“Jingles-R-Us”

Simon, John, and Nick were best friends in college who played in a very cool synth-pop/glam rock band back in the day. After graduation, they went their separate ways and traded in their rock star dreams for respectable 9-to-5 jobs. But, after reuniting at their 20-year college reunion, they decided that, even though they didn’t have their “rock star” looks anymore, and even though they lived on opposite coasts (Simon and John were in LA, Nick was in NY), maybe they could join together and form a little side business to write jingles for commercials. They were excited to “get the band back together” and make music again. And, while the idea was mostly just for fun, deep down, the old friends really wanted to make a go of it and see if they could make a little money as musicians.

They tracked down their old groupie, Jennifer, who had since become a successful tax attorney, and asked her advice. She referred them to a colleague of hers who could help them draw up a business plan. They formed a partnership called “Jingles-R-Us.” Simon and John were responsible for writing the lyrics and the music, and Nick would focus on marketing the jingles.

Although they were very excited, in reality, the jingle business got off to a slow start. Since each of them retained their regular day jobs, it was tough to really devote the necessary time to the band. Nevertheless, each of them had spent significant amounts of money on instruments, software and equipment for mixing music, travel and dining expenses for wooing potential jingle buyers, and all manner of music-making and music-promoting accoutrements. They did manage to sell a jingle on occasion, but after 5 years of off-and-on effort, they had yet to turn a profit. Every year, when tax season came around, each band member reported their share of the partnership’s meager profits, and fully deducted all of their expenses as business expenses under section 162.

One day, the IRS came knocking. After an exam, the IRS concluded that the deductions were not allowable under section 162, and were instead limited by section 183, because the band members didn’t have the necessary profit motive. Their jingle business was really just a hobby. Simon, John, and Nick each received notices of deficiency, showing that they each owed an additional $30,000 to $40,000 in tax for the years under exam, and promptly called Jennifer for help.

Jennifer’s research on hobby losses revealed a variety of available case law on point; some positive, some negative. The Ninth Circuit – the court of appeals to which an appeal of Simon’s and John’s cases would lie – has clear negative authority on point, requiring that to get the full deductions under section 162, the taxpayer has to show that the activity was entered into with the “dominant hope and intent” of realizing a profit. The Second Circuit – the court of appeals to which an appeal of Nick’s case would lie – has similar tough language in a case, but the case is unpublished. In the Tax Court, in decisions appealable to other circuits, the case law is favorable to the band members. The Court of Federal Claims also has favorable case law, but the Federal Circuit has not yet ruled on this subject.

Scene 1 – Jennifer meets with the band members to discuss their options.

Scene 2 – Jennifer argues Nick’s case in Tax Court, as an S-case.

Scene 3 – The Tax Court considers adopting changes to the Golsen rule.

**SCENE #1**

Setting: Three band members meet with their attorney at the Law Office of Jennifer D. TaxLawyer

Cast:

Jennifer – TBD

Simon – TBD

Nick – TBD

John – TBD

SIMON: Thanks so much for meeting with us on short notice, Jennifer. We are all really bummed out about these tax bills, man.

JENNIFER: It’s no problem. I’m so sorry your grand plan for getting the band back together is giving you tax troubles and I’m really hoping I can help you guys out.

NICK: Anything you can do, man, because there is NO WAY I can pay this bill. After all the cash I’ve blown on new equipment, I just have nothing left.

JENNIFER: Why don’t you tell me a little about what happened? I know you guys got together at our 20-year college reunion a few years ago, and decided you wanted to look into starting up the band again to sell commercial jingles on the side. You formed the “Jingles-R-Us” partnership, with Simon and John writing the lyrics and music out in LA and Nick focusing on selling the jingles in New York. So, what happened next?

JOHN: Well, we were all really excited after the reunion, and each of us really wanted to make a go of it, right? When Simon and I got back to LA, it was all we could talk about. And Nick too, he spent all his spare time researching the jingle business, figuring out how he was gonna sell the great tunes I knew Simon and me were going to come up with. We all sunk a load of cash into buying all new equipment to make music. I mean, it was only a part-time thing, since we each had day jobs, but we really wanted to do it.

SIMON: Yeah, so the first year, was pretty much just getting our groove back, right? John and I met up every few weeks or so, on the weekends, to just jam and think about music, you know?

NICK: Well, I was actually pretty nervous at first, because we were spending so much money before we’d even had a single song written, let alone sold. But eventually, we made some catchy jingles, and I schlepped them around New York and finally, in our second year, we started selling them. We sold 3 jingles that year and made a nice profit. But the next couple years, we only sold 1 jingle, and last year we didn’t sell any.

JOHN: The jingle business was harder than I expected it to be, and I think our enthusiasm waned a bit.

