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Taxation

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TAXATION

OVERVIEW

The Tenth Circuit Court of Appeals considered several cases in the area of federal taxation during the period covered by this survey. This article will review the significant changes and additions in the law of federal taxation resulting from the court's published decisions.

I. CONSTRUCTIVE DIVIDENDS

In *Williams v. Commissioner*,[1] the Tenth Circuit Court of Appeals considered whether cash withdrawals from closely held corporations are taxable dividends or bona fide loans. In the *Williams* case, the taxpayers appealed from a tax court decision which upheld the Commissioner's determination of deficiencies for the tax years 1964-69.[2] The court of appeals relied upon an earlier Tenth Circuit decision, *Dolese v. United States*,[3] in upholding the tax court.

The taxpayers owned most of the stock and were the controlling officers in three Oklahoma Corporations.[4] Although they received salaries, they withdrew additional funds from 1964 until 1969.[5] The three corporations had significant earned surplus for the years 1964-69, yet neither declared nor paid any dividends during that period.[6] Throughout that time the corporations' accountant advised the taxpayers to make notes to the companies for the withdrawals.[7] In 1967, some notes were drawn by the taxpayers. The notes, however, were not made for the full amount due, nor did any of the notes contain a payment schedule or interest rate.[8] Apparently no payments were ever made on these notes.

In August 1969, after the taxpayers became aware that their tax returns for 1964-68 were being audited, they executed notes for the entire amount of the withdrawals.[9] The notes bore interest and a payment schedule that corresponded with a note the taxpayers had received earlier.[10]

The taxpayers' three corporations were acquired in October 1969 by Smith International, Inc. in a stock exchange in which the taxpayers received 90,000 shares of Smith stock.[11] The taxpayers then assigned a sepa-

1. 627 F.2d 1032 (10th Cir. 1980).
2. TAX CT. MEM. DEC. (P-H) ¶ 78,306.
3. 605 F.2d 1146 (10th Cir. 1979), *cert. denied*, 445 U.S. 961 (1980). For a brief note on the *Dolese* case, see *Taxation, Seventh Annual Tenth Circuit Survey*, 58 DEN. L.J. 523 (1981).
4. 627 F.2d at 1032-33.
5. *Id.* at 1033.
6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.* at 1033-34.
10. *Id.* One of the taxpayers had sold some Canadian property on April 16, 1969, for which he received cash and a note secured by a second mortgage and seven sales contracts. *Id.* at 1033.
11. *Id.* at 1034.

rate note to the three corporations to fulfill their note obligation to the corporations.[12] Eighteen months later, the assigned note was returned to the taxpayers in exchange for their Smith stock.[13]

The Tenth Circuit Court of Appeals stated that the question of whether taxpayers' withdrawals are loans or constructive dividends is normally one of fact. Since the evidence in this case was undisputed, however, such a determination was a question of law.[14]

The taxpayers argued that their intent to repay the notes indicated that the payments were nontaxable loans and not taxable constructive dividends.[15] The court of appeals disagreed, stating that subjective intent is not enough to prove that payments are loans.[16] The court found that four factors combined to outweigh the taxpayers' subjective intent to repay which rendered the payments constructive dividends. First, no repayment on the withdrawals was made until the taxpayers knew of the audit even though they had the means to repay earlier. Additionally, the withdrawals were made over a long period of time; the companies were controlled by the taxpayers; and a large earned surplus had accumulated.[17] In further support of its decision, the court of appeals noted that it must give "primary weight" to the trier of fact who had found that the taxpayers did not intend to repay.[18]

The taxpayers also argued that equitable estoppel should apply because the Internal Revenue Service (IRS) had settled on a disputed 1970 tax return.[19] The court noted that equitable estoppel does not apply to prior tax returns and thus does not extend to subsequent returns or settlements.[20]

II. SALE OF STOCK[21]

The Tenth Circuit, in *Sprague v. United States*,[22] considered the proper use of the "installment sales" method of reporting income from the sale of stock. The action was originally brought in the district court for a refund of federal income taxes.[23] The district court found that the taxpayer did not

12. *Id.* Payment was in full except for a later satisfied obligation. *Id.* The separate note assigned to the three corporations was the note received by one of the taxpayers for Canadian property he had sold. *See* note 10 *supra*.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.* (citing Alterman Foods, Inc. v. United States, 505 F.2d 873, 877 (5th Cir. 1974); Fin Hay Realty Co. v. United States, 398 F.2d 694, 697 (3d Cir. 1968)).

17. 627 F.2d at 1034-35.

18. *Id.* (citing Commissioner v. Duberstein, 363 U.S. 278, 289 (1960)). *See also* Tollefson v. Commissioner, 431 F.2d 511, 513 (2d Cir. 1970).

