THE MPT®

MULTISTATE PERFORMANCE TEST

# July 2016 MPTs and Point Sheets

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**Contents**

## Preface

The Multistate Performance Test (MPT) is developed by the National Conference of Bar Examiners (NCBE). This publication includes the items and Point Sheets from the July 2016 MPT. The instructions for the test appear on page iii.

The MPT Point Sheets describe the factual and legal points encompassed within the lawyering tasks to be completed. They outline the possible issues and points that might be addressed by an examinee. They are provided to the user jurisdictions to assist graders in grading the examination by identifying the issues and suggesting the resolution of the problem contemplated by the drafters.

For more information about the MPT, including a list of skills tested, visit the NCBE website at www.ncbex.org.

## Description of the MPT

The MPT consists of two 90-minute items and is a component of the Uniform Bar Examination (UBE). It is administered by user jurisdictions as part of the bar examination on the Tuesday before the last Wednesday in February and July of each year. User jurisdictions may select one or both items to include as part of their bar examinations. (Jurisdictions that administer the UBE use two MPTs.)

The materials for each MPT include a File and a Library. The File consists of source documents containing all the facts of the case. The specific assignment the examinee is to complete is described in a memorandum from a supervising attorney. The File might also include transcripts of interviews, depositions, hearings or trials, pleadings, correspondence, client documents, contracts, newspaper articles, medical records, police reports, or lawyer's notes. Relevant as well as irrelevant facts are included. Facts are sometimes ambiguous, incomplete, or even conflicting. As in practice, a client's or a supervising attorney's version of events may be incomplete or unreliable. Examinees are expected to recognize when facts are inconsistent or missing and are expected to identify potential sources of additional facts.

The Library may contain cases, statutes, regulations, or rules, some of which may not be relevant to the assigned lawyering task. The examinee is expected to extract from the Library the legal principles necessary to analyze the problem and perform the task. The MPT is not a test of substantive law; the Library materials provide sufficient substantive information to complete the task.

The MPT is designed to test an examinee's ability to use fundamental lawyering skills in a realistic situation and complete a task that a beginning lawyer should be able to accomplish. The MPT is not a test of substantive knowledge. Rather, it is designed to evaluate six fundamental skills lawyers are expected to demonstrate regardless of the area of law in which the skills are applied. The MPT requires examinees to (1) sort detailed factual materials and separate relevant from irrelevant facts; (2) analyze statutory, case, and administrative materials for applicable principles of law; (3) apply the relevant law to the relevant facts in a manner likely to resolve a client's problem; (4) identify and resolve ethical dilemmas, when present; (5) communicate effectively in writing; and (6) complete a lawyering task within time constraints. These skills are tested by requiring examinees to perform one or more of a variety of lawyering tasks. For example, examinees might be instructed to complete any of the following: a memorandum to a supervising attorney, a letter to a client, a persuasive memorandum or brief, a statement of facts, a contract provision, a will, a counseling plan, a proposal for settlement or agreement, a discovery plan, a witness examination plan, or a closing argument.

## Instructions

The back cover of each test booklet contains the following instructions:

> You will be instructed when to begin and when to stop this test. Do not break the seal on this booklet until you are told to begin. This test is designed to evaluate your ability to handle a select number of legal authorities in the context of a factual problem involving a client.
>
> The problem is set in the fictitious state of Franklin, in the fictitious Fifteenth Circuit of the United States. Columbia and Olympia are also fictitious states in the Fifteenth Circuit. In Franklin, the trial court of general jurisdiction is the District Court, the intermediate appellate court is the Court of Appeal, and the highest court is the Supreme Court.
>
> You will have two kinds of materials with which to work: a File and a Library. The first document in the File is a memorandum containing the instructions for the task you are to complete. The other documents in the File contain factual information about your case and may include some facts that are not relevant.
>
> The Library contains the legal authorities needed to complete the task and may also include some authorities that are not relevant. Any cases may be real, modified, or written solely for the purpose of this examination. If the cases appear familiar to you, do not assume that they are precisely the same as you have read before. Read them thoroughly, as if they all were new to you. You should assume that the cases were decided in the jurisdictions and on the dates shown. In citing cases from the Library, you may use abbreviations and omit page references.
>
> Your response must be written in the answer book provided. If you are using a laptop computer to answer the questions, your jurisdiction will provide you with specific instructions. In answering this performance test, you should concentrate on the materials in the File and Library. What you have learned in law school and elsewhere provides the general background for analyzing the problem; the File and Library provide the specific materials with which you must work.
>
> Although there are no restrictions on how you apportion your time, you should allocate approximately half your time to reading and digesting the materials and to organizing your answer before you begin writing it. You may make notes anywhere in the test materials; blank pages are provided at the end of the booklet. You may not tear pages from the question booklet.
>
> Do not include your actual name anywhere in the work product required by the task memorandum.
>
> This performance test will be graded on your responsiveness to the instructions regarding the task you are to complete, which are given to you in the first memorandum in the File, and on the content, thoroughness, and organization of your response.

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*July 2016*
*MPT-1 File:*
*In re Whirley*

**HUMPHRIES & ASSOCIATES, LLP**
**ATTORNEYS AT LAW**
2700 MADISON AVE., SUITE 120
FRANKLIN CITY, FRANKLIN 33017

**MEMORANDUM**

**TO:** Examinee
**FROM:** Della Gregson, Partner
**DATE:** July 26, 2016
**RE:** Barbara Whirley matter

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Our client, Barbara Whirley, is renting a house. She is a little over halfway through a one-year residential lease and has encountered several problems with the house. Ms. Whirley would prefer not to move and wants the conditions repaired. She needs to know her options under Franklin law to remedy each condition.

In Franklin, specific statutes govern the landlord-tenant relationship. *See* Franklin Civil Code § 540 *et seq*. Both landlords and tenants have certain statutory duties, in addition to any duties they may have under a written lease.

Please draft a memorandum to me analyzing and evaluating Ms. Whirley's options with regard to each of the unrepaired conditions, which are described in the attached client interview summary. If more than one option is available with regard to a specific condition, explain the potential advantages and disadvantages of each option. If an option is *not* available to Ms. Whirley with respect to a particular condition, briefly explain why. Do not include a separate statement of facts, but be sure to incorporate the relevant facts, analyze the applicable legal authorities, and explain how the facts and law affect your analysis.

