

Introduction

You are an entrepreneurial, recently-barred attorney, who recently moved to Westeros, a geographic area in the central United States, and accepted a generous offer from the prestigious Westerosi law firm of Citadel & Hightower. One of Westeros's wealthier residents, Ty Lannister, heard that Citadel & Hightower was hiring some of the brightest young legal minds, and so retained your firm to assist him with planning for and evaluating his income tax burden.

Given the wide scope of issues he faces, Ty and the firm agreed that it would advise and represent him solely regarding a discrete set of federal tax issues, stated below. You are confident he will pay his legal debts, but you remember that your retainer agreement explicitly states that the firm will be compensated only for answering the questions presented. Archmaester Ebrose, the managing partner of Citadel & Hightower's tax group, requests you analyze Ty Lannister's tax issues and prepare a ten-page memorandum addressing the questions presented below.

In his never-ending quest to know things, Ty began to read the basics of U.S. tax law. While he cares deeply for the people of Westeros, he agrees with Judge Learned Hand that he owes no public duty to pay more than the law demands. Gregory v. Helvering, 69 F.2d 809, 810 (2d Cir. 1934), aff'd, 293 U.S. 465 (1935). He therefore wishes to arrange his affairs "as to keep taxes as low as possible." Id. He seeks you to counsel him as to how to accomplish this (always citing relevant authority). In addition to the ten-page memorandum for your firm, you must write him a five-page letter recommending specific actions and explaining why they are the preferable options.

Facts

In 2016, Ty suffered a bad injury that left him scarred. Back then, Ty was working as the municipal manager of the Westerosi city of King's Landing, and his sister, Cindy Lannister, was acting mayor. Ty's primary responsibilities were to maintain the city's infrastructure and budget, for which he earned \$25,000 per month and which he spent living the high life. In the course of his official duties, Ty responded to a serious security incident, during which a man under Cindy's direct employ sliced his face. He suspects the employee intentionally inflicted the wound at Cindy's direction because she was threatened by Ty's success as municipal manager and feared he may become a political rival. Directing an agent to commit such an act would render Cindy liable for the injury under Westerosi tort law. Not only is the scar ugly, itchy, and painful, but the pain causes Ty to have nightmares about the fight, some of which are so vivid that he is now frightened of having blades near his face and refuses to shave. Ty had corrective surgery in 2016 to mitigate the itchiness and pain the scar on his face caused. The surgery was expensive - \$200,000 - and prevented him from working for the last two months of the year while recovering. Without any savings or a steady paycheck, he was unable to pay the medical bill up front.

The injury was one of many events that lead to a dramatic fallout with his family. On January 1, 2017, Ty left King's Landing and moved to the eastern Westerosi city of Meereen, where Valyrian is a common second language. So as to learn the language, Ty signed a \$1,000 per month contract to hire a tutor to teach him Valyrian during the entire year.

Without any money or savings, on January 15, 2017, Ty started a new job working for Danielle "Dany" Targaryen. Dany was recently made Mayor of Meereen in the wake of significant political upheaval due to her popular stances on security and fair labor standards. But given the sudden power shift from one political party to the other, Meereen was a hotbed of political violence. Dany hired Ty to serve as a strategic political adviser to her in her capacity as Mayor, namely in community affairs. Ty's previous work as municipal manager had never involved political advising, but Ty had always thought he would have a knack for it. To better serve in his new role, he immediately enrolled in two night courses taught at a local college, Harpy University: Contemporary Meereenese History I and Meereenese Law I. Harpy University teaches on a trimester system. Each course costs \$4,000, payable on the first class attended. Ty remained a student at Harpy University for the entire calendar year, signing up for Contemporary Meereenese History II and Meereenese Law II in the second trimester, and Contemporary Meereenese History III and Meereenese Law III in the third trimester. He paid for all the courses out-of-pocket as a non-degree student. He continues to excel now in the third trimester.

Ty negotiated a \$575,000 salary for his work in 2017. He also received city-provided housing in a building known as "The Great Pyramid." This mixed-use building housed Dany's apartment, the city's executive offices, and Harpy University. Ty's employment contract explained he must be available to advise Dany on demand, 24 hours per day, and that because of the political upheaval, his housing must meet certain security requirements. These requirements made living anywhere besides The Great Pyramid impossible. Rent in the comparable building next door is \$3,000 per month. Furthermore, given the rigors of the job, Ty was provided three meals a day and bottomless wine in The Great Pyramid's employee cafeteria, including fine Arbor vintages. The Pyramid Chefs normally charge \$20 per meal and Ty's tastes in wine has cost them \$200 per month in lost revenue.

After a particularly virulent incident of political violence, Dany was forced to take an extended leave of absence effective 11:59:59pm on June 30th, 2017. The deputy mayor reassigned Ty from strategic

political advisor to municipal manager, without a change in salary, benefits, or security concerns that require him to live in the Great Pyramid. Ty was glad to get back to the same infrastructure and budget concerns he was previously familiar with. He will continue this role at least through December 31st, 2017.

