

Free research paper on memorandum

[Law](#), [Criminal Justice](#)



RE: Mr. and Mrs. Julio Zavala

I have reviewed the memo regarding the requests of Julio and Clara Zavala regarding their taxes. The couple is married. He has enough money at his disposal that he was able to quit his 9 to 5 job and travel extensively. Here is a summary of the four main tax issues according to the information you provided. The first issue to consider is whether or not Julio Zavala's expenditures can be considered as tax deductions. These trips were combination of work objectives and leisure activities to entertain his potential clients who are also old friends. His activities have resulted (a) in no board appointments, (b) a small amount of consulting fees for tax advice he provided, and (c) receipts for large expenditures for travel and entertainment Mr. Zavala assumes are deductible. The second issue to consider are whether Clara Zavala's expenditures can be considered as tax deductions. Mrs. Zavala travelled with her husband part of the time in order to research a book she is writing. The third issue is whether or not health recovery costs can be considered business costs. The couple were ill in Argentina and want to deduct the fees they paid for the drugs and a spa-like treatment facility they needed. The drug was not FDA approved and cost a total of \$30, 000 (\$15, 000 each). The stay at the facility cost a total of \$22, 400 (14 days at \$800 per day per person). Mr. Zavala's rationale for taking a business deduction for the total expenditure of \$52, 000 (\$30, 000 + \$22, 400) was because his reason for being in Argentina by invitation of a former banking client. No clear business collaboration was in the invitation ("at the request of a former banking client with whom he hoped to do business"). The fourth issue is the status of the fees paid to a teacher for their autistic son.

The son, Robin, is 28 years old. The teacher works with Robin about 15 hours each week. The teacher has two similar clients with similar needs.

TAX ISSUES

Both Mr and Mrs. Zavala are combining work and leisure travel. Mr. Zavala is looking for potential clients from a pool of former colleagues therefore are his efforts an extension of his former job or a new business. He quit his job due to his substantial savings. Mrs. Zavala is researching a book she is writing about the people she interviews on the trips. The potential clients and interviewees are also friends of Mr. Zavala. Her status as an author needs to be established. The health costs must be evaluated on their status as being paid - in another country, for treatment in a spa-like facility and for a pharmaceutical that is a non-FDA approved drug. Mr. Zavala contends these medical costs should be considered business costs because the couple was on a business trip. Consideration of tax deductions for the fees of Robin Zavala's teacher will have to be based on his age, medical condition and the possibility of an itemized deduction on the taxes. These are the tax issues that need to be addressed.

IS MR. ZAVALA CONDUCTING A TRADE OR BUSINESS?

Unfortunately the US tax code does not define ' trade or business.' Although Mr. Zavala seems to have an undetermined amount of intent to earn money it is not clear that he has started a business (Commissioner v. Groetzinger, 480 U. S. 23 (1987)) In Jackson v. Commissioner the general test used to determine whether a person has a " trade or business" (IRC § 162) means determining the seriousness of profit making as a goal and making a profit is

the “ primary purpose and intent.” (Jackson v. Commissioner [89-1 USTC ¶ 9123], 864 F. 2d 1521, 1525 (10th Cir. 1989)) it is necessary to clearly prove that expenses are “ incurred in the pursuit of business of the taxpayer’s employer.” Jackson v. Commissioner [89-1 USTC ¶ 9123], 864 F. 2d 1521, 1525 (10th Cir. 1989) (Oct. 22, 1980) BACK REFERENCES: 85FED ¶3237. 10 Mr. Zavala claims to be self-employed as a private financial consultant but brought forward only one project that he had accomplished.

IS THERE INTENT TO MAKE A PROFIT?