19. *Id.*

20. *Id.* (citing Automobile Club v. Commissioner, 353 U.S. 180, 183 (1957); Union Equity Coop. Exch. v. Commissioner, 481 F.2d 812, 817 (10th Cir.), *cert. denied*, 414 U.S. 1028 (1973); Wiles v. United States, 312 F.2d 574, 577 (10th Cir. 1962)).

21. Another case decided by the court in this area is Monarch Cement Co. v. United States, 634 F.2d 484 (10th Cir. 1980). There the court affirmed the district court's valuation of stock warrants. A full discussion of the case is not included in this survey because the Tenth Circuit was not required to determine the value of the warrants, but merely considered whether the district court had committed clear error. *Id.* at 486.

22. 627 F.2d 1044 (10th Cir. 1980).

23. Sprague v. United States, 78-2 T.C. ¶ 9650 (W.D. Okla. Aug. 2, 1972).

qualify for the installment sales method of reporting a stock sale and thus was not entitled to a refund.[24] The court of appeals reversed, holding that the taxpayer was entitled to report under the installment sales method.[25]

The stock in question was owned by a partnership to which the taxpayer had belonged and was held primarily by banks as collateral for loans to the partnership. The partnership arranged to sell the stock to Transairco, Inc. on a deferred payment plan. The partnership received a down payment of cash and debt assumption which amounted to 29.3% of the total sales price. The balance due consisted of notes payable to the partnership.[26]

To release the stock used as security for the partnership's loans, the partnership assigned the notes made by Transairco to the banks holding the partnership's loans. The partnership was still primarily liable on the loans, but in the event of default the banks were to look to Transairco to pay the notes. If Transairco defaulted on its notes, the banks were to look to the security on the notes.[27]

Following the stock sale, the partnership became substantially dormant and payments on the bank loans were usually made by drawing on the letters of credit supplied as security by Transairco. On the basis of the above transactions, the taxpayer reported the stock sale to Transairco under the installment sales method,[28] and claimed a loss carryback to 1967 resulting in a claimed refund of $905.53.[29]

The Tenth Circuit Court of Appeals designated the issues as whether 1) the partnership constructively received year-of-sale payments or 2) realized year-of-sale debt relief, in either case receiving more than thirty percent of the selling price in the year of sale. Either situation would disqualify the taxpayer from reporting under the installment sales method.[30]

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24. 627 F.2d at 1046.

25. *Id.*

26. *Id.*

27. *Id.* Initially the security was certificates of deposit but after the stock sale letters of credit were used.

28. *Id.* The installment sales provision in effect at the time of decision provided:

> Installment Method.
>
> (a) Dealers in personal property.
>
> (1) In general.—Under regulations prescribed by the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.
>
> . . .
>
> (b) Sales of realty and casual sales of personalty.
>
> (1) General rule.—Income from— . . .
>
> (B) a casual sale or other casual disposition of personal property . . . for a price exceeding $1,000, may (under regulations prescribed by the Secretary) be returned on the basis and in the manner prescribed in subsection (a).
>
> (2) Limitation.—Paragraph (1) shall apply only if in the taxable year of the sale or other disposition—
>
> (A) there are no payments, or
>
> (B) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

I.R.C. § 453 (subsequently amended by Act of Oct. 19, 1980, Pub. L. No. 96-471, § 2a, 94 Stat. 2247).

29. 627 F.2d at 1047.

30. *Id.*

A. *Constructive Receipt*

The Government relied on three different theories in contending that the partnership had constructively received payment. First the Government asserted that since the underlying security made the notes certain of collection the security was as good as cash, and the taxpayer should be treated as having received cash. The court noted that secured and unsecured notes are treated the same under the installment sales method.[31] Thus, "certainty of collection" on a note or security has no bearing on the constructive receipt of any cash value.[32]

The Government next theorized that the partnership actually received the value of the security in the year of sale because the security could be readily converted into cash.[33] The court found no merit in this argument because the right to convert the security into cash would have arisen under the security agreement only when Transairco defaulted on the notes, which were not due until after the year of receipt.[34]

Finally, the Government argued "substance over form"—that the notes as security were in reality payments constructively received.[35] The critical inquiry under this argument is whether the purchaser is effectively relieved of his debt obligations.[36] The court stated that the partnership was not actually relieved of its debt; indeed, Transairco was unable to pay the full cash price of the stock at the time of the sale. There had been no substitution of a third party as an obligor,[37] and therefore, the Government's "substance over form" theory failed.

B. *Debt Relief*

The Government further alleged that in the year of sale the partnership had received debt relief which, when included with the other payments

31. 627 F.2d at 1047-48 (citing R. L. Brown Coal & Coke Co. v. Commissioner, 14 B.T.A. 609 (1928)).

32. 627 F.2d at 1048. The court noted that the Government's "certainty of collection" theory would penalize those who were most careful in guarding against default by requiring good security on the debt owed them. *Id.*

33. The court said that this was closer to the actual concept of constructive receipt as defined at Treas. Reg. § 1.451.2(a) T.D. 6723, 1964-1 (Part I) C.B. 73:

> Constructive Receipt of Income.
>
> (a) *General Rule*. Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

627 F.2d at 1048.

34. 627 F.2d at 1048.

