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# Tax Court Update and Contracts

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# Goals of Presentation

- Tax Court Update – Summary of TC opinions issued since February 11<sup>th</sup>. Bulk of presentation.
- Contracts – High-level (and Brief), Front-End considerations to avoid *Back-End* pains.
- Have fun with the Tax Code, Treasury Regulations, NFTLs, FPAA, CDP, and so much more...

# Tax Court Update

## Hacker v. Comm’r, T.C. Memo. 2022-16 | March 7, 2022

**Facts:** The Hackers were sole shareholders and sole officers of Blossom Day Care Centers, Inc., Hacker Corp. (an S corp), and Hacker Investments, LLC. The IRS examined the Hackers, with a focus on, among other things, unreported cash deposits, income received from Blossom and Hacker Corp., and numerous transactions among and between the Hackers and their companies that were not reported, or that were underreported on the Hackers’ federal tax returns for the five years examined.

“Blossom provided petitioners and their children with the use of personal vehicles; paid for vacations for petitioners and their children to the Bahamas, Europe, Hawaii, Las Vegas, and New Orleans; purchased jewelry and other luxury items; and paid numerous routine personal expenses, including restaurant meals, auto expenses, personal medical expenses, mortgage payments, and college tuition. Petitioners did not report on their personal returns the receipt of these benefits, providing incomplete information to their bookkeepers and return preparers. During the examination of their returns, petitioners attempted to conceal them from respondent through the examination, such as by providing vague, misleading, or outright false statements to RA Floyd.”

## Hacker v. Comm’r, T.C. Memo. 2022-16 | March 7, 2022

### Nuggets:

- Compensation in the form of money, property, and other direct and indirect benefits is gross income.
- Bank deposits are prima facie evidence of taxable income of a taxpayer.
- Every person subject to income tax is required to maintain books and records to establish the amount of gross income and deductions shown by that person on his or her income tax return. – **Example:** “He [Hacker] was emphatic, however, that the unexplained deposits were “absolutely not” the undeposited payments from Blossom parents.”
- When a corporation distributes property to a shareholder as a dividend, whether formally or informally, the shareholder must include the distribution in gross income to the extent of the corporation’s earnings and profits.
- Hackers attempted to conceal matters from the IRS, such as by providing vague, misleading, or false statements to the examining agent. Such conduct, coupled with other factors, was sufficient to sustain fraud-related penalties.

## Shaddix v. Comm'r | TC Memo. 2022-11 | February 28, 2022

**Facts:** The IRS sent the Shaddix a NFTL for an unpaid liability of about \$40,000 for 2013-2016. At the CDP hearing, a settlement officer stated that Shaddix could not challenge the liability based on the mistaken belief that the IRS had audited the returns. Shaddix made an offer in compromise. A specialist recommended accepting the OIC of \$4,400, considering Petitioner's net operation loss (NOL) of over \$700,000 in 2017, *only if* Petitioner agreed the NOL would apply against future tax only after repayment of the unpaid NFTL liability. Declined. Second officer upheld the NFTL, stating flatly that Shaddix could not challenge the liability.

## Shaddix v. Comm’r | TC Memo. 2022-11 | February 28, 2022

### Nuggets:

- A taxpayer may challenge an underlying liability in a CDP case if the taxpayer did not receive a statutory notice of deficiency for the liability or did not otherwise have an opportunity to dispute a liability self-reported by the taxpayer on a return or reported by the IRS in a substitute for a return.
- Shaddix appeared to have the right to challenge the NFTL at the CDP stage given that the liability stated in the NFTL were self-reported and there was no evidence of Shaddix having received a notice of deficiency or of examination.
- Because the IRS’s determination was not supported by the record, the Tax Court deemed the decision an arbitrary and capricious abuse of discretion and remanded to Appeals for a supplemental CDP hearing.

## **Bunton v. Comm’r, T.C. Memo. 2022-20 | March 10, 2022**

**Facts:** For tax years 2013, 2014, 2015, and 2016, the Buntons timely filed applicable Form 1040s and in them, reported gross income of zero and tax of zero and claimed significant refunds. In each instance, the IRS paid the refund. Then, in 2016, the IRS issued a notice of deficiency for tax years 2013 and 2014, mailed to the Buntons. In 2017, the IRS did the same for tax year 2015. The Buntons did not file a petition with the Tax Court disputing the liability.

