



**2024
National Income Tax
Workbook**

Chapter 12: Rulings & Cases
PP 429 - 488



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Selected cases:



<u>Page</u>	<u>Name</u>	<u>Issue</u>
441	<i>Soroban Capital</i>	Self employment tax – limited partner
443	<i>Parkway Gravel</i>	Sham transaction
446	<i>Conrad v. Com'r</i>	Yacht and airplane depreciation
449	<i>Short Stop Electric</i>	Capitalized interest – cash basis taxpayer
453	<i>Parker v. Com'r</i>	Cancellation of debt vs sales proceeds
458	<i>Qevy v. Com'r</i>	Wrongful termination – IRC 104? Medical?

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HOW DID WE GET HERE?

Return preparer determined facts and applied the law **YEARS!**

IRS Examination determined incorrect application of law


Appeals Division reviewed facts and law and upheld the IRS Position

Now Tax Court or District Court reviewing facts and interpretation of law. Made a decision.

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You be the judge!

Candy if the judge agrees with you!

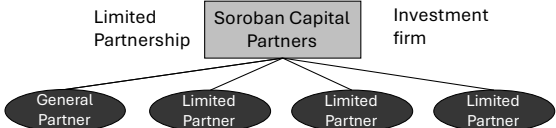


Number your paper one through 6. All answers are YES or NO.

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Soroban Capital Partners 441

Limited Partnership
Soroban Capital Partners
Investment firm



SE earnings:	General Partner	Limited Partner	Limited Partner	Limited Partner
Guaranteed Payments	X	X	X	X
Share of ordinary inc	X	No	No	No

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Soroban Capital Partners 441

- Limited partnership agreement provided roles and responsibilities and how profit is to be allocated.

Analysis – income subject to SE tax?

- IRC 1401(a) – “distributed share from any trade or business carried on by a partnership”
- Exception: IRC 1401(a)(13) excludes earnings from **“limited partners, as such”** ie: an investment nature
- In *Renkemeyer* applied a functional test.

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Soroban Capital Partners 442

Taxpayer
 The limited partners are "state law limited partners" Therefore, the exception applies

IRS
 State law limited partners are not automatically exempt. Must apply a functional analysis

Is the limited partnership share of income subject to SE Tax? YES or NO?

YES - exception does not apply. Simply adding "limited partner" to name is insufficient. By adding "as such" Congress made clear exception only applies to those functioning as a limited partner



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Parkway Gravel 443

Sand and gravel mining company. Real estate development

Parkway Gravel Inc

related

V + N

Mini storage Rented R/E

Land "freeway pit"

Wanted to sell, but couldn't

Granted option to purchase, in return, V + N is required to rezone pit to make suitable for sale

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Parkway Gravel 443

Pit finally sold!

Parkway Gravel Inc

V + N

Land "freeway pit"

Option - required to get rezoned

Sold Pit x,xxx,xxx allocated (x,xxx,xxx) reported x,xxx,xxx

x,xxx,xxx

Is this allocation of income acceptable?

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Parkway Gravel 444

<p>Taxpayer</p> <ul style="list-style-type: none"> ➤ Agreement in writing ➤ Assigned tasked to each party ➤ Consideration comparable to unrelated parties ➤ Long history of carrying on separate trades or businesses ➤ Common control did not provide basis for disregarding separate status 	<p>IRS</p> <p>Related parties. Factual and economic sham</p>
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Parkway Gravel 444

Factual Sham – did not occur, did not occur as reported, did not conform with normal commercial dealings

Economic Sham – transaction did take place, but had no independent economic significance aside from tax implications

Does the sham transaction rule apply? YES or NO?

NO. Transaction did occur and the consideration was reasonable for the tasks performed. Long history of separate businesses. Parkway needed assistance in selling the pit. V & N provided nontax benefits to rezone property. Services were essential of its sale.

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Conrad v. Comm 446

Thomas Conrad (51.25%) → Financial Management S corp → General partner → Hedge Fund (15 managers)

Thomas to travel up and down East coast to meet clients

2003 travelled 71 days and met with 20 clients. 3 to 10 nights. Used as an office. Never used again. Claimed depr, storage, maintenance, upkeep in 2008 & 2009. IRS disallowed Depr & all deductions.

What do you think?


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Conrad v. Comm 446

Depreciation
Depreciation Allowed? YES or NO

162 expenses
162 expenses Allowed? YES or NO

NO. Depreciation disallowed



YES. Storage, maintenance and upkeep allowed. No personal use

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Conrad v. Comm 446

Thomas Conrad 51.25% → Financial Management S corp → General partner → Hedge Fund

Purchased Plane → 15 managers

For Thomas to fly around country to meet clients. Thomas took flying lessons. Health reasons, couldn't continue. Available for rent, but no rentals.

Deducted depreciation, storage, maintenance.

What do you think?


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Conrad v. Comm 446

Depreciation
Depreciation Allowed? YES or NO

162 expenses
162 expenses Allowed? YES or NO

NO. Depreciation disallowed. Not placed in service.