**HUMPHRIES & ASSOCIATES, LLP**
**ATTORNEYS AT LAW**
2700 MADISON AVE., SUITE 120
FRANKLIN CITY, FRANKLIN 33017

**MEMORANDUM TO FILE**

**FROM:** Della Gregson, Partner
**DATE:** July 25, 2016
**RE:** Summary of interview of Barbara Whirley

Today I met with Barbara Whirley regarding her dispute with her landlord over repairs needed to the rental house where she resides. This memorandum summarizes the interview:

- In January of this year, Whirley rented a three-bedroom, two-bathroom house from Sean Spears. See attached lease.
- Whirley is the only occupant of the home, and she has a dog, Bentley. She and Spears agreed in a separate "Pet Addendum" to the lease that she was allowed to have a dog. Whirley will provide a copy of the Pet Addendum at our next meeting.
- The house has eight rooms: a kitchen, a living room, a master bedroom with bathroom, two additional bedrooms, one additional bathroom, and a laundry room. The master bathroom is accessible through the master bedroom. The second bathroom is in the hallway between the second and third bedrooms. She uses one spare bedroom as her home office and the other as a guest room for family and friends when they visit her (one or two visits per month).
- Whirley is experiencing a number of problems with the residence.
- About two months after she moved in, the toilet in the second bathroom began leaking.
- In late March, she began having problems with the outdoor sprinkler system not functioning.
- In May, she noticed a smell in the guest bedroom. The smell is coming from the carpet near the sliding glass door leading from the bedroom to the backyard. The carpet is damp, and there is a half-inch gap between the bottom of the door and the door frame. Whirley isn't sure whether the door is off its track or whether the door is too small for the door frame. She has not opened the door since she moved in. The door is currently in the

closed position, but she isn't sure whether any of her houseguests may have used the door. When she discovered the gap between the door and door frame and tried to open the door, the door wouldn't budge. She has placed plastic along the door frame to try to keep outside moisture from coming in, to no avail. The carpet near the sliding door is increasingly discolored and smelly, and she has noticed mold growing around the door. The smell is so bad now that no one can use the room.

- Whirley keeps Bentley in the laundry room on weekdays while she is at work, because the laundry room door exits to the backyard and has a "doggy door" that allows Bentley to go in and out of the laundry room throughout the day. Bentley is a golden retriever, and sometimes he gets bored when Whirley is at work and chews on things. Five days ago, Whirley realized that Bentley had sneaked along the side of the washing machine next to the wall and chewed away a two-foot strip of the baseboard and areas of the wall above the baseboard. She has since moved the washing machine closer to the wall to prevent Bentley from having access to the chewed area. Since Spears allowed Whirley to have a dog at the house, she would like to have him take care of the repairs to the wall and baseboard if possible.
- Whirley has notified Spears about the toilet, sprinkler system, and guest bedroom sliding door and carpet, but he has not made any repairs. See attached emails.
- Whirley is now considering making arrangements herself to have the repairs completed. She has obtained an estimate from a handyman, a copy of which is attached.
- Whirley has paid her rent ($1,200) on time every month.
- The average cost to rent a two-bedroom house in the same area is $1,000. The average cost to rent a three-bedroom house in the area is $1,200 (what Whirley is currently paying).
- Whirley does not want to leave her home because it is close to her workplace in a desirable neighborhood with limited rental options.

# RESIDENTIAL LEASE AGREEMENT

THIS AGREEMENT (the "Agreement") is made and entered into this 1st day of January 2016 by and between Sean Spears ("Landlord") and Barbara Whirley ("Tenant"). For and in consideration of the covenants and obligations contained herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereby agree as follows:

**1. PROPERTY.** Landlord owns certain real property and improvements located at 1254 Longwood Drive, Franklin City, Franklin 33015 (the "Premises"). Landlord desires to lease the Premises to Tenant for use as a private residence upon the terms and conditions contained herein. Tenant desires to lease the Premises from Landlord for use as a private residence upon the terms and conditions contained herein.

**2. TERM.** This Agreement shall commence on January 1, 2016, and shall continue until December 31, 2016, as a term lease.

**3. RENT.** Tenant agrees to pay $ 1,200 per month by no later than the 3rd day of each month during the lease term . . . .

* * *

**8. PETS.** No animals are allowed on the Premises, even temporarily, unless authorized by a separate written Pet Addendum to this Agreement. Tenant will pay Landlord $ 25.00 per day per animal as additional rent for each day Tenant violates the animal restrictions by keeping an unauthorized animal. Landlord may remove or cause to be removed any unauthorized animal and shall not be liable for any harm, injury, death, or sickness to unauthorized animals. Tenant is responsible and liable for any damage or required cleaning to the Premises caused by any unauthorized animal . . . .

**9. SECURITY DEPOSIT.** On or before execution of this Agreement, Tenant will pay a security deposit to Landlord of $ 1,200 . . . . At the end of the lease, Landlord may deduct reasonable charges from the security deposit for damage to the Premises, excluding normal wear and tear, and all reasonable costs associated with repairing the Premises.

* * *

**11. DESTRUCTION OF PREMISES.** If the Premises become totally or partially destroyed during the term of this Agreement such that Tenant's use is seriously impaired, Landlord or Tenant may terminate this Agreement immediately upon three days' written notice to the other.

* * *

**14. PROPERTY MAINTENANCE.**

A. Tenant's General Responsibilities. Tenant, at Tenant's expense, shall

(1) keep the property clean;

(2) promptly dispose of all garbage in appropriate receptacles;

. . .

(11) not leave windows or doors in an open position during any inclement weather;

(12) promptly notify Landlord, in writing, of all needed repairs.

B. Yard Maintenance. Unless prohibited by ordinance or other law, Tenant will water the yard at reasonable and appropriate times and will, at Tenant's expense, maintain the yard.

* * *

**16. EARLY DEPARTURE FROM PREMISES.** If Tenant vacates the Premises before the end of the lease term, Landlord may hold Tenant responsible for all rent payments due for the balance of the lease term, subject to any remedies available to Tenant under Franklin law.

Dated this _1st_ day of _January, 2016_

Tenant's Signature Barbara Whirley

Landlord's Signature Sean Spears

## Email Correspondence between Barbara Whirley and Sean Spears

**From:** Barbara Whirley<bwhirl@cmail.com>
**To:** Sean Spears<sspears65@cmail.com>
**Subject:** Repair request
**Date:** February 19, 2016

Hi, Sean. Last weekend I noticed some water on the floor of the hall bathroom between the toilet and the shower. I think the toilet may have a leak. Can you please stop by in the next couple of days to see if the toilet is leaking? I'll put a towel down and make sure to keep the area dry in the meantime. Thanks!

---

**From:** Sean Spears<sspears65@cmail.com>
**To:** Barbara Whirley<bwhirl@cmail.com>
**Subject:** Repair request
**Date:** February 27, 2016

Hi, Barbara. I'm sorry it's taken me a while to get back to you. I've been out of town—my oldest son just got married! I'm back in town now, but I'm absolutely snowed under at work this week. I should be able to swing by this weekend—would Saturday morning work for you?

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**From:** Barbara Whirley<bwhirl@cmail.com>
**To:** Sean Spears<sspears65@cmail.com>
**Subject:** Leaking toilet
**Date:** March 4, 2016

Sean, I left two phone messages that last Saturday morning was good for me, and I waited at the house until almost 2 p.m. that day, but you never showed up. The leak in the toilet is getting worse. I've put a plastic bucket behind the toilet to catch the dripping water. Please stop by as soon as you can. I am home most weeknights by 6 p.m. and should be around this weekend. Thanks!