The taxpayer needs to demonstrate a clear intention of seriously being involved in start-up or on-going business activities; that requires a clear motive for making a profit. Samuel E. and Frances G. Eastman v. The United States, United States Tax Cases (1913-1999), [80-2 USTC ¶ 9742] U. S. Court of Claims (Oct. 22, 1980). The serious intent to make a profit can be considered as criteria for whether or not Mr. Zavala is conducting a trade or a business. Commissioner v. Groetzinger 480 U. S. 23 (1987) established that proof of business depends on “ whether the taxpayer’s primary purpose and intention is engaging in the activity to make a profit.” Also the taxpayer must be involved in the activity with continuity and regularity and with the primary purpose of realizing a profit.

WHAT EXPENSES CAN BE DEDUCTIBLE? IS IT A START-UP BUSINESS OR IS IT ONGOING?

The 26 USC § 162 states that “ travelling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business” are allowed as deductions. IRC sect. 163 allows for

tax deductions “ for expenses paid or incurred during the taxable year” provided they were for trade or business activities. 26 U. S. C. §162(a) was cited in the case Owens v. Commissioner [78-1 USTC ¶ 9144] 568 F 2d 1233, 1243 (6th Cir. 1977). The taxpayer was not allowed deductions because the expenditures were found to be for a hobby and not for business purposes. Travelling may be a hobby for the Zavalas rather than a genuine effort to gain a profit from a business. USC 26 Rule 162(a) states that “ Deductions are a matter of legislative grace, and taxpayers bear the burden of establishing entitlement to any claimed deduction.” Taxpayers must prove their case so establishing proof is the taxpayer’s responsibility. (Hilvering v. Taylor [35-1 USTC ¶ 9044], 293 U. S. 507, 515 (1935)); (INDOPCO, Inc. v. Commissioner, 503 U. S. 79, 84 (1992))

Capitalization of expenditures for the purpose of deduction for start-up expenditures, according to 26 USC § 195 is based on the amount of money expended and the amount of time after the trade or business has started. According to the Internal Revenue Code (I. R. C.) §162 in general “ no deduction shall be allowed for personal, living, or family expenses” however I. R. C. 26 U. S. C. §162(a) notes the two following details: taxpayers may deduct “ ordinary and necessary expenses” spent paid or incurred during on a business may include expenses for travelling if the travel is necessary for the business. For the court case Commissioner v. Flowers [46-1 USTC ¶ 9127] 326 U. S. 465 (1946) the Supreme Court set conditions which must be satisfied in order to deduct travelling expenses under the category of business expenditures. The first it is that only “ reasonable and necessary travelling expenses are acceptable.” This has yet to be proved because the

boundary between business and entertainment of his friends is blurred. The second is that the taxpayer must incur the expenses “ while away from home. The third criterion is that the expenses claimed must be directly linked to meeting business and/or trade goals. [Commissioner v. Flowers [46-1 USTC ¶ 9127], 326 U. S. 465 (1946)]

It is necessary for a taxpayer to prove deductibility for expenses are the appropriate receipts and other substantiation . The deductibility criteria for business travel expenses must meet the appropriate statute of limitations and the appropriate level of substantiation. Also the “ propriety of deducting travel expenses incurred on non-working days” must be taken under consideration. The Opinion of the Court noted that expenses incurred by Mr. Balunas, a free-lance consulting engineer, for weekend trips, “ certain medical expenses, entertainment and travel” that was not properly substantiated. The I. R. S. considered the disputed costs as “ non-deductible commuting expenses but the Tax Court considered them in the context of substantiation. (Vincent W. Balunas and Helen L. Balunas, Appellants v. Commissioner of Internal Revenue, [76-2 USTC ¶9774], U. S. Court of Appeals, Third Circuit, (Oct. 12, 1976))

A married couple, Debra L. Streck and Donald W. Streck, Petitioners-Appellants v. Commissioner of Internal Revenue, Respondent-Appellee (CA-6), U. S. Court of Appeals, 6th Circuit, 98-1064, 6/16/99, 153 F. 3d 445 wanted to deduct expenditures for a ranch property they owned. The evidence available demonstrated that the ranch was used for personal activities. “ No journals, ledgers, invoices, or cancelled checks” were presented to substantiate their claims. This is an example demonstrating

that Mr. Zavala must substantiate his claims. The court found that the Strecks were claiming a hobby was a business so they were allowed the deductions they were requesting. The same judgement was made in a related decision. Francis A. and Mary Joan Blake's "claimed deductions for cost of goods sold, rent, legal fees, insurance, commissions and depreciation" were all denied. The failure to substantiate their claims resulted in a couple's denial of taking deductions for ordinary and necessary business expenses.

