

# Who Says Taxes Aren't Fun

By Robert W. Wood

To make tax lawyers interesting in *The Firm*, author John Grisham had to invent a Mafia-controlled law firm run amok in money laundering and murder. Hollywood hasn't rushed to grapple with real-life tax lawyers, but there are plenty of interesting things we do. Here are some real-life examples.

## Marriage to Divorce?

A division of property between divorcing spouses is tax-free, so neither spouse pays tax until they sell the divided property. What happens, though, if the couple isn't really married? You can't take advantage of this tax rule, which is why taxes in palimony and cohabitation disputes can be a nightmare.

This true-life story involved Mary and Bob, who were divorcing and dividing a pile of highly appreciated stock Bob acquired in a merger when he sold his company. A background check revealed that Mary was still married to someone else when she and Bob tied the knot. That "void" marriage meant if they divvied up the stock, one or both would be liable for a whopping tax.

Think zero basis stock worth \$100 million, divided 50/50. To get around this, sometimes simplest is best. You guessed it: the couple had a quickie marriage so they could immediately get a quickie divorce and divide the stock tax free. Vows about divorce and taxes, why not?

## Animals Have to Eat Too

In many states, sales tax isn't applied to food, but a restaurant meal or takeout is usually taxable. So is animal or pet food, but not purchases of raw human food. A wholesale produce seller had a contract to deliver fruits and vegetables to city schools, hospitals, and the zoo. Pet food is taxable, but the zoo got the same produce the hospitals and schools did.

State sales tax auditors hit the wholesaler with crippling back sales tax bills for produce delivered to the zoo. It was being consumed by animals, which made it taxable, they said. The zoo had snack bars and a cafeteria, but the wholesaler couldn't show which carrots and bananas were consumed by people and which by animals. It turned out that if you tell a supermarket checker the broccoli you are buying is for your dog, the clerk has no way to charge you sales tax. In the end, the state's position seemed unjust, even silly, and the produce seller was vindicated.

## Sex in Church?

Despite the separation of church and state, the IRS has the power to recognize a church and give it a tax exemption. For decades the IRS refused to recognize Scientology as a church, but the IRS eventually relented in the face of an avalanche of lawsuits. Sometimes, it is hard to take church claims too seriously.

Take the case of a different spin on religion offered by a group promoting orgies as religious fulfillment that wanted an IRS ruling that they were a church. From what I could tell—based solely on reading their materials—all they did during

their services was engage in wild sex that was supposed to energize their religious icon at the center of the room, I mean church.

## My Dog Ate My Homework

A one-page S election converts a regular C corporation into an "S corporation," which is taxed as a pass-through. Corporations without S elections face double taxation, one tax levied on corporate income, the other on shareholders when they receive dividends. So an S election is a corporate tax get-out-of-jail-free card. Like everything else in the tax system, there's a deadline too. What happens if you thought your S election was filed 15 years ago, but it turns out your dog ate it or true to our story, a spurned former girlfriend threw it away in spite?

Sam and Sally discovered this toxic tax problem when they were about to sell their company. Normally I'd say they were out of luck, but at times it pays to go hat in hand to the IRS. In this case, we had testimony the S election was prepared on time and that their lawyer—Sam's former girlfriend—was supposed to file it. Plus, the company's S corporation tax returns for 15 years proved Sam and Sally thought it was filed. This true story was compelling (and downright sizzling) enough that the IRS made an exception and made the S election retroactive.

## Hobby Horse

If you lose money in business, it's deductible against other income, so the government ends up covering a big chunk of your losses. In contrast, you pay for 100 percent of your hobby. If you spend major cash on a personal race car this year, you are out the cash. But if it is a business, your cost can drop by up to half. If you lose money more than three years out of five, you may have a hard time convincing the IRS you're in business and not a hobby.

Yet even some consistent losers can produce deductions. The hobby loss label can arise anywhere, but prime candidates are part-time farmers, horse operations, and race car drivers. I've seen dog shows, fishing consultants, sports agents, travel book writers, cultural anthropologists, stamp collectors, whippet breeders, recipe inventors and more. Tax lawyers are armchair travelers, defending quirky clients against the IRS.

## Suing Over Taxes

Private lawsuits raise lots of tax issues for everyone—plaintiffs, defendants and their lawyers. They call a tax lawyer, and sometimes, they should call sooner. Even after the settlement agreement is signed, problems can surface. When one employee and company settled employment litigation, the company filed IRS Forms 1099 reporting the payment. Miffed, the employee sued the company again, this time over tax reporting.

The IRS refused to intervene, leaving it to the parties to resolve. In fact, the IRS will never intervene in this kind of dispute, so tax lawyers are at the eye of the storm. It happens in arbitration too, disputes over Forms 1099, wage withholding, refusals to supply a Form W-9, backup

withholding, and more. These are messy, but interesting. One father and son sued each other five times over their big family company. How the company distributed profits and was taxed was key. The trial lawyers may get the glory and headlines, but hey, tax lawyers can be important too.

### **Conclusion**

Not every tax matter is quirky or interesting, but you might be surprised how many are. Tax considerations are everywhere, perhaps more so today than ever before. In 1961, JFK admonished that "the phrase 'it's deductible' should pass from our scene," but more than sixty years later, it's unlikely it ever will.

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