---

**From:** Barbara Whirley<bwhirl@cmail.com>
**To:** Sean Spears<sspears65@cmail.com>
**Subject:** Needed repairs
**Date:** March 31, 2016

Sean, I've tried calling you several times over the last few weeks and left voicemail messages about the leaking toilet, but you haven't called me back. The toilet really needs to be fixed. The leak is so bad now that I have to empty the plastic bucket twice a day and sometimes the toilet doesn't flush. In addition, the automatic sprinkler system for the front yard just stopped working, so I have to water the front flower beds by hand two or three times a week. This takes 15–20 minutes and is a real hassle—especially in this hot weather. I do not see any leaks, so I think the sprinkler box has malfunctioned. Can you please figure out what is wrong and get it fixed? Please call or email me about both of these problems ASAP. Thanks!

---

**From:** Sean Spears<sspears65@cmail.com>
**To:** Barbara Whirley<bwhirl@cmail.com>
**Subject:** Needed repairs
**Date:** April 6, 2016

Barbara, I'm sorry for the delay, but I've got a lot on my plate right now. I promise I will get by the house to check on everything as soon as I can. Please hold down the fort in the meantime! Thanks!

---

**From:** Barbara Whirley<bwhirl@cmail.com>
**To:** Sean Spears<sspears65@cmail.com>
**Subject:** Needed repairs
**Date:** April 27, 2016

Sean, I just got your voicemail message saying you wanted to stop by this weekend. I will be out of town Friday and Saturday, but anytime on Sunday would work for me. See you Sunday!

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**From:** Barbara Whirley<bwhirl@cmail.com>
**To:** Sean Spears<sspears65@cmail.com>
**Subject:** Needed repairs
**Date:** May 4, 2016

Sean, what happened Sunday?! I thought you were going to stop by.... If you can't make it, then please at least have the courtesy to call and let me know! When can you come by?

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**From:** Barbara Whirley<bwhirl@cmail.com>
**To:** Sean Spears<sspears65@cmail.com>
**Subject:** Problem with sliding door and other repairs
**Date:** May 26, 2016

Sean, I have been very patient. The toilet in the hall bathroom has been leaking for the past three months, and the automatic sprinkler system is still not working. These problems are very troubling, but now there's an even bigger problem—the sliding glass door in the guest bedroom is leaking and the carpet is wet and smelly. The smell is so bad that I can't even use the guest bedroom! Plus, mold is growing around the door, and I know that mold can cause health problems, so I have stopped using this room. I think the door and the carpet need to be replaced! Maybe you didn't take seriously the other problems I reported and that's why you haven't made any of the other repairs I've requested. But now a whole room in the house is completely unusable! Why should I pay rent for a 3-bedroom house when all I'm really getting is a 2-bedroom house and my guests have to sleep on the living room couch? If you don't make arrangements to get everything fixed, then I'm going to look into making the repairs myself and take appropriate legal action. I really like living here, but I can't continue to "hold down the fort" any longer!

## JB Handyman Services

*You Break It, We Fix It!*

98 Meadow Lane
Franklin City, Franklin 33019
Phone 111-555-4500

Estimate 000347
**DATE:** June 23, 2016

**TO:**
Barbara Whirley
1254 Longwood Drive
Franklin City, Franklin 33015

| Description | Amount |
|---|---|
| Replace toilet water supply valve and hose; Reseal toilet tank | $200 |
| Replace automatic sprinkler control box (6 zones) | $300 |
| Replace sliding glass door, door frame, and insulation;<br>Replace 10 X 12 square-foot carpet and pad adjacent to door | $1,800 |
| Replace 2-foot section of baseboard in laundry room;<br>Patch and repair drywall above damaged baseboard;<br>Retexture and repaint damaged wall to match existing wall | $300 |

**Total Estimate $2,600**

THANK YOU FOR YOUR BUSINESS!

*July 2016*
*MPT-1 Library:*
*In re Whirley*

## Excerpts from Franklin Civil Code

**Franklin Civil Code § 540 – Requirement of Tenantability**

The lessor of a building intended for human occupation must put it into a condition fit for such occupation and repair all subsequent conditions that render it untenantable.

**Franklin Civil Code § 541 – Untenantable Dwellings**

A dwelling shall be deemed untenantable for purposes of Section 540 if it lacks any of the following:

(1) Effective waterproofing and weather protection of roof and exterior walls, including unbroken windows and doors.

(2) Plumbing or gas facilities . . . maintained in good working order.

(3) Heating facilities . . . maintained in good working order.

. . .

(7) Electrical lighting, wiring, and equipment . . . maintained in good working order.

(8) Floors, stairways, and railings maintained in good repair.

(9) Interior spaces free from insect or vermin infestation.

**Franklin Civil Code § 542 – Tenant's Remedies for Untenantable Dwellings**

(a) If a landlord neglects to repair conditions that render a premises untenantable within a reasonable time after receiving written notice from the tenant of the conditions, for each condition, the tenant may:

(1) if the cost of such repairs does not exceed one month's rent of the premises, make repairs and deduct the cost of repairs from the rent when due;

(2) if the cost of repairs exceeds one month's rent, make repairs and sue the landlord for the cost of repairs;

(3) vacate the premises, in which case the tenant shall be discharged from further payment of rent or performance of other conditions as of the date of vacating the premises; or

(4) withhold a portion or all of the rent until the landlord makes the relevant repairs, except that the tenant may only withhold an appropriate portion of the rent if the conditions substantially threaten the tenant's health and safety.

(b) If the exercise of any of these remedies leads to an eviction action, a justified use of the remedies provided in (a)(1)–(4) in this section is an affirmative defense and may shape the tenant's relief in the event it is determined that the landlord has breached Section 540.

(c) For the purposes of this section, if a tenant makes repairs more than 30 days after giving notice to the landlord, the tenant is presumed to have acted after a reasonable time. A tenant may make repairs after shorter notice if the circumstances require shorter notice.

(d) The tenant's remedies under subsection (a) shall not be available if the condition was caused by the violation of Section 543.

(e) The remedies provided by this section are in addition to any other remedy provided by this chapter, the rental agreement, or other applicable statutory or common law.

**Franklin Civil Code § 543 – Tenant's Affirmative Obligations**

No duty on the part of the landlord to repair shall arise under Section 540 or 541 if the tenant is in violation of any of the following affirmative obligations, provided the tenant's violation contributes materially to the existence of the condition or interferes materially with the landlord's obligation under Section 540 to effect the necessary repairs:

(1) To keep that part of the premises which the tenant occupies and uses clean and sanitary as the condition of the premises permits.

(2) To properly use and operate all electrical, gas, and plumbing fixtures and keep them as clean and sanitary as their condition permits.

(3) Not to permit any person or animal on the premises to destroy, deface, damage, impair, or remove any part of the dwelling unit or the facilities, equipment, or appurtenances thereto.

* * *

**Franklin Civil Code § 550 – Eviction Proceedings**

(a) In an eviction action involving residential premises in which the tenant has raised as an affirmative defense a breach of the landlord's obligation under Section 540, the court shall determine whether a substantial breach of this obligation has occurred.