35. *Id.* at 1049. *See, e.g.*, Oden v. Commissioner, 56 T.C. 569 (1971); Pozzi v. Commissioner, 49 T.C. 119 (1967).

36. 627 F.2d at 1049.

37. *Id.* at 1050. Substitution of a third party as obligor would occur if the purchaser would put the total sale price in an escrow account directed to be paid to the seller at certain intervals. *See, e.g.*, Trivett v. Commissioner, 36 T.C.M. (CCH) 675 (1977), *aff'd*, 611 F.2d 655 (6th Cir. 1979); Oden v. Commissioner, 56 T.C. 569 (1971); Pozzi v. Commissioner, 49 T.C. 119 (1967).

made to the partnership, exceeded thirty percent of the selling price.[38] The Government contended that Transairco had assumed the partnership's debts because the partnership had assigned the Transairco notes as substitute collateral for its loans. The court of appeals found that the notes were "only 'further security' " and that the partnership was still primarily liable.[39]

The Government also asserted that the substitution of collateral was actually a "sham" arrangement to substitute Transairco as the debtor in place of the partnership.[40] The fatal flaw in that argument, according to the court, was that the substitution of collateral took place after the actual sale transaction. Nothing at the time of sale suggested anything other than an installment sale transaction.[41] Accordingly, the Tenth Circuit Court of Appeals held that the taxpayer was entitled to report the sale on an installment sale basis.[42]

III. FEDERAL TAX LIENS

The Tenth Circuit Court of Appeals had an opportunity this past year to review the law regarding attachment of federal tax liens and government foreclosures on such liens. The issue whether a federal tax lien may attach to a spouse's interest in the homestead of both spouses was decided in *Tillery v. Parks*.[43] The wife brought an action to quiet title on the family homestead. The homestead was burdened by a federal tax lien that the IRS had filed[44] because the husband had defaulted on his obligation to pay withholding taxes. The taxes were due from corporations of which the husband was the responsible officer.[45] The district court granted relief by ordering the tax lien discharged as to the homestead property.[46]

The plaintiff argued that the Tenth Circuit had previously held that a federal tax lien could not attach to homestead property.[47] The court of appeals distinguished its earlier decisions by noting that those decisions dealt with foreclosures, and not solely with the attachment of liens. In this case no forclosure action had been undertaken.[48]

In upholding the federal tax lien on the husband's undivided one-half interest in the homestead property, the court reiterated the distinction between the attachment of a lien and a foreclosure action. The attachment of

38. 627 F.2d at 1050. This would then disqualify the taxpayer from using the "installment sales method." Riss v. Commissioner, 368 F.2d 965, 968 (10th Cir. 1966).

39. 627 F.2d at 1050.

40. *Id.* at 1051.

41. *Id.*

42. *Id.* at 1052.

43. 630 F.2d 775 (10th Cir. 1980).

44. Section 6321 of the Internal Revenue Code grants the IRS the right to file tax liens. That section states that liens shall be "in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." The question of what property or property right belongs to the taxpayer is determined by state law. Aquilino v. United States, 363 U.S. 509, 513 (1960). *See In re* Carlson, 580 F.2d 1365, 1368-69 (10th Cir. 1978).

45. 630 F.2d at 776.

46. *Id.*

47. 630 F.2d at 777. *See* United States v. Hershberger, 475 F.2d 677 (10th Cir. 1973); Jones v. Kemp, 144 F.2d 478 (10th Cir. 1944).

48. 630 F.2d at 777.

a lien is not discretionary, whereas the court has equitable discretion to order foreclosure.[49]

In *United States v. Annis*[50] the court of appeals reviewed a district court authorization of a federal tax lien foreclosure on a taxpayer's property. The Government had filed the lien following a judgment in the tax court against the taxpayer for taxes, penalties, and interest.[51] No appeal was taken from the tax court judgment.[52] After the lien on the taxpayer's real estate was perfected, the taxpayer conveyed the tract of land to a trust. The Government filed suit to set aside the transfer as a fraudulent conveyance and to foreclose on the lien. The district court granted summary judgment in favor of the Government, and the taxpayer appealed.[53]

The court of appeals first held that the taxpayer could not relitigate the tax deficiency issued since such relitigation was barred by the doctrine of res judicata.[54] The court stated further that because the Government was seeking to enforce the lien—an action in equity—the taxpayer did not have a right to a jury trial.[55] The court also held that the Government's dropping of one of its claims did not constitute a denial of due process. The defense of the case had actually been simplified.[56]

The taxpayer alleged that summary judgment was not proper because the amount of the lien was significantly higher than the assessed tax deficiency. The allegation was without merit because the penalties and interest on an assessed tax deficiency run from the date of judgment until it is paid.[57] The lien reflected those costs, and thus the taxpayer's argument was insufficient to deny the validity of summary judgment.[58]

