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Taxation in the Confederacy

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Taxation in the Confederate States of America is a subject not often studied by either professional academics or laypeople. This is not at all surprising: there is a natural tendency to avoid giving deep attention to things considered deplorable, and since the legacy of the Confederacy is construed as wretched by so many people, it follows that a great many are ignorant of the details of Confederate society. Today, we will go against natural tendency and take a look at the tax acts passed by the rebel government in its attempt to raise revenue for the war.

Revenue derived from taxation made up only a very small part of the war fund for the South. In total, taxes constituted roughly 8.2 percent of the war account; this is less than half of the percentage contributed by taxes for the Union. Compared to the North, the Confederacy was slow to impose a "direct" tax on its population in large part because of its strong commitment to state's rights and opposition to centralized government. As we will explore in detail below, the Confederate Congress passed two tax measures during the course of the war; neither of these measures generated sufficient income, and by the end of the war it was evident that financial trouble had played a substantial role in the demise of the South.

War Tax of 1861

At the beginning of the war, the Confederate government relied on tax revenue derived from international trade (i.e. tariffs and taxes on exports) and financial contributions from private citizens. These sources of funding started off well, but by the close of 1861 both had

dried up almost entirely. The collapse of these sources prompted the Confederacy to impose a “War Tax” which was passed in August of 1861. The War Tax consisted of taxes on a number of items identified by the Treasury and a tax on real property greater than $500 in value.

In its first year (1862) of operation, the War Tax contributed a measly 5 percent of total war revenue. Not only was the tax relatively gentle in its basic terms, collection proved to be much more difficult than Confederate lawmakers had anticipated.

Agricultural Produce Tax of 1863

In response to the lackluster performance of the tax act of 1861, the Confederate Congress passed the Tithe Act – otherwise known as the Tax-in-Kind – in April of 1863. On top of the taxes imposed by the War Tax, the Tithe Act placed a tax of 10 percent on agricultural produce. The Tithe Act was referred to as the “tax-in-kind” because it was not paid in currency but with physical goods; under this act, 10 percent of the actual produce of plantation owners was handed over directly to the government, not 10 percent of their profits. Though it was plagued by implementation difficulties of its own, the produce tax was relatively successful and contributed a substantial portion of overall tax revenue in the remaining years of the conflict.

Controversy surrounded the tax-in-kind because it was interpreted as a direct tax by the Confederate Congress. Though they were in rebellion against the Union, the lawmakers of the Confederate Congress still adhered to the constitutional principle of apportionment for direct taxes and so many felt the Tithe Act unacceptable on this principle. The financial condition of the South ultimately tipped the scales and the act was passed out of sheer necessity.

References

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A Quick Look at the Tea Act of 1773

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It has been noted before on Huddleston Tax Weekly that there is a strong tendency in contemporary society to associate taxes with things which are mundane, dull and boring. We've also noted that these associations are based on the conditions of our society at the present moment and would make little sense if based on conditions from previous eras. Throughout the bulk of recorded history, taxes have been closely tied to a host of exciting and oftentimes frightening things. With few exceptions, substantive changes in tax policy have accompanied sweeping changes to the existing social order, and the Tea Act of 1773 does not stray from this general rule.

As we will see, the significance of the Tea Act of 1773 stems mostly from the way it was received by the American colonists of the British Empire. The purpose of the act was not simply to generate revenue, but to provide confirmation of the power of the British Parliament to directly tax the American colonies. The act not only failed to achieve its intended goals but also sparked a reaction which ultimately altered the entire course of world history.

Historical Setting

The passing of the Tea Act was surrounded by a number of important political and business phenomena. One of the most pressing concerns of the British Parliament during this (pre-revolutionary) era was to have its power to tax the American colonies fully accepted by American colonists. This concern was among the driving forces behind the so-called Townshend Acts. The Townshend Acts consisted of a series of measures which dealt with a variety of issues relating to the administration of the American colonies. The first of these acts – the Revenue Act of 1767, also referred to simply as the Townshend Act – imposed a tax on tea (and several other items) imported to the colonies. The act forbade the colonists to purchase tea from any supplier other than Great Britain.

The Revenue Act was met with serious opposition from the American colonists who swiftly condemned the measure as a piece of blatant tyranny. Thenceforth the aim to legitimize the taxing power of the British Parliament over its colonies intensified.

Before the Tea Act, the British East India Company had been directed to sell its tea exclusively in London. Tea from the company which did make it to North America did so only through outside merchants who specialized in international sales. By the time the tea reached the market for American consumers, markups and the tax imposed by the Revenue Act made the tea an unattractive buy. As a consequence of these policies, an underground market developed in which foreign (Dutch) tea was smuggled into the colonies and sold at much lower prices. In addition to legitimizing the Parliament's taxing power, the Tea Act was also passed with the aim of improving the financial condition of the East India Company and shutting down the flow of smuggled foreign tea.

The act contained these terms: the East India Company had the ability to ship its tea directly to North America; the company was no longer bound to sell its tea exclusively in London; duties on tea charged in Britain which were shipped out for international sale would either be refunded when exiting the country or not imposed; and finally, those receiving the company's tea were required to pay a deposit up front following delivery.

Colonial Reaction

The British lawmakers in the Parliament had reason to believe that the Tea Act would produce favorable results: the tea sold by the East India Company was of higher quality than Dutch tea, and since its price had been lowered, the lawmakers could sensibly infer that the smuggled Dutch tea would lose its competitive advantage. Unfortunately for the British lawmakers, the act would be opposed not only by those colonists who continued to reject Parliament's ability to lay the tax of the Revenue Act, but also by colonial merchants and underground businessmen who had a financial interest in preventing the ascendancy of the East India Company.

After the act was passed, the East India Company sent a number of ships to America in the hope of unloading its tea on the market; none of these ships was to unload its cargo successfully. Most famously, the ships which arrived at the ports in Boston were raided by irate colonists who tossed the company's tea into the harbor. This incident came to be known as the "Boston Tea Party," though it was referred to as the "Destruction of the Tea" in its own time. The colonial stance on the Parliament's ability to impose taxes was clear, and the stage was set for the massive insurrection which was to eventually give birth to the sovereignty of the States.

Bailey v. Drexel Furniture Co. & the Child Labor Tax Act of 1919

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To most contemporary Americans, exploitative child labor practices seem like an ancient, prehistoric phenomenon far removed from the context of advanced civilization. But, crazy though it sounds to modern ears, such practices sadly occurred on a fairly regular basis in the not too distant past of our society. In fact, our society was grappling for ways to combat this problem less than 100 years ago. In 1919, Congress addressed this issue through its Child Labor Tax Law. The law imposed a tax of 10 percent on the net profits of companies which employed children (as defined by the age limits of the law).

With the Child Labor Tax Law, the Congress was attempting to curtail child labor by regulating business through its taxing power. In effect, Congress was "punishing" businesses for exploiting the labor of children through the tax.

One curious result of constitutional restrictions on government power is that occasionally good laws are thrown out. Obviously, no one in 1919 disputed the desirability of a law which aimed to prevent abusive child labor practices; the issue which arose in *Bailey v. Drexel Furniture Co.* (1922) was whether the Congress went beyond the bounds of its constitutionally delineated authority by using a "tax" to stop unethical behavior. As we will see, the *Bailey* case illustrates the difficulty

involved with maintaining restrictions on government power even when such power is being tailored for good ends.

Facts

Drexel (plaintiff in original suit and respondent in appellate case) was a furniture manufacturing company which employed a child under the age of 14 during the 1919 tax year. In agreement with the Tax Law, Bailey (the tax collector for the government) assessed a tax of $6,312.79 for such behavior. Drexel paid the full amount and then sued for recovery.

Drexel argued that the tax was a covert “penalty” designed to punish undesirable behavior and that the law was therefore an unconstitutional attempt to regulate business. The government argued that the levying of the tax was fully consistent with its broad taxing powers as prescribed by Article One of the Constitution.

Law

The Congress has the power to lay and collect taxes as outlined by the Constitution. However, this power is not unlimited and when the Congress attempts to step beyond its bounds such attempts must be struck down.

Ruling

The Supreme Court ruled in favor of Drexel (as did the lower court). Although no issue was raised as to the desirability of the Tax Law, the court reasoned that the tax created by the law was in fact a disguised penalty and it was therefore impermissible. The court defined a “tax” as a source of revenue for the government, while a penalty is a

punishment intended to deter certain behavior. Penalizing unethical behavior is not a function of the taxing power of the Congress but should be addressed through the criminal law of individual states.

The decision in *Bailey* was controversial in part because other taxes aimed at curtailing (or in some sense penalizing) certain behavior had been upheld. For instance, excise taxes on drugs and firearms have not been regarded as improper attempts by the Congress to regulate business. But the court in *Bailey* recognized that an overly broad reading of Congress' taxing power could result in the obfuscation of its proper function and unfairly reduce the power of the states.

How War Shaped Modern U.S. Taxation

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The idea that war has in some sense impacted tax policy throughout our nation's history should strike no one as being controversial. War and taxes have always had a close relationship, not only within the United States but across the whole globe. In fact, it is probably the case that taxes have played a role in just about every military conflict in history, though the role may not have always been overt and openly recognized. War is essentially a dispute over power, and since money is often a source of power it should surprise nobody that taxes are frequently looming in the background of such disputes.

What fewer people realize, however, is that war has arguably been the single greatest engine behind the development of U.S. tax structure since the outbreak of the War Between the States. As we will see,

without war, our tax structure would likely be radically dissimilar from what it is today. The federal income tax may not have been established, and certainly the size of our government would be much smaller by comparison to what we have now.

The Birth of the Income Tax

The founders of the U.S. wished to limit the taxing power of their government and the Constitution was drafted in a fashion consistent with this desire. Up to 1861, the government of the United States had only collected excise taxes and taxes on foreign imports (tariffs); there was no controversy surrounding the income tax because no such tax had yet been imposed. This state of affairs, a state which had carried on stably for over seven decades after the writing of the Constitution, was disrupted by the War Between the States. Soon after the war broke out the Revenue Act of 1861 was passed and the first income tax was implemented on the American population. Two additional acts were passed subsequent to the act of 1861 which made modifications to the rate structure of the tax.

Though they were (supposedly) only intended as strictly wartime measures, the acts passed during the war produced an indelible precedent, and by 1894 the income tax had reemerged as part of the Wilson-Gorman Tariff Act. Whether the income tax would have been created in the absence of the War Between the States is a matter open to speculation. What is certain is that the war had a tremendous impact on the course of U.S. tax policy.

The First World War

The income tax provision of the Wilson-Gorman Tariff Act of 1894 was ruled unconstitutional by the Supreme Court with its decision

in *Pollock v. Farmers' Loan & Trust Co.* (1895). That ruling marked the beginning of a near two decade long hiatus during which the income tax disappeared. The income tax made its reappearance with the Revenue Act of 1913 which was developed after the taxing powers of the Congress were expanded through the sixteenth amendment.

Now, it may be untrue that the income tax itself did not reemerge as a direct consequence of the First World War; but there can be no questions of any sort that this war provided the impetus for the massive increases made to the rate structure of the income tax when it did return. When the U.S. entered the war the top rate of the income tax was changed from seven percent to an astounding sixty-seven percent; by the close of the war the top rate had been further increased to seventy-seven percent. Tax rates for individuals fluctuated after the war during the 1920s; by the end of the 1920s the top rate for individuals reached a low of 25 percent.

Rates for individuals were increased following the Great Depression and they would continue to remain high both during and long after the conclusion of the Second World War. The top rate for individuals would not fall below 30 percent until the late 1980s.

Again, we can only speculate about how U.S. tax policy would have developed without war. Was a federal income tax a historical inevitability? Would the rate structure of the income tax look dramatically different if war had not caused us to lean heavily on our wealthiest citizens and corporations? These questions can never be answered given how events have unfolded. One thing which is not open to speculation, however, is that our tax policy looks unrecognizably different than the way it looked at the time of the founding.

United States v. E. C. Knight Co. & the Scope of the Sherman Antitrust Act

Published on December 21, 2016

One of the chief functions of our government is to ensure a fair and equitable market in which businesses may compete to offer goods and services to consumers. Our law has been developed and shaped in accord with this function. In order for free enterprise to flourish, our government must see that the marketplace is kept *competitive* and that attempts to obstruct or excessively limit competitiveness be swiftly eradicated. In the late nineteenth century, one particular law – the so-called Sherman Antitrust Act of 1890 – was passed with the purpose of promoting business competitiveness. The law forbade individuals from creating (or attempting to create) a monopoly of any part of the trade or commerce among the states or with foreign nations. This law stood in its original form until 1914 when it was expanded in scope by the Clayton Antitrust Act.

Very soon after the Sherman act was passed, disputes arose which required that the scope of the act be clarified. The case of the *United States v. E. C. Knight Co.* (1895) was one of these disputes. As we will see, the ruling of this case showed that the scope of the Sherman act was not so far-reaching that it could suppress a monopoly of the *manufacture* of a good.