(b) If the court finds that a substantial breach of Section 540 has occurred, the court shall (i) order the landlord to make repairs and correct the conditions which constitute the breach, (ii)

order that the monthly rent be reduced by an appropriate amount until repairs are completed, and (iii) award the tenant possession of the premises.

(c) If the court determines that there has been no substantial breach of Section 540 by the landlord, then judgment shall be entered in favor of the landlord.

(d) As used in this section, "substantial breach" means the failure of the landlord to maintain the premises with respect to those conditions that materially affect a tenant's health and safety.

**Burk v. Harris**

Franklin Court of Appeal (2002)

Defendant Ashley Harris (Tenant) appeals the judgment entered in favor of plaintiff Roger Burk (Landlord) in this eviction action. The issue on appeal is whether the trial court misapplied the law when it found that the conditions proved to exist were nonsubstantial and therefore not a breach of the warranty of tenantability.

Landlord sought possession of the premises, forfeiture of the lease agreement, and past-due rent. Tenant asserted the defense of breach of the warranty of tenantability, set forth in Franklin Civil Code § 540, and the right to withhold rent under § 542(a)(4).

At trial, Tenant testified that the roof and windows of the premises had leaked during the entire term of her tenancy and, as a result, had caused water damage to the walls and floors and had damaged her personal property. Tenant also testified that the thermostat was broken and that the shower leaked. Tenant offered into evidence several letters she sent to Landlord complaining about the leaking roof and other conditions in the apartment, as well as photographs documenting the problems. Landlord denied receiving any such letters, asserted that he had not been inside the premises since Tenant moved in and did not have a key to the residence, and introduced before-and-after photos of repairs he had made upon learning of Tenant's complaints.

The trial court found that the conditions were not "substantial" as defined in Franklin Civil Code § 550. Accordingly, it entered judgment for Landlord for possession of the premises and past-due rent.

In *Gordon v. Centralia Properties Inc.* (Fr. Sup. Ct. 1975), the Franklin Supreme Court held that in every residential lease, there is an implied warranty of tenantability. In *Gordon*, the Franklin Supreme Court further held that a tenant who proves that the landlord has breached the warranty of tenantability is entitled not only to maintain possession of the premises but also to an appropriate reduction of rent corresponding to the reduced value of the premises. The *Gordon* court further held that a tenant is not entitled to a reduction in rent for minor violations that do not materially affect a tenant's health and safety. *Id.*

The *Gordon* decision is codified in the Franklin Civil Code. Under this statutory scheme, when a tenant raises breach of the warranty of tenantability as a defense in an eviction case, the trial court is required to determine whether a substantial breach has occurred. *See* §§ 542(b) and 550(a). If the court finds that there has been a substantial breach, it shall order the landlord to

make the repairs and correct the conditions caused by the breach, order that monthly rent be reduced by an appropriate amount, and award the tenant possession of the premises. § 550(b).

Section 540 requires that the landlord of a building intended for human occupation "put it into a condition fit for such occupation and repair all subsequent conditions that render it untenantable." Under § 541, a dwelling is untenantable for human occupancy if it lacks effective waterproofing and weather protection of roof and exterior walls, plumbing maintained in good working order, heating facilities maintained in good working order, and floors maintained in good repair.

Here, the trial court found that the premises were not properly waterproofed from the outside elements, the thermostat did not work, and the shower leaked. The trial court erred when it concluded that these conditions were nonsubstantial. These conditions are not merely cosmetic defects or matters of convenience but affect Tenant's health and safety.

Accordingly, Tenant is entitled to judgment on the defense of breach of the warranty of tenantability, to possession of the premises, and to an appropriately reduced rent. *See* §§ 542(a)(4) and 550(b).

To determine the appropriate reduction in rent, a trial court may either (i) measure the difference between the fair rental value of the premises if they had been as warranted and the fair rental value as they were during occupancy in unsafe or unsanitary condition, or (ii) reduce a tenant's rental obligation by the percentage corresponding to the relative reduction of use of the leased premises caused by the landlord's breach.

Additionally, the trial court must order Landlord to make the repairs necessary under the statute. These are issues for the trial court to determine on remand. Reversed and remanded.

**Shea v. Willowbrook Properties LP**

Franklin Court of Appeal (2012)

After suffering through two separate bedbug infestations in his apartment, plaintiff Jordan Shea moved out and filed a complaint against his landlord, Willowbrook Properties LP, seeking to recover rent he had paid for the apartment ($1,000/month for 16 months) and out-of-pocket expenses relating to the infestation ($2,000). After a bench trial, the trial court found Willowbrook responsible for the first infestation, but not the second. It awarded Shea a fraction of the damages he sought ($400), limiting his recovery to his documented out-of-pocket expenses and declining to award any rent recovery. Shea appeals.

The facts are as follows: within a few days of entering into a six-month lease with Willowbrook on July 1, 2010, Shea began to suffer from insect bites, which he discovered were the result of bedbugs. He reported this to Willowbrook, which sprayed his apartment, replaced his carpeting, and cleaned his apartment thoroughly to remove the bugs. While this work was being done, Shea stayed at a nearby motel. For several months after Willowbrook cleaned his apartment, Shea experienced no bedbug problems, so he believed that the problem had been corrected. In January 2011, he renewed his lease for an additional year; he then departed for a three-week study-abroad program. Upon his return, he started to get bedbug bites again; the bedbug problem continued throughout the renewal period, but Shea failed to report the second infestation to Willowbrook. He finally moved out of the apartment in October 2011, two months before the end of his lease.

**A. Rent**

The trial court denied Shea's claim that he was entitled to a full refund of all the rent he had paid over the course of his tenancy. When a landlord breaches the warranty of tenantability and creates an untenantable property, as is alleged here, a tenant has several options: (1) repair and deduct the cost of repairs if the cost of the repairs is less than one month's rent; (2) repair and sue, if the cost of the repairs exceeds one month's rent; (3) vacate the premises and be discharged of paying further rent; or (4) withhold some or all of the rent if the landlord does not make the repairs, provided the conditions substantially threaten the tenant's health and safety. Franklin Civil Code §§ 540, 542. In his lawsuit, Shea sought to recover all the rent he had paid ($16,000) pursuant to the initial and renewed leases.

We believe that the trial court correctly declined to award Shea the rent requested. First, the evidence supports the conclusion that Willowbrook's efforts to address the first infestation (spraying, replacing carpet, and cleaning the apartment) were successful. Shea even renewed his lease for another 12 months, from which the trial court concluded that the apartment was free of the infestation when he renewed and was therefore not untenantable as he claimed. Thus there is no factual basis to support awarding Shea damages for rent paid in 2010 under the first lease.

