CHAPTER 10

FEDERAL INCOME TAX

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Federal Income Tax

Approach

Teaching Tax through Stories

In tax law, as in other subject areas, there are certain landmark cases that set the law on a path that continues to shape much of the current developments in the field. In these seminal cases, the tax law was faced with a fundamental choice, the resolution of which would influence tax law for generations to come. (Or, as Yogi Berra would put it, the tax law came to a fork in the road and took it.) My thesis is that we tax teachers should re-focus on the pivotal issues reflected in the major cases, rather than the “noise” of the latest tax developments that students will forget (if they ever learned them in the first place) soon after the final exam. With new tax legislation now an almost annual event, along with an increasing torrent of new cases, regulations, and rulings, the basic tax course needs to convey the underlying tax architecture to empower students to understand the tax law du jour. The major cases are the best markers to guide the journey down the tax law’s currents and eddies. [A disclaimer: I am the editor of Tax Stories: An In-Depth Look at Ten Leading Federal Income Tax Cases (Foundation Press, 2003), and the general editor of a new series of Law Stories books in other areas of law patterned after Tax Stories. I discuss the pedagogical theory behind the Law Stories approach in Back to the Future: Teaching Law through Stories, 71 U. Cin. L. Rev. 405 (2002)(symposium).] Whatever one’s views about the case method, it remains the predominant mode of law school instruction. I believe that the use of Tax Stories can enrich the case method in the classroom. (See the Materials section of this chapter for a brief description of Tax Stories.) I agree with Kevin Clermont that “if we try to use the case method, we should do it as well as we can.” Teaching Civil Procedure Through Its Top Ten Cases, Plus or Minus Two, 47 St. Louis L.J. 111, 115 (2002)(symposium). He extols the benefits of “teaching a slightly smaller number of cases and pausing on the key ones, thoroughly examining them in a rich context.” This in-depth analysis of fewer cases allows students to engage in “schema-building” — a bottom-up process of constructing their own schematic understanding of an area of law. Cognitive science teaches that such active learning produces more lasting value to students, who are better equipped to process new information and solve new problems within the context of their self-constructed schemata. Professors thus should resist the temptation to do this work for students, conveying our schemata in a top-down fashion, with students playing a merely passive role in receiving this oracular wisdom. As a result, we should not sacrifice depth of coverage at the altar of scope of coverage. Rather than rush through the signature tax cases in order to get to the latest hot topic or fashionable theory, we should savor the opportunity to unpack with our students what it is that makes these cases central to a deep understanding of tax law. Whatever its other faults, the case method is ideally suited to help students build their own schematic understanding of tax law.

Paul L. Caron, University of Cincinnati College of Law

Goals, Philosophy, and Coverage

Goals

On my Tax I syllabus, I list the following course objectives:

1. Survey the major components of the federal income tax system and their underlying concepts; develop an understanding of these elements sufficient to successfully surmount any bar examination in this area.
2. Develop problem-solving skills in analyzing complex tax problems, utilizing knowledge of statutes gained from extensive interpretive readings of the tax code and regulations.
3. Learn research skills that will enable the student to answer any tax question at any time, even in the wake of statutory change.
4. Perfect writing skills in the composition of a research problem (an extensive research problem may satisfy a basic or comprehensive writing requirement).
5. Learn tax return preparation skills (bye, bye, H & R Block!!).
7. Learn the relationship taxation law bears to the larger communities of law and politics, and recognize the important role taxation law can play in promoting the ideals of social justice.

Some of these requirements are unique to the State of Oregon and the University of Oregon. Federal income tax is a subject on our bar exam and passage of the bar is probably the most important goal to the student, other than getting an "A" in the course. In addition, our students must write both a basic and a comprehensive writing project to graduate and they often fulfill these requirements through a course.

General Philosophy

The tax code is a wonderful place to deal with the impact of law on women, minorities, gays, lesbians, and the poor. For example, many tax code provisions (fringe benefits, medical deduction, joint return, imputed income) provide benefits to the taxpayer with a spouse and/or children. These rules therefore discriminate against single and unmarried cohabitants, in particular gays and lesbians. In addition, the tax code provides numerous benefits to the rich. Tax shelters (rentals), capital gains, deferrals (like-kind exchanges), and exclusions (gifts, inheritances, fringe benefits) all have an upside-down effect. Deductions are also more beneficial the wealthier the taxpayer. Many tax benefits (such as educational credits, child care and child credits, adoption credits, etc.) are not even available to those with no tax liability.

In addition, the tax code can be used to explore policy issues: political, economic, social, and environmental. Why do we exempt municipal bond interests and not corporate bond interests or savings account interest? Do cash rebates and low tax rate promote economic growth? Is it good policy to allow home owners to deduct mortgage interest and real estate taxes on both their principal residence and vacation home, while renters get no deductions? Does it make good environmental sense to allow an exclusion for employer-provided parking?

Coverage and Organizational Scheme

I essentially divide the course into three segments. I spend the first half of the course on understanding gross income, exclusions, above- and below-the-line deductions, personal and dependency exemptions, and credits. Most of the second half of the course deals with property, including discussions of basis, adjustments to basis, mortgages, capital gains and losses, realization, and non-recognition. Included here are analyses of discharge of indebtedness, annuities, life insurance damages, divorce, hobbies, home office, and passive activities. I end the course with a two-week segment on “who is the taxpayer?” Here we deal with income from services and property, the kiddie tax, income in respect to decedent, and the grantor trust rules.