Facts

E. C. Knight Company (the defendant) was acquired by the American Sugar Refining Company. This acquisition gave the company control over approximately 98 percent of the sugar refining industry. The U.S. government (plaintiff) attempted to utilize the provisions of the Sherman act to prevent the acquisition and thwart the creation of the virtual monopoly. The key question was whether the Sherman act allowed the government to interfere with a monopoly of the manufacture of a good as opposed to its distribution across state lines.

Law

The U.S. Constitution grants the Congress the power to regulate commerce among the states. The Sherman Antitrust Act included provisions which were ultimately in agreement with this basic power. The second section of the Sherman act reads as follows: "…Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony…"

The scope of the Sherman act clearly extends to monopolies of the distribution of a good; but did the Sherman act extend to monopolies of the manufacture of a good on a strictly *local* level?

Ruling

The court ruled that the Sherman act did not apply to this type of locally defined activity. However, since the acquisition resulted in a monopoly over the manufacture of a "necessity of life" (in the words of the court), this meant that the acquisition could be subject to individual state regulation.

In effect, the ruling of this case significantly curtailed the authority of the Congress to regulate the national economy as it declared manufacturing monopolies to be local matters. This restrictive view on Congressional authority to regulate commerce would remain unchanged until the late 1930s.

The case of the *United States v. E. C. Knight Co.* shows clearly some of the difficulties involved in trying to balance the ideals of a competitive marketplace and limited government. And for this reason the legacy of *E. C. Knight Co.* represents different things to people on different places of the ideological spectrum. However it is interpreted in any individual instance, there can be no denying its stature as a pivotal case in U.S. judicial history.

The Rise of the Progressive Federal Income Tax System

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Before we dive into the details of the Revenue Act of 1913 and the progressive tax system, let's briefly go over what we've learned about the history of the income tax. During the War Between the States, the U.S. government imposed the first income tax in order to fund the Union army. This tax – which was brought about through the Revenue Act of 1861 – was conceived as an emergency measure and was not intended to continue after the war. Following the surrender at Appomattox, the income tax lingered around until about 1872, but it then disappeared for over twenty years. The income tax made its reappearance with the Wilson-Gorman Tariff Act of 1894, but the tax

provision of this act was quickly struck down with the opinion stated in the case of *Pollock v. Farmers' Loan & Trust Co.* (1895). This second hiatus was interrupted by the sixteenth amendment to the U.S. Constitution which consolidated the taxing power of the Congress by eliminating the rule of apportionment which had applied to direct taxes.

With the sixteenth amendment, the Congress was transformed into a monstrously powerful entity, a taxing giant free of traditional legalistic constraints. When historians of the future assess the relative importance of the many amendments to the Constitution, their assessment can be said to be accurate only if it includes the sixteenth amendment near the very top of the list.

On October 3, 1913, President Woodrow Wilson signed the Revenue Act of 1913 into law. Along with reducing tariff rates, the act instituted a *progressive tax structure* in which higher earning individuals had a greater tax liability. Just as the sixteenth amendment allowed, the tax could be collected on income derived from any source, no matter whether it be direct or indirect, without any requirement to apportion among the states according to population.

Original Tax Table

By current standards, the tax table created by the act of 1913 was remarkably gentle. Single filers who earned less than $3,000 were exempt, as were married filers who earned $4,000; adjusted for inflation, in 2016 these amounts would translate to approximately $73,100 for single filers and $97,500 for married filers. Single filers were required to pay one percent on earnings above $3,000 ($4,000 for married filers); income above $20,000 but below $50,000 was taxed at a rate of two percent; income above $50,000 but below $75,000 was

taxed at a rate of three percent; income above $75,000 but below $100,000 was taxed at a rate of four percent; income above $100,000 but below $250,000 was taxed at a rate of five percent; income above $250,000 but below $500,000 was taxed at a rate of six percent; and all incomes above $500,000 were taxed at a rate of seven percent.

Subsequent Tax Acts

This tax table created by the Revenue Act of 1913 only lasted for three years. It was replaced by a new table contained in the Revenue Act of 1916. The tax table of the act of 1916 (which can be viewed in full here) doubled the lowest income tax rate from one percent to two percent, and it increased the highest tax rate to fifteen percent. The 1916 tax table lasted for only a single year as it was replaced by the War Revenue Act of 1917. Prompted by America's entry into World War I, the act of 1917 greatly increased tax rates across all income levels in order to support the war effort. The 1917 act imposed a top rate of sixty-seven percent on income above $2,000,000.

The act of 1917 was superseded by the Revenue Act of 1918. This act saw a top rate of seventy-seven percent and this applied to all incomes above $1,000,000. The revenue derived from these wartime acts contributed approximately one-third of the total fund for World War I; eye-catching of itself, this fact is made all the more impressive considering that only about five percent of the population paid income taxes in 1918.

After the Great War, the Congress continued to make revisions to the tax structure. In the 1920s, four different tax acts were passed – the acts were passed in 1921, 1924, 1926 and 1928. The act of 1921 was noteworthy as it implemented a tax on corporate income of ten percent. This rate on corporate income was likewise revised and by the

1928 act the rate was increased to twelve percent. Though the scourge of war formed the basis for the transformation of the income tax, little interest was shown by the politicians in Washington in reducing the tax to pre-war rates. And the decades following the 1920s would see a steady increase in the share of Americans filing tax returns. The federal income tax was firmly in place, supported by our nation's political leaders and fully backed by constitutional law.

Brushaber v. Union Pacific Railroad Co. & the Rise of the Federal Income Tax

Published on December 19, 2016

As we have learned in previous installments, for most of its history, the United States has recognized a distinction between direct taxes and indirect taxes, and this distinction informed our law prior to the adoption of the sixteenth amendment. After the sixteenth amendment, the Congress was no longer bound to ensure that direct taxes follow the rule of apportionment outlined by Article 1, Section 9, Clause 4 of the U.S. Constitution. And given that this rule of apportionment was the main reason behind the distinction between direct and indirect taxes, it follows that subsequent to the sixteenth amendment such a distinction was essentially meaningless.

Immediately after the rule of apportionment had been lifted, the Congress passed the Revenue Act of 1913 (also referred to as the Underwood-Simmons Act). In addition to lowering tariff rates, this act

implemented a progressive federal income tax system. This income tax was originally intended to compensate for the deficit created by the reduced tariff rates, but soon after its implementation it became the chief source of revenue for the U.S. government. Consistent with the language of the sixteenth amendment, the tax on income could be derived from any source (wages, dividends, interest, rents, etc.). Amazingly, in its first several years of application, the federal income tax only applied to roughly 1 percent of the population as the other 99 percent did not meet the income threshold to qualify.

Even though the language contained in the sixteenth amendment was quite clear, not much time passed before the validity of the Revenue Act of 1913 was challenged. As we will see, the case of *Brushaber v. Union Pacific Railroad Co.* (1916) upheld the ability of the Congress to tax income (whether direct or indirect) without the traditional constraint of apportionment.

Facts

Mr. Frank Brushaber (plaintiff) owned stock in Union Pacific Railroad Company (defendant). The railroad attempted to pay a tax on Brushaber's income and Brushaber brought a suit to prevent the railroad from doing so. Brushaber based his suit on several grounds: he argued that (1) the Revenue Act of 1913 violated the due process clause of the Constitution, (2) that the act was unconstitutional because it exempted specific types of income, and (3) that the act was unconstitutional because it failed to follow the rule of apportionment put forth by Article 1, Section 9, Clause 4.

Law

The Congress has always had the power to tax income. This power is derived from the Constitution and consequently there cannot be any conflict between this constitutionally conferred power and the due process clause.

The sixteenth amendment removes the requirement that direct taxes must be properly apportioned among the states according to population. Hence, the Congress is able to lay and collect taxes, both direct and indirect, without regard to the apportionment rule laid out by Article 1, Section 9, Clause 4.

Ruling

The Supreme Court threw out all three arguments made by Brushaber and ruled that the federal income tax created by the Revenue Act of 1913 was fully valid and did not violate the Constitution. In essence, the court in *Brushaber* simply reaffirmed the clear language of the sixteenth amendment. Following *Brushaber*, challenging the validity of the Revenue Act would have been a pointless endeavor.

The early twentieth century saw two extremely important developments in U.S. taxation: the consolidation of the taxing power of the Congress by way of the sixteenth amendment and the creation of the federal progressive income tax system. In our next installment, we will look more closely at the provisions of the Revenue Act of 1913 and discuss how the federal income tax system evolved up to its present form.

A Note on Direct & Indirect Taxes

Published on December 9, 2016

In recent installments, we have discussed some of the legal and political issues surrounding the income tax. Upon reviewing these installments, there can be little doubt that the history of taxation in these United States is quite complex. Though the Congress has always had a power to tax, the precise scope of its taxing power has evolved in tandem with various social, economic and military events. The taxing power of the Congress was clarified a great deal by the sixteenth amendment – by way of this amendment, the Congress gained the power to tax income "from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Before the sixteenth amendment, the Congress was limited in its ability to lay and collect "direct" taxes. Article 1, Section 2, Clause 3 of the U.S. Constitution states that direct taxes must be apportioned among the states according to their respective numbers; the rationale of this provision was to ensure that no state was disproportionately – and therefore unfairly – burdened by an oppressive tax system.

Every type of tax can be classified as being either a direct or indirect tax. Broadly speaking, a direct tax is one paid by the individual (or business entity) to the government; it is aimed specifically at the person who is paying the tax. By contrast, an indirect tax is one levied upon a *transaction*, it is not targeted to a specific individual. Sales tax, use tax and value added tax are all examples of indirect taxes. Historically, U.S. tax law regarded tax on labor (or wages) as an indirect tax.

Prior to the opinion made in *Pollock v. Farmers' Loan & Trust Co.* (1895), tax on income derived from property (i.e. from real estate, stocks, bonds, etc.) was not considered a direct tax. The *Pollock* case overturned this consideration and ruled that such a tax was a type of direct tax and that therefore the income tax provision of the Wilson-Gorman act was unconstitutional. In effect, the *Pollock* decision made it essentially impossible for the government to impose a federal income tax without a constitutional amendment. The sixteenth amendment, which was ratified in 1913, was a direct response to the *Pollock* ruling: the politicians in the Congress came to understand the full implications of *Pollock* and so the sixteenth amendment simply did away with the longstanding requirements concerning direct taxes.

When viewed in proper historical context, the sixteenth amendment was a political act of truly monumental significance. Through this act, the dichotomy of direct and indirect taxes – a dichotomy which had shaped our system of taxation throughout our nation's entire history – was suddenly made to have no meaning at all. Immediately subsequent to this act, the Revenue Act of 1913 was passed, and the progressive income tax system which we have come to know so well was implemented.

Pollock v. Farmers' Loan & Trust Co. and the Defeat of the Income Tax

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In the previous installment of Huddleston Tax Weekly, brief reference was made to the case of *Pollock v. Farmers' Loan & Trust Company* of

1895. The opinion in this case – which was a landmark decision in its time – held that the power granted by the Wilson-Gorman Tariff Act of 1894 to collect an income tax on interest, dividends and rents was unconstitutional. The opinion set forth in *Pollock* was effectively nullified by the sixteenth amendment, but if not for this amendment *Pollock* certainly would be regarded among the most important decisions in U.S. history. Given its significance as a historical matter, let's look at the *Pollock* case in greater detail.

Facts

As we learned previously, the Wilson-Gorman measure imposed a 2 percent tax on income above $4,000. This tax was implemented in order to cover the deficit created from the reduced tariff rates put in place by the measure. After the measure was passed, the Farmers' Loan and Trust Company (the defendant) announced to its shareholders that, in addition to paying the tax required by the law, it would furnish the names of the shareholders liable for the tax to the collector. Pollock (the plaintiff) owned only ten shares of stock in Farmers' Loan, but he brought suit against the company to prevent it from paying the tax.

Law

Article 1, Section 2, Clause 3 of the U.S. Constitution holds that direct taxes are permissible but they must be apportioned among the states of the union based on population. If a tax is found to be classifiable as direct, then it must contain a provision to be properly apportioned in accord with this rule.

Ruling

The court (Supreme Court of the United States) ruled that the income tax imposed by the Wilson-Gorman act was a direct tax because of its substantial impact on personal property (i.e. stocks, bonds, etc.). Since it was a direct tax, it needed to be apportioned consistent with constitutional requirements. And because it was not apportioned in this manner it was invalid.

Pollock was an extremely important opinion because, in effect, it substantially curtailed the taxing power of the Congress. If every tax on income derived from property is regarded as a direct tax, then the rule of apportionment would need to be abandoned entirely to collect any tax other than excise taxes. This is precisely the function served by the sixteenth amendment: the sixteenth amendment holds that direct taxes need not be subject to the traditional rule of apportionment.