(USTC Cases, United States of America, Plaintiff v. Francis A. Blake and Mary Joan Blake, Defendants., U. S. District Court, E. D. Michigan, 2011-2 USTC ¶50, 760, (Dec. 12, 2011))

STATUS OF CLARA ZAVALA'S ACTIVITIES

Authors also need to use their residence as the address for the income tax payments. Mrs. Zavala claims that her travelling expenditures count as business deduction because she needs to travel to to research for her book. Another author though, lost his case when he moved to another area and travelled for his writing job. Arthur Crossland, a technical writer, was denied deduction of travelling expenses in an opinion of the Tax Court because during the time under question the only home address was a Pennsylvania home where he no longer lived due to a divorce. The request to deduct travel expenditures was also turned down in the appeals court. (United States Tax Cases (1913-1999), [76-1 USTC ¶9188], Arthur and Susan Crossland, Appellants v. Commissioner of Internal Revenue, (Dec. 18, 1975) and [Code Sec. 162].

An example of what is necessary for substantiation for a writer researching a

<https://assignbuster.com/free-research-paper-on-memorandum/>

book is R. L. Vitale. Mrs. Zavala must gather the materials to substantiate her expenses for the writing of her book will need to be carefully done with an eye to detail. The writer, Ralph Louis Vitale, Jr. was allowed to deduct “ three fifths of his claimed costs, including meals, and lodging expenses.” He had detailed records of his expenses which he offered to the court as substantiation. One of the Judges, Judge Fay explained the criteria used to consider discrepancies in two years of Federal Income Tax declarations related to the profession of writer. It needed to be established if during the years cited in the case the taxpayer was a writer and if that is true than it needs to be established if the expenses claimed as deductible are in fact “ ordinary and necessary under section 162.” The plaintiff’s travel expenses need to be substantiated in accordance with section 274(d). The findings of fact for the case included details of Vitale’s career path including his writer related studies and activities as a student and professional. His experience as a writer and published author were reviewed. A review of a journal he kept to record the process of researching for the book was also considered. (Ralph Louis Vitale, Jr. v. Commissioner, U. S. Tax Court, CCH Dec. 53, 346(M), T. C. Memo. 53, 346(M), 77 T. C. M. 1869, T. C. Memo. 1999-131, (Apr. 21, 1999))

MEDICAL COSTS INCURRED IN ARGENTINA

It is not clear that Mr. and Mrs. Zavala have shown a link between their illness and their business activities. The business activities are the gaining of potential clients or a position for Mr. Zavala and researching a book for Mrs. Zavala. But deductions for medical costs while travelling on business must be directly linked to business activities. “ The expense must be incurred in

pursuit of business. This means that there must be a direct link between the expenses paid and the relationship to the business (or trade). It must be demonstrated that the money spent is needed and that the expenditures are appropriate to trade. (Commissioner v. Flowers [46-1 USTC ¶ 9127], 326 U. S. 465 (1946), the Supreme Court.)