Nor is there a basis to award damages with respect to the second bedbug infestation, which arose in 2011 after Shea returned from abroad. Shea failed to demonstrate that the 2011 prolonged bedbug infestation occurred through Willowbrook's fault and through no fault of his own. If Shea were responsible, he would have been obligated to resolve the issue himself. *See* Franklin Civil Code § 543 (landlord has no duty to repair under § 540 or 541 if tenant has breached his affirmative obligation to keep premises as clean and sanitary as the condition of premises permits). If Shea believed that his landlord was responsible for the bedbug infestation, he had an obligation to mitigate his damages by promptly notifying Willowbrook to give it an opportunity to resolve the problem. *See Burk v. Harris* (Fr. Ct. App. 2002). Since this did not occur, the trial court declined to find Willowbrook responsible for the second infestation and concluded that Shea was not entitled to vacate the premises under § 542(a)(3). Because Shea retained possession of the apartment and reaped the benefit of staying, he could have been held responsible for the remaining two months of rent under the lease had Willowbrook sought it.

The trial court correctly declined to award Shea any damages related to rent already paid. We affirm the denial of the $16,000 rent reimbursement claim.

**B. Out-of-pocket expenses**

Shea also requested a total of $2,000 for motel and medication costs he incurred while living in the apartment. However, Shea submitted a receipt only for $400 for the motel room he rented while his apartment was being sprayed for bedbugs during the initial infestation in 2010. He provided no further documentation of his claimed expenses. Therefore, the trial court properly awarded him $400 but appropriately declined to award $1,600 for medication because Shea provided no documentation or explanation of how he came to that number.

Affirmed.

# *July 2016*
# *MPT-2 File:*
# *Nash v. Franklin Department of Revenue*

*The Carter Law Firm LLC*
1891 Virginia Way
Bristol, Franklin 33800

**MEMORANDUM**

**TO:** Examinee
**FROM:** Sara Carter
**DATE:** July 26, 2016
**RE:** Tax Appeal of Joseph and Ellen Nash

Our clients Joseph and Ellen Nash own property in Knox Hollow, on which they raise Christmas trees for sale. For many years, they sold only to friends and neighbors. Five years ago, they started a commercial tree-farming operation and put a lot more money into the farm.

Starting that same year, they began to claim tax deductions for expenses from a trade or business. They had a huge start-up loss to report in the first year. Since then, their income from the farm has gone up, but their expenses have varied. For each of the past five years, they reported a loss on their joint tax return.

Since the Nashes' last tax filing, as the law allows, the Franklin Department of Revenue (FDR) reviewed the Nashes' returns for the years 2011–2015 and denied their claim of full deductions for the farm expenses for those years. The FDR said that the Nashes could only take deductions to offset income they earned from the farm in each of those five years. The Nashes want the full deductions so that they can offset the business losses against their other income.

The FDR also denied the Nashes' claim for a home office deduction.

The FDR assessed the Nashes with additional tax for all five years. To avoid interest and penalties, the Nashes paid the additional tax. Representing themselves, they filed an internal administrative review with the FDR, which was unsuccessful. (See attached Notice of Decision.)

The Nashes then retained us and we filed an appeal to the Franklin Tax Court, which went to hearing last week. We stipulated to the dollar amounts in question, and Mr. Nash testified. I have attached a transcript. The Tax Court has requested post-hearing briefing.

Please draft the legal argument portion of our brief to the Tax Court, following the attached guidelines for drafting persuasive briefs. You should argue that Mr. Nash's testimony establishes the Nashes' right under Franklin law to the full deductions that they claimed. Franklin law uses the federal Internal Revenue Code and regulations to calculate Franklin tax liability.

***The Carter Law Firm LLC***
1891 Virginia Way
Bristol, Franklin 33800

**OFFICE MEMORANDUM**

**TO:** Attorneys
**FROM:** Sara Carter
**DATE:** August 18, 2014
**RE:** Format for Persuasive Briefs

The following guidelines apply to persuasive briefs filed in the Franklin Tax Court.

[Other sections omitted]

. . .

III. Legal Argument

Your legal argument should be brief and to the point. Make your points clearly and succinctly, citing relevant authority for each legal proposition.

Do not restate the facts as a whole at the beginning of your legal argument. Instead, integrate the facts into your legal argument in a way that makes the strongest case for our client.

Use headings to separate the sections of your argument, and follow the same rule as your argument: do not state abstract conclusions, but integrate factual detail into legal propositions to make them more persuasive. An ineffective heading states only: "The deduction should be allowed." An effective heading states: "Under the Internal Revenue Code, the appellant may deduct the amount by which the value of the gift exceeds the value of the concert ticket he received."

The body of your argument should analyze applicable legal authority and persuasively argue how both the facts and the law support our client's position. Supporting authority should be emphasized, but contrary authority should also be cited, addressed in the argument, and explained or distinguished.

Finally, anticipate and accommodate any weaknesses in your case in the body of your argument. If possible, structure your argument in such a way as to highlight your argument's strengths and minimize its weaknesses. If necessary, make concessions, but only on points that do not concede essential elements of your claim or defense.

**FRANKLIN DEPARTMENT OF REVENUE**
**NOTICE OF DECISION — ADMINISTRATIVE REVIEW**

**Taxpayers:** Joseph Nash and Ellen Nash
**Tax Years:** 2011–2015
**Type:** Joint Filing
**Date Issued:** May 16, 2016

The taxpayers claim that the Franklin Department of Revenue incorrectly denied their claims for (1) deductions for expenses paid or incurred during the taxable year in carrying on a trade or business and (2) deductions related to the business use of their home.

(1) The taxpayers claim certain deductions related to the carrying on of a "Christmas tree farming" business as follows:

| | ***2011*** | ***2012*** | ***2013*** | ***2014*** | ***2015*** |
|---|---|---|---|---|---|
| Income | $1,500 | $2,000 | $2,000 | $3,500 | $5,000 |
| Deductions | $35,000 | $9,500 | $7,000 | $9,000 | $12,500 |
| Gain/(Loss) | ($33,500) | ($7,500) | ($5,000) | ($5,500) | ($7,500) |

The Department determines that the taxpayers are not engaged in the tree-farming business for profit, due to the lack of a profit motive. Therefore, the taxpayers cannot take full deductions in each year. Instead, they may only deduct annual expenses up to the amount of income earned from the tree-farming activity: $1,500 in 2011; $2,000 in 2012; $2,000 in 2013; $3,500 in 2014; $5,000 in 2015. Of the nine factors identified in federal regulation 26 C.F.R. § 1.183–2(b)(1–9), which is controlling in Franklin tax cases, these factors support our conclusion: no profit in the tax years in question; a regular history of losses; no plan to recoup those losses; a history of similar activity without any deductions; and no evidence of operations in a businesslike manner.

(2) The taxpayers may take no deduction attributable to the use of a room in their home because the room was not used exclusively for business purposes. Internal Revenue Code § 280A(c)(1).

The assessment of tax for the years in question is affirmed. The taxpayers have exhausted their internal administrative remedies. They have the right to appeal to the Franklin Tax Court.