The court of appeals did find merit in the claim that the trustee could have been an indispensable party and should have been joined in the suit.[59] The court noted, however, that it did not see any meritorious defenses that could be raised by the trustee that had not been raised by the taxpayer. Nevertheless, the court remanded the case to the district court to determine whether the trustee has title to the property.[60]

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49. *Id.* The attachment of a lien is provided for under I.R.C. § 6321 which states that the lien shall attach to the property of the taxpayer. *See* note 44 *supra*. Whereas I.R.C. § 7403

> gives the Government authority to bring an action in district court to enforce a tax lien of the United States against the property of the delinquent taxpayer. . . . 'The court . . . may decree a sale of such property, by the proper officer of the court, and a distribution of the proceeds of such sale according to the findings of the court in respect to the interest of the parties and of the United States.'

630 F.2d at 777 n.2 (quoting I.R.C. § 7403(c)).

50. 634 F.2d 1270 (10th Cir. 1980).

51. *Id.* at 1272.

52. *Id.*

53. *Id.*

54. *Id.* (citing Commissioner v. Sunnen, 333 U.S. 591, 598 (1948)).

55. 634 F.2d at 1272.

56. *Id.*

57. *Id.* 1272-73.

58. The court stated that the "[t]axpayer has the burden of showing error in the amount of an assessment; none has been shown here." *Id.* at 1273 (citations omitted).

59. *Id.*

60. *Id.*

IV. POWER OF APPOINTMENT

In the *Estate of Rosenblatt v. Commissioner*,[61] the Tenth Circuit Court of Appeals considered the issue of whether a beneficiary's minority diminishes her power of appointment and thus allows the value of a trust to be excluded from the gross estate of the minor for estate tax purposes. The trustee had petitioned the tax court to have the trust's value excluded from the value of the gross estate of the beneficiary. The beneficiary of the trust had died at age sixteen, too young to make an effective will.[62] The tax court held that the beneficiary had a vested remainder in the trust income, and the value of the trust should, therefore, be included in the beneficiary's gross taxable estate.[63]

The original trust instrument provided that the beneficiary of the trust had a general power of appointment as to the property and income of the trust.[64] Federal estate tax law provides that the value of trust income and property must be included in the gross estate of the beneficiary if the beneficiary has the power of appointment, regardless of whether the power is exercised.[65] The trustee argued that because of the beneficiary's minority, her power of appointment was rendered useless.[66] Since the "power" was therefore not really a "power," the value of the trust should not have been included in the gross estate of the beneficiary.[67]

The court of appeals rejected the trustee's argument. "The federal estate tax is a tax on the exercise of the privilege of directing the course of property at one's death."[68] The property of the trust or estate can be directed without exercising the power of appointment.[69] The court stated further that section 2041 of the Internal Revenue Code was drafted to make

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61. 633 F.2d 176 (10th Cir. 1980).

62. UTAH CODE ANN. § 75-2-501 (repl. vol. 1978) ("Any person 18 or more years of age who is of sound mind may make a will.").

63. *Id.* at 178. The tax court made its decision under I.R.C. § 2033 which states, "The value of the gross estate shall include the value of all property . . . to the extent of the interest therein of the decedent at the time of his death." The court of appeals stated that application of I.R.C. § 2041 would be more appropriate in this case. 633 F.2d at 178. Those provisions, in relevant part, are:

> (a) The value of the gross estate shall include the value of all property.
>
> . . .
>
> (2) To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942 . . . such property would be includible in the decedent's gross estate. . . . For purposes of this paragraph (2), the power of appointment shall be considered to exist on the date of the decedent's death . . . whether or not on or before the date of the decedent's death . . . the power has been exercised.
>
> . . . .
>
> (b)(1) The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate. . . .

64. 633 F.2d at 177 n.1.

65. I.R.C. § 2041(a)(2). *See* note 63 *supra*.

66. In Utah, a minor may also disaffirm a contract. UTAH CODE ANN. § 15-2-2, -3 (1953).

67. 633 F.2d at 178-79.

68. *Id.* at 179 (quoting Estate of Bagley v. United States, 443 F.2d 1266, 1270 (5th Cir. 1971) (Ainsworth, J., dissenting)).

69. 633 F.2d at 179. The court stated, "one who holds the general power of appointment can effectively 'direct the course' of property subject to it by *failing* to exercise it and thus deciding in favor of the takers by default." (Citing S. REP. NO. 1631, 77th Cong., 2d Sess. 232 (1942); Alperstein v. Commissioner, 613 F.2d 1213, 1216 (2d Cir. 1979), *cert. denied*, 446 U.S. 918 (1980);

"capacity to exercise general powers irrelevant."[70] Therefore, the beneficiary's failure or incapacity to exercise her power of appointment does not cause the value of the trust to be excluded from her gross estate. Since there was a valid power of appointment in the trust instrument, the property and income of the trust were required to be included in the beneficiary's gross estate.