After receiving notice of intent to levy, the Buntons submitted a request for hearing but did not select a basis for disagreement or position to the intent to levy. Instead, the Buntons disputed the taxes owed, requested verification that the IRS followed all applicable rules, and requested a face-to-face hearing. The IRS informed the Buntons that the proposed levy was proper, all requirements for the levy had been met, and that a face-to-face hearing would not be allowed. The Buntons petitioned the Tax Court challenging the liability and the other determinations of the Office of Appeals.



## Bunton v. Comm’r, T.C. Memo. 2022-20 | March 10, 2022

### Nuggets:

- 6331(a) authorizes the Treas. Sec. (who acts through the IRS) to levy upon property of a taxpayer liable for tax if the taxpayer fails to pay the tax within 10 days after notice/demand for payment.
- The IRS is first required to notify the taxpayer in writing of his or her right to a pre-levy hearing with the Office of Appeals on the issue of whether the levy is appropriate. § 6330(a)(1), (b)(1).
- If a taxpayer requests a hearing, such hearing shall be held. § 6330(b)(3).
- Before the IRS can assess and collect a tax deficiency, it must first mail the taxpayer a notice of deficiency. If the taxpayer does not receive the notice of deficiency, the taxpayer can contest the liability at a CDP hearing. That a notice of deficiency is mailed does not mean it is received. The taxpayer bears the burden of proof to support an assertion that it did not receive a notice.
- A taxpayer dissatisfied with a § 6330 determination of the Office of Appeals may file a petition with the Tax Court. If the existence or amount of tax liability is properly at issue, the Court applies a de novo review. If the existence or amount of tax liability is not properly at issue, the Tax Court reviews the matter under an abuse of discretion standard, meaning that the decision of the Office of Appeals will be sustained unless it was made arbitrarily, capriciously, or without sound basis in fact or law.
- A “hearing” under Treas. Reg. § 301.6330-1(d)(2), Q&A-D6, does not require a face-to-face meeting.

## Estate of Kazmi v. Comm'r, T.C. Memo. 2022-13 | March 1, 2022

**Facts:** CDP case; NFTL filed with respect to trust fund recovery penalties (TFRPs) assessed against Kazmi. Kazmi claimed he was not liable because he was not a **responsible person** who willfully failed to pay over withholding taxes pursuant to 6672. Applying § 6330(c)(2)(B), the appeals settlement officer determined that Kazmi was precluded from raising this liability issue during the CDP hearing because Kazmi received a properly mailed Letter 1153 providing him with a pre-assessment opportunity to dispute the merits of the proposed TFRPs at an Appeals conference.

## Estate of Kazmi v. Comm’r, T.C. Memo. 2022-13 | March 1, 2022

### Nuggets:

- The Court agreed that Kazmi had a “prior opportunity” for purposes of 6330(c)(2)(B); sustained the notice of determination for the NFTL filing without considering the merits of Kazmi’s liability claim.
- Section 6672(a) imposes the TFRP on any person required to collect, account for, and pay over any tax imposed under the Code who “willfully” fails to collect, account for and pay over such tax.
- **The term “person” under 6672, generally referred to as “responsible person,” includes an officer or employee of a business who is under a duty to collect, account for, and pay over withholding tax. Factors to determine “responsible person” status include: owning interest in the business, corporate office, serving on the board, having authority to sign checks, and having control over corporate financial affairs.**
- **The Tax Court is not a court of equity.** The Court will follow precedent, even when it leads to a seemingly harsh result. Kazmi was a sympathetic taxpayer. He was a part-time bookkeeper for a company that failed to pay over employment taxes. He was not an officer of the company; he had no check writing authority and no authority to make payments on behalf of his employer.

## **Corning Place Ohio, LLC v. Comm’r, T.C. Memo. 2022-12 | Feb. 28, 2022**

**Facts:** In 2015, Corning Place Ohio, LLC (LLC) purchased for \$6 million, a building that was built in 1893 for sons of President James A. Garfield on land owned by John D. Rockefeller. After making renovations, LLC deeded a façade easement to a “qualified organization” within the meaning of section 170(h)(3). The deed provided for a split of sales proceeds between LLC and the organization if the property was sold following judicial extinguishment of the easement. For tax year 2016, LLC claimed a charitable contribution deduction of \$22,601,000. The IRS disallowed the deduction.