Nancy Shurtz, University of Oregon School of Law

Statutory Interpretation and the Development of a Civic Perspective

I set five goals for the basic federal income tax course. I lay these out to the students on the first day. I hope that by the end of the course they will:

- Understand and be able to apply the basic principles and rules of the income tax system as it applies to individuals;
- Be familiar with different approaches to statutory interpretation and have some ability to apply those approaches when reading legislation;
- Have a good working knowledge of the major policy decisions that inform the personal income tax system;
• Be able to apply tools of tax policy analysis to evaluate potential advantages of, and problems with, the current system, including the impact of income tax law on different groups and individuals; and
• Understand the role of lawyers in tax planning and tax reform, including the issues of professional responsibility and ethics.

Of these goals, I am most concerned about the students’ ability to understand and apply different approaches to statutory interpretation and to understand the policy decisions that inform the personal income tax system.

I think it is easy in federal income taxation to become obsessed with the various detailed rules that apply to individual taxpayers. This is a mistake. If students have the skill to read and interpret legislation, they will be able to figure out the rules on their own. Realistically, all of the applicable rules cannot be covered in the course. In addition, for many students the basic tax course is the only significant exposure they have to developing the skill of statutory interpretation, even though many of their upper-year courses involve reading legislation.

Understanding at least some of the policy underlying the income tax system makes students better members of civil society. A society’s economic and social policy is intricately connected to the kind of taxes it imposes. When students realize the significance of the tax system — its role in raising revenue, redistributing income, influencing behavior, correcting market failure, and stabilizing the economy — they become more informed about the political and social choices they make as citizens.

Kim Brooks, Queen’s University Faculty of Law

Problems, Previews, Participation, and Preparation

In my experience, the problem method works best for most tax courses, including Federal Income Tax. I find it helpful to start out with an overview of the course presented in the format of computing an individual taxpayer’s tax liability. I use a handout that I distribute with the syllabus (see the Materials section of this chapter) to facilitate analysis of an overview problem in the casebook that I use, Burke and Friel, Taxation of Individual Income.

I tell the students in the first class that one focus of the class is learning to read, interpret, and apply the Internal Revenue Code. Another focus is exploring the main themes of: (1) what constitutes gross income, (2) what is deductible, (3) when items are income or deductible (timing), (4) who is the taxpayer, and (5) character (ordinary or capital). I also stress that every student should leave the class understanding basis, how to compute gain or loss realized on the sale or other disposition of property, and the differences in the tax treatment of recognition and nonrecognition transactions.

In covering the material, I follow the traditional order of gross income, deductions, and miscellaneous issues. I find that order works well with the course overview that focuses on computing tax liability.

There are several areas that students typically do not find intuitive initially, so I cover those each year, generally with examples. I explain the progressive tax rate system, illustrating that the rate structure taxes each additional dollar at the taxpayer’s top marginal rate but does not increase the rate of tax on prior dollars even when the taxpayer enters a new tax bracket. I also illustrate the very different dollar value of a deduction and a credit. Another thing I need to illustrate and remind students of is that lower taxes cannot be considered in a vacuum. For example, a taxpayer probably will not turn down a $50,000 raise just to avoid paying the taxes on it. As another example, students generally need to be reminded that when a couple is divorcing, working together to lower the couple’s aggregate tax liability preserves more assets that the spouses can then divide between them.

I seek and obtain a lot of class participation. I strive for an atmosphere in which students feel comfortable participating but do not waste class time with tangential questions. With respect to student questions, in the first class I tell the students that they should feel free to ask questions but that I may sometimes determine a question would be better answered outside of class, and they should not take that personally. I also inform students that,
with respect to my frequent questions, I will take volunteers first and then call on students who tend not to vol-
unteer. I generally ask more follow-up questions of those called on randomly than of volunteers. I check off stu-
dents on my seating chart as they participate to try to ensure widespread participation.

I monitor attendance through a roll sheet and preparedness by requiring unprepared students to give me a note. I reserve the right to lower the grade of a student with excessive absences and/or unprepareds, and, in an extreme case, to bar a student from taking the final. If I catch a student unprepared who has not given me a note, I sternly reiterate my policy and mark on the roll sheet or on my seating chart that the student was unprepared. That generally results in a high degree of compliance with my unprepared policy.

Leandra Lederman, George Mason University School of Law

Providing a Framework for Learning

Below is an excerpt from a course description I provide to students about the basic tax course. It describes my approach to teaching federal income taxation.

This course introduces students to the principles and policies of federal income taxation. Although the details of tax law are constantly changing, the overall structure and design issues related to an income tax remain relatively stable. The course provides a framework for recognizing and dealing with tax issues and with tax-related strategies or transactions encountered in other legal practice specialties.

The course is designed to provide students with the following:

• A basic understanding of the major theoretical and structural issues posed by an income tax and of the policy considerations involved in resolving those issues;
• A basic knowledge of the individual income tax treatment of various types of business and personal transactions and events (including taxation of compensation and fringe benefits, the taxation of various types of investment vehicles, debt-financed property transactions, installment sales, issues related to capitalization and cost recovery, timing issues, and selected issues regarding taxation of the family);
• The skills necessary to apply a complex statute;
• An understanding of the planning function provided by tax lawyers; and
• The technical grounding necessary for further tax study or research.