The Birth & Growth of the Income Tax in the United States

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Most people are oblivious of the fact that the United States has not always consistently imposed an income tax. Most people assume that the Internal Revenue Service has existed in its current form forever. Though it is false, this assumption is not without reason: national governments have a well-earned reputation of being tax hungry entities. In reality, however, the U.S. has only consistently collected a tax on income since the passing of the sixteenth amendment in 1913. But though the U.S. has only regularly collected an income tax since

after the sixteenth amendment, this does not mean that the U.S. government never collected such a tax earlier.

After the eruption of the Civil War, President Lincoln and the Congress passed the Revenue Act of 1861, and this act allowed the government to impose a tax on income to fund the war effort for the Union. The Revenue Act gave birth to a federal office in charge of collecting the tax, and this office was the embryonic form of the IRS.

The Revenue Act of 1861 grew out of necessity. The Union army needed additional funds in its struggle against the Confederacy. The 1861 act first put forth a rate of 3 percent on income above $800. This rate was subsequently discarded when the Revenue Act of 1862 was passed. The act of 1862 imposed a rate of 3 percent on income between $600 and $10,000, and 5 percent on income over $10,000. These rates were also later discarded and in 1864 a new act (the Revenue Act of 1864) imposed rates of 5 percent on income between $600 and $5,000, 7.5 percent on income between $5,000 and $10,000 and 10 percent on income above $10,000. These multiple acts provided the Union with a large source of its revenue: approximately 21 percent of Union funds were raised from income taxes.

Though it was only intended as a temporary measure during wartime, the income tax lingered for a bit after the Union declared victory. The various public projects associated with the Reconstruction era required funding, and so an income tax was collected until roughly 1872. But even though the tax expired around this time, a precedent was established, and in 1894 a peacetime income tax was included as a provision of the so-called Wilson-Gorman Tariff Act. The Wilson-Gorman act reduced the tariff rates set by a previous act, and proposed a 2 percent tax on income above $4,000 in order to cover the deficit. The income tax provision of the Wilson-Gorman measure was ruled

unconstitutional by the Supreme Court in its opinion of *Pollock v. Farmers' Loan & Trust Co.* in 1895, but the income tax eventually made its return with the sixteenth amendment.

To this day, opponents of the income tax continue to make arguments against its constitutionality, but none of these arguments have passed legal scrutiny. No matter what your position on the income tax, it is important to remember that even if this tax disappeared tomorrow we can be certain another one would take its place in double quick time.

Dickinson v. Dodds & the Legal Importance of Time

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In so many areas of life, timing is of extreme importance. Timing is particularly important in the business world. As so many stock brokers and other businesspeople are aware, small portions of time can mean the difference between many thousands – and even millions – of dollars. Smart businesspeople know that most – if not all – sound business decisions involve an element of time: a sound decision is not solely about what transpires, but when something transpires as well.

Unsurprisingly, business contracts follow this same rule: our law recognizes that time is something which naturally carries value of itself. In contract parlance, time has bargaining power, and as such it can be used to provide *consideration* for an agreement. The case of *Dickinson v. Dodds* (1876) should be required reading for every business professional: in this famous case, an offer was extended for a certain

period of time, but because nothing of value was given by the prospective buyer, the seller was free to withdraw the offer prematurely and give a new offer to a third party. *Dickinson v. Dodds* provides clear evidence of the legal significance of time in contract formation.

Facts

Dickinson (the buyer and plaintiff) received an offer from Dodds (the seller and defendant) regarding a piece of real property. Dodds offered to sell his property to Dickinson for a sum of £800. Dodds made the offer on Wednesday and verbally agreed to keep the offer open until 9 am on Friday. On Thursday, while Dickinson was still contemplating the offer, a third party (Mr. Berry) notified Dickinson that the property had already been sold to another party (Mr. Allan). Dickinson, believing that the original offer was still viable, met Dodds at a railway station at approximately 7 am on Friday and attempted to accept the price of £800 for the property. Dodds informed Dickinson that the property had indeed already been sold to the other party and that, although the original offer was apparently still open until Friday morning, acceptance was no longer possible.

Dickinson brought suit against Dodds (and Mr. Allan) in order to nullify the sale on the grounds that a valid offer was still "on the table."

Law

In the formation of contracts, time has value, and therefore it must be bargained for in order for one party to benefit from it. Hence, if a buying party wishes to keep an offer open for a certain period of time while he contemplates its merits, he must give something of value in return otherwise there is no *consideration* for the period of time given by the selling party.

Ruling

The court (the Court of Appeal of the Chancery Division in England) ruled in favor of Dodds. Dickinson's interpretation of the communication from Dodds, which held that a third party could not purchase the property until after 9 am on Friday morning, was false. Though, on the surface, it may have seemed like Dickinson had the exclusive privilege of buying the property until Friday morning, this was not actually the case because the element of time had not been bargained for.

Dickinson's acceptance at approximately 7 am on Friday was invalid given the fact that he had already received reliable communication of acceptance by another party. Dickinson's attempted acceptance on Friday morning was predicated on the assumption that Dodds was unable to extend an offer to a different party until after 9 am on Friday. This assumption was false.

The lesson is clear: the significance of time is such that it is encoded in our law. Businesspeople must be aware of the fact that time has this type of legal importance as they engage in business negotiations.

Property Law Terminology: Fee Simple & Fee Tail

Published on December 1, 2016

As we have discussed before, American law descends from English law, and as a consequence many of our legal concepts and much of our legal language are borrowed directly from this source. This is perhaps most evident in our law of property. Much of our property law nomenclature derives straight from medieval English society. Today we will cover two terms which both take their origin from feudal England: *fee simple* and *fee tail.*

One of the overriding concerns of real property owners is the successful transmission of ownership to their property. To address this concern, our law of property has a variety of devices which are intended to assist property owners transmit their property in exactly the manner they wish it to be transmitted. Fee simple and fee tail are two such devices.

Fee Simple

A fee simple is an ownership interest which confers upon its holder full control over the future disposal of the land with which it is associated. Hence, an individual who has a fee simple not only has a present ownership interest but also may decide who acquires ownership interests in the future. A fee simple with no restrictions whatsoever is referred to as a *fee simple absolute*. A fee simple absolute confers an interest which is unlimited and may not revert back to the grantor under any circumstances.

It is possible for a grantor to place restrictions on a fee simple. One common reason for this would be to ensure that a piece of property is used for a specific purpose; another reason would be to prevent a grantee from engaging in a particular type of behavior. A restricted fee simple is referred to as being either a *fee simple determinable* or *fee simple subject to a condition subsequent*.

Historically, to create a fee simple absolute, the grantor needed to use particular language. This language was as follows: "To the grantee and his heirs." These words needed to be present or else a smaller estate was transferred.

Fee Tail

In contrast to a fee simple, a fee tail *necessarily restricts* the ability of the grantee to transfer title of the land in the future. Traditionally, the underlying purpose of a fee tail was to prevent property from falling into the hands of persons who were not direct descendants of the original grantor. In other words, a fee tail was a mechanism created to maintain family wealth over successive generations.

To create a fee tail, the grantor had to use language such as the following: "To the grantee and the heirs of his body." This language prevented the grantee from disposing of the land at will and automatically transferred ownership interest in the land to a direct descendant. Unlike a fee simple, therefore, a fee tail granted present possessory rights but did not allow the grantee to control the future direction of the land.

As mentioned earlier, these concepts are archaic and have roots which stretch back all the way to feudal England. However, it is still important to be aware of them as they contributed heavily to our modern law of property.

Murphy v. Financial Development Corporation: The Importance of Due Diligence

Published on November 30, 2016

No one who procures a mortgage loan ever wishes to fail to fulfill their financial obligation to the lending institution. However, it does happen that a person with a mortgage – known as a mortgagor in legal lingo – becomes unable to consistently make payments to their lender. There can be any number of reasons as to why this may happen: for example, a job loss can suddenly turn an otherwise good mortgage into a troubled one very quickly. Sometimes, a mortgagor can repair a mortgage loan by working out an agreement with the lender. But if such an agreement between the mortgagor and lending institution cannot be reached then the mortgagor will inevitably face foreclosure.

However, what not everyone realizes is that lenders are still obliged to act within certain ethical bounds even after a foreclosure has been implemented. All lenders – or "mortgagees" – must conduct themselves with "good faith" and exercise "due diligence" to see that the adverse impact of the default is kept to an absolute minimum. Failure to abide by these ethical standards is a serious issue and transgressors can face severe penalties. When a default occurs, mortgagees must try to reach an outcome which fairly settles the matter, they cannot simply view the default as an opportunity to enrich themselves.

The case of *Murphy v. Financial Development Corporation* (1985) provides a sense of what due diligence requires from a lending

institution. This is a case which all mortgagors should be aware of, even those who figure they have not the slightest chance of ever falling into financial trouble.

Facts

The plaintiff (Murphy) suffered a job loss in early 1981 and fell behind with making payments on his mortgage loan. The plaintiff attempted to negotiate with the defendant (Financial Development Corporation) in order to repair the loan. However, the plaintiff was not able to successfully repair the loan and eventually the defendant sold the house at auction to one of its representatives in December of 1981.

The plaintiff had approximately $19,000 of equity in the home and owed roughly $27,000. The defendant sold the house to its representative for $27,000. Immediately following the sale to its representative, the defendant sold the house to a new buyer for $38,000. Hence, the initial sale of $27,000 to the defendant's representative had the dual effect of making the defendant "whole" while failing to account for the plaintiff's substantial equity. At the time of the auction, the house had a market value of around $46,000.

Though the defendant clearly acted in good faith by negotiating with the plaintiff and giving the plaintiff an opportunity to repair the mortgage, the question before the court was whether the defendant acted with due diligence by selling the house to its representative.

Law

Whether a mortgagee has acted with due diligence when selling a house which has been foreclosed upon requires a case-specific analysis.

In general, due diligence requires that a mortgagee expend reasonable effort to obtain a fair price for the property.

Ruling

The court (Supreme Court of New Hampshire) upheld the decision reached by the trial court and ruled in favor of the plaintiff. The court determined that, in this instance, the defendant had acted in good faith but failed to exercise due diligence. The court based its decision on the following facts: the defendant put only a small amount of effort toward advertising the auction; the defendant did not place a minimum bid at the auction; the defendant accepted an offer substantially below the market value of the property; and the defendant immediately sold the property to a new buyer for a quick profit.

As mentioned before, the determination of whether due diligence has been exercised is a case-by-case analysis. In this case, though the defendant acted in good faith, it was clear that not enough action was taken in order to meet the requirement of due diligence.

All mortgagors need to be aware of this fact: even if you fall behind on your payments, you still need to make certain that your lender conducts itself according to prevailing ethical standards.

Scutage: The Knight's Tax of Feudal England

Published on November 29, 2016

As has been discussed in an earlier installment of Huddleston Tax Weekly, taxes have not always been associated with calculators, receipts and refund checks. In point of fact, the history of tax is replete with all sorts of high-powered phenomena – armed rebellions, popular revolts and regime transformations. Here at HTC, we think it is pretty clear that taxation has evolved for the better; but, though this may be the case, we also think it is important to occasionally take a glance at the old tax practices of the past. By examining the history of tax we can be certain to avoid past mistakes; we can also get a sense of where some of our tax terminology comes from.

Beginnings

Like the geld, scutage was a medieval tax issued and collected principally in England. Scutage originally developed as a payment made by possessors of knight's fees to opt out of military service. Feudal law enabled knights to acquire "fees" (sections of land) in exchange for military service. Knights who wished to avoid military service began offering sums of money to tenants-in-chief as a means of "buying out" of their obligation.

Scutage existed in this form as early as 1100 (the beginning of the reign of Henry I). Payments made by knights were useful to the crown in part because mercenaries became common during this era.

Decline

Though scutage initially developed as a straightforward transaction between knights and their tenants-in-chief, the English crown gradually began to extend scutage beyond this original purpose. The crown started to levy the tax on specific areas and at various points in

time; importantly, the tax ceased its function as a monetary payment in exchange for release of military service. The king began to demand excessive sums from the population and as a consequence a rebellion broke out in 1215. This rebellion eventually led to the proclamation of the Magna Carta. Among other things, the Magna Carta attempted to prohibit the English crown from demanding oppressive sums in the form of scutage.

Scutage endured up to the reign of Edward III (ruled from 1327-1377). By that time, it had become common practice for scutage to be imposed by tenants-in-chief on their under-tenants. Under feudal law, the practice of subinfeudation allowed tenants-in-chief to give portions of their land to others in exchange for services (or payments). By the reign of Edward III, subinfeudation was so widespread and so rampant that assigning liability for scutage among the various under-tenants of a fee became a near impossible task. Under-tenants had already been absorbing the costs of scutage for centuries, but an excess number of under-tenants per fee made it difficult for this process to continue.