**Issues:** Was the IRS entitled to a summary judgment on the denial of the charitable contribution deduction when: (1) LLC reserved a right to sales proceeds, thus challenging the “perpetuity” of the conservation easement; and/or (2) in LLC’s applicable tax return, LLC failed to include (i) the \$500 statutory filing fee and (ii) the qualifications of the appraiser?

## Corning Place Ohio, LLC v. Comm’r, T.C. Memo. 2022-12 | Feb. 28, 2022

### Nuggets:

- 170: Deductibility of charitable contributions. Regs distinguish between cash & noncash. § 1.170A-13.
- One type of noncash charitable contribution: donation of a partial interest in real estate. Code generally disallows a charitable contribution deduction for a gift of real property of less than the taxpayer’s entire interest in the property. **Exception:** conservation easements. § 170(f)(3)(A)-(B).
- Qualified conservation easement contribution is a contribution: (A) qualified real property interest; (B) to qualified organization; (C) exclusively for conservation purposes. A contribution not treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.
- Subsequent unexpected change in the conditions can make impossible or impractical the continued use of the property for conservation purposes. Thus, the Regs permit a conveyance to contain certain qualified divisions of sales proceeds in the event of a judicial extinguishment of the easement.
- A taxpayer claiming a deduction for donating a conservation easement must include with its return a “qualified appraisal.” The appraisal must set forth, among other things, the qualifications of the appraiser, and the taxpayer must also include with its return photographs of the building’s exterior.
- No deduction allowed unless the taxpayer includes a \$500 filing fee. 26 U.S.C. § 170(f)(13)(A).

## Estate of Levine v. Comm’r, 158 T.C. No. 2 | February 28, 2022

**Facts:** Split-dollar life insurance arrangement. Levine, revocable trust paid premiums on life insurance policies taken out on her daughter and son-in-law that were purchased and held by a separate and irrevocable life-insurance trust. Levine’s revocable trust had the right to be repaid for the premiums or the value of the policies upon their termination. Decisions for investments in the irrevocable life-insurance trust could be made only by its investment committee, which consisted of one person—Levine’s long-time friend and business partner. Levine died.

**Issue:** What has to be included in her taxable estate: (1) value of her revocable trust’s right to be repaid in the future (\$2,282,195), or (2) the cash-surrender values of those policies at the time of death (\$6,153,478)?

## Estate of Levine v. Comm’r, 158 T.C. No. 2 | February 28, 2022

### Nuggets:

- Split-dollar arrangements after 9/17/2003 are governed by Treas. Reg. 1.61-22. An arrangement between an owner and a non-owner of a life-insurance contract in which:
  - (i) either party pays all or a portion of the premiums;
  - (ii) a party making the premium payments is entitled to recover all or a portion of those premium payments, and repayment is to be made from or secured by the insurance proceeds; and
  - (iii) the arrangement is not part of a group-term life insurance plan.
- Taxable estate is the value of a decedent’s gross estate minus applicable deductions. A decedent’s gross estate includes the value of any property that a decedent had an interest in at the time of her death.
- 2034 through 2045 identify what other property to include in an estate.
- 2036(a) is a catchall designed to prevent a taxpayer from avoiding estate tax simply by transferring assets before the taxpayer’s death.
- 2038 allows a “claw-back” into an estate the value of property that was transferred in which the decedent retained an interest or right to alter, amend, revoke, or terminate the transferee’s enjoyment of the transferred property.



## *Bonus Nuggets* -- Estate of Levine

- “[A]ll other things being equal, tax tomorrow is better than tax today. And tax decades from now is better still.”
- “The Commissioner assigned as his champion estate-and-gift-tax attorney Scott Ratke.”
- “The Commissioner . . . tries to unhorse the Estate’s argument with the pointed assertion that we should look at the transaction as a whole to get a clear picture of where each party stands and its role in the transaction. And that is exactly what we will do.”
- “A persnickety textualist might quickly respond that it was. But the Supreme Court looked at the text of the trust agreement itself.”



## Ola-Buraimo v. Comm’r, T.C. Summary Opinion 2022-2 | February 14, 2022

**Facts:** Mom (former spouse of Dad) had sole custody of children. Dad had visitation rights. Dad claimed a dependency exemption for one of the children as well as a dependent-related earned income credit. Dad failed to include Form 8332, Release/Revocation of Claim to Exemption for Child by Custodial Parent, signed by Mom. Deficiency issued as the IRS believed Dad was not entitled to the dependency exemption. Dad challenged.