A set of problems is used as a focus of class discussion and as a means of accomplishing the goals described above. I distribute the problems and assignments at the beginning of each unit and require students to analyze and apply the statutory provisions, administrative rulings, and course book readings assigned for class discussion. Students are encouraged to meet in groups to discuss the problems prior to class; many find small-group discussion of the problems useful as an aid to learning by identifying additional issues and approaches they may not have considered in answering the problem. During class discussions, students may be asked to discuss, among other things: 1) how to approach the problem under current law or from a tax policy perspective, 2) the difficulties encountered in reaching a conclusion (including the types of additional information needed), and 3) the reasoning process used in coming to a resolution of the issue. There is an examination at the end of the course.

This course is a foundational course, and students are encouraged to take it during their second year of law school. Although taking a tax course is not technically required in many law schools today (including our own), the course provides important basic knowledge that will add a necessary dimension to the transactions discussed in (or the skills needed for) other upper-level courses regardless of the legal practice area.

Mary L. Heen, University of Richmond School of Law
Statutory Analysis, Not Arithmetic

The Personal Income Tax course I teach is a three-credit class. The course is “strongly recommended” to our students, so most of them take it at some point in their last two years. As with the other basic business course I teach, Business Organizations, many of the students have little business background and tend to be intimidated by the subject matter. I believe this intimidation flows largely from the perception that tax is a numbers course. I try to dispel this notion early on by noting that the course focuses on the tax statute (the Internal Revenue Code) and any problems involving numbers is really about reading the statute. Moreover, any “number” problem generally can be handled by basic arithmetic. I remind the students that tax is as much about how the government operates and civics, as it is about numbers.

I want students to read and rely on the Code, rather than any textual explanation. Indeed, I believe that all students should emerge from Personal Income Tax with solid Code-reading skills. This focus on the Code is reinforced by my final exam, in which the students may use only their Code and Regulations volume (annotated). In addition, I use a “sight-reading” problem in which students must work through a Code section that was not covered during the semester.

Eric Lustig, New England School of Law

TaxProf: A Virtual Tax Community

TaxProf opened its virtual doors on (appropriately) April 15, 1995, as an email discussion list enabling law school tax professors to exchange information about tax teaching and scholarship. In the ensuing seven and one-half years, TaxProf has become an electronic academic community in which tax colleagues from around the country can communicate with each other at the stroke of a computer key. Indeed, Eric Jensen recently noted that “the TaxProf bulletin board has brought quite a few tax scholars together for electronic bull sessions.” Critical Tax Theory and the Loneliness of the Tax Prof, N.C. L. Rev. 1753, 1754 (1998).

TaxProf is now the “official” listserv of the AALS Section on Taxation and has over 300 members. Over 15,000 messages about tax teaching and scholarship have been posted on TaxProf through the years, but daily traffic is quite manageable—averaging fewer than 10 messages per day. Tax professors are an eclectic lot, and list discussions run the gamut from narrow questions about the application of specific tax rules to broad tax policy and theoretical debates.

TaxProf discussions often make their way into the media. For example, the New York Times reported the TaxProf debate over the appropriate tax treatment of the fan who caught Mark McGwire’s 62nd home run, and the Wall Street Journal reported (on the front page) TaxProf exchanges over the appropriate tax treatment of Olympic gold medals and of the cash settlement in the O.J. Simpson civil litigation.

TaxProf also provides a vehicle to test scholarly ideas. For example, Jeffrey Sherman noted that his article had “benefited immensely from the challenging questions and thoughtful suggestions of [certain tax colleagues], thanks to a splendid Internet automated mailing list called TaxProf.” All You Really Need to Know About Subchapter J You Learned from This Article, 63 Mo. L. Rev. 1, 1 n.* (1998). Similarly, Daniel Posin noted that his article “was developed from several drafts presented [on] TaxProf, the tax law professors’ computer discussion group…. [He] would like to acknowledge the substantial contributions of [various list members], as well as the general free-wheeling atmosphere of the discussion group.” The Big Bear: Calculating Capital Gains After the 1997 Act, 76 Tax Notes 1450, 1450 (1997).

TaxProf also has been useful in assisting list members in the classroom. Posts often begin by saying something like “I was preparing for class today and I can’t figure out…,” or “a student in class today asked…” TaxProf provides a forum to get a quick response from tax colleagues—a virtual tax faculty lounge if you will. Early on I mentioned that I responded to student complaints that my course was too “theoretical” and not “practical” enough by handing out the President’s tax return on the first day of class and referring to it periodically through-
out the semester to explain where various items are reported on the form. Nearly 50 list members took me up
on my offer each year to give copies to other interested faculty (until I stopped the practice in recent years as the
return became readily available on the Web).

If you are not already a TaxProf list member, I urge you to give it a try. You can subscribe by visiting http://list-
serv.uc.edu or by sending me an email at paul.caron@law.uc.edu.