SIMON: Yeah, it was hard to really focus on it, since we all have full-time jobs and families and everything. Maybe our rock star days are over.

NICK: So, one day, we each got a letter from the IRS saying our returns were selected for examination. I also got laid off at work on the same day, so it was a pretty rough time.

JOHN: Look, we gave the IRS everything. We had receipts for all of our expenses, we had our partnership agreement, and I know Nick kept a ton of records of every networking event he attended and all of his efforts to sell our jingles.

SIMON: And John and I had records of all of our time spent composing music. So, I figured it was all a big misunderstanding and the IRS would say we did everything right.

NICK: But that’s not how it went at all. Next thing we knew, we got these Notice of Deficiency things in the mail, and now I owe $40,000 plus interest for three years of back taxes??? I can’t take this, man!

JOHN: Yeah, according to the IRS, we aren’t in the music business. Our big rock n’ roll jingle domination plans are just a “hobby.” So not cool of them to judge us like that, man.

JENNIFER: Ok, try not to stress. I’ve handled many hobby loss cases over the years and I think I can help you guys. There are a couple different ways to litigate tax issues like this. One option is to pay the tax that the IRS says you owe, and then file a refund suit in district court. Or, there is a pre-payment option, where you don’t have to pay the tax right now, and you can litigate the deficiency in the U.S. Tax Court.

NICK: I’ll take the option where you don’t have to pay.

JENNIFER: I hear ya, Nick, but it’s not that easy.

NICK: Yes, it is. I’m broke.

JENNIFER: Ok, but let’s just talk this through for a minute. The Tax Court has many cases on this subject matter, and some are very favorable on facts similar to yours. So, that’s good news. But, I did some research on the appellate case law in the circuits where you guys live. Simon and John, you live in California, so that’s the Ninth Circuit. Unfortunately, the Ninth Circuit has strong case law in this area that is pretty negative for your situation. Under Ninth Circuit precedent, the issue of whether you can claim all your jingle expenses as business deductions depends on whether the activity was entered into with the “dominant hope and intent of realizing a profit.”

JOHN: Of course we wanted to make a profit!

SIMON: Well, I don’t know. I mean, it was really more for fun for me. Profit would be nice, of course, but it’s not like I was really counting on this to make money. It was kind of a lark.

NICK: Oh NOW he tells me!!! I drained my savings for this, man!

JOHN: I’m starting to remember why we broke up in college . . .

JENNIFER: Ok, so the point I’m making here is that we have some risk trying to win our case on this Ninth Circuit standard. Now, for Nick, your situation is a little different. You live in New York, so you’re covered by the Second Circuit. In that circuit, there’s only one decision on the requisite profit motive standard, and while the language is almost the same as the Ninth Circuit, so pretty adverse to us, the decision is unpublished, so it has no precedential value.

SIMON: Speak English, please.

JENNIFER: Sorry. What I’m getting at is, you probably don’t want to file a refund suit in your home districts because the available case law is not on your side.

NICK: So, let’s go to Tax Court. Didn’t you say that was the free one with the friendly case law?

JENNIFER: Yes, but the Tax Court uses something called the *Golsen* rule. Under this rule, the Tax Court judge is, essentially, required to apply binding precedent from the circuit to which an appeal would lie. So, even if we go to that Court, we’re still stuck with the Ninth Circuit case law. The Second Circuit case isn’t precedential, so there’s a chance we won’t be stuck with it, but that’s kind of a gamble.

JOHN: What is this *Golsen* rule?

JENNIFER: Well, unlike district courts, the Tax Court has nationwide jurisdiction. So, before the *Golsen* decision came along, the Tax Court’s position was a little different. In the Lawrence case, decided back in 1957, the Court considered what it should do when a tax issue came before it a second time, after a court of appeals had reversed the Tax Court on the same point. In that case, the Court determined that, while it should certainly give serious consideration to the reasoning of the reversing court of appeals, the Tax Court should not follow the decision if the Court believes it is incorrect. In that case, the Tax Court said, “if still of the opinion that its original result was right, a court of national jurisdiction, to avoid confusion, should follow its own honest beliefs until the Supreme Court decides the point.” The Court also noted that, as the IRS has the duty of administering the tax laws uniformly throughout the United States, so to, the Tax Court, being a tribunal with national jurisdiction over litigation involving the tax laws which may come to it from all parts of the country, has a similar obligation to apply its interpretation of the tax laws uniformly, unless or until either Congress or the Supreme Court directs otherwise.

SIMON: [YAWNING] So, when did *Golsen* come along to ruin my life?