Though scutage gradually fell by the wayside, the English crown was not dismayed by its disappearance: the king simply used other tools to collect funds from his subjects.

What Every Business Owner Should Know About Contract Law

Published on November 28, 2016

It is unrealistic to expect every business owner to have a thorough command of contract law. Running a business is a very demanding job, and so unless they are fortunate to have a formal background in law business owners simply do not have the time required to master all the finer points of contracts. But, though mastery may be unattainable, most – and ideally all – business owners should make it a priority to acquire at least a basic understanding of contract law.

Having a grasp of basic contract principles is beneficial to business owners in myriad ways. Business owners can look forward to negotiating deals with other businesspeople with greater confidence; they can confer with business lawyers with greater ability; they will have a better sense of the implications which can follow from discussions with employees. In short, they will be able to run all areas of their business with an increased level of independence.

Business owners can best serve themselves by gaining a firm understanding of the elements of a contract. The elements of a contract are relatively easy to learn; but, as we have seen in prior installments of Huddleston Tax Weekly, tricky things start to emerge when these seemingly straightforward elements apply to complex factual scenarios.

Contract Elements

There are five elements which must always be met in order for a valid (i.e. enforceable) contract to be formed: these elements are offer, acceptance, consideration, legality and capacity. The sixth element of a contract – writing – need only be met in certain rather than all cases.

The rationale of each of these elements is quite straightforward. In order for a contract to be formed, there must be an *offer* which

discloses clearly what the terms of the agreement will be. These terms must be clearly understood by all parties. The terms must be fully *accepted* by all parties. There must be adequate *consideration* between the parties – that is, there must be an exchange of things which are of roughly equal value. The terms of the contract must be *legal* – in other words, people cannot contract for goods or services which are prohibited by law. And the parties of a contract must have the *capacity* – meaning they are of sufficient age and mental condition – to accept the terms of the agreement.

In cases involving things which are of high monetary value the parties must also put the terms of the contract in writing. However, if writing is not required, a valid contract has been formed when all of the other five elements have been satisfied.

The Enforceability of Promises

Contract law is concerned with determining which agreements (or promises) are enforceable by courts. The elements listed above are required in order for an agreement to be facially valid; however, though this is the case, in certain instances promises may be enforced despite the fact that not all elements were met. For example, the doctrine of promissory estoppel can be invoked when someone relies on a promise to their detriment even though a facially valid contract may not have been formed.

As mentioned above, complexity arises when these elements are applied to real factual scenarios. The factual details of agreements may yield doubt as to whether specific contractual elements were properly satisfied; courts are designed to step in and settle these disputes. Our entire body of contract case law is a record of how parties can have

very disparate views of the same facts which surround the creation of a contract.

It is important for business owners to fully understand the elements of a contract; but they must also be aware of how easily disputes can arise as to whether elements were adequately met.

Underhill v. United States Trust Company: An Introduction to Trusts

Published on November 22, 2016

One of the chief goals of Huddleston Tax Weekly is to acquaint our readers with as many financial concepts as possible. The more financial knowledge our readers possess, the better they will be able to make sound decisions. Today we will discuss the concept of the financial trust. A trust is a legally recognized arrangement in which property is held by one party (referred to as the trustee) for the benefit of a different party (referred to as the beneficiary). Trusts are frequently established in wills in order to ensure that property is adequately managed and controlled for its beneficiaries. The terms of a trust can vary widely; one constant is that the trustee has a legal obligation to act in the interests of the beneficiaries.

With the creation of a trust, the individual who places the property into the hands of the trustee (known as the settlor) sacrifices a portion of his "bundle of rights" to the property. Consistent with this fact, typically a trust cannot be unilaterally removed by the settlor once it has been established. Hence, those thinking about setting up a trust

should reason through the matter thoroughly and carefully because trusts are not the easiest things to do away with.

As we will see, the case of *Underhill v. United States Trust Company* (1929) provides good evidence for this last statement.

Facts

Ms. Evie Underhill (settlor) created a trust in which the trustee (United States Trust Company) was granted power to sell the property of the trust and then reinvest the profits at its discretion. Upon selling the property of the trust the trustee was supposed to receive a commission. Thus, due to the particular terms of the trust, the trustee acquired a "contingent interest" in its continuation because of its power to sell the property.

Both the settlor and the beneficiary attempted to dissolve the trust before the trustee had a chance to sell the property. The settlor and the beneficiary argued that dissolution of the trust was permissible because it was desired by both of them; the trustee argued that dissolution was impermissible because the terms of the trust granted him an interest in its continuation.

Law

When the express terms of a trust create a contingent interest for the trustee it is not permissible for the court, settlor or beneficiary (or both the settlor and beneficiary together) to alter or terminate the trust without the consent of the trustee.

Ruling

The court did not allow Ms. Underhill and the beneficiary to terminate the trust. The key aspect of the case was that the terms of the trust expressly conveyed an interest to the trustee. And since a trust is essentially a contractual agreement it follows that there must be consent from all parties in order to have the trust terminated.

Let this be a lesson: be sure that the terms you attach to your trust are such that they completely capture your full desire not only in the present moment but also the remote future.

Choose Tenants Wisely: The Case of Reid v. Mutual of Omaha Insurance Company

Published on November 14, 2016

It is well known that acquiring property for the purpose of renting to tenants is a potentially highly lucrative endeavor. Rental property can yield enormous financial benefits to property owners, and these benefits can be even greater when owners are equipped with adequate tax knowledge. Huddleston Tax CPAs encourages rental property owners (and future owners) to peruse our material on this topic. If obtaining rental property is within your contemplation, however, it is important to consider that owning such property frequently presents complications. Things do not always go smoothly, and there are snags which can be a severe drain on your supply of mental and physical energy. The case of *Reid v. Mutual of Omaha Insurance*

Company (1989) is a telling example of the sort of headache which can result from owning rental property.

Of course, this case is not intended to discourage rental property ownership. But future owners should certainly be aware that hassles such as the kind in *Reid v. Mutual of Omaha Insurance Company* are fairly common. Rental property ownership can be extremely rewarding, but it involves a great deal more than just collecting rent checks!

Facts

Reid (the plaintiff) contracted with Mutual (the defendant) to rent out a piece of office space for a period of five years. Mutual was supposed to pay Reid a monthly rent of $1100. Approximately two years after the five year lease was signed, another company, Intermountain Marketing, moved into the adjacent space. Mutual made a formal complaint to Reid about the behavior of Intermountain. Mutual claimed that Intermountain was too noisy and that Intermountain employees were using up all of Mutual's allotted parking spots. Reid failed to adequately address Mutual's complaint and as a consequence Mutual moved out of the office space and ceased paying rent. Soon after Mutual's departure, Intermountain expanded into Mutual's former space and effectively took over Mutual's lease. However, Intermountain soon went bankrupt and then exited the space.

Reid sued Mutual and argued that Mutual's failure to pay rent constituted a breach of contract. Mutual argued that Reid's failure to address Intermountain's troublesome behavior constituted a "constructive eviction" and therefore Mutual's contractual obligation was released. Mutual also claimed that Reid had a duty to mitigate any

resulting losses from the alleged breach and that Mutual was only liable for a portion of the losses as a consequence.

Law

When a contract has been breached, the breaching party is not necessarily liable for all losses which follow from the breach. The other party of the contract has a duty to mitigate, and the damages which are recoverable are limited to those which were unavoidable despite reasonable effort to mitigate.

Ruling

The court (Supreme Court of Utah) ruled in favor of the plaintiff, but determined that the plaintiff was not entitled to the full value of the lease because the breach triggered a duty to mitigate. The plaintiff could only recover a sum which represented losses which were deemed unavoidable even after reasonable attempts to mitigate.

Reid v. Mutual of Omaha Insurance Company offers a very important lesson for future rental property owners: even with a long-term lease, unpaid rent is not always recoverable. Cases such as this one emphasize the importance of choosing tenants with extreme care!

Conklin v. Davi: Adverse Possession and Marketable Titles

Published on November 9, 2016

Huddleston Tax Weekly will continue to examine legal cases which involve real estate because such cases can be of substantial value to our readers who are either current or future property owners. When engaging in real estate transactions, it is always best to draw up a contract which captures every conceivable detail of the exchange. Developing a thoroughly detailed contract will help to avoid the possibility of any legal disputes. The case of *Conklin v. Davi* (1978) is an interesting example of a dispute which could have been avoided if the parties had created a more detailed contract.

Facts

Conklin (the plaintiff) sold real estate to Davi (the defendant). A section of the property was acquired through adverse possession. Adverse possession is the process through which real property may be obtained without a monetary transaction; adverse possession occurs when an individual actively and openly "possesses" land for a specified period of time. The contract between the parties omitted reference to the fact that a portion of the land was acquired through adverse possession. Davi wished to obtain a title which was wholly "marketable" so that the land could be sold again in the future without complication. Davi believed that a marketable title could not be gained through the transaction due to the fact that a piece of the land had been acquired through adverse possession. Based on this belief, Davi refused to conclude the transaction. Conklin sued for specific performance and Davi counterclaimed for rescission of the contract.

Law

The critical issue before the court was whether land acquired through adverse possession can have a marketable title when transferred via sale. The answer is yes: provided that the seller shows proof that the

land was acquired legally through adverse possession, the buyer is capable of obtaining a title which is wholly marketable.

Ruling

The court (the Supreme Court of New Jersey) ruled in favor of the plaintiff (Conklin). The defendant could have procured a marketable title to the entire land as long as the plaintiff provided proof of ownership through adverse possession. The court ordered the plaintiff to provide such proof before suing the defendant for specific performance.

As *Conklin v. Davi* shows, land acquired through adverse possession can yield a wholly marketable title. The issue was that the plaintiff did not provide proof of ownership when the contract was formed; another issue was that the parties were unaware that adverse possession could produce a marketable title. The lesson is clear: before selling or buying real estate, be sure to conduct research and develop a sufficiently detailed contract!

Hawkins v. McGee: The Case Every Doctor Should Know About

Published on November 1, 2016

Every medical operation, no matter how familiar or routine it may be, carries with it a certain level of risk. There is always a chance that an operation will fail to produce its desired result. What's more, there is always a possibility that a patient will suffer negative consequences

from the operation. The case of *Hawkins v. McGee* (1929) is a famous example of a surgical procedure which put the patient in a condition worse than the one he started in. *Hawkins v. McGee* should be required reading for all physicians and future physicians just to show them the bizarre possibilities which are a natural part of their profession.

Facts

The plaintiff (Hawkins) injured his hand during childhood when he touched a piece of electrical wire. The defendant (McGee) claimed that he could perform surgery on plaintiff's hand and make it a "one hundred percent good hand." The defendant expressly guaranteed that the plaintiff's hand would be returned to top condition following the operation. The defendant used a surgical technique known as "skin grafting" and placed skin taken from the plaintiff's chest area into the injured hand. The operation failed to fully repair the injured hand. Moreover, the plaintiff's hand soon started to grow hair! The plaintiff claimed he was entitled to damages for the breach of contract and for the pain and suffering caused by the operation.

Law

If a contract is breached, the underlying aim is to put the injured party in a position which most approximates the position they would be in had the breach not occurred. There are a variety of ways to approach this goal. In this situation, the court found that the plaintiff should be entitled to expectation damages as a result of the breach. Expectation damages amount to the *difference in value* between what the plaintiff received and what the defendant promised to deliver.

Ruling

The court (the New Hampshire Supreme Court) ruled in favor of the plaintiff and found that expectation damages should be recovered. The plaintiff contracted for a “one hundred percent good hand” and received a hand which grew hair and was still injured. The plaintiff was therefore entitled to a sum which approximated the difference between what was contracted for and what was received. The court found that the plaintiff was not entitled to recover damages for pain and suffering as these things were a normal part of undergoing such a procedure.

Hamer v. Sidway & the Benefit-Detriment Theory of Consideration

Published on October 31, 2016

In America, our law is a constantly evolving mechanism. Along with the codes passed by legislative bodies and administrative agencies, we adhere to principles derived from our common law tradition. In our common law system, established principles have significant weight, but they are not necessarily binding because our society understands that old principles cannot adequately address every factual scenario. Sometimes a novel scenario requires that an established principle be modified – or a new principle be developed altogether – in order to produce an equitable outcome. Our whole body of common law is quite literally the sum of all the changes which have been made in response to new factual scenarios.

Our law of contracts has been shaped by this continually evolving system. Because an infinite number of factual scenarios are possible, it

follows that our law of contracts will never be completely "set" or finished; but as more and more rulings are issued our general picture of our law of contracts will become clearer. The famous case of *Hamer v. Sidway* (1891) is an excellent example of a scenario which helped to clarify the concept of consideration. Because the facts of *Hamer v. Sidway* were unique, the court could not simply apply preexisting principles in a straightforward manner but instead had to innovate to create a just ruling.