V. TAX EVASION

The Tenth Circuit Court of Appeals recently considered cases involving willful failure to file a federal tax return and filing false returns. The conviction of a tax protester for willful failure to file a federal tax return was upheld by the court in *United States v. Rickman*.[71] The taxpayer set forth five arguments that were easily rejected by the court of appeals.

The taxpayer first argued that his prosecution was selective and discriminatory. He alleged that his prosecution resulted from his speaking publicly about his opposition to taxes.[72] The court of appeals found that the taxpayer had established none of the elements required to sustain a claim of unconstitutional selective enforcement.[73] The court also noted that vocal opposition to taxes creates no immunity from prosecution.[74]

The court of appeals found no merit in the taxpayer's claim that his rights under the Privacy Act of 1974[75] were violated. The taxpayer claimed that the Privacy Act requires disclosure, on the tax form, of the potential criminal penaties for failing to file a tax return. The court stated that no such notice was required, and furthermore, that the taxpayer's filing of returns in previous years indicated that he knew of his duty to do so.[76]

The taxpayer next claimed that he had filed a tax return for 1975 and therefore should not have been charged with failure to file a tax return for that year. The taxpayer did indeed file, but with little information on the form other than his name and address and "000.00" in certain places on the form.[77] The court upheld the taxpayer's conviction on the 1975 count, noting that the Tenth Circuit had previously sustained a conviction of a taxpayer who had filed a return and furnished only his name, address, and

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Estate of Bagley v. United States, 443 F.2d 1266, 1270 (5th Cir. 1971) (Ainsworth, J., dissenting)). *See* note 63 *supra*.

70. 633 F.2d at 180. The court reiterated that a decedent's incapacity and inability to exercise the power of appointment does not cause any property to be excluded from the decedent's gross estate (citing Alperstein v. Commissioner, 613 F.2d 1213 (2d Cir. 1979), *cert. denied*, 446 U.S. 918 (1980); Pennsylvania Bank & Trust Co. v. United States, 597 F.2d 382 (3d Cir.), *cert. denied*, 444 U.S. 980 (1979); Fish v. United States, 432 F.2d 1278 (9th Cir. 1970)).

71. 638 F.2d 182 (10th Cir. 1980).

72. The taxpayer claimed his protests were reported by one of his students, the daughter of an Internal Revenue Service agent. *Id.* at 183.

73. *Id.* The elements of unconstitutional selective enforcement are set forth in Barton v. Malley, 626 F.2d 151, 155 (10th Cir. 1980).

74. 638 F.2d at 183 (citing United States v. Stout, 601 F.2d 325, 328 (7th Cir. 1979)). *See also* United States v. Catlett, 584 F.2d 864, 866-67 (8th Cir. 1978).

75. 5 U.S.C. § 552(a) (1976 & Supp. I 1977).

76. 638 F.2d at 183.

77. *Id.*

references to the constitution.[78]

The court of appeals considered the taxpayer's last two claims to be spurious. The taxpayer alleged that the money he received when paid was not legal tender or lawful money under the United States Constitution.[79] The court held that the Federal Reserve Notes with which the taxpayer was paid were indeed lawful money.[80] Defendant's "scattered" attacks on the lower court's instructions were also held to be without merit.[81] Therefore, the conviction of the taxpayer was upheld.[82]

The Tenth Circuit also upheld the conviction of an attorney for filing false returns and tax evasion in *United States v. Samara*.[83] The lower court had fined the defendant $15,000 and had sentenced him to prison terms.[84] The defendant appealed.

The defendant attorney maintained a crude and inaccurate filing and bookkeeping system. A substantial portion of the defendant's revenue was cash or checks which were not deposited into any bank account.[85] As a result, the accountant and the lawyer who prepared the defendant's return had insufficient information from which to determine his actual income. Witnesses were presented at trial who testified how much they had paid the defendant, and further evidence showed that little of that money was deposited by the defendant into a bank account.[86] Other evidence showed that the defendant had told one of his past secretaries not to tell the court about his criminal work, which was in fact the defendant's major source of income.[87]

The defendant claimed that his tax evasion was not willful because he had relied on his accountant and attorney. The court rejected that argument because the defendant's attorney and accountant had not been supplied with the correct information.[88] The court of appeals stated that an act is willful when it involves "concealment of assets or covering up sources of information, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or conceal."[89]

The court also discussed two evidentiary questions. Evidence from the state court docket showing the activity of the defendant in the courts was held to be properly admitted because it was relevant and not prejudicial.[90] The court also said that the lower court acted properly in not admitting

78. *Id.* at 184. United States v. Porth, 426 F.2d 519, 523 (10th Cir. 1970); *see also* Florsheim Bros. Drygoods v. United States, 280 U.S. 453, 462 (1930).

79. 638 F.2d at 184. U.S. CONST., art. 1, § 8.