JENNIFER: In 1970. The *Golsen* decision rejected Lawrence, at least where a case in the Tax Court is appealable to a Court of Appeals that previously has taken a position on precisely the same issue. In such a case, it would appear a virtual certainty that the non-prevailing party would appeal and secure a reversal from the Court of Appeals. Under those circumstances, the application of the Lawrence doctrine would ensure the waste of substantial resources, both of the taxpayer and of the court system, and, ultimately, achieve nothing. So, in *Golsen*, the Tax Court said that, where a reversal would appear inevitable, due to the clearly established position of the Court of Appeals to which an appeal would lie, the Tax Court’s obligation as a national court did not require a futile and wasteful insistence on its own view. In short, the Tax Court decided that better judicial administration required it to follow a Court of Appeals decision which is squarely on point, where appeal lies to that Court of Appeals and that court alone.

[THE BAND MEMBERS HAVE ALL FALLEN ASLEEP]

JENNIFER: Uh, you guys? Hello?

[THEY WAKE UP]

NICK: Oh, sorry! Uh, did all of that babbling mean we’re screwed?

JENNIFER: Well, not necessarily. The *Golsen* rule is narrow, and there are exceptions where the language from the appellate decision is merely dicta, or where the facts of the appellate decision are distinguishable. There may also be an exception where the appellate decision is unpublished. But, in my honest opinion, it’s going to be an uphill battle for you guys in the Tax Court, I’m afraid.

JOHN: Are there any other options?

JENNIFER: Yes. I think what we might want to try under these circumstances is have you guys pay the tax and then sue for a refund in the Court of Federal Claims.

SIMON: Dude, you totally buried the lede! And you were a journalism major in college! What’s this Court of Federal whatchamacallit?

JENNIFER: So, the Court of Federal Claims is another refund forum. It’s a national court that sits in Washington DC, kind of like the Tax Court, but its decisions are appealed to the Federal Circuit, which has never actually weighed in on this issue. So, we won’t know for sure how the case will go, but at least we won’t have any binding precedent to try to get around. There are some very favorable decisions in the Court of Federal Claims, so I think that’s our best chance.

JOHN: Fantastic!

SIMON: Rock n’ roll!

[JOHN AND SIMON HIGH-FIVE EACH OTHER]

NICK: Wait a minute, so to litigate my case, I have to first pay the whole $40,000??? I gotta tell you guys, I just can’t do it. I mean, I probably can’t even afford to pay your hourly rate to litigate in the Tax Court. I’m sunk.

JENNIFER: Look, I was your #1 fan in college, remember? I’m going to do everything I can to help you. We can still try our luck in the Tax Court, and argue for an exception to the *Golsen* rule. I can take your case pro bono, and we can file it as an S-case, which isn’t appealable, but should be pretty quick, and we’ll just see how we go, ok?

NICK: I’ll try anything. Thanks for your help.

JENNIFER: Ok, I think we have a plan to move forward. I’ll get to work and I’ll be in touch with each of you separately, to get each case ready to go. I’ll talk to you soon.

SIMON: Groovy.

JOHN: Thanks, Jennifer.

**SCENE #2**

Setting: Jennifer appears before the court after Nick's trial.

Cast:

Judge – TBD

Jennifer – TBD

JUDGE: Counsel, having heard all of the evidence I find that your client did want to and, indeed, hoped and intended to make money when he founded this enterprise with his buddies. However, that was not his primary motivation. What motivated him was not money, but his wolf-like hunger to relive his glory days with his buddies. Because he lives in Brooklyn, I am constrained by the *Golsen* rule to follow Second Circuit precedent regarding the business deductions he claimed for "Jingles-R-Us." That circuit requires that taxpayers have a "dominant hope and intent" to turn a profit in order to be entitled to full 162 deductions. Your client did not and therefore I must disallow these deductions for business expenses, despite my own feeling that the proper rule would allow him to take them.

JENNIFER: Your Honor, thank you for your candor but I respectfully disagree with your application of the *Golsen* rule here. The *Golsen* rule only requires that you follow binding circuit precedent to avoid automatic overturning of case after case that would waste both the Tax Court and the appellate court's time. That policy is inapplicable here. First, the Second circuit opinion to which you cite is unpublished and therefore non-precedential. Because the Second Circuit has not officially spoken on this issue you are not constrained by *Golsen* and you can rule as your own reasoning directs.

Also, the policy behind *Golsen* does not apply to this case even if the Second Circuit had issued a binding ruling on this issue. This is an S-case and therefore may not be appealed. Therefore, no automatic overruling looms if you were issue an opinion that contradicted circuit precedent.

JUDGE: Interesting points counselor, I will look into whether that opinion is unpublished. Even if it was, wouldn't this indicate that the Second Circuit would overturn any opinion that applied a different standard in this case? As for your second argument, I think we would need a compelling reason to reverse course on a long standing rule (thereby disrupting our ordinary world) and we have traditionally applied the *Golsen* rule even to S-cases. We do not want our small cases to be substantively treated differently than larger cases. The law is what it is, regardless of the amount at stake. Also, I smell some inequity among the partners here as I believe the two song writing partners live in the 9th circuit which very clearly favors the government's position in this case.