Facts

The basis of the suit was a promise made between an uncle (William E. Story I) and his nephew (William E. Story II). The uncle promised his nephew a sum of $5,000 if he would avoid alcohol, tobacco, foul language and gambling until the age of 21. The nephew agreed to abstain from such things and fully complied until his 21st birthday. However, though the promise had concluded, the uncle convinced his nephew to postpone receiving the sum of money until a later period in his life. The uncle passed away before he could transfer the money to his nephew. Subsequently, a suit was brought to collect the sum because the executor of the uncle's estate (Franklin Sidway) denied that a valid contract had been created.

Sidway argued that valid consideration did not exist because there was no bargaining process or anything of value exchanged between the parties. The counterargument was that consideration had been created because the nephew had voluntarily agreed to avoid certain activities even though he was legally permitted to partake in them.

Law

At the time of *Hamer v. Sidway*, the so-called "benefit-detriment theory" of consideration was still viable. This particular theory of consideration held that valid consideration could be established through a detriment suffered or forbearing from an activity.

Ruling

Though the nephew did not confer a benefit or transfer something of value to his uncle, valid consideration was created because the nephew voluntarily refrained from engaging in a number of activities he was otherwise permitted to engage in. The court (the New York Court of Appeals) overturned the decision of the intermediate appellate court and ruled in favor of Hamer.

Today, the benefit-detriment theory of consideration holds less weight than it did in the time of *Hamer v. Sidway*, but it is still relevant. Business owners need to be aware of the many theories which govern the law of contracts so that they can make informed decisions.

Vancouver's Latest Tax May Impact Seattle Real Estate Market

Published on October 28, 2016

Though the Seattle real estate market is attractive on its own merits, a recent tax issued in Vancouver, Canada may create even more demand in the Seattle housing market. In recent years, foreign buyers have caused housing prices in the Vancouver market to rise substantially. In response, the city (of Vancouver) implemented a tax to help stabilize

the market. Some observers speculate that new tax will push foreign home buyers south toward Seattle. Let's take a look at the facts and develop an informed view of the matter.

Foreign Buyer Transfer Tax

The new tax – which is known as the Foreign Buyer Transfer Tax – applies specifically to foreign buyers in the Vancouver housing market. Whenever a foreigner purchases a piece of Vancouver real estate they must pay an additional 15 percent on top of the home price. The tax took effect on August 2nd of this year.

Because little time has passed since the implementation of the tax, predicting its long-term impact is not an easy task. However, it seems likely that foreign real estate buyers – who are predominantly Chinese – will look toward Seattle simply because of the large disparities in home prices between the two markets. In August, the benchmark home price in Vancouver rose to $1.57 million; in Seattle the median home price is $625,000. It seems reasonable to predict that the new Vancouver tax will create an additional incentive to migrate south on top of other incentives which already exist.

Since August, investment in the luxury real estate market of Vancouver has declined by approximately 20 percent. Whether this decline is attributable specifically to the new tax is not fully clear. Along with Seattle, foreign buyers will probably also look toward Toronto.

Possible Impact on Seattle Market

As of right now, there is relatively little hard evidence to support the idea that the Vancouver tax will lead to a stampede of foreign

investment in the Seattle real estate market. In fact, there are some data which may suggest a decline in foreign investment. As a general matter, tracking foreign investment is a difficult task, but one way to obtain an imperfect sense of foreign investment trends is to look at cash sales. Cash sales may reflect foreign investment trends to a degree because many (though not all) foreign buyers pay in cash because they are unable to obtain financing in the U.S. But, as it turns out, cash sales have actually declined in Seattle in the past several years. Though this is not conclusive evidence, it tends to throw doubt on the migration hypothesis.

Even without a pile of solid evidence surrounding it, the Vancouver tax has still managed to catch the attention of the Seattle political establishment. Seattle officials are very concerned about keeping housing prices affordable and the potential impact of the Vancouver tax has already sparked discussion about policy considerations. However, it seems certain that no measures will be adopted until there is more firm data on the effect of the tax.

The new Vancouver tax is an interesting example of a city taking action to stabilize its housing market. But at this point it appears that the idea of this tax creating a veritable avalanche of foreign investment in Seattle is almost pure speculation.

Jacob & Youngs v. Kent: A Lesson on Substantial Performance

Published on October 25, 2016

Huddleston Tax Weekly will continue to feature articles on contracts because it is very important for business owners to have at least a basic knowledge of contract law. Business owners negotiate and execute contracts on a recurring basis and so an understanding of fundamental contract principles is essential. Today we will discuss the concept of *substantial performance* and demonstrate how this concept informs how damages are settled when a contract has been breached.

Many people assume that when a breach of contract has occurred damages necessarily follow in all instances. In reality, this is not always the case. If an offending party violates a contract in such a way that the violation does not materially affect the goals of the contract then damages usually do not follow. The case of *Jacob & Youngs v. Kent* (1921) is a famous example of a breach which ended up not leading to any damages.

Facts

The plaintiff (Jacob & Youngs) contracted with defendant (Kent) to build a house. The defendant wished to have a specific brand of pipe installed and the contract reflected this wish. When the plaintiff was nearly completed with the project the defendant discovered that a different brand of pipe had been used. The pipe used by the plaintiff was of equal quality to the brand of pipe desired by defendant. The plaintiff originally brought suit in order to receive the remainder owed by the defendant on the original contract price. The defendant argued that the breach was material and requested that the existing pipe should be replaced with the desired brand. The plaintiff argued that using a different brand was a trivial error and that replacement would present an oppressive burden.

Law

The doctrine of substantial performance prevents trivial offenses from totally wiping out an existing contract. When a breach of contract is deemed trivial such that it does not materially affect the goals of a contract the offending party must pay for whatever *difference in value* occurs as a consequence of its breach. The offending party is not required to redo every part of the contract.

Ruling

The court (New York Court of Appeals, highest court in the state of New York) found that using a pipe of a different brand but of the same type and quality was a trivial error. Ordering the plaintiff to completely replace the existing pipe with the desired brand would be oppressively expensive. However, since the plaintiff did breach the contract, the defendant is entitled to the difference in value between the product received and the product promised. In this case, the difference in value was literally zero because the two brands of pipe were of the same quality.

In the world of business, these kinds of trivial mistakes are quite common. Having an awareness of the concept of substantial performance can give you a sense of what to expect when these sorts of errors happen.

Basic Facts of Cost Segregation

Published on October 21, 2016

Cost segregation is a process which involves separating personal property assets from real property assets for the purpose of shortening the time of depreciation and reducing tax liability. In a cost segregation study, assets are classed together according to their depreciation period. Cost segregation has the potential to save building owners large sums of money because it enables certain costs to be depreciated over a much shorter period of time (5, 7 or 15 years) than they normally would be (27.5 or 39 years).

Personal Property Assets

Certain elements of a building may be categorized as the "personal property" of the owner as opposed to real property for tax purposes. For instance, non-structural elements – such as wall covering, carpet, lighting, certain parts of the electrical system and others – may be categorized as personal property in most instances. Certain types of land improvements – such as landscaping and sidewalk improvements – may also be categorized in this manner. When categorized in this fashion, these elements will have relatively shorter "useful lives" than they otherwise would have, and consequently owners may have a reduced tax burden and may take advantage of depreciation deductions.

Typically, cost segregation studies are financially prudent for buildings which have been bought or remodeled for over $200,000. Cost segregation studies can be performed on any building which has been bought, constructed, expanded or remodeled since 1987. Hence, studies can be performed "retroactively" on buildings which are not newly completed.

Cost segregation can be a tremendous positive force for business owners as it can give them access to cash much more quickly than

would otherwise be possible. In the world of business, timing is of immense importance, and so taking earlier deductions can literally alter the whole direction of a company's long-term future.

Cost Segregation Studies

The IRS scrutinizes cost segregation studies very thoroughly. This is because such studies can – and frequently do – translate into many thousands of dollars in tax savings. When hiring someone to perform a cost segregation study, it is important that your hire be well-informed not only on the relevant architectural and engineering specifications but also on the applicable law. Simply hiring a construction engineer or architect with no prior experience with cost segregation analysis is unadvisable. There are heavy penalties imposed by the IRS when cost segregation is used improperly and so it imperative to hire a qualified specialist to perform the analysis.

What is Commercial Paper?

Published on October 20, 2016

There is a variety of means companies can utilize in order to generate capital. Companies employ certain means rather than others depending on what specific needs they have to fulfill. Commercial paper is an unsecured promissory note which is typically used to fund short-term company projects. Since commercial paper is unsecured – meaning that it is not backed by collateral – it can only be issued by companies which have impeccable (or near impeccable) credit history. In this article we will discuss some of the basic facts of commercial

paper and highlight how it is distinguished from other types of financial instruments.

Short-Term Debt Security

One of the main qualities which sets commercial paper apart from other types of debt securities is its short-term nature. Most commercial paper matures after 45 days, and the vast majority has a maturity date lasting no longer than 90 days. As a fixed rule, commercial paper cannot have a maturity date which lasts longer than 270 days because after 270 days the security would need to be registered with the SEC.

Because of its short-term nature, commercial paper generally has lower interest repayment rates when compared with long-term bonds.

In some ways, commercial paper can be viewed as a cost-effective alternative to lines of credit issued by banks. Commercial paper usually has lower interest rates and, being unsecured, also does not create a lien against the company. Of course, commercial paper cannot supplant lines of credit because the stellar credit ratings required to issue commercial paper necessarily limit its availability in the market.

Issuance

Investors can either purchase commercial paper directly from the issuing company or from a third-party dealer. The third-party dealer is typically an investment bank, although commercial banks are increasingly taking part in the commercial paper market as third-party dealers. Commercial paper is typically sold in round lots of $100,000 and $250,000, although some commercial paper is available in lots of $25,000.

As of October of 2008, there was approximately $1.78 trillion in outstanding commercial paper in the United States. Commercial paper is issued frequently outside of the United States as well. The European market currently has about $500 million in outstanding commercial paper.

Though it is not something a small business owner will encounter on a regular basis, it is important for every businessperson to be familiar with commercial paper since it plays such a large role in the world of corporate finance.

Jones v. Star Credit Corporation: An Example of an Unconscionable Transaction

Published on October 18, 2016

Simply because all of the elements of a contract have been completed does not necessarily mean that a court will enforce the contract in every individual case. There are special conditions which can make an otherwise perfectly valid contract unenforceable. For instance, when a contract – or a particular clause within a contract – has been deemed "unconscionable" for whatever reason by a court, it may be rendered unenforceable.

The doctrine of unconscionability developed from a tradition in English common law which has attempted to prevent the most vulnerable members of society from being unfairly taken advantage of

by merchants. This doctrine continued in American law and was then adopted by the Uniform Commercial Code. The UCC section 2-302 states that when a court determines that a contract (or clause of a contract) is unconscionable it has the power to correct the situation in such manner as to avoid injustice. Courts have taken the language of the UCC on the doctrine of unconscionability and applied it to a number of specific cases. *Jones v. Star Credit Corporation* (1969) is an example of an unconscionable contract which was rendered unenforceable.

Facts

The plaintiffs (Jones) bought a home freezer from a door-to-door sales representative. Since they were unable to pay the full amount up front, the plaintiffs set up a financing arrangement through the defendant. The retail price of the freezer was approximately $300, but the plaintiffs were charged a price of $900 plus various other credit and insurance charges. The final purchase price of the freezer came out to $1234.80. The plaintiffs had paid $619.88 when the matter was brought before the court. The issue is whether the very large difference between the purchase price of the freezer and its maximum retail price indicates an unconscionable contract.

Law

As mentioned above, a court may render an otherwise valid contract unenforceable if it finds the contract to be unconscionable either in whole or in part. In sales transactions, the court may give weight to the difference between the market (or retail) price of an item and its selling price. The court may also give weight to the specific circumstances (i.e. socioeconomic, financial, etc.) of the buyer.

Ruling

The court (the Supreme Court of New York, Second District) determined that the contract was unenforceable given that the difference between the retail price and selling price was so vast. Although the court did not find any evidence of fraud or malice, the court nonetheless found that the sheer size of the disparity indicated an unconscionable contractual agreement on its face.

Kirksey v. Kirksey: The Case of the Promise Which Lacked Consideration

Published on October 17, 2016

The law of contracts is primarily concerned with deciding whether promises are enforceable in a given set of circumstances. In order to be (facially) valid, the elements of a contract must all be satisfied. A contract consists of the following elements: offer, acceptance, consideration, legality, capacity and writing (when applicable). Occasionally, a dispute arises over whether one (or more) of these elements has been successfully established. These disputes have created an enormous body of case law which serves to clarify the requirements for contractual elements. This body of case law stretches back literally hundreds of years. In the case of *Kirksey v. Kirksey* (1845), a dispute developed over whether adequate consideration was exchanged when a landowner encouraged his sister-in-law to live on his land.