Paul L. Caron, University of Cincinnati College of Law

Material

Tax Case Limericks

In the fall of 2001, Professor Barbara Hauser asked on the TaxProf listserv run by Professor Paul Caron of
Cincinnati Law School (see the Approach section of this chapter) whether anyone could locate a limerick about
Farid-es-Sultaneh v. Commissioner, 160 F.2d 812 (2nd Cir. 1947), that she remembered reading. Professor Daniel
Posin of Tulane Law School responded with a limerick about that case and one about Crane v. Commissioner, 331
U.S. 1 (1947). That sparked contributions by a number of other professors. Professor Hauser subsequently dis-
covered the lost limerick in a prior edition of the income tax casebook co-authored by Professor Michael Graetz,
and reprinted it, along with the collected contributions, in the article Tax Case Limericks: A Casual Collection, 93
Tax Notes 865 (2001). Tax Notes also included a note encouraging readers to submit their own tax limericks. A few
days later, Mary ("Handy") Hevener responded to the article, explaining in a letter to the editor that she had au-
thored the lost limerick as well as several others when she had taken Income Tax from Professor Edwin Cohen at
the University of Virginia in 1976. (See Mary B. Hevener, Tax Case Limericks: Some Golden Oldies, 93 Tax Notes
1003 (2001).) She explained that when Professor Graetz expressed an interest in the limericks several years later,
she sent some to him. Her letter to Tax Notes includes as exhibits both the limericks she sent to Professor Graetz
and his thank-you note. Professor Graetz responded to the letter to Tax Notes, partly in limerick format (see Michael
J. Graetz, Tax Case Limericks; The Rest of the Story, 93 Tax Notes 1225 (2001)). Ms. Hevener replied with a letter
to the editor written in rhyme (see Mary B. Hevener, Edward Lear Would be Proud, 93 Tax Notes 1348 (2001)).
During the same time period as this exchange, Tax Notes also published limericks about Gitlitz v. Commissioner,
531 U.S. 206 (2001), and Alexander v. Commissioner, Tax Notes 1115 (2001). The discussion closed with Alvin D.
Lurie's contribution, An Ode to Crane and Tufts, 93 Tax Notes 1505 (2001). The letters and the limericks make for
fun reading. The following two previously unpublished limericks should serve as something of a sample:

Olk v. United States, 536 F.2d 876 (9th Cir. 1976):

There was a craps dealer named Olk
Who excluded from income his tokes
"No dice" said the court —
Fortune's bounty was sought
And to you they're like tips from these folks

Philadelphia Park Amusement Co. v. United States, 130 Ct. Cl. 166 (Ct. Cl. 1954):

Phila. Park made a taxable trade:
rail franchise received, bridge conveyed
Its basis was cost
(franchise value), a loss
when abandoned within a decade

Leandra Lederman, George Mason University School of Law
Tax Stories: An In-Depth Look at Ten Leading Federal Income Tax Cases

Tax Stories (Foundation Press, 2003) provides additional raw material to enhance the study of federal income tax. It tells the stories behind the 10 leading U.S. Supreme Court federal income tax cases, exploring the historic contexts of these cases and the role they continue to play in our current tax law. Each of the 10 chapters sets forth the social, factual, and legal background of the case, discusses the various court proceedings and judicial opinions, and explores the immediate impact and continuing importance of the case. The companion website (www.law.uc.edu/TaxStories) contains the complete record of the case in the Supreme Court, including the lower court opinions, briefs of the parties and amici curiae, oral arguments (audiotapes and transcripts, where available), and the Supreme Court’s opinion.

Paul L. Caron, University of Cincinnati College of Law

Tax Returns, Casebooks, and Slides

I have found that one way of making the subject accessible and topical is to begin the course with something that most, if not all, students are familiar with—the individual income tax return. I can usually get their attention by using the most recent tax returns filed by the President and Vice-President. (Although these returns, like all returns, are non-public information, most Presidents since the early 1970s have generally made their returns public. Returns from Presidents Franklin Roosevelt, Nixon, Carter, Reagan, George H.W. Bush, Bill Clinton, and George W. Bush have been archived at Tax Analyst’s Tax History Project (http://www.taxhistory.org/presidential/).) I then move from the tax return to a slide setting forth the components of the computation of taxable income and tax (gross income (inclusions and exclusions), deductions from gross income, deductions from adjusted gross income, determination of tax, and credits). This slide becomes a template for the structure of the course as well.

There are two particular methods that I employ in teaching Personal Income Tax: (1) using the problem approach combined with frequently changing the casebook and (2) using slides in class. Like many who teach tax, I use the problem approach to work through the intricacies of the statute. I believe the problem method works best when the students have struggled with the problem. Indeed, it is often most effective when the students make the obvious mistakes and their missteps become clear as we go through the problem in class. I have found that one difficulty has been when I use the same book for a number of years the students tend to pass class notes from year to year (including the solutions to the problems). I have found that the most effective way to deal with this is to change casebooks yearly. (I actually rotate through four or so casebooks. So it really is not a completely new preparation each year.) Because most of the books cover the same basic cases and areas, albeit in somewhat different organizational form, what I mostly gain are new problem sets. And I am able to incorporate particularly good problems and cases from other books into my lecture as hypotheticals. Most importantly, the basic organizational structure of the Internal Revenue Code remains the same.

For a number of years I have utilized slides in class. The slides are overhead transparencies. I am transitioning into using computer-projected PowerPoint slides. The slides fill several roles. First and most important, I have slides for all of the major Internal Code provisions that we study. As we go through a section, I can underline key words, point out cross-references, and add annotations. In addition, terms like “flush” paragraph are easier to utilize if the students can literally see the paragraph flush against the margin. I also use slides to provide conceptual overviews as well as to illustrate the application of a statutory provision. Finally, I use slides to illustrate case facts and problem sets. Most of the conceptual and Code-application slides were prepared using PowerPoint. These slides are a combination of concepts and diagrams from courses I have taken, treatises, and teacher’s manuals. And some are my own creation. I believe that it is very helpful to distribute the slides to the students at the beginning of class so that they do not have to copy the illustration and can simply take notes on the handout. This distribution can also be done electronically by email list or web page. (Five sample slides follow.)