## Ola-Buraimo v. Comm’r, T.C. Summary Opinion 2022-2 | February 14, 2022

### Nuggets:

- Dad was not entitled to a dependency exemption or related earned income credit.
- Dad presented no evidence that any child met the definition of “qualifying child.”
- Dad did not include a declaration signed by Mom/the custodial parent.
- An individual is allowed a deduction for an exemption for “each individual who is a dependent of the taxpayer for the taxable year.” § 151(c).
- “Dependent” includes “a qualifying child,” and to so qualify, the child must: (1) bear a specified relationship to the taxpayer (e.g., be a child of the taxpayer), (2) have the same principal place of abode as the taxpayer for more than one-half of such taxable year, (3) meet certain age requirements, (4) not have provided over one-half of such individual’s support for the taxable year, and (5) not have filed a joint return for that year. § 152(c)(1).

## Hicks v. Comm’r, T.C. Memo. 2022-10 | February 23, 2022

**Facts:** Noncustodial parent claims a dependency deduction for a child. Hicks conceded that the two children in issue (C1 and C2) did not reside with him for more than one-half of the tax year and thus could not be “qualifying children” for dependency purposes. But, Hicks claimed that the children were still “qualifying relatives” since Hicks provided over one-half of their support; thus, Hicks claimed dependency deductions and child credits.

## Hicks v. Comm’r, T.C. Memo. 2022-10 | February 23, 2022

### Nuggets:

- An individual is allowed a deduction for an exemption for “each individual who is a dependent of the taxpayer for the taxable year.” § 151(c). “Dependent” includes “a qualifying child” or a “qualifying relative.”
- “Qualifying child” – the child must: (1) bear a specified relationship to the taxpayer, (2) have the same principal place of abode as the taxpayer for more than 1/2 of tax year, (3) meet certain age requirements, (4) not have provided over 1/2 of individual’s support for the tax year, and (5) not have filed a joint return. § 152(c).
- “Qualifying relative”: individual (A) who bears a specified relationship to the taxpayer, including being a child or grandchild; (B) whose gross income is less than the exemption amount; (C) with respect to whom the taxpayer provides over 1/2 support; and (D) who is not a qualifying child of the taxpayer or any taxpayer. § 152(d)(1)-(2).

## Hicks v. Comm’r, T.C. Memo. 2022-10 | February 23, 2022

### Additional Nuggets:

- **Tie-Breaker:** If an individual may be claimed as a “qualifying child” by two or more taxpayers, such individual shall be treated as the qualifying child of (1) the taxpayer who is the parent of the individual or (2) if a parent does not so qualify, the taxpayer with the highest AGI for the tax year.
- However, if a parent is a dependent of a taxpayer for a tax year, that parent is treated as having no dependents for that year, and thus the above-noted “tie-breaker” does not apply.
- **Divorced or Separated Parents:** Child may be treated as a qualifying child of the noncustodial parent rather than of the custodial parent. See 26 U.S.C. § 152(e)(1)-(2), (4). Key criteria include that the custodial parent sign a written declaration that such custodial parent will not claim such child as a dependent, and the noncustodial parent must attach such written declaration to the noncustodial parent’s return for the relevant tax year.
- IRS Form 8332, Release/Revocation of Claim to Exemption for Child by Custodial Parent

## Hoops, LP v. Comm'r, T.C. Memo. 2022-9 | February 23, 2022

**Facts:** Hoops, LP owned the Memphis Grizzlies, an NBA franchise. In 2012, Hoops sold substantially all its assets, and assigned its liabilities to a buyer. The liabilities included two NBA player contracts and deferred compensation that earned by the players but not due to be paid by Hoops until after the 2012 sale. In computing its gain on the 2012 sale, Hoops claimed \$10,673,327 (total deferred compensation discounted by 3%) as a deduction on Hoops' 2012 return. The IRS issued a notice of final partnership administrative adjustment (FPAA) for the 2012 tax year, disallowing the deduction. Heisley Member, Inc., the tax matters partner of Hoops, filed a petition for readjustment. By the parties' concessions, the case focuses on Section 404(a)(5) of the Internal Revenue Code and the deductibility of compensation that is earned but payable in a later year under a nonqualified plan of deferred compensation.