Facts

The plaintiff was the defendant's sister-in-law. After the death of her husband, the plaintiff received a letter from the defendant in which he encouraged her to move from her current location to his farm. He promised that if she moved he would allow her to live in a house on his property. The plaintiff took the defendant's offer and moved into the house on the defendant's land. Two years later the defendant ordered the plaintiff to leave the property. The plaintiff brought suit against the defendant and argued that the promise extended to her was an enforceable contract.

Law

In order for a contract to be enforceable, there must be adequate *consideration*. Consideration roughly equates to value. Consideration is present when the parties of a contract exchange things which are of equal value. For instance, when a house is sold for its market price, this constitutes valid consideration because there is an exchange of equal value. If someone were to sell a house for well below its market value – say, for just $1 – consideration has not been established because the values are so disparate.

Ruling

The court (the Supreme Court of Alabama) ruled that the promise made by the defendant was unenforceable because, even though the plaintiff uprooted herself and relied on the defendant's word, no consideration had occurred. The main reason that the defendant wanted the plaintiff to move was so he could be closer to her and her children following the death of her husband (the defendant's brother), and so the plaintiff essentially exchanged her physical "closeness" for her stay on the property. And so even though the plaintiff's reliance on

the promise was reasonable, she did not offer enough in return in order to produce valid consideration.

Though the message of this case may seem almost childishly self-evident to us today, it represents an important development in the law of contracts since it added clarification to the element of consideration. In law, boundaries are sometimes never completely defined, they are only made slightly clearer and clearer as new factual scenarios add more and more clarification. *Kirksey v. Kirksey* is one example of this process!

Tulip Mania: An Old Presage of Modern Economic Bubbles

Published on October 3, 2016

The term "tulip mania" refers to the period during the Dutch Golden Age when the Netherlands saw an incredible rise in the popularity and sale of tulips. Tulips were first introduced to Europe when they were brought from the Ottoman Empire in 1554. They were initially brought to Vienna but made their way to the Netherlands soon thereafter. The increase in popularity of the tulip in the Netherlands is generally thought to have occurred around 1593; this increase coincides with the establishment of the "hortus academicus" by the Flemish botanist Carolus Clusius at the University of Leiden.

The high popularity of the tulip was due to its beauty and rarity. Tulips take a substantial amount of time to produce – daughter offsets usually take 1-3 years to become flowing bulbs – and so even at the height of

its popularity the tulip was in short supply. These factors, coupled with the spectacular economic development of the Netherlands during this era, combined to transform the tulip into a status symbol which was highly coveted throughout Dutch society.

By the early 1600s tulips were a thriving commodity. Tulips became extremely expensive during this time. A number of varieties of the flower were developed and certain varieties commanded far higher prices than others. One variety, the Viceroy, was allegedly traded for goods equaling roughly 2500 florins in 1636; a skilled craftsman typically earned 300 florins per year.

Since tulips only bloom during a short window every year (in the Northern Hemisphere), futures contracts were made by tulip traders so that tulips could be bought in advance. By 1636, a formal futures market was created in which contracts to buy bulbs could be bought and sold. By that time, tulips had come to play a massive part in the Dutch economy: by 1636 the tulip became the fourth leading export of the Netherlands.

Fascinatingly, in February of 1637, the tulip bulb market crashed in the Netherlands. Tulip prices plummeted and trading abruptly ceased. A number of theories have been advanced but so far an explanation for the collapse of the tulip market which is universally satisfactory has yet to be uncovered. For various reasons, the demand for tulips fell sharply in 1637 and as a consequence many individuals lost considerable sums of money on tulip contracts. Many modern economists point to tulip mania as one early example of an economic bubble; others contend that the phenomenon should not be considered an economic bubble by modern standards. However it is classified, tulip mania remains an exceptionally interesting example of market volatility and price fluctuation.

The Beginning and End of the Amsterdam Stock Exchange

Published on September 28, 2016

Long before the New York Stock Exchange was even a dim possibility, the Amsterdam Stock Exchange reigned as the world's leading market for the trading of securities. Though stock transactions took place elsewhere prior to its creation, the Amsterdam Stock Exchange was the first financial institution established specifically for the purpose of buying and selling securities.

The Amsterdam Stock Exchange was created in 1602 by the Dutch East India Company (the *Verenigde Oostindische Compagnie* or VOC in Dutch). In its time, the VOC was an extraordinarily powerful corporate entity. In 1602, the States General of the Netherlands granted the VOC a special charter over trade affairs in Asia; this charter gave the VOC quasi-governmental authority and expanded its influence many times over. The stock exchange in Amsterdam was created in order to encourage investment in the activities of the VOC. Before 1602, the market which eventually became the Amsterdam Stock Exchange had only dealt in commodities.

The creation of the stock exchange proved to be an incredibly successful mechanism to stimulate investment in the VOC. Interested parties flocked to the exchange and paid considerable sums for a stake in the company's endeavors. Dividends were periodically paid out to shareholders in order to incentivize future investment. Investors were

given the option of selling their shares to a third party. As a result of this option a secondary market rapidly developed in which investors sold shares to outside third parties. These third party transactions were recorded by an official bookkeeper. This “official” secondary market allowed securities trading to flourish and the stock exchange gained an increased level of importance.

In 1623, the first charter granted by the States General of the Netherlands expired and a second charter was promptly implemented. This charter enabled the stock exchange to flourish still further. The success of the stock exchange ultimately led to the development of “trading clubs” and other such sub-markets in which securities were bought and sold. Potential investors began to seek out information from experienced traders in order to maximize their investment opportunities. Hence, the market in Amsterdam during this era came to resemble modern stock markets in many respects.

In 2000, the Amsterdam Stock Exchange formally merged with the stock exchanges of Brussels and Paris to form Euronext. The market in Amsterdam is now known as Euronext Amsterdam.

Though we are far removed from the days when the Amsterdam Stock Exchange reigned supreme, it is important to occasionally glance back and remember where our modern stock markets come from. If you were an ambitious businessperson four hundred years ago, in many ways it would’ve been helpful to learn Dutch!

Hadley v. Baxendale:
The Case of Unforeseen Damages

Published on September 26, 2016

In the United States, most people are aware that our legal system is modeled on the British legal system. However, people are generally less aware that British law informs our own law in many areas. In point of fact, a number of our most fundamental legal concepts take origin in British case law. The famous case of *Hadley v. Baxendale* (1854) is one important example of this phenomenon.

Hadley v. Baxendale is an English contract law case which made a major contribution to the legal doctrine of foreseeability. As we will see, the plaintiff Hadley (who was the defendant in the appellate case) suffered considerably in lost profits as a consequence of the poor performance of Baxendale. However, the lost profits were not recoverable because the loss of such profits was not a reasonably foreseeable consequence of this performance.

Facts

Mr. Hadley and his associate were millers who worked together in the town of Gloucester. Hadley hired Baxendale to deliver a broken crankshaft to a repair shop in Greenwich so that the repairmen could correctly make a new crankshaft. The delivery was a time sensitive matter and Hadley needed the part to arrive at the repair shop by a specific date. Baxendale failed to deliver the broken crankshaft to the shop by the proper date and as a consequence of this lateness Hadley lost business. Hadley brought a claim against Baxendale to recover the profits which were lost as a result of Baxendale's poor performance. The trial court jury awarded Hadley £25 (roughly £2500 today). This award was appealed and then brought before the Court of Exchequer.

Law

In cases where a breach of contract has occurred, damages which result from the breach are recoverable only when such damages could be *reasonably foreseen* unless special circumstances were communicated explicitly between the parties involved. Just because damages result from a breach of contract does not mean that they are automatically recoverable; they must be a reasonably foreseeable consequence of the breach.

Ruling

The appellate court (Court of Exchequer) overturned the jury award and determined that, although Baxendale had violated the contract by failing to deliver the crankshaft at the proper time, it was not reasonably foreseeable that the lateness would have caused a substantial loss of profits. In order for such lost profits to have been recoverable Hadley needed to have specifically communicated the fact that such lost profits were a probable consequence of late delivery.

Though factually and theoretically very simple, the case of *Hadley v. Baxendale* is a landmark decision and still informs our contract law today. As spectacular as it may sound, *Hadley* may still be invoked today when a package is not delivered on time!

The Cost of Starbucks' Dutch Connection

Published on September 20, 2016

Back in October of 2015, the European Commission ordered the Dutch government to recover approximately €30 million (or about $34 million) from Starbucks. The EC determined that the arrangement made between the two entities was illegal and had given Starbucks an unfair advantage in the marketplace. The Netherlands and Starbucks are expected to appeal the decision.

The EC ruling is significant for a number of reasons. For one, it brings attention to the complex maneuvers multinational corporations employ in order to receive the best tax treatment. And it also highlights how serious the European Union has become in its efforts to crackdown on tax avoidance. While the sum that the Dutch government is required to recover in back taxes is not outrageously large, the decision may prove to be extremely important as a portent of future events.

The Decision

The European Commission found that the tax deal made between the Netherlands and Starbucks enabled the multinational coffee company to shift profits and dramatically lower its tax burden. Through its ruling, the EC intends to shut down the tax avoidance strategies utilized by large companies. Such strategies are usually highly sophisticated and unavailable to start-up companies and small to medium sized businesses. Hence, even though Starbucks maintains it didn't violate any established rules, the arrangement compounds the preexisting economic advantage Starbucks already possesses.

Although it may be tempting to immediately side with the EC, it should be kept in mind that EU states face an increasingly competitive world and tax deals are just one means to attract foreign investment.

And if Starbucks is able to employ complex tax strategies which give it an advantage, perhaps this is just a natural consequence of how the market works? And besides, even if this ruling curtails tax avoidance strategies in the short-term, what guarantee exists that companies will not respond with even more creative strategies in the future?

Starbucks may be stuck with a sizable tax bill, but the days of sophisticated tax structuring are far from over.

Greiner v. Greiner: Be Careful with Promises

Published on September 13, 2016

Promises which are made among family members very rarely end up involving the legal system. But those which do tend to offer valuable lessons which, if heeded, can help people avoid considerable hassle and headache. The case of *Greiner v. Greiner* (1930) is an interesting example of a promise made between family members gone awry. Though the peculiar facts of *Greiner* are highly unlikely to be replicated today, the case still gives useful information for those who are considering giving something of great value away to a family member or close friend. Real estate owners in particular should pay close attention so that they can avoid the ordeal which the Greiner family had to experience.

Facts

Mrs. Greiner inherited a large piece of land following the death of her husband. She made a promise to her son, Frank Greiner, which allowed him to have a small portion of this land provided that he move his family onto the land and live there indefinitely. In direct response to this promise Frank Greiner moved onto the property with his family. Over time, Frank Greiner made improvements to the property and eventually asked Mrs. Greiner for a deed. Mrs. Greiner refused to give the deed and soon thereafter brought suit against her son in the hope of forcibly removing him from the premises. Mrs. Greiner argued before the court that a valid contract had not been made and therefore forcible removal was warranted; on the other hand, Frank Greiner argued that he had relied on the promise extended by his mother to such an extent that forcible removal would be unjust.

Law

Though a valid contract had not been made because no consideration was exchanged, the rule of promissory estoppel was still triggered by the offer given to Frank Greiner. The doctrine of promissory estoppel states that when a person reasonably relies on a promise to their detriment that promise may be enforceable by law in order to avoid injustice.

Ruling

The court (Supreme Court of Kansas) ruled that the doctrine of promissory estoppel applied given the facts of the case. It was reasonable to expect that Frank Greiner would uproot himself, move his family onto the property and then make valuable improvements to the property because of the promise made by Mrs. Greiner. And since he reasonably relied on the promise in this manner the promise should be enforceable by law. The court granted the land to Frank Greiner.

As *Greiner v. Greiner* illustrates, one has to be very careful when making promises which involve things of exceptional value. This is true even when the promise is made among family members. If you're a real estate owner, be very careful before you promise any part of your land to someone else!

Apple's New Tax Bill

Published on September 12, 2016

The European Commission has recently ordered multinational tech giant Apple, Inc. to pay €13 billion to Ireland to settle back tax debt. The EC concluded that the deal made between Apple and Ireland was illegal and aided Apple in avoiding its proper tax liability. Though it is not the largest corporate back tax bill by a long shot, this tax bill will certainly spell substantial changes in the way Apple conducts its tax affairs.

Commissioner Margrethe Vestager determined that the Irish deal enabled Apple to pay an effective tax rate of just 1 percent on its European profits in 2003, and that this sunk to just 0.005 percent in 2014. The European authorities have put Ireland in charge of recovering the €13 billion (approximately $14.6 billion) from Apple.

This new tax bill can accurately be perceived as an inevitable consequence of Apple's practice of using creative accounting strategies to avoid tax obligations.