Eric Lustig, New England School of Law
Sources of Tax Law

Admin. Department of Treasury
- Policy
  - Treasury Dept. Reports
- IRS
- House (Orig Cl)
- JCT
- Senate
- Supreme Ct.
  - Conf. Comm.
  - Senate Finance
  - Circ. Cts. of Appeal
    - Tax Court Deficiency Juris
    - Dist. Ct. Refund Juris
    - Ct. of Fed. Claims Refund Juris

Legislative

Judicial
**Tax Computation**

Gross Income

less Above-the-Line Deduction

= Adjusted Gross Income

less either Itemized Deductions or Standard Deduction

less Personal Exemptions

= Taxable Income

\[ \times \text{Tax Rate} \]

= Tax

less Credits

= Tax
Section 1001(a)

Gain = Amount Realized – (excess over) Adjusted Basis

To 61(a)(3)
<table>
<thead>
<tr>
<th>Payor Spouse</th>
<th>Payee Spouse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deductible §215 and 71</td>
<td>Included §71</td>
</tr>
<tr>
<td>Not deductible §71(c)</td>
<td>Not included see §1041(b) for basis</td>
</tr>
</tbody>
</table>

**Tax Treatment of Payments in Divorce/Separation**

- **Alimony**
  - Payor Spouse: Deductible §215 and 71
  - Payee Spouse: Included §71
  - Child Support: Not deductible, but see §1041(a) for basis nonrecognition
  - Property Settlement: Not included see §1041(b) for basis
Section 1015

General Rule

Donor's basis

gain

loss

Donor's basis

gain

loss

Exception

Donor's basis

FMV@D.O.G.

gain

loss
Text and Handouts

I use Fundamentals of Federal Income Taxation (Foundation Press) by Freeland, Lind, and Stephens because it has great cases and wonderful problems that elucidate specific code provisions. I supplement the book with comprehensive problems, sample exams, and bar exam questions as well as useful charts, newspaper articles, and short journal articles.

I have included (below) two of my favorite handouts. “Framework for Studying Deductions” leads the student through deductions and can actually be filled out by students. “Gains from Dealing in Property” leads the student through part of the property segment of my course.

Nancy Shurtz, University of Oregon School of Law

Framework for Studying Deductions (Handout)

<table>
<thead>
<tr>
<th>Specific Code Section Allowing the Deduction?</th>
<th>Specific Code Section Limiting the Deduction?</th>
<th>Is the Deduction Above the Line Under § 62?</th>
<th>If the Deduction is Below the Line Under § 67?</th>
<th>Are the Deductions Subject to § 68?</th>
<th>Is it Better to Elect to Itemize or Take the Standard Deduction?</th>
</tr>
</thead>
<tbody>
<tr>
<td>§ 162 Trade a Business</td>
<td>§ 262 Personal</td>
<td>Employer Business Expenses</td>
<td>§ 162</td>
<td>§ 162</td>
<td>Not § 213</td>
</tr>
<tr>
<td>§ 212</td>
<td>§ 274</td>
<td>Employee Business Expenses</td>
<td>§ 165</td>
<td>§ 165</td>
<td>Not § 163(d)</td>
</tr>
<tr>
<td>Nonbusiness</td>
<td>§ 263 Capital</td>
<td>• Employer Business Expenses</td>
<td>§ 165(c)(1)</td>
<td>§ 165(c)(2)</td>
<td>Not casualty or theft losses under § 165(c)(2)</td>
</tr>
<tr>
<td>§ 165 Loss</td>
<td>§ 1211 Capital</td>
<td>• Employee Business Expenses</td>
<td>§ 167-168</td>
<td>§ 212</td>
<td>or (3)</td>
</tr>
<tr>
<td>§ 167-168 Depreciation</td>
<td>§ 465 At Risk</td>
<td>• Employee Business Expenses</td>
<td>§ 179</td>
<td>§ 179</td>
<td>Not wagering losses under § 165(d)</td>
</tr>
<tr>
<td>§ 216 Alimony</td>
<td>§ 183 Hobby Loss</td>
<td>• Employee Business Expenses</td>
<td>§ 166</td>
<td>§ 166</td>
<td></td>
</tr>
<tr>
<td>§ 166 Bad Debts</td>
<td>§ 280-A Vacation Home and Home Office</td>
<td>• Capital Loss</td>
<td>Not § 163</td>
<td>Not § 163</td>
<td></td>
</tr>
<tr>
<td>§ 170 Charitable</td>
<td>§ 469 Passive Loss</td>
<td>• Production of Rents</td>
<td>Not § 164</td>
<td>Not § 164</td>
<td></td>
</tr>
<tr>
<td>§ 179 Election to Expense</td>
<td>§ 469 Passive Loss</td>
<td>• Production of Rents</td>
<td>Not § 165(c)(3)</td>
<td>Not § 165</td>
<td></td>
</tr>
<tr>
<td>Depreciable Business Assets</td>
<td>§ 469 Passive Loss</td>
<td>• Production of Royalties</td>
<td>Not § 170</td>
<td>Not § 170</td>
<td></td>
</tr>
<tr>
<td>§ 195 Start Up Expenditures</td>
<td>§ 172 NOLs</td>
<td>• Alimony</td>
<td>Not § 213</td>
<td>Not § 213</td>
<td></td>
</tr>
<tr>
<td>§ 213 Medical</td>
<td>§ 275 Taxes</td>
<td></td>
<td></td>
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## Gains from Dealing in Property (Handout)

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General Outline of Federal Income Tax (Handout)

I note to the students that this mini-outline is not a substitute for their own detailed outline or other synthesis of the course material.