## Hoops, LP v. Comm'r, T.C. Memo. 2022-9 | February 23, 2022

### Nuggets:

- The Tax Court is a court of limited jurisdiction. The Court's jurisdiction over a TEFRA partnership-level proceeding is invoked upon the Commissioner's issuance of a valid FPAA and the proper filing of a petition for readjustment of partnership items for the year or years to which the FPAA pertains. See 26 U.S.C. § 6226(a).
- IRS's determinations in an FPAA are presumed correct; the party challenging the FPAA bears the burden of proving that the determinations are erroneous.
- A disregarded entity for federal tax purposes but a general partner under state law may be designated as the tax matters partner of a partnership subject to the TEFRA partnership provisions.
- Deductions are a matter of legislative grace, and the burden is on the challenging party to prove entitlement to any claimed deductions.



# Hoops, LP v. Comm’r, T.C. Memo. 2022-9 | February 23, 2022

## Additional Nuggets:

- Section 162(a) allows a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.
- If amounts are contributed by an employer under any plan of deferred compensation, Section 404(a) governs the deductibility of such amounts and prescribes limitations as to the amount deductible. Treas. Reg. § 1.404(a)-1(a)(1); *see also* Treas. Reg. § 1.162-10(c).
- 404(a)(5) -- in a case of a nonqualified plan, a deduction for deferred compensation paid or accrued is allowable for the taxable year for which an amount attributable to the contribution is includible in the gross income of the employees participating in the plan.
- 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis. The “amount realized” is the sum of any money received plus the fair market value of the property (other than money) received, including the amount of liabilities from which the transferor is discharged as a result of the sale or other disposition.
- **Summation:** As shown in *Hoops, L.P.*, and under the special rules for deductions set forth in Section 404, if an employer on the accrual basis defers paying any compensation to the employee until a later year or years, the employer will not be allowed a deduction until the year in which the compensation is paid, even if the compensation would otherwise be deductible under Section 162.



## Harwood v. Comm’r, T.C. memo. 2022-8 | February 15, 2022

**Facts:** Deductibility of unreimbursed employee expenses incurred by Harwood while working as a construction worker for various employers. The work required that Harwood leave his home for significant “chunks of time.” He sought to deduct unreimbursed expenses for meals and entertainment, lodging, vehicle, and other incurred during employment. The IRS issued a deficiency based on the disallowance of a portion of Harwoods’ claimed deductions.

## Harwood v. Comm’r, T.C. memo. 2022-8 | February 15, 2022

### Nuggets:

- § 162(a) allows deduction of “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.”
- “Trade or business” includes performing services as an employee.
- A cash basis taxpayer deducts expenses for the year of payment. **To deduct, must prove that he or she did not receive, and did not have had the right to receive reimbursement from employer.**
- Taxpayer bears the burden of establishing and substantiating entitlement to permissible deductions. § 6001. Unless specifically enumerated, no deductions are allowed for personal, living, or family expenses. § 262(a).
- For travel (including meals/lodging while *away from home*), no deduction is allowed unless the taxpayer substantiates by adequate records or by sufficient and credible evidence corroborating his own statement the amount, time and place, and business purpose. § 274(d).
- Adequate records for this purpose include an account book, log, or similar record and documentary evidence, contemporaneously made with the expense, that together are sufficient to establish each element of the expenditure. *See* Treas. Reg. § 1.274-5T(c)(2)(i)-(ii)(C).
- “Home” refers to the vicinity of a taxpayer’s principal place of business rather than his personal residence. Thus, a taxpayer’s residence may be treated as his tax home, if his principal place of business is temporary rather than indefinite. Employment is “temporary” if it is the type that can be expected to last for only a short period, and is indefinite if “its termination cannot be foreseen within a fixed or reasonably short period of time.”

## Sonntag v. Comm’r, T.C. Summary Opinion 2022-3 | February 17, 2022

**Facts:** Deductibility of item-by-item expenses contained on Schedule C (Profit or Loss From Business) of the taxpayers’ 2017 Form 1040 Individual Tax Return. Mainly, one of the taxpayers was music producer and musician; expense categories included books and publications, costume cleaning, physical culture (i.e., Zen Fit training sessions), iTunes, Spotify, and Netflix. The IRS issued a notice of deficiency disallowing deductions for \$37,800 of the total \$47,385 of Schedule C expenses. The taxpayers challenged that decision.