80. 638 F.2d at 184 (citing United States v. Ware, 608 F.2d 400, 402-03 (10th Cir. 1979)).

81. 638 F.2d at 184.

82. *Id.* at 185.

83. 643 F.2d 701 (10th Cir. 1981).

84. *Id.* at 702.

85. *Id.*

86. *Id.* at 702-03.

87. *Id.* at 703-04.

88. *Id.* at 703 (citing United States v. Jett, 352 F.2d 179, 182 (6th Cir. 1965); United States v. Baldwin, 307 F.2d 577, 579 (7th Cir. 1962) (reliance on lawyer's and accountant's advice does not negate willfulness unless all pertinent facts all disclosed)).

89. 643 F.2d at 704 (quoting Spies v. United States, 317 U.S. 492, 499 (1943)).

90. 643 F.2d at 704-05.

expert testimony that infringed upon the right of determination by the jury.[91] The claims of the defendant were therefore struck down, and his conviction was upheld.

VI. DEPLETION ALLOWANCE ON MINING PROCESSES

The Tenth Circuit in *Ranchers Exploration & Development Corp. v. United States*,[92] determined the issue of whether solvent extraction and electrowinning of copper is a "mining process" deductible through a depletion allowance. The case was appealed by the Government after the lower court entered judgment for the taxpayers.

The court of appeals undertook a complicated factual anaysis of a relatively straightforward issue: to what extent was the process used by the taxpayer in the extraction of copper from ore a mining process?[93] If the extraction process is a "mining process," then the Internal Revenue Code allows a deduction for depletion based on the company's gross income from the mining.[94]

The taxpayer operated an open-pit copper mine and had used a process called "cementation" to extract the copper from the ore until 1968, when the process became economically infeasible.[95]

In 1968 the company began using a new process described as solvent extraction and electrowinning.[96] In this process the solution taken from the heaps of ore is slightly different from that extracted during cementation because it is treated with a different acid solution. The solution from the ore is treated in a two-stage solvent process where the impurities in the ore are precipitated out of the solution. What remains is introduced into tanks containing lead anodes and copper cathodes submerged in a copper sulfate solution. The passage of electrical current between the anodes and cathodes causes the copper in the copper sulfate solution to precipitate and form on the cathodes, which are removed and subsequently refined.[97]

The district court found that the solvent extraction process was similar to "beneficiation by concentration" and the electrowinning process was a "precipitation process," both of which fall within the description of "mining processes" in the Internal Revenue Code.[98] The court of appeals noted that the end product still requires refining before a commercially pure product is produced.[99] It affirmed the district court finding that the new process is a

91. *Id.* at 705. A witness testified regarding the credibility of other witness, which is an issue for the jury. *Id.* (citing United States v. Brown, 540 F.2d 1048, 1054 (10th Cir. 1976), *cert. denied*, 429 U.S. 1100 (1977); United States v. Ward, 169 F.2d 460, 462 (3d Cir. 1948)).

92. 634 F.2d 487 (10th Cir. 1980).

93. *Id.*

94. *Id.* at 488. I.R.C. §§ 611(a), 613(a)(b)(2)(A).

95. 634 F.2d at 488. Cementation is a process, described simply, where the copper ore is treated with an acid while the ore is piled in heaps. The resulting runoff is a solution that, when treated with iron, produces a copper cement which is then refined into commercial-grade copper. Cementation is a "mining process." *Id.*

96. 634 F.2d at 489.

97. *Id.*

98. 634 F.2d at 490. I.R.C. § 613(c)(4)(D).

99. 634 F.2d at 491 n.3.

mining process and that the taxpayer is eligible for the depletion allowance.[100]

VII. RETROACTIVE APPLICATION OF TAX LAW

The issue of retroactive application of tax law was examined in *Westwick v. Commissioner*.[101] The taxpayer sold a duplex for a capital gain of $12,184.44. Under section 56 of the old Internal Revenue Code, this would not have been subject to any "minimum tax."[102] However, on the date that the sale of the duplex was closed, October 4, 1976, the President signed into law an amendment to I.R.C. section 56.[103] The amendment made the taxpayer's sale of the duplex subject to a tax of $327.67, which the taxpayer contested.[104]

The court of appeals held that amended section 56 did not violate due process when applied retroactively.[105] It was not a new tax, but only a change in rate, which is a valid retroactive change in taxation.[106]

VIII. DEDUCTION OF THE VALUE OF OBSOLETE ASSETS

In *J.B.N. Telephone Co. v. United States*,[107] the Tenth Circuit Court of Appeals considered the right of a taxpayer to deduct the value of an abandoned asset. The taxpayer, who paid a deficiency after the IRS disallowed a deduction taken by it, commenced suit when the IRS denied a refund claim. The district court held that the taxpayer was entitled to the deduction and awarded a refund of $27,737.18.[108]

The suit arose out of the taxpayer's agreement to purchase five small phone companies in 1969. The telephone businesses were manually operated exchanges which the taxpayer intended to convert to an automatic dial

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100. *Id.* at 493.