General Outline of Basic Federal income Tax

COMPUTING TAX LIABILITY: Gross Income – “above-the-line” deductions = Adjusted Gross Income (AGI)– {Standard Deduction (SD) or Itemized Deductions (IDs)} – personal (and dependent) exemptions (PDEs) = Taxable Income x rates = Tentative Tax Liability – credits = tax due or refund owed

Subject to phaseout for at higher levels of AGI: IDs, PDEs.

Subject to inflation adjustments: SD, PDEs, rate breakpoints. (Also various other amounts in other parts of course.) Special capped rates may apply to any “net capital gain” that was included in GI: § 1(h).

GROSS INCOME: §§ 61, 74, etc. Very broad, includes most “accessions to wealth” absent applicable exclusionary provision. Specifically includes, e.g., salaries, rents, interest, dividends, punitive damages, gains from dealings in property, prizes, awards, found money, annuities, discharge of indebtedness, amounts received under claim of right. Also must determine who is the proper taxpayer if there is more than one candidate for taxation.

GAINS are derived from dealings in property. On sale or other disposition, \( A/R - AB = gain realized \) (§ 1001). Recognized gains are recognized unless an exclusion provision applies.

EXCLUSIONS FROM GROSS INCOME include loan proceeds, gain on sale of principal residence (subject to cap — § 121), gifts & bequests (§ 102), qualified scholarships (§ 117), life insurance proceeds paid by reason of death of the insured (§ 101), discharge of indebtedness in insolvency and other situations (§ 108), statutory fringe benefits (§§ 106, 119, 132).

OTHER NON-RECOGNITION PROVISIONS resulting in exclusions from gross income include like-kind exchanges (gain realized is only recognized to the extent of “boot” received, § 1031), and transfers between spouses incident to divorce (§ 1041).

DEDUCTIONS may be taken for allowable expenses and losses.

DEDUCTIBLE EXPENSES include amounts that qualify as trade/business expenses under § 162, including, e.g., supplies; employee salaries; office rent; business travel, including travel away from home; certain business-related education; and certain meals and entertainment expenses. They also include investment/profit-seeking expenses under § 212, such as expenses to produce income from stock or securities or rental income; depreciation expense on business and investment property (§§ 167, 168); interest expense (§ 163); tax expense (§ 164); medical expenses, subject to a 7.5% floor (§ 215); deductible IRAs (§ 219); and qualified moving expenses (§ 217). PERSONAL/FAMILY EXPENSES (commuting, many meals, most clothing, costs of automobile for personal use, legal fees for divorce, etc.) ARE NOT DEDUCTIBLE — § 262.

DEDUCTIBLE LOSSES are those allowed by §§ 165 and 166, generally trade/business losses, investment/profit-seeking losses, casualty losses, theft losses, and bad debt losses. Losses may occur on sale or other disposition of property (\( AB - A/R = loss realized \)), or on uncollectibility of debt. Realized losses are not recognized unless they are (1) allowed by §§ 165 or 166 and (2) not disallowed by another provision.

DEDUCTIONS MAY BE DISALLOWED even if they are otherwise deductible.

Re: EXPENSES: § 274 disallows certain meal and entertainment expenses, and generally limits the rest to 50%. § 265 disallows a deduction for expenses to produce tax-free income. §§ 263 & 263A disallow a deduction for CAPITAL EXPENDITURES. Those expenditures create basis instead.

Re: LOSSES: § 267 disallows loss on sale to related party. § 1211 limits deductibility of capital losses.

CHARACTER OF GAINS & LOSSES: Character may be capital or ordinary. Capital gain/loss requires (1) a capital asset (§ 1221), (2) a sale or exchange (§ 1222). HOLDING PERIOD does not determine character. Capital gains and losses may be long-term or short-term.

CREDITS (dollar-for-dollar reduction of tax liability): Credits include child care credit (§ 21), child tax credit (§ 24), HOPE scholarship and lifetime learning credit (§ 25A), withholding tax (§ 31), and earned income credit (§ 32).

Leandra Lederman, George Mason University School of Law
Computing Taxable Gain (Handout)

**COMPUTING TAXABLE GAIN**

§ 61(a)(3): Gross income includes gains derived from dealings in property. How do you compute this gain?

Reg. § 1.61-6(a): “GAIN is the excess of amount realized over the unrecovered cost or other basis for the property sold or exchanged.” It refers you to § 1001 for specific rules.

§ 1001(b): “AMOUNT REALIZED from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.”

§ 1011(a): The ADJUSTED BASIS for determining the gain or loss from the sale or other disposition of property shall be the basis (determined under section 1012 or other applicable sections…), adjusted as provided in section 1016.**

§ 1012: “The BASIS of property shall be the cost of such property, except as otherwise provided….“ We will get to other basis provisions (e.g., for gifts, inheritances, & property received in tax-free exchanges), in later chapters.

§ 1001(c): In general, except as otherwise provided, “the entire amount of gain or loss, determined under this section, on the sale of property shall be recognized.”

