *Battlestein v. Comm’r*, 631 F.2d 1182 (5<sup>th</sup> Cir. 1980)
- **Code:**
  - 263 (read generally, not for detail)
  - 446
  - 448
  - 461(f)
- **Regulations:**
  - 1.451-2(a)
  - 1.263(a)-4 (creation of intangibles) (These are ridiculously long. I will make a highlighted copy available to you. Do not focus on details).
  - 1.263(a)-3 (creation of tangibles, effective 9/13/13). (These are ridiculously long. I will make a highlighted copy available to you. Do not focus on details).
- **Doctrines:** see, TOP 50 TAX DOCTRINES
  - CONSTRUCTIVE RECEIPT DOCTRINE
  - CASH EQUIVALENCE DOCTRINE
  - ECONOMIC BENEFIT DOCTRINE
  - RABBI TRUST DOCTRINE
  - *BURGESS/BATTLESTEIN* SCENARIO
  - *IDAHO POWER* DOCTRINE

## WEEKS FIVE AND PART OF SIX: ACCRUAL METHOD OF ACCOUNTING

Income in Week Five and Deductions in Week Six.

- **Text:**
  - Chapter 8: Accrual Method
- **Articles:** I encourage you to read the responses from Professors Geier and Johnson.
  - *It’s Time for Schlude to Go*, <http://ssrn.com/abstract=285387>
  - *Show Me the Numbers . . . Please*, <http://ssrn.com/abstract=292464>
  - *Leave Albertson’s Alone*, <http://ssrn.com/abstract=1638487> (week Five)
  - *Albertson’s: A Little Less Emotion, Please!*, <http://ssrn.com/abstract=1638455> (week Five)
- **Slides:**
  - *accrualm.pdf*
- **Cases and Rulings:** see, TOP 100 TAX CASES. Be familiar with the holding. If you have time, read the edited version.
  - *Schlude v. Comm’r*, 372 U.S. 128 (1963)
  - *Arnell Co. v. Comm’r*, 400 F.2d 981 (7<sup>th</sup> Cir. 1968)
  - **Rev. Proc. 71-21**
  - *Boise Cascade Corp. v. U. S.*, 530 F.2d 1367 (Ct. Cl. 1976)
  - *Albertson’s v. Comm’r*, 42 F.3d 537 (9<sup>th</sup> Cir. 1994) (week five)

- **Code:**
  - 461(h) (week five)
- **Regulations:**
  - 1.451-5
- **Doctrines:** see, TOP 50 TAX DOCTRINES
  - *SCHLUDE DOCTRINE*

In relation to deductions (in week five), you need to cover section 461(h). This appears to be very simple. Indeed, applying it to a given set of facts is simple *if* you are familiar with the regulations. The regulations construe the statute in ways you may not expect. But, more importantly, you need to understand the *economic* consequences of section 461(h): if you planning a transaction, you may want to modify the facts such that you obtain the desired result, but nevertheless avoid the sometimes detrimental effects of section 461(h). Most students view this as the most difficult part of the course: the section is simple, and getting around the section is simple; however, knowing when to get around the section is not always intuitive. Indeed, much of what we cover may appear counter-intuitive . . . even to students with a finance background.

I believe the historic cases in Chapter 7 are very important: they will help you understand the situation existing before section 461(h). This perspective will help you understand what the drafters were attempting. They grossly over-reacted, in my opinion. Many students dislike reading with old cases that no longer apply to anything. I find that unfortunate, but not surprising.

## PART II: TIME VALUE OF MONEY

### WEEK SEVEN: TIME VALUE OF MONEY, AN OVERVIEW AND BELOW MARKET LOANS

- **Text:**
  - Chapter 11: Below Market Loans
- **Slides:**
  - tvn.pdf
- **Code:**
  - 7872

You have probably covered this before. We will do it in greater depth. It is very straightforward, albeit intricate. The regulations really add nothing but confusion. Read them if you want: I find them largely useless. To anyone with a finance background, the section makes perfect sense. I may introduce Original Issue Discount Loans this week, as section 7872(b) sends us to sections 1272-73.