## Sonntag v. Comm’r, T.C. Summary Opinion 2022-3 | February 17, 2022

### Nuggets:

- Grooming expenses are never deductible because they are inherently personal. Fitness memberships and health supplements are also inherently personal expenses.
- Deduction for credit card interest and annual fees may be denied where the credit card is used for personal expenses and the taxpayer fails to provide documentation to allocate interest and fees to business versus personal.
- Where business clothes are suitable for general wear, a deduction for them is not allowed.
- Purchase of periodicals of general interest does not generate an ordinary and necessary business expense under section 162. Expense for a trade-related periodical may be deductible, but the taxpayer bears the burden of proof on the issue.

## **Sherwin Community Painters Inc. v. Comm’r, T.C. Memo. 2022-19 | March 9, 2022**

**Facts:** The IRS determined separate tax deficiencies against the company (Sherwin) and its individual owners, the Robert and Swanette Ward. Issues presented to the court were (1) whether Sherwin was entitled to certain business expense deductions for office equipment and, among other things, the expense of paying for a non-employee’s (i.e., Ward’s daughter’s boyfriend) tuition for a coding course since he helped with Sherwin’s website; and (2) whether Swanette Ward received constructive dividends from Sherwin by virtue of the IRS recharacterizing a loan from Ward to Sherwin as a disallowed business expense deductions.

# Sherwin Community Painters Inc. v. Comm’r, T.C. Memo. 2022-19 | March 9, 2022

## Nuggets:

- I.R.C. section 162(a) contains the general rule for allowing a deduction for ordinary and necessary expenses incurred in carrying on any trade or business, including a reasonable allowance for compensation for personal services.
- “Ordinary” means that the expense is normal, usual, or customary in the taxpayer’s trade or business.
- “Necessary” means the expense is appropriate or helpful in carrying on the trade or business. The expenses must proximately relate to the taxpayer’s trade or business. All of these are determined by the facts of the case.
- A constructive dividend arises when a corporation confers an economic benefit on a shareholder without an expectation of repayment where the corporation has current or accumulated earnings and profits. Constructive dividends are includible in the shareholder’s gross income under section 61(a)(7). Where a claimed business expense of a company is disallowed, the amount may be considered a constructive dividend to a shareholder where the shareholder receives an economic benefit from the amount of the disallowed expenses.

## **Lord v. Comm’r, T.C. Memo. 2022-14 | March 1, 2022**

**Facts:** In 2012, Mr. Lord owned interests in a limited liability company and an S corporation, both of which were formed in the State of Colorado and both of which were licensed by that state to cultivate, process, and distribute medical marijuana. The businesses did not have audited financial statements for 2012 and were not otherwise required to maintain books and records or financial reports in accordance with GAAP. The businesses calculated the depreciation included in their cost of goods sold (“COGS”) for the year by using the accelerated cost recovery method in section 168(a), and they claimed bonus depreciation under section 168(k). The businesses used methods under section 168(a) and (k) that did not conform with GAAP.

Mr. and Mrs. Lord (“Petitioners”) timely filed a joint Form 1040 for 2012. In a notice of deficiency for that year, the Commissioner determined adjustments to the depreciation deductions that the businesses had claimed. The adjustments reflected the Commissioner’s position that section 263A should not have been relied upon for the calculation of inventory and the determination of COGS.



## Lord v. Comm’r, T.C. Memo. 2022-14 | March 1, 2022

### Nuggets:

- 162(a) - deduct from gross income ordinary and necessary business expenses. 261: In computing taxable income no deduction shall be allowed in respect of the items specified in this part, including 280E.
- 280E prohibits taxpayers from deducting expenses related to a business that consists of trafficking in controlled substances. 280E applies only to deductions for business expenses and does not prevent businesses from taking into account their COGS.
- Medical marijuana is a controlled substance. Because dispensing medical marijuana is illegal under federal law, such activity triggers 280E.
- COGS is not a deduction under 162(a) but is subtracted from gross receipts in determining gross income.
- Gross income generally is gross receipts less COGS.
- COGS is the cost of acquiring inventory, including by production. COGS is determined under 471 and related regulations. Producers are required to include in COGS direct/indirect costs of creating inventory.
- 471 directs taxpayers to 263A for additional rules. 263A instructs both producers and resellers to include “indirect” inventory costs in the cost of their inventory. Indirect costs are defined broadly as all costs other than direct material costs and direct labor costs (for producers) and acquisition costs (for resellers). § 1.263A-1(e)(3).
- But, the flush text of 263A(a)(2): “[a]ny cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.”
- **“The unlawfulness of an activity does not prevent its taxation.”**



## Slone v. Comm’r, T.C. Memo 2022-6 | February 7, 2022

**Facts:** 4 consolidated *Slone* opinions stem from a stock-sale transaction commonly known as an “intermediary company” or “Midco” transaction which ultimately resulted in a \$13,494,884 federal income tax deficiency and a \$2,698,997 accuracy-related penalty, plus accrued interest, against a judgment-proof corporation. IRS pursued the tax liability against transferees of the corporation’s assets.