**General Formulas from § 1001(a):**

**Amount Realized** minus **Adjusted Basis** equals **Gain Realized**

\[
\text{AR} - <\text{AB}> = \text{Gain Realized}^{**}
\]

**Adjusted Basis** minus **Amount Realized** equals **Loss Realized**

\[
\text{AB} - <\text{AR}> = \text{Loss Realized}^{**}
\]

* As we will study in subsequent chapters, an asset’s basis is “adjusted” to reflect recovery of investment or additional investment in that asset. In effect, an asset’s adjusted basis reflects the “tax history” of that asset.

** Caveat: Realized gain and loss is not always recognized. We will study various nonrecognition provisions in subsequent chapters.

Leandra Lederman, George Mason University School of Law
Introduction to Deductions Problems (Handout)

Introduction to Deductions Problems

Part I. Instructions: Provide a brief answer.

1. What is the “2% floor?”

2. Explain the mechanics and effect of Code § 68.

Part II. Instructions: Please label each of the types of deductions listed below with all of the following that apply: *Above-the-line* deduction, *below-the-line* deduction, *miscellaneous itemized* deduction.

1. The home mortgage interest deduction of § 163.

   ________________________________________________

2. The deduction for alimony paid under § 215.

   ________________________________________________

3. The deduction under § 212 for expenses incurred in the production of dividend income.

   ________________________________________________

4. The deduction under § 170 for charitable contributions.

   ________________________________________________

5. The deduction under § 162 for non-employee ordinary and necessary trade or business expenses.

   ________________________________________________

Leandra Lederman, George Mason University School of Law
Exercises

Introducing Statutory Interpretation with Song Lyrics

Statutory interpretation can be a hard sell for a class of 75, so I try to find some way to make it real. I start with song lyrics. It is much easier to feel passionate about song lyrics than to feel excited about whether a bicycle is a “vehicle.”

And because I am addicted to Bruce Springsteen, I start with Bruce.

I begin by playing the opening bars of the version of “Born in the U.S.A.” from Tracks (1998), an album that contains songs and versions of songs that never made it to release. (This version of “Born in the U.S.A.” was originally recorded for Nebraska (1982).) The opening bars are moody. The tone is despondent. Alienating. I stop the CD before the first verse begins.

I ask if anyone knows the song. No one does.

I then play the opening bars of “Born in the U.S.A.” from Born in the U.S.A. (1984). Immediately everyone knows the song. Again, I stop the CD before the first verse begins.

I ask the class what the song is about. This usually requires some care, because there are some people who actually have listened carefully to the lyrics. I can usually find someone who will guess that it is, in essence, an anthem to America. I think this is the common perception of the song.

I then ask them to listen carefully to the first verse. “Born down in a dead man's town, the first kick I took was when I hit the ground. You end up like a dog that's been beat too much, till you spend half your life just covering up.”

It is hardly an anthem. And yet in 1984, as reported by Eric Alterman, a number of politicians actually referred to or used the song in their political campaigns.

I then ask the students to talk about some of their favorite songs and how those songs are misunderstood. There are lots of examples. And the conversations involve debate about the meanings of the lyrics.

A lot of this discussion essentially serves the purpose of getting the students’ attention. There isn’t much about statutory interpretation that can be learned, except that you have to be careful when you read and interpret language. Also, students can see from the Bruce example that the context of words is important. If Bruce had released “Born in the U.S.A.” as it was recorded for Nebraska it would not have been misinterpreted.

Kim Brooks, Queens University Faculty of Law

Brief Gems

Role-Playing

We role-play every day we discuss a case — one student is the taxpayer, one student is the IRS, one student is the attorney for the taxpayer, and one student is the judge. The class gets to criticize the judge's conclusions and reasoning and ask questions of all parties.

Nancy Shurtz, University of Oregon School of Law

“Boot”

For like-kind exchanges, the first (and often only) non-recognition transaction that I cover, I explain the origin of the term “boot” when describing non-qualifying property — the taxpayer receives something else (other than qualifying property) “to boot.”

Leandra Lederman, George Mason University School of Law
Cartoons

I have a series of cartoons in my supplement that elucidate the case materials. For example, I have a cartoon of a mom on a beach, looking at her baby who has just picked up a diamond ring. She is saying “Leave it there, dear. It may knock us out of our bracket.” This helps illustrate Cesarini, the treasure-trove case, as well as casualty loss. I have a cartoon for barter that shows a man who has just finished painting a house, saying “I painted your house and you fixed my computer.” The owner, in the doorway, says “That makes us even?” A neighbor is peering over the fence saying “I didn’t see a thing if you paint my house, too!!”

IRC 212 Area Code

Students often have trouble remembering the Code section number for expenses for the production of income, although they tend to remember the section for trade or business expenses, section 162. The section for production of income (investment-type expenses) is 212, and I tell them that that’s the telephone area code for Manhattan — where Wall Street is located.
Getting the Class Started and the Power of Bruce

This is how I have started the course.

Sheldon Cohen, Former Commissioner of Internal Revenue, has said, “Taxation, in reality, is life. If you know the position a person takes on taxes, you can tell their whole philosophy. The tax code, once you get to know it, embodies all the essence of life: greed, politics, power, goodness, charity.”

I’d like to add something to that. Taxation, and Bruce Springsteen, are life. Anytime you want to know something about the way life is you can figure it out from tax law or Bruce Springsteen, or both.

Why is Bruce Springsteen relevant for tax students? First his lyrics are terrific. But I won’t be able to convince all of you that this is the case. There is no accounting for taste.

Second, he plays full out. You can’t fight me on this. When Bruce gives a concert, it’s three hours of sweaty mess. There is no opening act. There is no fooling around. The music screams from the stage and the audience is entranced. It is a rock and roll revival. It is a regeneration of souls.