The archives did not show tax cases that address a business deduction taken for medical costs for a drug that is considered illegal in the US. The drug the couple took when they were ill has not been approved by the United States Federal Drug Agency (U. S. F. D. A) so perhaps some insight into its status as a deductible medical expense can be deduced by reviewing a marijuana case in California. Marijuana is considered a controlled substance in the same classification as heroin by the federal government. Some state governments have allowed marijuana use for medicinal purposes though. An organization providing care giving and medical marijuana for its clients was denied deducting the expenses for the marijuana. Judge Laro explained that care giving and providing medical marijuana are two separate trade or business activities. Therefore it was decided that based on sec. 280E, I. R. C. and sec. 280E, I. R. C. “ does not preclude the organisation from deducting” those expenses which can be proved to be necessary for the care-giving services which were provided. (Californians Helping to Alleviate Medical Problems, Inc. v. Commissioner, U. S. Tax Court, CCH Dec. 56, 935, 128 T. C. No. 14, 128 T. C. No. 173, (May 15, 2007) U. S. Tax Court, Dkt. No. 20795-05 , 128 TC 173, May 15, 2007).

ROBIN ZAVALA'S TEACHER'S FEES

IRC 26 USC § 263(2b) addresses the issue of capital expenditures. The definition for ' family' according the rule is " the taxpayer, the spouse of the taxpayer, and any of their children who have not attained age 18 before the close of the taxable year." Robin Zavala is an adult child with autism. His age is 28 years. The earned income credit for a qualifying child is addressed in the itemized deductions section of the tax form. The earned income credit only covers children under the age of 21 years, not adult children. (The Domestic Volunteer Service Act of 1973, as amended, Pub. L. 93-113, Oct. 1, 1973, 87 Stat. 396, 42 U. S. C. 4950 et seq. 45 CFR 2552. 12 definitions) Social Security is available for adult children with severe disabilities but income and the status of parents determines qualification. The income of his parents was not included in the memo but they do not seem to be physically or mentally disabled in any way from the information given. If Robin is receiving Social Security the rules of deductions on Social Security payments apply. (Louis W. SULLIVAN, Secretary of Health and Human Services, Petitioner v. Brian ZEBLEY et al. 493 U. S. 521 (110 S. Ct. 885, 107 L. Ed. 2d 967) Louis W. SULLIVAN, Secretary of Health and Human Services, Petitioner v. Brian ZEBLEY et al. No. 88-1377. Decision - Feb. 20, 1990.)

CONCLUSIONS AND RECOMMENDATIONS

Good faith must be shown that the purpose of the expenditures he is submitting for deductions were spent in order to make a profit Goetzer v. Commissioner

1. A clear intent to make a profit for Mr. Zavala's business needs to be established by proving a routine purposeful agenda. To show that profit is a

motive for the business consistency in the efforts to establish a business need to be demonstrated.

2. Mr. Zavala needs to substantiate whether or not he is active in an ongoing business or seriously establishing a start up business. Detailed records need to be made available to prove that travelling is indeed a business activity and not a leisure activity/hobby. The expenditures that will be deemed deductible will be established by the proof he provides.

3. It is unlikely that Mrs. Zavala will succeed with her claim that she must travel to research the book she is writing. Unless she has more proof of being a professional writer than the two books she wrote about her children, the claim that she is legitimately a write by profession will not be taken seriously. The travel expenses for researching her book have not been shown to be necessary for writing the book. She could interview her interviewees over the phone or Skype. She does not need to travel to gather the data she needs.

4. No link between business and the couple's illness which occurred outside the borders of the US has been demonstrated. The chance that the drug they took to cure their illness can be considered a business deduction is highly unlikely. The expense to pursue a business deduction for the money spent to recover is not realistic.

5. Finding a ruling that would allow the couple to deduct the teacher's fees for Robin Zavalas' teacher does not seem realistic. There does not seem to be a precedent that is similar to the situation. The fact that the couple travels extensively and leads a comfortable life style while travelling precludes an opportunity for them to deduct Robin's teacher's fees.

