

The Tax Court Cases You Have to Know About

RACHEL PAPPY
CO-OWNER POLSTON TAX

United States v. Michael Balice

- ▶ Michael and Marion Balice owed taxes for several years.
- ▶ In 1994, the Balices attended a seminar on creating a trust to protect your assets when you owe taxes.
- ▶ The Balices executed a quitclaim deed to place their property in a trust.
- ▶ The IRS wanted to foreclose on the property that was held in trust.

What Did the Court Say?

- ▶ Was consideration paid?
- ▶ Was the property transferred in anticipation of taxes due?
- ▶ Did the transferor continue to use the property?
- ▶ Did the transferor retain enjoyment and benefits of the transferred property?
- ▶ Was there a close relationship between the transferor and trustee?
- ▶ Was the transfer recorded?

United States v. Robert Welemin

- ▶ Bob Welemin was unable to pay the \$1,000 per month rent for the house he lived in that was owned by a Trust.
- ▶ Bob offered to do handyman maintenance services and repairs for the eight-unit apartment building and sixteen family homes owned by the Trust.
- ▶ The Trust agreed to this arrangement and Bob provided maintenance and repair services in lieu of \$1,000 per month rent.
- ▶ At the end of the year, the Trust issued Bob a 1099-MISC in the amount of \$12,000.
- ▶ Bob disagreed with this amount and did not claim it on his tax return.

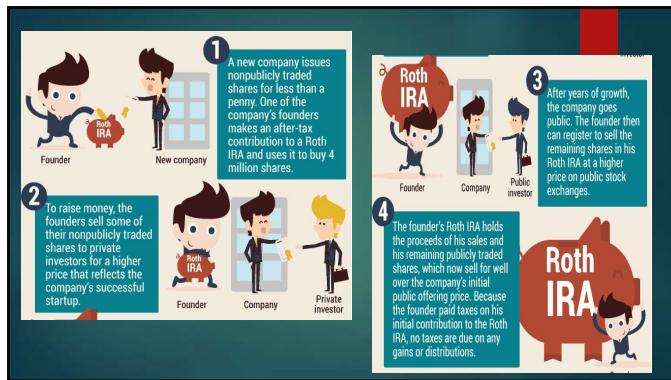
What Did the Court Say?

- ▶ Prior to the case arriving in Tax Court, the Trust issued a corrected 1099-MISC in the amount of \$7,275.
- ▶ The Trust is unsure why the reduced this amount to only \$7,275.
- ▶ Bob argued that the income was not taxable because it was lodging provided by the employer, for the convenience of the employer.
- ▶ The Trust argued that Bob was an independent contractor and was not required to stay at the property.
- ▶ The Court agreed with the Trust and found Bob responsible for \$7,275 in taxable income that was not claimed on his tax return. A 20% failure to report penalty was assessed against Bob as well as the taxes due on the taxable income.

Government Accountability Office

IRAs with over \$1mil in assets

IRA balance	Estimated number of taxpayers
\$1 million or less	42,382,192
> \$1 million to \$2 million	502,392
> \$2 million to \$3 million	83,529
> \$3 million to \$5 million	36,171
> \$5 million to \$10 million	7,952
> \$10 million to \$25 million	791
> \$25 million	314



Summa Holdings Inc. v. Commissioner

- ▶ Congress designed "Domestic International Sales Corporations" to incentivize companies to export their goods by deferring and lowering their taxes on export income.
- ▶ Summa Holdings is the parent corporation of a group of companies that manufacture a variety of industrial products.
- ▶ In 2001, the beneficiaries of the Clement Benenson Trust each established a Roth IRA and contributed \$3,500 each.
- ▶ Each Roth IRA paid \$1,500 for 1,500 shares of stock in JC Export, a newly formed DISC.
- ▶ JC Holding purchased the shares of JC Export from the Roth IRAs.
- ▶ Each Roth IRA owned 50% of JC Holding, which was the sole owner of JC Export.

How the tax savings occurred:

- ▶ Summa Holdings paid commissions to JC Export, which distributed the money as a dividend to JC Holding, its sole shareholder.
- ▶ JC Holding paid a 33% income tax on the dividends, then distributed the balance as a dividend to its shareholders – the two Roth IRAs.
- ▶ From 2002 to 2008 \$5,182,314 was transferred from Summa Holdings to the Roth IRAs.
- ▶ The IRS issued Notice of Deficiencies on this income.

What did the Court Say?

- ▶ The IRS argued "substance over form" doctrine, and argued that this setup was a sham.
- ▶ The Tax Court agreed.
- ▶ However on appeal, the United States Court of Appeals for the Sixth Circuit disagreed.
- ▶ They found that this setup was not a sham, and was a literal interpretation of the law as written.
- ▶ If the IRS did not like the application of the law, Congress could rewrite it, but the court would not interpret it differently for their benefit.

Questions?