## Slone v. Comm’r, T.C. Memo 2022-6 | February 7, 2022

### Nuggets:

- An “intermediary company” or “Midco” transactions. Basically, sham to attempt to avoid corporate-level tax, thus benefitting the shareholders of the target company. In 2001, the IRS listed Midco transactions as reportable transactions.
- The Commissioner is permitted to assess a tax liability against a person who is the transferee of assets of a taxpayer who owes income tax, estate tax, or gift tax. The tax liability of a transferor may be collected only once. However, transferee liability is several under 6901, and each applicable transferee is severally liable for a transferor’s tax debt up to the value of the assets that each transferee received.
- The determination of such transferee liability depends on whether the person is substantively liable for the transferor’s unpaid taxes under state law and whether that party is a “transferee” within the meaning of 6901.
- In a fraudulent transfer matter, “if the transferred assets are insufficient to satisfy the IRS’s claim against the transferor, the IRS may have a further right to collect pre-notice interest from the transferee, based on the transferee’s wrongful use of the transferred assets.”

# A Brief Discussion on Contracts

*front-end considerations to avoid back-end pains*

# Freedom to Contract

“[Persons] of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice.

Therefore, you have this paramount public policy to consider—that you are not lightly to interfere with this freedom of contract.”

*Chalker Energy Partners III, LLC v. LE Norman Operating LLC*, 595 S.W.3d 668, 673 (Tex. 2020) (quoting a long line of authorities)

# Stay Vigilant

“The law helps those who help themselves, generally aids the vigilant, but rarely the sleeping, and never the acquiescent.”

*Hannan v. Dusch*, 154 Va. 356 (Va. 1930)

# Judicial View on Contracts

- A court's primary concern when interpreting contract language is to ascertain the true intent of the parties as expressed in the contract language.
- Courts interpret contract language according to its plain grammatical reading unless to do so would defeat the parties' intent.
- Courts avoid unreasonable interpretations when possible and proper to do so.
- Courts consider the entire contract, harmonizing and giving effect to all of the contract's provisions so that none will be rendered meaningless.
- No single provision taken alone is given controlling effect; each must be considered in the context of the contract as a whole.
- Courts must not make new contracts between the parties and must enforce the contract as written.

*See, e.g., In re Davenport*, 522 S.W.2d 452, 457 (Tex. 2017) (orig. proceeding).

# Common and Re-Occurring Provisions

# Common Provisions – High-Level Overview

- Party Identification
- Pricing
- Billing and Invoicing
- Term
- Exclusivity and Quantity Requirements
- Shipping and Delivery
- Specifications / Standards
- Force Majeure
- Indemnification
- Insurance
- No Waiver
- Remedies and Limitations on Liability
- Confidentiality, Public Filings and Press Releases
- Compliance with Applicable Law
- Dispute Resolution
- Amendment
- Termination
- Governing Law and Venue



**Select (Non-Exclusive) Provisions  
and  
Constant Battle Grounds**

# Select Provisions and Constant Battle Grounds

## Warranty – example:

- TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, THE SERVICE PROVIDER SOFTWARE AND SERVICES ARE PROVIDED “AS IS” AND “AS AVAILABLE”, WITH ALL FAULTS AND WITHOUT WARRANTY OF ANY KIND, AND SERVICE PROVIDER HEREBY DISCLAIM ALL WARRANTIES AND CONDITIONS WITH RESPECT TO THE SOFTWARE AND SERVICES, EITHER EXPRESS, IMPLIED OR STATUTORY, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES AND/OR CONDITIONS OF MERCHANTABILITY, SATISFACTORY QUALITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, QUIET ENJOYMENT, AND NON-INFRINGEMENT OF THIRD PARTY RIGHTS.
- WE DISCLAIM ANY WARRANTIES, EXPRESS OR IMPLIED, OF QUALITY, PERFORMANCE, MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE OR NON-INFRINGEMENT. NO ORAL OR WRITTEN ADVICE OR INFORMATION PROVIDED BY US SHALL CREATE A WARRANTY, AND YOU ARE NOT ENTITLED TO RELY ON ANY SUCH ADVICE OR INFORMATION. THIS DISCLAIMER OF WARRANTIES IS AN ESSENTIAL CONDITION OF THIS AGREEMENT.