### WEEKS SEVEN AND EIGHT: DISCOUNT LOANS

- **Slides:**
  - tvn.pdf
- **Code:**
  - 1271-86



Mostly, we cover sections 1272 through 1276. OID (original discount interest) tends to frighten students who lack a finance background. It should not. I will provide you with a 14-step method that is foolproof, as well as an OID calculator. Still, you should understand the sections. Unfortunately, whoever wrote them must have been intoxicated. Rather than follow from step one to step 14, they jump around and they sometimes use bizarre definitions. Typically, a student with a finance degree can predict exactly what the rules are; however, also typically, such a student has considerable difficulty following the statutes. Alas, I will get you through them. The regulations grotesquely complicate what is basically simple. Read them, if you wish.

In addition to OID, we will also cover Market Discount and Acquisition Premium. These occur when interest rates change in the market place and thus must apply to pre-existing instruments. Arguably, a rational system would provide a single method to amortize discount or premium. At the core, no important difference exists between a discount and a premium, just as Steven Hawking would argue no important difference exists between the past and the future. Ignoring quantum theory, the arrow of time appears to matter in our world and discounts appear different from premiums. Alas, our system provides 4 optional methods for MD and 2 for AP. Remarkably, the MD and AP methods are not mirror images! Almost always, two of the MD options result in malpractice if you select them, as does one of the AP methods. I call this a tax on ignorance: Congress gives you an option you'd be an idiot to select because it results in higher tax. But, you are allowed to be stupid.

If we have time, we will cover section 1286 and relate it to the familiar ASSIGNMENT OF INCOME DOCTRINE. This is a beautiful code provision that deserves to be expanded. You will want to ponder whether anything is left of *Helvering v. Horst*.

## WEEK NINE: OTHER TVM SECTIONS

- Code:
  - 483
  - 467
  - 468, 468A, 468B

Section 483 is simple and fairly boring, to me. But, we have to cover it.

I love covering the other sections; indeed, it is my favorite topic in all of tax. Imagine a situation in which costs have been incurred but deferred: *i.e.*, for accounting purposes, all events have occurred such that the taxpayer is liable to suffer the costs and the amounts can be determined with reasonable accuracy. Yet, because of business realities, the taxpayer does not actually suffer the costs until some point in the future (perhaps determinable and perhaps not). For example, each mile an aircraft flies, the responsibility for aircraft maintenance increases. But, we do not continuously maintain an airplane: we do it, instead, at regular intervals--sometimes spaced over many years. Likewise, as a mining company operates, it creates a hole or debris that it must someday ameliorate. It cannot realistically clean up continuously; instead, it does so at the end of the operation. The same thing happens with nuclear (and other) power plants, with oil rigs (they must someday be dismantled at great cost), with progressive slot machines and with many other

common business activities and legal situations, such as structured settlement payments for torts.

The basic facts of the various scenarios are the same: because of what happens this year (and which generates revenue/income this year), a business must incur a determinable cost in the future. This raises accounting issues for the cost, as well as time value of money issues for the delay. It also raises error correction problems for taxpayers who analyze the situation incorrectly initially or who fail to complete the transactions (which may span decades). In an ideal system, we would have a straightforward method to deal with such scenarios. We, however, have at least 11 methods for dealing with them. Algebraically, they simplify to 5 different methods (notice, we have provisions which appear very different, but which are truly identical – that should annoy you). Because we treat different industries differently, some are subsidized while others are penalized. That is worth contemplating. Also, as long as you are in the planning stage of a transaction, you may be able to modify your facts (without changing your substance) so that you can operate under a more beneficial method. This will not be possible, however, unless you understand both the mechanics and the *economic* consequences of the provisions.

You will find some who argue that all of these methods are algebraically identical. I will provide you with citations. I encourage you to study this and to challenge my math. In my 30+ years of teaching this, no one has successfully done so, although many have tried . . . mostly finance and accounting majors.

## PART III: ERROR CORRECTION

### WEEK TEN: CHANGES OF ACCOUNTING METHOD

We spend at most *one hour* on this; hence, we will likely move on to the topic for Week Eleven.