YES. Storage, maintenance allowed.

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Short stop Electric v. Com'r 449

Bob Boyum (Majority Owner) → Short Stop Electric C corp (Uses Cash Basis Deducted interest expense)

12/31 – Bob decides how much interest he wanted

Revolving Line of credit
Made no interest payments

12/31 – apply the rated needed to arrive at the interest Bob wanted and add that amount to the principal. Also, Bob buys ¼ interest in Cabin – 90,000. Transfers interest to Short Stop. Added the 90,000 to revolving line of credit. All this interest created an NOL.

Uses Cash Basis. Reported as income

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Short stop Electric v. Com'r 449

Is the interest deductible?

YES? NO?

NO - Cash-basis taxpayer must pay interest to be able to deduct it. Merely creating a promissory note for interest is not actually paying interest.

Capitalizing Interest – Adding interest to the principal of a loan. Courts consistently held is not the same as paying it.

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Short stop Electric v. Com'r 449

Secondary issue - NOL

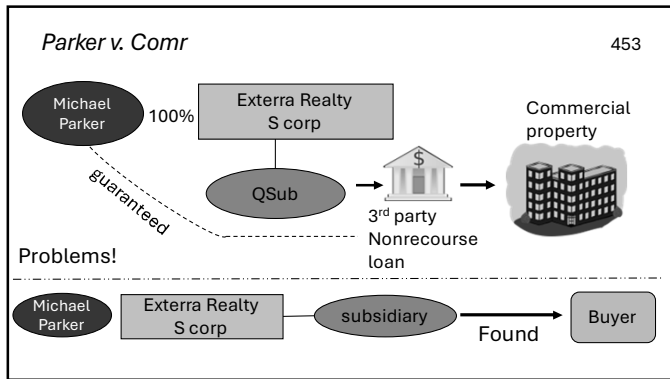
Prior years | Current Year

NOL carryover (unpaid interest deducted) → (xxx,xxx)

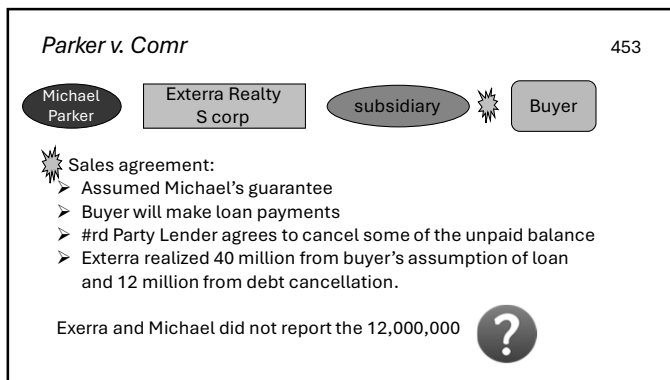
Can the IRS disallow the NOL carryover?

YES. The NOL claimed in the current year not allowed because it was generated by unpaid interest in prior years.

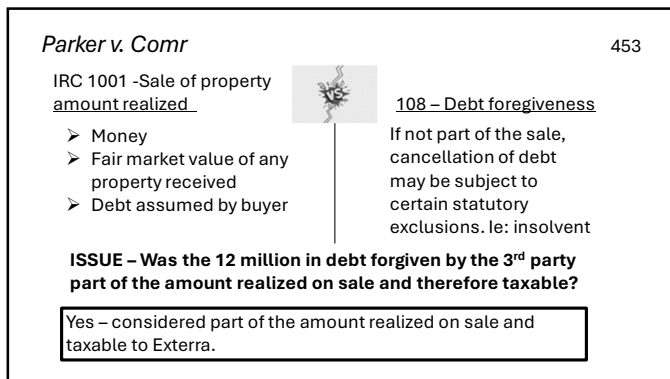
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Quevy v Comr 458



Kristen
Engineer

Employer



1. Anxiety, migraines
4. Unable to return to office
5. Unable to return to work
8. Sued for wrongful termination on basis of her disabilities
10. Excluded 90% of the 75,000 from income – IRC 104
11. IRS – IRC 104 does not apply
2. Allowed to work from home
3. Asked to return to office
6. Asked her to go on unpaid medical leave
7. Terminated
9. Paid Kristen 75,000 to settle claims

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Quevy v Comr 458

IRC 104 analysis

- Excludes damages **on account of** physical personal injury or physical sickness. (does not include emotional distress)
- **on account of** - if there is a direct link between the action giving rise to the damages and the physical injury or physical sickness
- First look at the terms of the agreement
- If terms ambiguous, look at facts and circumstances.

<p><u>Taxpayer</u></p> <p>Settlement was for compensation for personal physical injury or physical illness</p>	<p><u>IRS</u></p> <p>Settlement for claims of discrimination and wrongful termination</p>
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Quevy v Comr 458

ISSUE – Is the settlement excludable under IRC 104?

NO. Employer compensated Kristen for a broad release of claims. “severance compensation”. Resolve all issues.
Looking at facts, employer compensated Kristen for wrongful termination not personal injury or physical illness. **Taxable**

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