# Select Provisions and Constant Battle Grounds

## Disclaimer / Limitations of Liability – example:

- WE SHALL NOT BE LIABLE TO YOU: IN RESPECT OF ANY CLAIM, DEMAND OR ACTION, IRRESPECTIVE OF THE NATURE OF THE CAUSE OF THE CLAIM, DEMAND OR ACTION ALLEGING ANY LOSS, INJURY OR DAMAGES, DIRECT OR INDIRECT, WHICH MAY RESULT FROM THE USE OR POSSESSION OF THE APPLICATION; OR FOR ANY LOSS OF PROFIT, REVENUE, CONTRACTS OR SAVINGS, OR ANY OTHER DIRECT, INDIRECT, INCIDENTAL, SPECIAL OR CONSEQUENTIAL DAMAGES ARISING OUT OF YOUR USE OF OR INABILITY TO USE THE APPLICATION, ANY DEFECT IN THE APPLICATION, OR THE BREACH OF THESE TERMS OR CONDITIONS, WHETHER IN AN ACTION IN CONTRACT OR TORT OR BASED ON A WARRANTY, EVEN IF WE HAVE BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES. OUR TOTAL AGGREGATE LIABILITY WITH RESPECT TO OUR OBLIGATIONS UNDER THIS AGREEMENT OR OTHERWISE WITH RESPECT TO THE APPLICATION SHALL NOT EXCEED \$1.00.

# Select Provisions and Constant Battle Grounds

## Indemnification – example:

- Client agrees to indemnify and hold CPA and its partners, principals, shareholders, officers, directors, members, employees, agents harmless with respect to any and all claims arising from the use of the tax returns for any purpose other than filing with the IRS and state and local tax authorities regardless of the nature of the claim, **including the negligence of any party.**

Alternative:

- Client agrees to indemnify CPA, its managers, members, officers, directors, employees and agents from **any third-party** liability, claim or expense, including reasonable attorney's fees, arising out of or in connection with this Agreement or the services of CPA hereunder, **except to the extent attributable to gross negligence, fraud or willful misconduct of CPA.**
- CPA agrees to indemnify the Client, its officers, directors, employees and agents from any third-party liability, claim or expense, including reasonable attorney's fees, arising out of or in connection with any gross negligence, fraud or willful misconduct committed by CPA.

# Select Provisions and Constant Battle Grounds

## Venue – example:

- Client and CPA irrevocably elect the Courts of X and the Federal Courts of the United States, sitting in Y state/county as the sole judicial forum for any disputing arise under or in connection with this Agreement.

## Alternative:

- Client and CPA irrevocably elect the Courts of Y County and the Federal Courts of the United States, sitting in Z state as the sole judicial forum for the adjudication of any **legal proceeding first initiated by Client** and which arise under or in connection with this Agreement.
- In turn, Client and CPA irrevocably elect federal and state courts of or located in A County and the Federal Courts of the United States, sitting in B state as the sole judicial forum for the adjudication of any legal proceeding **first initiated by CPA** and which arise under or in connection with this Agreement. Client and CPA consent to the jurisdiction of the federal and state courts of these venues with respect to the legal proceedings indicated.

# Select Provisions and Constant Battle Grounds

## Dispute Resolution – example:

- If the dispute has not been resolved informally, the parties agree to mediate the dispute with a mediator selected jointly by the parties, or if they cannot agree, a mediator selected or appointed by the American Arbitration Association in accordance with its rules then in effect.
- The mediation shall be conducted remotely and by electronic video conference means, unless the parties agree in writing to mediate in person.
- Each party shall assume its own costs associated with the mediation.
- The mediator's compensation and expenses and any administrative fees or costs associated with the mediation proceeding shall be borne equally by the parties, unless otherwise agreed in writing.

# Reminder and Closing Thanks

“The law helps those who help themselves, generally aids the vigilant, but rarely the sleeping, and never the acquiescent.”

*Hannan v. Dusch*, 154 Va. 356 (Va. 1930)



THANK YOU.

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