Context

Apple has <u>used</u> three primary methods to minimize its tax burden: deferral, transfer pricing and check-the-box. Deferral simply allows U.S. firms to avoid paying U.S. tax on income earned abroad until it is physically returned to the states. In reality, companies often keep international earnings offshore indefinitely and thus avoid paying tax altogether. Transfer pricing is a bookkeeping method used by companies to distribute expenses among their affiliates. Apple is able to utilize transfer pricing to its benefit by charging small fees to foreign subsidiaries for use of its intellectual property; in this way, Apple maximizes the profits of its affiliates and minimizes its intellectual property income in the U.S. Check-the-box allows firms to classify their affiliates as "disregarded entities" which are not subject to U.S. income tax.

The deal struck with Ireland further enhanced the effectiveness of these strategies. Apple set up two entities in Ireland through which it was able to channel two-thirds of its pre-tax global income. The income which passed through these Irish entities did not return back to Apple but was instead routed to the U.S.-based bank accounts of these entities. This allowed the income to avoid U.S. tax.

Final Thoughts

The European Union is trying diligently to crack down on faulty agreements between multinational firms and EU member states. European authorities have already ordered the Dutch government to recover €30 million from Starbucks and demanded that Luxembourg recover roughly the same amount from Fiat Chrysler. Both Amazon and McDonald's are also likely to face similar treatment in the near future as a result of their dealings with Luxembourg. Though creative

accounting will almost certainly continue well into the future, it appears that European authorities will take an increasingly aggressive approach to enforcing EU tax laws.

Apple certainly has the cash to settle its tax bill. And its relationship with Ireland is likely to suffer little as Ireland still has a relatively low corporate tax rate of 12.5 percent. However, it seems clear that Apple will have to employ cleverer strategies in the future in order to dodge the European taxman.

Baker v. Weedon: A Case of Mistakenly Sold Property

Published on September 8, 2016

The process of selling real estate is typically fairly complicated. In order to sell a piece of real estate properly, one usually has to consult with a variety of professionals, such as an appraiser, a licensed agent, a construction professional and others as well. To reap the greatest possible benefit, the seller must also conduct a great deal of market research and be fully conscious of both past and future market trends. Selling a home is tricky enough when the ownership status of the home is straightforward; when ownership status is not straightforward, however, the process of selling a home can be downright maddening. The case of *Baker v. Weedon* (1972) is one example of a sale of land made complicated by the presence of multiple ownership interests (specifically contingent remainder interests). As we will see, if you are preparing to sell your home and are worried about the complexity of

the process, just be thankful you aren't saddled with the circumstances of *Baker v. Weedon*!

Facts

In *Baker v. Weedon*, a dispute developed over the sale of a portion of land in Alcorn County, Mississippi. The person who attempted to sell the land, Anna Plaxico Weedon, was married to the original owner, John Harrison Weedon, and had been granted a life estate interest in the land following Mr. Weedon's death. The will of Mr. Weedon stated that if Anna had any children ownership of the land would be transferred to them upon Anna's death; however, in the event that Anna died without children, the land would be transferred to his biological grandchildren from a previous marriage. Hence, these grandchildren (who initiated the suit against Anna) had a contingent remainder interest in the land in that they may have someday claimed ownership if Anna died without children.

Anna sold a portion of the land in 1964 to the city. At the time of the sale, the land was appreciating in value in tandem with commercial development in the surrounding area. In fact, the value of the land was projected to increase by over $150,000 in just a few years following the initial trial. Anna felt she needed to sell the portion of land so that she could construct a new home for herself and live comfortably in old age. However, selling the land clearly presented problems as doing so removed the remainder interests of the grandchildren as well as thousands of dollars in unrealized income. The issue presented was whether the court could order a sale of land affected by future interests given the unique facts of the case.

Law

A court may order a judicial sale of land in certain situations. For instance, a court may order a sale in order to avoid economic waste and prevent deterioration of the land. However, when making a ruling, the court must consider what is necessary for the best interest of all parties.

Ruling

In this case, the court decided that the interests of the life tenant (Anna) and the remaindermen (grandchildren) were not properly served by the sale of the portion of land made by Anna. Though such a sale may have been appropriate under different circumstances, in this case the court reasoned that the sale would have resulted in too great of a financial loss for the remaindermen due to the fact that the value of the land was appreciating so rapidly. The court (the Supreme Court of Mississippi) sent the case back to the chancery court with instructions to find a more equitable solution to the problem.

The facts of *Baker v. Weedon* are of course exceptional, but they are useful to illustrate the level of complexity which can arise when real property is sold. Let's be happy this type of situation doesn't develop very often!

The Basics of the Google Tax Quandary in the U.K.

Published on September 6, 2016

With total earnings of approximately $74.5 billion for 2015, Google is truly a multinational corporate juggernaut. International sales constitute a substantial portion of Google's overall revenue source. Presently, sales in the United Kingdom make up about a tenth of Google's entire income. In recent years, a controversy has developed over Google's supposed attempts to divert profits in an effort to avoid paying the typical corporate tax rate for U.K. sales. The standard corporate tax rate in the United Kingdom is 20 percent. By way of a host of creative strategies, Google has historically paid nothing close to this rate. Two recent developments — a settlement regarding Google's back tax debt and a law passed by the British parliament — have helped create a measure of progress, but the matter remains far from fully resolved.

In the last three years, Google has managed to keep its effective tax rate on foreign (i.e. non-U.S.) profits at 6.6 percent. There appears to be some uncertainty over the exact rate paid by Google in the United Kingdom: some allege the rate is as low as 2.5 percent, although Matt Brittin, Google's president in Europe, states that the rate is much higher.

Back Tax Deal

In January of 2015, a settlement was reached regarding Google's past tax liability stretching back to 2005. Google agreed to a sum of $130 million (approximately £190 million). While many cite the deal as a clear triumph for the British government, many others see it as overly gentle on Google. Though the issue of profit shifting still lingers, this settlement brought at least some degree of satisfaction for the U.K.

Diverted Profits Tax

In its Finance Act of 2015, the British government included a provision called the Diverted Profits Tax — informally referred to as the Google Tax — which attempts to shut down the improper shifting of profits to offshore tax havens. In the past, Google has avoided paying the standard corporate tax rate on most of its U.K. profits due to its practice of shifting these profits to other venues, primarily Bermuda. The Diverted Profits Tax will attempt to halt this practice and implement a 25 percent tax rate on funds being shifted in this fashion.

There is uncertainty whether Google will comply with the law as Google contends that it already pays its fair share of taxes in the U.K. Only time will reveal precisely how the matter will be settled.

A Brief History of the Geld

Published on August 29, 2016

In the year of 2016, we tend to associate tax collection with a number of images and concepts, such as complex forms, expensive government programs and the IRS. Our perception of taxation is inevitably bound to the society in which we live. In reality, however, the basis of this association is merely founded on our general tendency to overlook the full history of tax collection. Historically, taxes have not always involved lots of tough number crunching, box checking and the tracking down of receipts; in many eras prior, taxes have been associated with much more lively and exciting things, including riots, protests, pillaging and popular revolts. The geld – also referred to as the Danegeld – is one example of a tax which, in its time, was

associated with things far different than the things we associate taxes with today.

The geld has its roots in feudal England. Though the first geld was collected in the early 800s in Frisia (modern day Netherlands and Germany), the practice of collecting the geld occurred most frequently in England. As we know, the English nation was formed through the interactions between natives and foreign invaders from Scandinavia and northern France over the course of a number of centuries. The geld was a payment – in the form of silver – which, at different points in history, performed either one of two functions: it paid off intruders or, once the intruders had more or less settled in England, it was used to pay the conquerors to defend the land against further invasion.

In pre-Norman England (also known as Anglo-Saxon England), the geld was used to buy off the Danes (and other Scandinavian invaders) so as to prevent harm to English property. Once the Danes emerged as the effective rulers of England, they continued to demand funds from the English in exchange for defense services. Hence, the geld took the form of an established land-tax levied by the Danes. In 1066, William the Conqueror defeated the English and incorporated England into his empire. Under Norman rule, the geld continued to be collected as a land-tax. The last geld was collected around 1161-1162 by Henry II.

The collection of the geld resulted in an enormous quantity of silver being shipped back to Scandinavia – over 100 tons of silver were captured.

The geld is a perfect example of a tax which had nothing to do with government bureaucracy and everything to do with greed and violence. In fact, it is difficult to conceive of a tax which is more distinct in nature from the system of taxation we have today. The next

time you feel the urge to complain about filling out your tax paperwork, just remind yourself that you have it much better than the typical person who lived in feudal England!

Gruen v. Gruen: A Lesson on Gift Delivery

Published on August 23, 2016

When we think of gift giving we tend to conjure a predictable set of ideas and images: we think of Christmas, birthdays, graduation ceremonies and other occasions in which gifts are exchanged. Seldom do we think of legal ramifications which may be triggered by the delivery of a gift. But when a gift is of exceptionally high monetary value, the act of gift giving can sometimes become a bit more complicated than normal. *Gruen v. Gruen* (1986) is an interesting case which involved the transfer of an extremely valuable piece of art from a father to his son; the ruling of the case clarified some of the uncertainty on the question of what constitutes proper or "valid" delivery of a gift. If you or someone you know is thinking about giving a gift of similar value, *Gruen v. Gruen* may be essential reading!

Facts

The father, Victor Gruen, attempted to make a gift of an oil painting by Gustav Klimt to his son, Michael Gruen, in 1963. The father wrote his son a letter in which he explained that, although he wished to transfer title of the gift, he wanted to retain physical possession of the painting for the duration of his life (in other words, retain a life estate

in the painting). After being advised against this by his lawyer and accountant, the father wrote another letter to his son regarding the gift and omitted reference to his continued physical possession of the painting. The issue of the case is whether a valid transfer of title of the painting occurred given the fact that the son never took physical possession of the painting while his father was alive.

Ruling

The court (the Supreme Court of New York, upholding the decision of the appellate court) ruled in favor of the son. The son was attempting to establish ownership of the painting against another relative (Michael Gruen's stepmother). The court found that the father had made a valid transfer of ownership despite the fact that he retained a lifetime interest in the painting. If someone wishes to transfer ownership of property specifically after their death, a will is required; the court reasoned that in this case present transfer of ownership occurred because there was a clear *donative intent* to bestow ownership upon the son.

Lessons

At the time the case was being tried, the painting by Klimt was worth approximately 2.5 million dollars – quite a birthday gift! The father was afraid that his son would have had to pay inheritance taxes on the gift if he (the father) continued to hold possession of it for the remainder of his life. As it turns out, his fear was without basis: *Gruen v. Gruen* shows that it is possible to make an *inter vivos* gift even without physical delivery of the property. As long as there is donative intent, physical or constructive delivery, and acceptance by the receiving party, a valid gift has been made.

The Amazon Sales Tax Dispute

Published on August 12, 2016

With its seemingly endless number of products, competitive prices and customer focused shipping practices, Amazon.com (Amazon) is truly a commercial force to be reckoned with. Headquartered in Seattle, Washington, Amazon.com is the largest internet-based retailer in the world and, as of 2015, has surpassed Walmart as the most valuable retailer in the United States. Amazon began as an online bookstore but has since broadened its range of products and now offers a wide assortment of goods and services.

For a number of years Amazon has been at the center of a controversy regarding the collection of sales tax from customers. Amazon sells and ships products to customers in every state throughout country but does not collect sales tax in every state. Since it is an ecommerce company, Amazon does not always have a substantial physical presence in the states in which it conducts business and so many state governments lack the capacity to compel Amazon to collect sales tax. Many state governments are attempting to pass legislation which would compel Amazon to collect the tax, but this may cause Amazon to simply cease conducting business in whichever state passes such legislation.

In May of 2011 legislation was introduced in Congress which, if passed, would settle the issue entirely. So far, Amazon has not taken a public stance on the bill.

State Argument

State governments argue that Amazon possesses an anti-competitive advantage in the marketplace over traditional storefront businesses. And since storefront businesses are of course forced to collect sales tax Amazon should likewise be compelled to do the same. In other words, the sheer impact which Amazon has on state economies is reason enough to collect the tax even though Amazon doesn't always maintain a strong physical presence in the states in which it conducts business.

State governments also have clear financial motivations to impose the tax as well, as sales taxes from Amazon transactions can add up to hundreds of millions of dollars per year in certain states.

Amazon Argument

In order for a business to be required to collect sales tax it must have a physical nexus in the state in question. Amazon contends that this physical nexus is either insufficient or nonexistent in many cases.

In order to sidestep the physical requirements, Amazon has created subsidiaries which are treated separately for tax purposes. Amazon also carefully monitors its relationships with affiliate businesses in order to make sure that its physical presence is kept to a minimum.

Final Thoughts

Both sides of the argument have a degree of merit. Amazon does make it difficult for many local retailers given its status as an internet-based company. But even if a given state passes legislation to compel Amazon to collect sales tax, Amazon may simply remove its activities from that state; this very thing has actually happened before on a

number of occasions. Obviously, state governments would love the dramatic rise in revenue which would occur with the collection of sales taxes from Amazon transactions; and Amazon would love to avoid collecting sales taxes since doing so gives it a competitive advantage. Perhaps the matter will only be fully resolved at the federal level.