101. 636 F.2d 291 (10th Cir. 1980).

102. The exemption rule under "old" I.R.C. § 56 was the greater of $30,000 or the regular tax liability of the taxpayer; the tax rate was 10%.

103. The Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified at 26 U.S.C. § 1 (1976)). New section 56 provides that the exclusion be reduced to the greater of $10,000 or 1/2 of the taxpayer's liability, and that the tax rate on the balance be increased to 15%. The amendment was retroactive to December 31, 1975. *Id.* § 56.

104. 636 F.2d at 292.

105. *Id. See* Brushaber v. Union Pacific R.R., 240 U.S. 1, 20 (1916); Stockdale v. Insurance Cos., 87 U.S. 323, 331 (1873). A retroactive tax cannot be a wholly new tax. *See* Untermeyer v. Anderson, 276 U.S. 440 (1928); Blodgett v. Holden, 275 U.S. 142 (1927); Nichols v. Coolidge, 274 U.S. 531 (1927).

106. The court cited Cohen v. Commissioner, 39 F.2d 540, 545 (2d Cir. 1930), in which Judge Learned Hand said:

> Nobody has a vested right in the rate of taxation, which may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset . . . . one may indeed complain that, could he have foreseen the increase, he would have kept the transaction unliquidated, but it will not avail him; he must be prepared for such possibilities (i.e., the retroactive increase in tax rates), the system being already in operation. His is a different case from that of one who, when he takes action, has no reason to suppose that any transactions of the sort will be taxed at all.

636 F.2d at 292.

107. 638 F.2d 227 (10th Cir. 1981).

108. *Id.* at 228-29.

system. Although the taxpayer made a down payment, the actual closing of the sale was to occur when the system was converted to automatic dial by the taxpayer. Prior to conversion the sellers were to maintain the system's operation and receive income from it. Any capital additions were to be paid for by the taxpayer at the sale closing.[109]

The taxpayer completed the conversion to automatic dial in 1971. In 1972, the taxpayer claimed a deduction of $42,014.36 for the equipment scrapped during the conversion.[110] The amount claimed for the deduction was the amount that the taxpayer paid for the equipment at the original sale, plus $32,014.38 which the taxpayer claimed on the basis of the "intangible right to do business."[111]

The Government first argued that the taxpayer was not entitled to a deduction because it had no basis in the property; abandonment had occurred before ownership had vested in the taxpayer.[112] The court of appeals disagreed with the Government and stated that the taxpayer would be entitled to a deduction even if the taxpayer had intended to abandon the equipment after the purchase.[113] Since the taxpayer used the equipment for some time at least, the court determined that the equipment did have a fair market value, even though it was abandoned soon after the sale.[114] The court also determined that for tax purposes, the taxpayer acquired the phone companies when the down payment was made, not at the closing.[115] When the " 'benefits and burdens' of ownership" pass,[116] the taxpayer has ownership for tax purposes. Because the taxpayer in this case was responsible for any capital expenditures and was to assume control of the operation if the seller was unable to continue, the court determined that ownerhip had passed for tax purposes.[117]

The court of appeals agreed with the Government's contention that if allowed, the deduction should have been for 1971, when the equipment was disposed of, rather than 1972.[118] The court noted that Treasury regulations provide that the deduction should be taken in the year the asset's useful life ends.[119]

The taxpayer argued that if the deduction should have been taken in 1971 then a refund should be allowed for that tax year under the "mitigation provisions" of the Code.[120] The court agreed, but noted that the taxpayer is

109. *Id.* at 229.
110. *Id.* at 230.
111. *Id.*
112. *Id.*
113. *Id.* at 232.
114. *Id.* W. E. G. Dial Tel. Inc. v. Commissioner, 25 T.C.M. 233 (1966), *but cf.* Wood County Tel. Co. v. Commissioner, 51 T.C. 72 (1968) (deduction not allowed because taxpayer knew equipment would have to be abandoned to convert to dial system).
115. 638 F.2d at 233.
116. *Id.* at 232 (citing Wagner v. Commissioner, 518 F.2d 655, 657 (10th Cir. 1975)).
117. 638 F.2d at 232-33. *See also* Frank Lyon Co. v. United States, 435 U.S. 561 (1978); Baird v. Commissioner, 68 T.C. 115 (1977).
118. 638 F.2d at 234.
119. *Id.* Treas. Reg. § 1.167(a)-8, -9 (1960); *see also* Tanforen Co. v. United States, 313 F. Supp. 796, 799-800 (N.D. Cal. 1970), *aff'd per curiam*, 462 F.2d 605 (9th Cir. 1972).
120. *Id.* at 234-35. I.R.C. §§ 1311-15. If the conditions of these sections are met a taxpayer,

required to file a claim for a refund with the Commissioner. The court suggested that the district court hold the suit in abeyance until the Commissioner acted upon the claim. If the refund is granted without the need for court proceedings, the action could be dismissed. If the refund is denied, relief could be sought in the same action without the delay of initiating a new action.[121]

