

NOTES ON THE ANSWERS TO FALL 1988 TAXATION EXAM

Question 1

I. The amendment has two important consequences. First, it allows taxpayers to take deductions currently that should be deducted in future years. Second, it allows taxpayers earning little or no income from artistic endeavors to use their expenses relating to those endeavors to offset income from the sources. It probably should be considered a tax expenditure because its purpose is to encourage and subsidize artistic activities.

II. **For.** Assuming that the market undervalues artistic endeavors, the special rules would increase welfare by increasing creative activities. It would also simplify tax accounting for some artists.

III. **Against.** Like most tax expenditures, it gives greater benefits to high-bracket artists than to low-bracket artists and gives no benefits to poor, struggling artists. It increases hobby-loss problems, and it presents some difficult line-drawing problems.

IV. The statute seems to prevent technical writers from obtaining benefits. This result may be justified, on the ground that the market properly values technical writing.

V. The language of the Code opens up the possibility of jewelers claiming the deduction, notwithstanding the legislative history. Obviously the special rule should not apply to manufacturers, but the line is hard to draw.

VI. The amendment is not justified on policy grounds. It reflects the inability of Congress to hold firm against a persistent lobby when the amount of revenue involved is relatively small.

Question 2

(1) **Consistent.** Under Section 21(d)(2), the couple gets the full credit allowable under Section 21 if one spouse works and the other is a full-time student.

(2) **Consistent.** The credit indirectly taxes imputed income by giving a tax benefit to couples presumed to have below

average amounts of such income. It is plausible to assume that couples comprised of a spouse working full-time in the marketplace and a spouse going to school full-time have lower imputed income than the typical one-job couple.

(3) **Inconsistent.** Giving a credit for a woman who goes to school does nothing to remove a barrier to that woman's participation in the workforce.

(4) **Inconsistent.** If the objective is to encourage education, the requirement of being a full-time student is irrational.

Question 3

The Code excludes all of the payments to Q under IRC Section 104. The proper result would be to include in income 20% of each payment representing lost wages plus the interest component of the remaining part of each payment.

Tank Truck is prohibited from claiming a deduction until the payments are made under IRC Section 461(h)(1) and (2)(C)(ii). The proper result would be to allow a deduction for the present value of the future obligation in the year of the settlement.

The harsh treatment of Tank Truck offsets the favorable treatment of Q, producing an overall result for the government that is acceptable. Presumably the negotiations between TT and Q will take tax consequences account, thereby producing a reasonably fair tax result.