References

Primary

Appellants v. Commissioner of Internal Revenue, Vincent W. Balunas and Helen L. Balunas, [76-2 USTC ¶9774], Statute of limitations (Oct. 12, 1976), U. S. Court of Appeals, Third Circuit, (Oct. 12, 1976); Vincent W. Balunas and Helen L. Balunas, Appellants v. Commissioner of Internal Revenue (CA-3), US Third Circuit, Court of Appeals, [No. 75-2086, 10/12/76] 34 TCM 860, Dec. 33, 281(M), TC Memo. 1975-199 [Code Secs. 162, 6211, 6501, and 7482--result unchanged under '76 Tax Reform Act--and Tax Court Rule 41])

Californians Helping to Alleviate Medical Problems, Inc. v. Commissioner, U. S. Tax Court, CCH Dec. 56, 935, 128 T. C. No. 14, 128 T. C. No. 173, (May 15, 2007) U. S. Tax Court, Dkt. No. 20795-05 , 128 TC 173, May 15, 2007.

[Appealable, barring stipulation to the contrary, to CA-9.—CCH.] [Code Secs. 162 and 280E] Retrieved from the Tax Court Regulars Archive.

Commissioner v. Flowers [46-1 USTC ¶ 9127], 326 U. S. 465 (1946)

Commissioner v. Groetzinger, [480 U. S. 23] (1987)

Domestic Volunteer Service Act of 1973, as amended, Pub. L. 93-113, Oct. 1, 1973, 87 Stat. 396, 42 U. S. C. 4950 et seq

Eastman, Samuel E. and Frances G. Eastman v The United States, [80-2 USTC ¶ 9742], U. S. Court of Claims, (Oct. 22, 1980)

Elverson v. Commissioner of Internal Revenue, T. C. Summary Opinion 2010-36 United States Tax Court. (Filed March 29, 2010.)

Helvering v. Taylor [35-1 USTC ¶ 9044], 93 U. S. 507, 515 (1935)

Jackson v. Commissioner [89-1 USTC ¶ 9 123], 864 F. 2d 1521, 1525 (10th Cir. 1989), (Oct. 22, 1980) Back References: 85FED ¶ 3237. 10 and 85FED ¶

3257. 25.

I. R. C. 26 USC § 146 - Volume cap

I. R. C. 26 U. S. C. §162 - Trade or business expenses

I. R. C. 26 U. S. C. §162(a) - Deductible Business Expense

I. R. C. 26 USC § 195 - Start-up expenditures

IRC 26 USC § 263(2b) - Capital expenditures and deductions

Streck, Debra L. and Donald W. Streck, Petitioners-Appellants v.

Commissioner of Internal Revenue, Respondent-Appellee (CA-6), U. S. Court of Appeals, 6th Circuit, 98-1064, 6/16/99, 153 F. 3d 445., Affirming the Tax Court 74 TCM 545, Dec. 52, 240(M), TC Memo. 1997-407 [Code Secs. 162 and 183] Back references: ¶ 8520. 517, 8520. 5875 and 12, 177. 70.

Sullivan, Louis W., Secretary of Health and Human Services, Petitioner v.

Brian ZEBLEY et al. 493 U. S. 521 (110 S. Ct. 885, 107 L. Ed. 2d 967) Louis W. SULLIVAN, Secretary of Health and Human Services, Petitioner v. Brian ZEBLEY et al. No. 88-1377. Decision - Feb. 20, 1990.

USTC Cases, United States of America, Plaintiff v. Francis A. Blake and Mary Joan Blake, Defendants., U. S. District Court, E. D. Michigan, 2011-2 USTC ¶50, 760, (Dec. 12, 2011) United States of America, Plaintiff v. Francis A. Blake and Mary Joan Blake, Defendants. U. S. District Court, E. D. Michigan, So. Div.; 09-14224, December 12, 2011. And 2011-1 USTC ¶ 50, 456. [Code Sec. 162] Back reference: ¶8520. 517.