IX. GIFT TAX APPLICATION TO POLITICAL CONTRIBUTIONS

The Tenth Circuit Court of Appeals determined that political contributions are not subject to the gift tax in *Carson v. Commissioner*.[122] The taxpayer made contributions totalling $209,472.25 to political campaigns during 1967, 1968, 1970, and 1971. The taxpayer did not report the political contributions on his federal gift tax returns for those years.[123] The Commissioner assessed a deficiency against the taxpayer, and the taxpayer initiated suit in the tax court. The tax court held that political contributions are not subject to the gift tax and granted judgment for the taxpayer.[124]

The Government appealed, contending that the taxpayer received no consideration for the contributions, that no donative intent was required, and that Congressional intent as well as additional sections of the Internal Revenue Code require the taxation of political contributions as gifts.[125] The court of appeals did not address the issues raised by the Government, but merely stated that political contributions "are simply not gifts within the meaning of the gift tax law."[126] The "purpose of the gift tax is to prevent an avoidance of estate tax by an inter vivos transfer of property;"[127] therefore, the taxpayer's political contributions were not subject to the gift tax.

X. IRS CIVIL SUMMONS

In *United States v. City National Bank & Trust Co.*,[128] the Tenth Circuit Court of Appeals upheld an IRS civil summons of the bank records of taxpayers. The district court held that the summons could not reach the deposit information of the taxpayers because the IRS could determine the tax liability of the taxpayers without the deposit information.[129]

The court of appeals, in a brief opinion, overturned the trial court as to the deposit records. According to the Tenth Circuit, it is irrelevant whether

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who claimed a deduction which is disallowed because it should have been claimed in a different year, may be granted relief.

121. 638 F.2d at 237. The court disagreed with the Second Circuit, which requires that a completely new lawsuit be filed. *See* Benenson v. United States, 385 F.2d 26 (2d Cir. 1967).

122. 641 F.2d 864 (10th Cir. 1981).

123. *Id.* at 864.

124. *Id.* at 865.

125. *Id.*

126. *Id.* at 866 (quoting Carson v. Commissioner, 71 T.C. 252, 263-64 (1978)).

127. 641 F.2d at 866 n.6 (citing Harris v. Commissioner, 340 U.S. 106 (1950); Estate of Sanford v. Commissioner, 308 U.S. 39, 44 (1939)). The court also noted that Congress has made the gift tax inapplicable to transfers to political organizations. 641 F.2d at 866. I.R.C. § 2501(a)(5).

128. 624 F.2d 388 (10th Cir. 1981).

129. *Id.* at 389-90.

the Government could have obtained the information without the deposit information.[130] The court ruled that the Government need only show that the requested records "might throw light on the correctness of the taxpayers' returns."[131] An affidavit of the investigating agent is enough to support the summons.[132] Since the Government had made the requisite showing the summons was upheld.[133]

XI. TAX CONSEQUENCES OF DIVORCE SETTLEMENT

The issue of whether payments made by a husband to a wife were alimony or a property settlement was determined by the Tenth Circuit Court of Appeals in *Riley v. Commissioner*.[134] The tax court determined that the payments were part of a property settlement and not deductible by the husband.[135] The husband appealed.

An agreement between the husband and wife made at the time of the divorce provided that the husband would pay his wife $36,000 in $300 monthly installments. The obligation to pay was binding on the husband's heirs and assigns. The payments were to continue until paid in full, regardless of remarriage or death of the wife.[136]

The controlling factor in determining whether a payment is part of a property settlement or alimony is the intent of the parties.[137] In this case the court found the following factors indicative of a property settlement payment: 1) the presence of a fixed sum, 2) the payments were not related to the husband's income, 3) the payments were to continue without regard to the wife's remarriage or death, 4) the wife relinquished property interests in return for the payments, and 5) the husband's payment was secured and guaranteed.[138] Therefore, the payments were not deductible by the husband.

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130. *Id.* at 390.
131. *Id.* at 389 (quoting United States v. Davey, 543 F.2d 996, 1000 (2d Cir. 1976)).
132. 624 F.2d at 389. United States v. Garden State Nat'l Bank, 607 F.2d 61, 68 (3d Cir. 1979).
133. 624 F.2d at 390.
134. 649 F.2d 768 (10th Cir. 1981).
135. *Id.* at 769-70. Property settlement payments are considered a division of capital and are neither includable in the wife's gross income nor deductible by the husband. *See* I.R.C. §§ 71, 215. A district court had earlier determined in a case involving the wife that the payments were part of a property settlement. Adam v. United States, 429 F. Supp. 38 (D. Wyo. 1977).
136. 649 F.2d at 770.
137. *Id.* at 772.
138. *Id.* at 774.