Being gainfully employed and without having to spend any of his money on basic necessities, Ty had more than enough money in August to pay the \$200,000 bill for his surgery. He promptly sued Cindy to recover tort damages for the cost of surgery, lost wages, punitive damages, and damages from emotional distress. Cindy hired Gregory “The Mountain” Clegane, a very successful defense attorney in Westeros, and pursuant to his counsel decided to settle the case in binding arbitration. So far, they agreed to a total settlement of \$500,000; that the settlement will be finalized and fully paid by December 31, 2017; and that any portion of the settlement not allocated by agreement before such deadline will be allocated as payment for punitive damages. Ty and Cindy have competing concerns on how to allocate the damages. Cindy is concerned that punitive damages will make her look weak politically, and so is pushing against any allocation thereto. Ty is pragmatic and simply wants to maximize his after-tax payout without taking an unjustifiably aggressive tax position. Citadel & Hightower charged Ty a flat rate of \$100,000 for handling all aspects of the case, payable from the proceeds of the finalized settlement.

Ty’s friend Jonathan Snow is always brooding and in every conversation makes sure to remind Ty that “winter is coming.” This gave Ty an idea: everyone in Westeros would soon be needing winter coats. In July 2017, Ty paid a consultant \$39,000 to investigate and analyze the future market for coats in Westeros. Her report was positive, so Ty purchased a coat-making machine for \$1,000,000. He made a \$300,000 down payment and skillfully negotiated to get a 10-year retail installment sales contract for the balance. His first \$70,000 principal plus 5% interest payment is due at the end of 2018. The machine will be delivered in December and operational in January 2018, but Ty is not concerned because he is certain the business will be profitable once he begins production.

Ty must also attend to some assets he inherited from the estate of his father, L.T. Lannister, who passed away on January 1, 2017. Ty accepted all title and responsibilities associated with Casterly Rock – a large Westerosi manor, its contents, and surrounding lands. Records show L.T. purchased the manor for \$1,000,000 and the land for \$3,000,000. Unfortunately, Casterly Rock’s fair market value plummeted after L.T.’s purchase. An appraisal of Casterly Rock valued the manor and its surrounding lands at \$500,000 and \$600,000, respectively, on the date of L.T.’s death. To make matters worse, it turns out that the manor was collateral for a significant loan L.T. took out at the Iron Bank, at 20% interest, to finance his participation in Westeros’ past feudal wars. By December 31, 2017, the debt plus its unpaid accumulated interest will be \$4,000,000. After paying his medical bill, Ty has no other debt outstanding, as a Lannister always pays his debts. Hearing of these troubles, Ty’s colleague Peter “Littlefinger” Baelish told Ty to move past that “always paying his debts” nonsense and negotiate a loan forgiveness agreement with the Iron Bank. Heeding the advice, Ty convinced the Iron Bank to forgive \$2,900,000 of the principal of the loan as of December 31. He unfortunately could not re-negotiate the interest rate, and will need to make his first interest payment of 20% of the new loan balance in 2018.

Ty senses that he won’t be in Meereen for long and hopes to move into Casterly Rock in 2018. With winter coming, Ty spent \$100,000 in 2017 to make necessary repairs to the manor. Nevertheless, he realizes he might have to sell some portions of the lands surrounding Casterly Rock to ensure the manor

has enough provisions. Once again, Littlefinger presented a solution: he offered to buy one half of Casterly Rock's land at fair market value, assuring Ty that because his father's purchase price was so high, Ty will benefit from a huge tax loss. The cash would help Ty make his loan payments, and it would be very nice to get that huge tax loss. Ty is wary of Littlefinger's increasingly generous advice, however, and so managed to push back the deadline for responding to the offer to January 1, 2018 so he may think over the offer.

On the personal front, Ty hopes to find a nice woman to marry, settle down with, and start a family. The only problem is that he is already married, unhappily, to Sandra Stark. They lived apart since 2016 and both agreed to use the "married filing separately" status on their taxes. Since they both left King's Landing and want to move on with their lives, they have preliminarily agreed to divorce. Ty is considering three divorce settlement options that Sandra approved: (i) sending Sandra or her designated beneficiaries \$20,000 per year for five years; (ii) buying and giving Sandra, in 2017, a plot of northern land valued at \$100,000; or (iii) giving Sandra, once he starts cataloguing and organizing its contents in 2018, 20% of the \$500,000 in appreciated personal property he knows is stored in Casterly Rock.

Questions

Based on the events that will occur by December 31, 2017,

- 1) What are the tax considerations in deciding whether to sell the land to Littlefinger?
- 2) Based on tax consequences, how should Ty structure the legal settlement with Cindy?
- 3) What is Ty's best divorce settlement option to minimize his taxes in 2017 and why?

Based on the advice you give on the questions above and the other facts provided,

- 4) What will Ty's gross income, adjusted gross income, and taxable income be for 2017? Explain each item you include in or exclude from gross income and whether any determinable amount is includable in another tax year. Further, explain the deductions you used to reach these amounts and the extent to which an expense is deductible in a different taxable year, non-deductible, or must be capitalized.
- 5) How much federal income tax will Ty owe in 2017? Explain how you reached this number.

Note: in answering the questions above, please assume that Ty has no income, expenses, assets, or liabilities other than those provided in the facts. Further, please disregard the application of the alternative minimum tax, any tax imposed in connection with the Affordable Care Act individual mandate, and any developments in U.S. law – statutory, regulatory, judicial, or otherwise – after September 1, 2017.