JENNIFER: Your Honor, forum shopping is exactly what makes this situation so inequitable. If this were a richer taxpayer, with more at stake, and the means to proceed to a pre-payment forum, any of the three "Jingles-R-Us" taxpayers could have proceeded with a refund suit in the Court of Federal Claims because of the Federal Circuit's favorable precedent on this point. Taxpayers of lesser wealth do not have this option. If the Tax Court applies the *Golsen* rule to S-cases, they are stuck with the precedent of their home circuits, while richer litigants can choose between their home circuit and the Federal Circuit. This rule constrains judges like yourself to decide cases based on the reasoning with which they disagree, based on a policy that does not play out in S-cases.

JUDGE: You are giving me a lot to think about. I will consider your arguments and issue an opinion soon.

**SCENE #3**

Setting: The Tax Court considers adopting changes to the *Golsen* rule. Three judges are eating lunch together and informally discussing the presentation that Jennifer made with respect to Nick’s case.

Cast:

Judge Flip-Flop – TBD

Judge Status Quo – TBD

Judge Change – TBD

JUDGE FLIP-FLOP: So, to recap, Jennifer, the lawyer for Nick, made a pretty strong argument on why the *Golsen* rule should not apply to this S-case because there is no precedential effect. For the first time, I’m having second thoughts about applying *Golsen* in this context, but I just can’t decide one way or the other. What are your thoughts?

JUDGE STATUS QUO: I don’t think we should change our rule of applying *Golsen* in S cases. Both parties, the taxpayer and the Commissioner, have the option up to generally the time of trial as to whether to remove the S designation and it seems to make the most sense to just apply *Golsen* to all taxpayers before us.

JUDGE CHANGE: Hmm, but I’m not sure *Golsen* should apply if the case is an S case by the time trial starts and truly not appealable. What resources are being wasted in applying our own analysis for this case where there is a small amount of money at stake and no appeal possible?

JUDGE STATUS QUO: So are the two of you suggesting that we go back to some type of *Lawrence* rule and just choosing the result that we believe is right? I am the only one of the three of us that was on the Tax Court back in 1970 when *Golsen* was decided. *Lawrence* was heavily criticized by practitioners and commentators before we came out with *Golsen* and I think it was the right decision and we should stand behind it. This is what we have been doing for the past half century so why modify our position now?

JUDGE CHANGE: I’m not saying to get rid of *Golsen* as a general rule. I’m simply suggesting that, in S cases, circuit court precedent should be considered persuasive authority but not binding authority. We should have the ability to follow our own Tax Court precedent for small cases. In addition, there is no chance of our opinion being automatically reversed by a circuit court so *Golsen* really has no application whatsoever.

JUDGE FLIP-FLOP: You both make good points. Tell me more about your respective positions.

JUDGE CHANGE: In thinking about this issue, I’m worried that almost half of our cases now are S cases and most are CDP or innocent spouse type cases. Why should these taxpayers be disadvantaged by a circuit court opinion that they cannot challenge on appeal?

JUDGE STATUS QUO: Well, be careful what you wish for. If we change from the *Golsen* rule, we could actually be harming these S case taxpayers and applying a more unfavorable rule than the circuit court opinion on point. And I’m still worried about some type of forum shopping going on in choosing whether to make the S case election or not.

JUDGE CHANGE: I think the forum shopping argument is overblown and why should taxpayers not be able to forum shop? The vast majority of these taxpayers also are pro se and it is very unlikely that they would have any insights into this issue.

JUDGE FLIP-FLOP: This is hard. What are some other options outside of keeping the status quo of applying *Golsen* in S cases, which is what Judge Status Quo seems to support, and not applying *Golsen* in S cases, which is what Judge Change seems to support.

JUDGE CHANGE: One other option is to consider applying either the precedent of the Tax Court or the precedent of the circuit to which the case would otherwise be appealable if the S case election had not been made, whichever precedent is more favorable to the taxpayer in the circumstances of the case.

JUDGE FLIP-FLOP: I’m not sure Chief Counsel’s office would like that approach.

JUDGE STATUS QUO: If we are going to start changing rules, why don’t we allow S case taxpayers to remove S designation after the opinion comes out if it is unfavorable to taxpayer based on *Golsen*? This way taxpayer can appeal to circuit court or even petition Supreme Court if there is an adverse decision?

JUDGE CHANGE: That’s actually a good idea.

JUDGE STATUS QUO: I was being sarcastic.

JUDGE FLIP-FLOP: Well, I keep changing my mind and can’t make a decision. We three are not going to decide this issue for whole court in any event. Let’s table this discussion until our next conference meeting of all the judges.