United States Tax Cases (1913-1999), [76-1 USTC ¶9188], Arthur and Susan Crossland, Appellants v. Commissioner of Internal Revenue, Appellee ,
Traveling expenses: Away from home: Technical writer(Dec. 18, 1975), U. S. Court of Appeals, Second Circuit, (Dec. 18, 1975)[76-1 USTC ¶9188]Arthur

and Susan Crossland, Appellants v. Commissioner of Internal Revenue, Appellee (CA-2), U. S. Court of Appeals, 2nd Circuit, 75-4184, 12/18/75, Affirming Tax Court decision at, CCH Dec. 32, 820(M), 33 TCM 1278, T. C. Memo. 1974-277 [Code Sec. 162]

United States Tax Cases (1913-1999), [82-1 USTC ¶9285], Paul Snyder and Helen J. Snyder, Plaintiff-Appellants v. United States of America, Defendant-Appellee, Trade or business expense deductions and a profit motive for the profession of: Author (Mar. 30, 1982), U. S. Court of Appeals, Tenth Circuit, (Mar. 30, 1982)[82-1 USTC ¶9285]Paul Snyder and Helen J. Snyder, Plaintiff-Appellants v. United States of America, Defendant-Appellee (CA-10), U. S. Court of Appeals, 10th Circuit, No. 80-1564, 674 F2d 1359, 3/30/82). Back References: 82FED ¶ 1332. 1084 and 82FED ¶ 2006. 3589.

United States Tax Cases (1913-1999), [76-1 USTC ¶ 9188], Arthur and Susan Crossland, Appellants v. Commissioner of Internal Revenue, Appellee, Traveling expenses: Away from home: Technical writer(Dec. 18, 1975), U. S. Court of Appeals, Second Circuit, (Dec. 18, 1975)[76-1 USTC ¶9188]Arthur and Susan Crossland, Appellants v. Commissioner of Internal Revenue, Appellee (CA-2), U. S. Court of Appeals, 2nd Circuit, 75-4184, 12/18/75, Affirming Tax Court decision at, CCH Dec. 32, 820(M), 33 TCM 1278, T. C. Memo. 1974-277 [Code Sec. 162]

Owens v. Commissioner [78-1 USTC¶ 9144] 568 F 2d 1233, 1243 (6th Cir. 1977) Treasury Regulation 1. 183-2 IRC sect. 162 and sect. 212

United States v. General Dynamics Corp. [87-1 USTC ¶ 9280], 481 U. S. 239, 242 (1987)

Vitale, Jr., Ralph Louis v. Commissioner, U. S. Tax Court, CCH Dec. 53,

346(M), T. C. Memo. 53, 346(M), 77 T. C. M. 1869, T. C. Memo. 1999-131, (Apr. 21, 1999) U. S. Tax Court, Docket No. 346-97, TC Memo. 1999-131, 77 TCM 1869, Filed April 21, 1999 [Appealable, barring stipulation to the contrary, to CA-4.—CCH.] Retrieved from Tax Court Memoranda (Archive).

Secondary

(CCH) Federal Tax Court Database. Retrieved from <http://intelliconnect.cch.com.ezproxy>.

Crilly, William M., and Andrew J. Sherman. The AMA Handbook of Due Diligence. Revised ed. New York: American Management Association, 2010. Questia. Web. 10 Mar. 2013.

Holub, Steven F. "Year Tax Planning: CPAS Can Help Clients Cope with Multiple Tax Hikes Scheduled to Take Effect in 2013." Journal of Accountancy 214, no. 6 (2012): 48+. <http://www.questia.com/read/1G1-310867934>.

Internal Revenue Code. USA Congress. (2012). "Legal Information Institute." Retrieved from <http://www.law.cornell.edu/uscode/text/26>

Internal Revenue Service (IRS). (2011). "Lawsuits, Awards, and Settlements Audit Techniques Guide." Retrieved from <http://www.irs.gov/businesses/small/article/0,,id=248471,00.html>

Leagle™, Retrieved from <http://www.leagle.com>

Schnee, Edward J. "FLP Affirmed by Tax Court." Journal of Accountancy 209. 4 (2010): 51+. Questia. Web. 10 Mar. 2013.