Understanding Cost Basis

Published on August 3, 2016

Cost basis is a tax concept which is used for determining the true amount which has either been gained or lost from the sale of a given commodity. When you sell property, basis is used to compute the correct amount of tax which is owed from the sale. Though cost basis is a relatively simple concept, it can be a bit difficult to apply in some situations. In this essay we will discuss the fundaments of the concept and explain why it can be a bit trickier than it may seem upon first glance.

Simple Definition

The IRS provides a simple definition of cost basis on its 551 publication: "Basis is the amount of your investment in property for tax purposes. Use the basis of property to figure depreciation, amortization, depletion and casualty losses. Also use it to figure gain or loss on the sale or other disposition of property. … The basis of property you buy is usually its cost."

Thus, in its simplest form, cost basis is the purchase price of your property. In the real world, however, cost basis is more subtle as the value of property tends to change over time; also, not all property is acquired through sale, and in cases where it is not acquired through sale computing cost basis is less straightforward.

Practical Definition

If a person buys an item — say a piece of furniture, such as a sofa — for $100, then $100 is the cost basis of the item (the sofa) at the outset. If the person decides to sell the sofa at a later date for $100, and the sofa has retained its original value of $100, then no tax is owed because no profit was realized. However, if the person managed to sell the sofa for $150, then a capital gain has been realized and therefore a tax is due (on the $50 of profit).

In other words, cost basis is a mechanism which is intended to offset one's investment in property so that an individual is not unfairly taxed. If an individual were taxed for a sale even when no profit was realized, the commercial world would literally be turned topsy-turvy.

However, as mentioned previously, the computation of cost basis is not always straightforward. Seldom does the value of property remain fixed; in many cases the value fluctuates over time as the market goes up and down. An asset's basis can decrease or increase depending on the way its value fluctuates over the course of its life. If an asset either improves or declines in value it acquires an *adjusted basis* which is then used to compute the correct amount realized from its sale.

Manner of Acquisition

When property is not acquired through a traditional sale the determination of its cost basis is more involved. For instance, when property is acquired through inheritance, the cost basis of the property is its fair market value at the time of the decedent's death. And when property is transferred by gift or trust, the cost basis can either be directly carried over from the donor (i.e. *transferred basis* or *carryover basis*) or it can be the fair market value of the property. Hence, these other means of acquiring assets add complexity to the determination of cost basis.

Final Thoughts

Basis is a foundational concept in U.S. tax law as it is used constantly to determine the true amount owed from sales. Although it is simple to understand in its most basic applications, it can be a bit subtle depending on the particular circumstances. We will explore this interesting concept in greater depth in a later post.

The Tax Benefits of the Legal Profession

Published on July 8, 2016

Few occupations receive as much attention as the legal profession. Lawyers hold a high position on the occupational totem pole and are regularly portrayed as characters in a variety of media – films, television shows, books and others. Historically, the legal profession has possessed a considerable amount of prestige and many of our most talented citizens aspire to work in law in one capacity or another. Along with prestige, the legal profession has also been regarded as one

of the surest routes to financial success. As it turns out, there are a variety of tax benefits lawyers may utilize to strengthen their financial condition. In this article we will discuss several of these benefits.

In order to develop their practice, lawyers regularly conduct formal business discussions with prospective clients and other professionals. Occasionally, these discussions occur just before or after some form of entertainment (such as a show, sporting event, etc.). Fortunately for lawyers, these entertainment expenses are deductible. However, under section 274 of the Internal Revenue Code, lawyers must comply with multiple requirements in order to deduct these expenses: they must be able to thoroughly substantiate the expenses (i.e. who was entertained, when did the entertainment occur, etc.), and they must also prove that there was a clear association between the entertainment and the business discussion.

Travel expenses incurred by lawyers are also deductible. As with entertainment expenses, travel expenses must be fully substantiated. The IRS is quite strict about these types of deductions and so it is imperative that lawyers keep excellent records of every individual expense.

Lawyers have to conduct a lot of research throughout the course of their practice and as a consequence they spend considerable sums on books, periodical and research software. The cost for books and subscription services which have a useful life greater than one year may be depreciated over a five year period; software is not considered depreciable and must be amortized over a three year straight line period. If a lawyer purchases books, periodicals or software on an annual subscription basis – thus making these materials accessible for one year at a time – then these expenses would be deductible in the normal fashion.

Another tax issue which lawyers must be aware of relates to client based expenses. It is not uncommon for lawyers to advance money to clients or to incur expenses on direct behalf of clients. If money is advanced to the client, this is treated as a loan for tax purposes and so it cannot be deducted. However, there is an important exception to this rule: if a lawyer incurs expenses on behalf of a client as part of normal operating procedure and then fails to receive reimbursement then these expenses become deductible. An example of this would be expenses such as postage and photocopies. These expenses are supposed to be charged to clients, but if a lawyer is somehow unable to collect payment for them then they may be written-off as "bad debts."

These are just a few of the tax perks available to lawyers. In addition to these benefits, lawyers also need contemplate other tax related issues such as entity selection (or business structure), client trust funds, client-related expenses, accounting methods and others as well.

The Basics of Starting Your Own Business

Published on July 7, 2016

Starting a new business is an exciting, life-altering endeavor. Historically, it has been America's entrepreneurial spirit which has pushed us along from the days of the general store up to the bustling multistate corporation. Whether self-taught or equipped with an MBA, all aspiring entrepreneurs have to be aware of a number of

essential points when setting up a brand new business. In this article we will discuss in detail several of these points.

One of the first – and most important – things an aspiring entrepreneur must consider is business structure. That is, future businesspeople must decide which business entity is most appropriate for them. Aspiring business owners can choose between the following options: sole proprietorship, LLC, partnership, C Corporation and S Corporation. Depending on the details of a person's circumstances, each of these options has the potential to be optimal. The sole proprietorship is the easiest entity to set up; however, one drawback of the sole proprietorship is that profits are subjected to the employment tax of 15.3 percent. Before selecting an entity, be sure that you consider every relevant aspect of your situation and then make the decision accordingly.

Another important item for businesspeople is name selection. When creating a new business, the future business owner cannot simply choose any name which suits his or her fancy; the businessperson must select a name which has not already been registered with the state. Whatever name a person decides on, the name must be unique. For this reason, before settling on a particular name, it is important to search your state's website in order to see whether a given name has already been chosen. Business owners will also need a license before they can begin any commercial activity. Licensing requirements vary state to state and so it is incumbent upon aspiring entrepreneurs to determine the specific requirements which apply in their state.

In the majority of cases, future business owners also need to procure an Employer Identification Number (EIN). EINs are required for corporations, partnerships and all businesses which have employees. Sole proprietorships and single-member LLCs with zero employees are

not required to obtain an EIN. The simplest way to obtain an EIN is to apply online on the website of the IRS; applying online will allow businesspeople to receive their EIN immediately. Business owners can also print out a paper application and then mail the form (known as SS4) directly to the IRS.

These are just several of the essential steps an aspiring businessperson must take in order to establish a new business. In addition to these steps, future entrepreneurs will also need to consider a few other things; they will need to determine what accounting method they will use, whether their business is considered a business or a hobby by the IRS, how to add employees, business taxes and so forth. If you'd like to pursue these issues in greater depth, check out the presentation given by our CPA Jessica Chisholm.

Tax Deductions for Engineers, Architects & Construction Professionals

Published on June 28, 2016

Careers in engineering, architecture and construction all have the potential to be extremely rewarding. Though these professions may emphasize different skill sets, they are similar in one very important dimension: all of these fields involve building new things from scratch. There is a creative process inherent to these fields which attracts workers who are not merely bright but also driven to see theoretical projects transmitted into physical reality. Professionals in engineering, architecture and construction play a vital role in our society as they develop and maintain the infrastructure which allows our economy to

function successfully. Given their important role in our society, it is not surprising that there are a variety of tax deductions available to professionals in these fields. In this article we will cover two of these deductions.

Engineers, architects and construction professionals may take advantage of the so-called “meals and entertainment” deduction. This deduction is designed to stimulate business activity and also promote productivity while on the job. With this perk, professionals from these fields may deduct 50% of their meals and entertainment costs on their tax return. However, there is one exception to this rule: if an employer provides a meal to his employees as a matter of convenience, then the cost is 100% deductible. This exception may come up if there are no eating establishments nearby a job site and the boss does not wish to risk his employees returning late from a meal break.

This deduction may be utilized when professionals engage in business discussions during the course of a meal. However, people who wish to use the deduction in this manner must be able to provide specific information regarding the occasion (i.e. who was entertained, where and when did the meal occur, why did the meal occur, what was the cost, and so forth).

Another perk available to professionals in these fields is the Domestic Production Activities Deduction (or the Section 199 Deduction). The DPAD is a very significant tax break which incentivizes professionals to operate on projects within the United States. With this perk, entities may take a 9% (as of the current year) deduction on net profit derived from engineering, architectural and construction services performed within the U.S. However, the amount of this deduction may not exceed 50% of W-2 wages, and this includes wages paid to the owner.

These are just two of the deductions currently available to engineering, architecture and construction professionals. To learn more about these and other deductions for professionals in these fields, be sure to read the transcript of the webcast by our CPA Jessica Chisholm.

The Tax Issues of the Medical Field

Published on June 22, 2016

When entering their chosen field, medical professionals mull over a number of important concerns. They think about their compensation; they ponder the frightening hours they may have to work; they think about the impact they will make on the lives of their patients. Rarely, if ever, do they wonder about the various tax issues which affect the medical field. As it turns out, tax matters should figure more prominently in the minds of medical professionals, because a sound education on the tax issues of the medical field can translate into thousands of dollars in savings. In this article we will cover some of the most substantial tax matters relative to the medical field.

One of the most significant tax issues facing medical professionals is entity selection. Medical professionals have four options to choose from when setting up their medical practice: sole proprietorship, limited liability company (LLC), C corporation and S corporation. Whether one of these entities is the most beneficial selection inevitably depends on the particular facts of a given case. For one professional, an LLC partnership may be the optimal route; and for another an S corporation may be the best choice. It is important that

medical professionals make an informed decision when establishing their practice because choosing a suboptimal entity can have severe financial repercussions.

Another noteworthy tax issue is the equipment deduction. The equipment used in the medical field is often very expensive and so the tax code has been designed to lessen the burden imposed by such costs. Professionals who choose to lease their equipment may deduct the full price of the lease on their return. If a doctor leases a high-tech medical device for $500 per month, he may deduct the total cost associated with this lease at the end of the tax year. Equipment which is bought may not be deducted outright but must be depreciated over the course of its useful life. In certain cases, section 179 may be invoked for the purpose of writing off the full value of equipment purchases right away. However, section 179 may not always be viable and so if a person wishes to invoke this section they should consult with a tax professional.

These are just a couple of the tax issues pertinent to the medical field. In addition to these issues, medical professionals should also be aware of the deferral of payroll taxes available to owners, the issue of hiring family members, the home office deduction, the auto deduction and other issues as well. For more information, view the transcript from our webcast on medical professionals here.

The Tax Benefits of Real Estate Ownership

Published on June 17, 2016

Most people — even those among the so-called millennial generation — would like to own property at some point in their lives. Since it relates to both our drive for prosperity as well as our abundance of space, there is something about real estate ownership which gives off a thoroughly American impression. As Americans, material success has always been among our primary concerns, and home ownership is a clear indication of such success. What's more, home ownership also has symbolic value as it represents stability. And in a land of such frenzied activity having a sense of stability can be a source of great pleasure.

What not all Americans realize, however, is that real estate ownership offers a number of important tax benefits which are unavailable to renters. And among those who have some sense of the benefits of home ownership very few are aware of exactly how advantageous these benefits can be. As it turns out, there is a whole range of perks available to those who own property. Property owners who take advantage of these perks can save a great deal of money.

For instance, property owners are able to deduct a number of items on Schedule A of their personal 1040. Individuals are able to deduct mortgage interest (on the first $1 million of home acquisition debt and the first $100,000 of home improvement debt), qualified mortgage insurance, real estate taxes, and the points paid when purchasing or refinancing. Individuals who sell their home may be able to exclude up to $250,000 ($500,000 if married and filing jointly) provided they meet the requirements of the Principal Residence Exclusion.

People who own rental property are able to take deductions for a variety of expenses which they may incur throughout the course of ownership. Advertising, cleaning bills, utilities (when the rental

property does not have a tenant or when utilities are included in rental price), mortgage interest, homeowners insurance and property taxes are all deductible. Repairs to rental property are deductible as well, while improvements to rental subject must be capitalized and then depreciated over their useful life.

There are many other benefits which may be derived from real estate ownership. For more information, view the resources from our webcast here.