And that is what tax is like. It’s four hours a week of sweaty mess. I’m going to be sweating; you’re going to be sweating. This is hard stuff. It is the stuff of life. People may have told you that life was about being nice to others, or being a good person, or making a lot of money. No. It is all about tax. At least, it will be all about tax for the four hours a week that we spend together.

There are two other common characteristics of the nature of both life and tax that I want to highlight before we begin. These are themes that recur in the songs of Bruce. One, it’s about discovery. Discovery of a path, or paths. Tax is like that. It’s a puzzle you’re given to solve. There are lots of solutions often. Some are better than others.

Two, you can’t do it alone. Generally true about life, certainly true about tax. You cannot do this alone. That’s why I’m here. That’s why your colleagues are here. When you lose your path, find me or find a fellow student.

Let’s get started.

Kim Brooks, Queen’s University Faculty of Law

“How Would the IRS Ever Know...”

I am often asked “How would the IRS ever know about...” a particular transaction or item of gross income. I periodically remind students that just because a law is difficult to enforce does not mean it’s not the law. I generally use mandatory seat belt laws as an analogy. I also remind students that their character forms part of their fitness to practice law. As my father says, “Honesty is a lawyer’s stock in trade.”

Leandra Lederman, George Mason University School of Law

Feedback and Evaluation

Designing Writing Assignments and Exams Based on Course Objectives

My main objectives in basic tax are: (1) to talk with students about approaches to statutory interpretation and have them develop some statutory interpretation skills and (2) to assist students in understanding some of the policy rationales that underlie the tax system.

I offer both exam and writing options. I offer three writing assignments, equally weighted at 33%. The exam is weighted for the difference between the value of the writing assignments students choose to complete and 100%.

About half the students choose to write only the exam. Instead of the traditional fact-pattern style exam, I ask about fourteen short-answer questions, each worth between 5 and 15 points (out of 100). This allows me to test
a variety of skills. I ask three types of questions, each type worth about one-third the total value of the exam. Conceptual questions ask the students to classify particular transactions or receipts: is X more like Y or more like Z? Knowledge questions ask the students to tell me the appropriate tax treatment of something. Policy questions ask the students to explain why a particular rule is drafted the way it is and to discuss whether this rule makes sense.

The other half of the students choose to complete the writing assignments (or a few writing assignments and the exam). I generally set two memoranda and one “policy” paper. Given that the course is designed to take up approximately three months, I set one assignment to be due at the end of each month.

The first assignment is a memorandum that requires little substantive knowledge but, instead, tests statutory interpretation skills. It generally requires students to take one section of the Code and apply it to a new fact situation.

The second assignment is the policy paper. This paper can test either the students’ understanding of the tax expenditure concept or their ability to grapple with tax policy issues. For example, it could be an evaluation of the mortgage interest deduction or an assessment of the arguments for and against a reduced tax rate on capital gains.

The final assignment is a second memorandum, but this memorandum is designed primarily to test substantive knowledge. The students receive a statement of facts and are asked to identify and discuss the issues raised. I place this assignment at the end of the course so that it potentially can include all the material we cover in the course. Also, I find this ensures that the students who choose the writing option remain engaged in the discussions we have in class.

There is no doubt that offering a writing option takes more time, both for students and for me. The length of the various assignments ranges from 6 to 20 pages. I provide significant feedback on the first two assignments and only limited feedback on the last assignment. This means that students get detailed feedback while they are still in the course and before they are required to hand in another assignment.

In general, the students who choose the writing assignments seem more engaged in class. I think this is in part because the issues we are discussing become relevant sooner. They do not have the luxury of hoping they will be able to put the course together between the end of classes and the exam. I also suspect that they learn more and are more engaged. And it is possible that they also become more interested in the role of taxes in civil society.

Kim Brooks, Queens University Faculty of Law

The TaxProf Exam Bank: Practical Help for the Tax Professor

One of the most thankless (and difficult) tasks of the tax professor is coming up with the end-of-the-semester examination. As anyone who has prepared a tax exam can attest, it takes quite a bit of time to come up with a fair exam that accurately measures student performance. The TaxProf Exam Bank assists tax professors in this process by giving them access to exams given by tax professors at other schools.

The TaxProf Exam Bank currently has over 100 exams in 10 tax subjects (income tax, business tax, corporate tax, advanced corporate tax, partnership tax, estate and gift tax, estate planning, income taxation of trusts and estates, international tax, and tax procedure). The site is password-protected; access is afforded only to TaxProf members. (See “TaxProf: Virtual Tax Community” in the Approach section for information about becoming a TaxProf member.)

Paul L. Caron, University of Cincinnati College of Law
Research Paper, Midterm, and Final Exam

I give the students a research paper (counts 10%), a midterm (counts 40% if student performs better than on the final), and a three-hour final (counts 50% if midterm counts, otherwise counts 90%). The midterm is mostly multiple choice and objective, with one essay. In general, the students like the midterm. First, it does not count if they do not do well. Second, if they do do well, there is less stress on the final exam. Third, the students appreciate the practice experience and the feedback given on the exam. The research paper is around five to seven pages long. The students can choose from 10 different research problems on hot topics such as contingent fees, alternative minimum tax, innocent spouse, jeopardy assessment, gambling losses and hobbies, etc. In this assignment, students must compare tax research using the books, with either Westlaw or Lexis.

Nancy Shurtz, University of Oregon School of Law