Ann Miller

Ann Miller, Commissioner of Franklin Department of Revenue

**FRANKLIN TAX COURT, SIXTH DISTRICT**
**Transcript of Testimony of Joseph Nash**
**July 21, 2016**

**DIRECT EXAMINATION BY ATTORNEY CARTER**

**Att'y Carter:** State your name for the record.

**Joseph Nash:** Joseph Nash.

**Carter:** Where do you live?

**Nash:** 3150 Old Sawmill Road in Knox Hollow, Franklin.

**Carter:** How long have you lived there?

**Nash:** Since we bought it in 1997.

**Carter:** Describe the land, please.

**Nash:** It's 13 acres: an acre for the house and sheds, and another two acres of fields. The rest is forested.

**Carter:** You started claiming tax deductions in 2011. Please tell the court how you used the land before then.

**Nash:** Originally, about two acres of the land had Leland cypress, spruce, and pine on it, good for Christmas trees. Soon after we bought it, our daughter and her friends would cut down trees for their own use. After a while, we put up a sign on the road each November and put out a garbage can with saws and twine in it. We charged $15 for the cypress, $20 for the pine, and $25 for the spruce.

**Carter:** What happened next?

**Nash:** At some point, we realized that most of the good trees would be gone in a few years. So I researched how to raise Christmas trees in a more orderly way.

**Carter:** What did you do?

**Nash:** I read a lot of books on raising trees, Christmas trees in particular. I took a whole series of classes on forest management. Finally, I met a nearby Christmas tree farmer and spent a whole vacation on that farm. I got really interested in it.

**Carter:** What did you do next?

**Nash:** First we set apart some of the acreage, cut everything down, and replanted in organized rows, leaving space to plant new seedlings in rotation. When the new trees came in, we'd sell them off, same as before.

**Carter:** How much did you make?

**Nash:** Up until five years ago, never more than $1,000 in any one year.

**Carter:** Did you report this as income on your tax returns during this period?

**Nash:** Yes. And up until that point, we claimed no deductions.

**Carter:** What happened then?

**Nash:** About five years ago, in 2011, the tree farmer I'd worked with let me know that he was planning to go out of business. And my wife retired from her job with the county. So we had to decide whether to step it up or not. We both liked working in the fields and selling the trees, so we said, "Why not?"

**Carter:** Then what happened?

**Nash:** That same year we contacted the farmer's commercial customers, as a target for expansion. Then we invited the farmer over to walk us through what a bigger operation would look like. He showed us how to keep records about the trees and to keep good books. We did exactly what he told us . . . still do.

**Carter:** You couldn't have sold that many more trees right away.

**Nash:** No, we didn't. 2011 was a hard year, because we cut down several acres of forest for additional fields and bought new equipment to deal with the additional planting. We couldn't do it by hand, the way we had before. So we bought specialized equipment to trim and shape the trees.

**Carter:** How do you manage things?

**Nash:** Starting in 2011, we set aside a room in the house just for this business. We keep the records there, and catalogues and books that we consult. We have a computer that we use just for the business and nothing else. The room has a desk and two chairs, and that's it. Nothing happens there but the business.

**Carter:** How did things go from then on?

**Nash:** Well, that first year, we made only $1,500, including sales to some retailers in the city. We made more each year after that, up until last year when we made $5,000.

**Carter:** How much of that was profit?

**Nash:** None of it. We had a huge loss in 2011. After that, we had to maintain the equipment, and we had to increase the size of each year's planting to

increase our sales five to six years later. For the past two years, we have had to hire people to help us during the harvest; it was just too much for us. And of course, the economy has been bad, and sales haven't been what we thought they would be. It's coming back, though.

**Carter:** How much time have you and your wife put into this?

**Nash:** Since 2011, my wife has spent pretty much full time year-round on this. I spend summers and weekends, when I can . . . a lot more time during the harvest. We love it; it's hard work, but it's outdoors and it's satisfying.

**Carter:** Just to be clear, you've never made a profit?

**Nash:** That's right.

**Carter:** Do you plan to make a profit?

**Nash:** Yes, we will make a profit, once the trees we started planting five years ago are big enough for harvesting. We have reliable customers who want our trees, and we've learned a lot in the past few years about how to keep costs down.

**Carter:** No further questions.

**CROSS-EXAMINATION BY Franklin Dep't of Revenue ATTORNEY SHEPARD**

**Att'y Shepard:** Mr. Nash, you work full-time at Knox County High School as an associate principal, correct?

**Joseph Nash:** Yes, that's right.

**Shepard:** Since your wife retired, hasn't she received a pension from the county?

**Nash:** Yes.

**Shepard:** You've lived off your salary and her pension the last five years, correct?

**Nash:** Yes.

**Shepard:** You've never run a business of your own, have you?

**Att'y Carter:** Objection. Argumentative.

**Shepard:** I'll rephrase. Other than this activity on your land, you and your wife have never run a business of your own, have you?

**Nash:** No.

**Shepard:** You've never taken a salary for either of you from this activity, have you?

**Nash:** No.

**Shepard:** You don't insure your trees, do you?

**Nash:** No. We do insure the farm equipment.

**Shepard:** You don't advertise, do you?

**Nash:** No, not commercially. Our local business is by word of mouth, and we have good connections with our commercial customers.

**Shepard:** You testified that you set a room aside only for this activity.

**Nash:** Yes.

**Shepard:** How did you use the room before?

**Nash:** We used it as a spare bedroom.

**Shepard:** You said that there is nothing in that room but a desk and two chairs?

**Nash:** Yes—we took out the bed.

**Shepard:** One of those two chairs is a recliner, isn't it? And you have a radio and TV there too, correct?

**Nash:** Yes. I keep the TV on the Weather Channel, for business reasons.

**Shepard:** The computer is connected to the Internet.

**Nash:** By wireless, yes.

**Shepard:** Your dogs will lie in that room with you while you're there?

**Nash:** Yes, they will.

**Shepard:** There's a fireplace in that room too, isn't there?

**Nash:** Yes.

**Shepard:** You testified that you love tree farming and are fascinated by it?

**Nash:** Yes.

**Shepard:** You enjoy working on the land and making things grow.

**Nash:** I do.

**Shepard:** It doesn't really matter to you if this activity makes a profit, does it?

**Nash:** Maybe not; but we mean to make one anyway. That's part of the fun.

**Shepard:** No further questions.

# *July 2016*
# *MPT-2 Library:*
# *Nash v. Franklin Department of Revenue*

## Excerpts from Internal Revenue Code

**Internal Revenue Code § 162. Trade or business expenses**

**(a) In general.** There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . .

**Internal Revenue Code § 183. Activities not engaged in for profit**

**(a) General rule.** In the case of an activity engaged in by an individual . . . , if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section.

**(b)** [deductions for activity not engaged in for profit limited to the amount of income earned by that activity] [text omitted]

**(c) Activity not engaged in for profit defined.** For purposes of this section, the term "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under section 162. . . .

**Internal Revenue Code § 280A. Disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.**

**(a) General rule.** Except as otherwise provided in this section, in the case of a taxpayer who is an individual . . . , no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.

. . .

