

LAW STUDENT TAX CHALLENGE

The Problem

Editor's Note: For the past three years, *NewsQuarterly* has excerpted the bench briefs after the Law Student Tax Challenge ended. This year, we are taking a different approach. In this issue, we present excerpts from the J.D. problem and reflections on their experience by the faculty coach and team members from the University of Pittsburgh School of Law.

—Gail Levin Richmond, Davie, FL

J.D. Problem Excerpt

Brainy Barry, a calendar-year cash-method taxpayer heads a team of approximately 75 engineers as the managing director of Honeycomb's aeronautical engineering group. He receives a salary of \$175,000 per year.

On June 20, 2012, Brainy and his team completed the final touches on the Series 4000X jet engine, a project two and a half years in the making. This engine marked a dramatic improvement in power and efficiency over the Series 3000X. Over the next six months, sales more than tripled Honeycomb's projections.

On December 20, 2012, at Honeycomb's annual holiday party, Honeycomb awarded Brainy Barry the "Honeycomb Engineer of the Year Award" for his stellar performance and leadership. Honeycomb's CEO personally presented him with a plaque and a giant check measuring over 4 feet in length for \$100,000. Honeycomb's controller approached Brainy Barry and told him in private that the giant check was just for show; a normal-sized check for \$100,000 was already in the mail. Brainy Barry brought the giant check home, had it framed, and hung it on the wall of his living room. Due to the large volume of mail around the holiday season, Brainy Barry did not receive the normal-sized check until January 3, 2013. Except for its size, it was identical in all respects to the giant check. He deposited that check into his bank account at Phoenix Star Bank on the same day.

On February 1, 2013, Brainy Barry purchased \$50,000 of Treasury Bills and donated \$30,000 to the Phoenix Homeless Shelter, a 501(c)(3) charity, using funds from his \$100,000 award. He decided to spend the remaining \$20,000 on a celebratory party (which included hotel rooms, gourmet foods, and fine wine) for the engineers in his aeronautical engineering group.

The celebratory party took place on February 5, 2013, at the Phoenix Slots casino and resort. Brainy Barry had never gambled in his life. Within a matter of minutes, he lost the entire \$1,000 that he had in his wallet and politely excused himself from the blackjack table.

As Brainy Barry stumbled toward the door, his colleague Lucky Lou suggested, "Why don't you give a shot at the Giant Jackpot slot machine? It has a \$5 million jackpot!" Brainy Barry responded that he had already lost \$1,000 at the blackjack tables and did not want to lose another penny.

Lucky Lou handed Brainy Barry a \$20 bill and said, "Tell you what, this one is on me. I have a good feeling about it." Brainy Barry inserted the \$20 bill into the Giant Jackpot slot machine, pulled the handle and hit three 7's. The manager of the Phoenix Slots directed Brainy Barry to the fine print on the Giant Jackpot slot machine, which stated that the \$5 million jackpot was payable over 20 years in equal annual installments of \$250,000 on January 1 of each year, with the first payment starting on January 1, 2014. The

manager presented Brainy Barry with a promissory note for \$5 million.

Brainy Barry returned to work at Honeycomb the following day. He told Lucky Lou that he wanted to split the \$5 million winnings with Lucky Lou. Lucky Lou asked Brainy Barry how they were going to split a \$5 million promissory note. Brainy Barry responded that he would give it some thought.

On March 6, 2013, while watching TV, Brainy Barry saw an advertisement for B.B. Billsworth offering cash on the spot for annuities and structured settlements. Brainy Barry called B.B. Billsworth the following day and was offered \$2.4 million in exchange for his promissory note. Brainy Barry agreed on the condition that B.B. Billsworth mailed a check to Brainy Barry for \$1.2 million and a separate check to Lucky Lou for \$1.2 million. Brainy Barry believed that he would not have to report the \$1.2 million check payable to Lucky Lou on his income tax return. On March 12, 2013, Brainy Barry deposited his check for \$1.2 million in his bank account at Phoenix Star Bank. On March 14, 2013, Lucky Lou deposited his check for \$1.2 million in his bank account at Arizona Sun Bank.

On June 1, 2013, Brainy Barry saw an advertisement on TV for the BattleBots Championship, a competition in Las Vegas to build a remote-controlled armored robot. Brainy Barry recognized that competing in the BattleBots Championship was an extremely expensive and time-consuming endeavor, but he was confident that he

would emerge as the winner and take home the \$2 million prize.

Brainy Barry produced a handwritten 32-page plan detailing the steps he would take to win the BattleBots Championship. From June 15, 2013, until September 1, 2013, he spent every minute of his free time converting his garage into a workshop. He outfitted his garage with the most advanced machinery at a cost of \$500,000. He spent another \$200,000 on some of the highest quality materials available for his robot and \$20,000 on some miscellaneous supplies. For each purchase, he recorded the date, cost, and a brief description of the item in an Excel spreadsheet on his personal computer. He kept the 32-page handwritten plan and the original receipts for each purchase in a wooden chest in his garage.

From September 1, 2013, until December 1, 2013, Brainy Barry spent approximately 30 hours per week constructing his robot. Brainy Barry paid \$10,000 to enter the BattleBots Championship, which took place on December 15, 2013, in Las Vegas. He cruised through the first three rounds. Unfortunately, in the final round, his robot fizzled due to a short circuit. He left the BattleBots Championship with a \$5,000 consolation prize.

Devastated by the loss, Brainy Barry decided that he had no further desire to compete in BattleBots. He sold the advanced machinery in his garage to Slick Sue, a fellow competitor at the BattleBots Championship. Slick Sue agreed to pay \$350,000, which was the fair market value of the advanced machinery at the time. On December 20, 2013, Slick Sue came by Brainy

Barry's garage with a rented truck and picked up all of the advanced machinery. She gave him a cashier's check dated the same day drawn on Arizona Sun Bank for \$350,000. The cashier's check appeared legitimate on its face, but Slick Sue had forged the check.

On December 23, 2013, Brainy Barry went to Phoenix Star Bank to deposit the check and learned that the check was

recover the advanced machinery. The fee included the cost of transporting any recovered machinery back to Phoenix.

On December 28, 2013, Hemlock Holmes found 3 pieces of the advanced machinery in an abandoned warehouse in New Mexico. On December 30, 2013, Hemlock Holmes shipped those pieces to Brainy Barry's home in Phoenix. They are scheduled to arrive on January 2,

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a forgery. In a fit of rage, Brainy Barry returned home, grabbed a baseball bat, and started smashing the remaining items in his garage. His robot and the wooden chest were smashed to pieces. The 32-page handwritten plan and most of the receipts inside the wooden chest went missing; Brainy Barry thinks he may have accidentally thrown them out when he cleaned up the wreckage. Brainy Barry can locate receipts totaling \$100,000 for the advanced machinery and \$40,000 for the materials for his robot. He still has the Excel spreadsheet saved on his personal computer.

On December 24, 2013, Brainy Barry contacted Hemlock Holmes, a private investigator. Brainy Barry paid Hemlock Holmes a non-refundable flat fee of \$25,000 to locate Slick Sue and

2014. Brainy Barry originally purchased those pieces for \$50,000, but their fair market value has since declined to \$20,000. As of December 31, 2013, Hemlock Holmes has several leads on Slick Sue's whereabouts and the location of the remaining advanced machinery, but he has not recovered any additional pieces.

Brainy Barry has come to us for advice on the tax consequences of the events that transpired in 2013. He wants us to minimize his tax liability, but he has been audited three times in the past decade, and he does not want to take any overly aggressive reporting positions on his tax return. ■