- **Text:**
  - Chapter 6: Changes of Accounting Method
- **Cases and Rulings:**
  - *Rev. Proc. 92-20*
  - *Rev. Rul.90-38*
  - *Diebold, Inc. v. United States*, 891 F.2d 1579 (Fed. Cir. 1989)
- **Code:**
  - 446(e)
  - 481
- **Regulations:**
  - 1.446-1(e)(2)(ii)(a), (b)

### WEEK ELEVEN: TAX MITIGATION

- **Text:**
  - Chapter 4: Tax Mitigation
- **Code:**
  - 1311-14

EQUITABLE RECOUPMENT and Mitigation are actually part of the procedure course. You cannot understand section 1341 and the TAX BENEFIT RULE without understanding mitigation and recoupment, however. I will mostly cover the jurisdictional issues of recoupment: does the Tax Court have jurisdiction, or not? This is unsettled (*though it appears settled*). If you guess wrong, you likely commit malpractice, so it is very, very important!

For both recoupment and mitigation, you essentially must be ignorant for them to apply . . . but then, if you are ignorant, you will not notice the issue and they will not apply. Isn't that fun! So, the client must first have a stupid lawyer/accountant to make a mistake, followed by another stupid lawyer/accountant who incorrectly reports and argues the resulting inconsistency, followed by a smart lawyer who notices the mitigation/recoupment solution. What a remarkable and strange system we have!

## WEEK TWELVE: EQUITABLE RECOUPMENT

- **Text:**
  - Chapter 3: DOCTRINE OF EQUITABLE RECOUPMENT
- **Articles:**
  - *Some Limits of Tax Mitigation, Equitable Recoupment, and Res Judicata: Reflections Prompted by Chertkof v. United States*, <http://ssrn.com/abstract=1638456>
  - *Offensive Versus Defensive Equitable Recoupment*, <http://ssrn.com/abstract=1638454>
- **Slides:**
  - ernew.pdf
- **Cases:**
  - *Bull v. United States*, 295 U.S. 247 (1935)
  - *Stone v. White*, 301 U.S. 532 (1937)
  - *McEachern v. Rose*, 302 U.S. 56 (1937)
  - *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296 (1946)
  - *United States v. Dalm*, 494 U.S. 596, (1990)
  - *Chertkof v. United States*, 676 F.2d 984 (4th Cir. 1982)
  - *O'Brien v. U.S.*, 766 F. 2d. 1038 (7th Cir. 1985)

## WEEK THIRTEEN: THE TAX BENEFIT RULE

- **Text:**
  - Chapter 5: TAX BENEFIT RULE
- **Articles:**
  - *The Tax Benefit Rule: A Different View and a Unified Theory of Error Correction*, <http://ssrn.com/abstract=1638448>
  - *Erroneous Deductions and the Tax Benefit Rule*, <http://ssrn.com/abstract=1638488>
- **Slides:**
  - tbr.pdf
- **Cases:** This is another long list of cases; however, they are all vocabulary cases (or at least honorable mentions): ones you should know by name. Each is on my

list of TOP 100 TAX CASES (OR ON THE HONORABLE MENTION LIST). Be familiar with the holdings. If you have time, read the edited versions.

- *Alice Phelan Sullivan*, 381 F.2d 399 (Ct. Cl. 1967)
  - *Hillsboro Nat'l Bank v. Comm'r*, *United States v. Bliss Dairy, Inc.*, 460 U.S. 370 (1983)
  - *Mayfair Minerals v. Comm'r*, 56 T.C. 82 (1971)
  - *Unvert v. Comm'r*, 656 F.2d 483 (9th Cir. 1981)
  - *Hughes & Luce v. Comm'r*, 70 F.3d 16 (5th Cir. 1995)
  - *Allan v. Comm'r*, 86 T.C. 655 (1986); *aff'd*, 856 F.2d 1169 (8th Cir. 1988)
- **Code:**
    - 111
    - 1016
    - 1312(7)

I will proffer my current theory that *virtually* nothing is left of the tax benefit rule following adoption of the section 263 regulations. That is a remarkable thing, if I am correct. Please challenge me. We need to figure this out.