**(c) Exceptions for certain business or rental use . . .**

**(1) Certain business use.** Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis—

**(A)** as the principal place of business for any trade or business of the taxpayer.

**Excerpts from Code of Federal Regulations**

**Title 26. Internal Revenue**

**26 C.F.R. § 1.183–2. Activity not engaged in for profit defined.**

**(a) In general.** [Except as otherwise provided . . . ,] no deductions are allowable for expenses incurred in connection with activities which are not engaged in for profit. . . . The determination whether an activity is engaged in for profit is to be made by reference to objective standards, taking into account all of the facts and circumstances of each case. Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the objective of making a profit. . . . In determining whether an activity is engaged in for profit, greater weight is given to objective facts than to the taxpayer's mere statement of his intent.

**(b) Relevant factors.** In determining whether an activity is engaged in for profit, all facts and circumstances with respect to the activity are to be taken into account. No one factor is determinative in making this determination. In addition, it is not intended that only the factors described in this paragraph are to be taken into account in making the determination, or that a determination is to be made on the basis that the number of factors (whether or not listed in this paragraph) indicating a lack of profit objective exceeds the number of factors indicating a profit objective, or vice versa. Among the factors which should normally be taken into account are the following:

**(1) Manner in which the taxpayer carries on the activity.** The fact that the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate that the activity is engaged in for profit. Similarly, where an activity is carried on in a manner substantially similar to other activities of the same nature which are profitable, a profit motive may be indicated. A change of operating methods, adoption of new techniques or abandonment of unprofitable methods in a manner consistent with an intent to improve profitability may also indicate a profit motive.

**(2) The expertise of the taxpayer or his advisors.** Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that the taxpayer has a profit motive where the taxpayer carries on the activity in accordance with such practices. . . .

**(3) The time and effort expended by the taxpayer in carrying on the activity.** The fact that the taxpayer devotes much of his personal time and effort to carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate an intention to derive a profit. A taxpayer's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. . . .

**(4) Expectation that assets used in activity may appreciate in value.** The term profit encompasses appreciation in the value of assets, such as land, used in the activity. . . .

**(5) The success of the taxpayer in carrying on other similar or dissimilar activities.** The fact that the taxpayer has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may indicate that he is engaged in the present activity for profit, even though the activity is presently unprofitable.

**(6) The taxpayer's history of income or losses with respect to the activity.** A series of losses during the initial or start-up stage of an activity may not necessarily be an indication that the activity is not engaged in for profit. However, where losses continue to be sustained beyond the period which customarily is necessary to bring the operation to profitable status, such continued losses, if not explainable as due to customary business risks or reverses, may be indicative that the activity is not being engaged in for profit. If losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damages, other involuntary conversions, or depressed market conditions, such losses would not be an indication that the activity is not engaged in for profit. A series of years in which net income was realized would of course be strong evidence that the activity is engaged in for profit.

**(7) The amount of occasional profits, if any, which are earned.** The amount of profits in relation to the amount of losses incurred, and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity, may provide useful criteria in determining the taxpayer's intent. An occasional small profit from an activity generating large losses, or from an activity in which the taxpayer has made a large investment, would not generally be determinative that the activity is engaged in for profit. However, substantial profit, though only occasional, would generally be indicative that an

activity is engaged in for profit, where the investment or losses are comparatively small. . . .

**(8) The financial status of the taxpayer.** The fact that the taxpayer does not have substantial income or capital from sources other than the activity may indicate that an activity is engaged in for profit. Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved.

**(9) Elements of personal pleasure or recreation.** The presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved. On the other hand, a profit motivation may be indicated where an activity lacks any appeal other than profit. It is not, however, necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits. . . . An activity will not be treated as not engaged in for profit merely because the taxpayer has purposes or motivations other than solely to make a profit. Also, the fact that the taxpayer derives personal pleasure from engaging in the activity is not sufficient to cause the activity to be classified as not engaged in for profit if the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.

**Stone v. Franklin Department of Revenue**

Franklin Tax Court (2008)

In this appeal, we review and affirm a decision of the Franklin Department of Revenue denying deductions to taxpayers Jim and Maxine Stone related to the operation of a horse-breeding business. Orders of the Department of Revenue are presumed correct and valid; the taxpayer bears the burden of demonstrating that the challenged order is incorrect. *Nelson v. Franklin Dep't of Revenue* (Franklin Tax Ct. 1998). The Franklin legislature intended to incorporate the federal Internal Revenue Code (IRC) and the Code of Federal Regulations (CFR) for the purpose of determining Franklin taxable income.

The Stones claimed deductions for expenses relating to the operations of an alleged trade or business: a horse-breeding business operated under the name "Irontree." The FDR limited their deductions to the amount of income that they earned from horse breeding in each of the last seven tax years, because the Stones lacked a profit motive. The Stones appeal, seeking full deductions.

26 C.F.R. § 1.183–2 outlines the activities that may be considered "for profit" in order to allow income tax deductions. The regulation requires an objective standard and delineates nine factors used to assess whether the taxpayer "entered into the activity, or continued the activity, with the objective of making a profit." 26 C.F.R. § 1.183–2(a) & (b). These factors are not exclusive, nor is one factor or combination of factors determinative on the issue of profit motive. *Morton v. Franklin Dep't of Revenue* (Franklin Sup. Ct. 1984).

**1) *Manner of Carrying Out Activity:*** The Stones operated Irontree for nearly 20 years, and began to claim deductions for the last seven. The Stones offered slight evidence of businesslike operations. They produced no records of business activities. Mr. Stone knew little about when horses were purchased or sold, the prices paid, or what training occurred. They lacked a business plan and had no plan to recoup their losses. Such plans can suggest a motive to earn a profit. *Jennings v. Franklin Dep't of Revenue* (Franklin Tax Ct. 2001).

The Stones bought horse semen from a national champion. The Stones contend that this purchase reflected an effort to stem their losses, an effort that failed. The Stones never paid or received a salary from Irontree. Only for a hobby does one work for nothing for 20 years. The Stones advertised only by attending horse shows, an insufficient effort to advertise a horse

breeding business. The Stones did not insure the assets of Irontree. Thus, when a horse slipped on some ice and eventually died, Irontree received nothing for its loss.

**2)** ***Taxpayer Expertise:*** The Stones have no formal education in breeding horses or the business of horse breeding. They have only recreational experience. They contend that they consulted with others on issues such as crossbreeding, animal care, and fence construction. But nothing shows that the Stones got or took advice on how to make Irontree profitable.

**3)** ***Time and Effort Invested:*** Mr. Stone claimed that he and his wife worked 30 to 40 hours per week on the farm, but did not show how he spent this time. The Stones kept full-time jobs. At best, we find this factor to be neutral.

**4)** ***Appreciation of Assets:*** Irontree consists of 20 acres, including the Stones' residence; barns for storage of hay, equipment, and tack; horse stalls; and wash stalls. Mr. Stone conceded that none of these assets appreciated.

**5)** ***Success in Similar Activities:*** Irontree was the Stones' first attempt at operating a horse-breeding operation or any business.

**6)** ***History of Income and Losses:*** The Stones own six horses. A seventh, Shiloh, was born and sold in 2005. During the years in question, Irontree accumulated losses of $132,751, compared to income of $4,000 from the sale of Shiloh. That $4,000 compared to losses of $33,901 in the same year. This history of losses over the entire existence of Irontree shows neither a history of profitability nor the potential for income to match losses.

**7)** ***Amount of Profits:*** Irontree made no profit in any of the years in question, or in any two consecutive years of its entire history. It seems unlikely that Irontree ever had the opportunity to generate a profit, let alone a profit substantial enough to justify the significant losses incurred.

**8)** ***Financial Status of Taxpayer:*** Mr. Stone worked for a bank during all the years in question, and Ms. Stone worked for an insurance agency. The Stones' income averaged $163,000. The Stones never received a salary or relied upon income from Irontree.

**9)** ***Recreational Nature of Activity:*** Mr. Stone engaged in rodeo events as part of his work with Irontree. He has been riding horses since he was a child, and rode horses in games and trail rides. Despite the hours and difficult work required to maintain the farm, the Stones' activities, including the pleasure in riding and caring for horses, indicate recreation, rather than operation of a business for profit.

***Conclusion***

For all of the foregoing reasons, we find that the factors outlined in 26 C.F.R. § 1.183–2(b)(1–9), except perhaps for factor three, weigh in favor of the Department. Therefore, we find that the Stones did not enter into the activity, or continue the activity, with the objective of making a profit. 26 C.F.R. § 1.183–2(a). The Department's assessment is affirmed.

**Lynn v. Franklin Department of Revenue**

Franklin Tax Court (2013)

Lorenzo Lynn claimed deductions for $2,307 in expenses attributable to the business use of his homes. The Franklin Department of Revenue denied those deductions and assessed additional tax due. Lynn paid the tax and then filed a claim for a refund. After an administrative review affirmed the Department's decision, Lynn timely appealed to this court. We affirm in part and reverse in part.

Lynn claimed that he operated his law practice first out of his house in Chatsworth, Franklin, and then out of his apartment in Athens, Franklin (to which he moved in May 2006). He claimed that the first floor of the Chatsworth house (25% of the total area of the house) and one of the eight rooms of the Athens apartment (the "computer office room") were used exclusively for his law practice. The Department argues that Lynn did not use any portion of either his house or his apartment exclusively as a principal place of business and that he is not entitled to any deduction for the business use of either residence.

We note that the Franklin legislature intended to make Franklin personal income tax law identical to the Internal Revenue Code (IRC) for purposes of determining Franklin taxable income, subject to adjustments and modifications specified by Franklin law. IRC § 280A provides that, generally, no deduction is allowed with respect to the personal residence of a taxpayer. However, under § 280A(c)(1)(A), this prohibition does not apply to expenses allocable to a portion of the taxpayer's residence that is used exclusively and on a regular basis as the principal place of business for any trade or business of the taxpayer. The exclusive use requirement is an "all-or-nothing" standard. *McBride v. Franklin Dep't of Revenue* (Franklin Tax Ct. 1990). The legislative history explains:

> Exclusive use of a portion of a taxpayer's dwelling unit means that the taxpayer must use a specific part of a dwelling unit solely for the purpose of carrying on his trade or business. The use of a portion of a dwelling unit for both personal purposes and for the carrying on of a trade or business does not meet the exclusive use test.

S. Rept. No. 94–938, at 48 (1976).

We first consider the Chatsworth house. We find that Lynn used the first floor of the premises—25% of the total area of the home—exclusively and on a regular basis as the principal

place of business of his law practice. The area's physical separation from the living areas of the home, its physical conversion from a residential-type "mother-in-law suite" to an office, and the fact that it had a separate entrance with an awning all inform our finding.

We next consider the "computer office room" of the Athens apartment. We find that Lynn did not prove that he used the "computer office room" exclusively as the principal place of business of his law practice. Lynn testified cursorily that he used the room exclusively for his law practice and that he stored files and law books there. But he offered almost no details about what was in the room and how the room was used. His reference to the room as the "computer office room" suggests that his computer was in the room, but we believe that he used his computer for both personal and business tasks. Moreover, he testified that he would occasionally watch his infant daughter in that room, while his wife attended to personal business, and that he would do so by having his daughter watch television at a low volume. The presence of a television in the room, coupled with his cursory testimony about business use, leads us to conclude that Lynn has not met his burden of proving that he used the "computer office room" exclusively as his principal place of business.

Accordingly, we reverse the determination of the Department as it relates to the business use of the Chatsworth home and affirm its determination as it relates to the Athens apartment.

# *July 2016*
# *MPT-1 Point Sheet:*
# *In re Whirley*

**In re Whirley**

**DRAFTERS' POINT SHEET**

In this item, the client, Barbara Whirley, seeks legal advice concerning her options for addressing a number of unrepaired conditions in the house that she rents. She is midway through a one-year lease. The problems with the rental house are (1) a leaking toilet in the hall bathroom, (2) a broken outdoor sprinkler system, (3) a leaking sliding glass door and damaged carpet in the guest bedroom, and (4) a damaged baseboard and wall in the laundry room. She has notified her landlord, Sean Spears, of most of the problems, but to date he has not made any repairs.

Examinees' task is to draft an objective memorandum analyzing and evaluating Whirley's options with regard to each of the unrepaired conditions, keeping in mind her desire to have the repairs made and to continue living in the house. For each condition, if an option is not available, examinees must briefly explain why. If more than one option is available with regard to a specific condition, examinees must explain the potential advantages and disadvantages of each such option.

The File contains the memo from the supervising attorney, a summary of the client interview, the written lease agreement, email correspondence between Whirley and Spears, and a repair estimate from a handyman. The Library contains excerpts from the Franklin Civil Code and two cases.

The following discussion covers all the points the drafters intended to raise in the problem.

## I. OVERVIEW

No specific formatting guidelines are provided. However, examinees are instructed not to prepare a separate statement of facts but to incorporate the relevant facts, analyze the applicable legal authorities, and explain how the facts and law affect their analyses.

## II. THE STATUTES AND CASES

Examinees should apply the following points from the Franklin Civil Code and the cases in their analyses:

- There is implied in every residential lease a warranty of tenantability. *Burk v. Harris* (Fr. Ct. App. 2002) (citing *Gordon v. Centralia Prop. Inc.* (Fr. Sup. Ct. 1975)).
- The *Gordon* decision is codified in Franklin Civil Code § 540 *et seq*. *Burk*.
- A residential landlord must put the dwelling into a condition fit for human occupation and repair all subsequent conditions that render it "untenantable." Fr. Civil Code § 540.
- A dwelling is "untenantable" under § 540 if it lacks any of a number of characteristics, including (1) effective waterproofing and weather protection of roof and exterior walls, including unbroken windows and doors; (2) plumbing maintained in good working order; and (3) floors, stairways, and railings maintained in good repair. § 541.

- If a landlord fails to repair conditions that render a premises untenantable within a reasonable time after written notice from the tenant of the conditions (typically 30 days but sooner if warranted), the tenant may make repairs that cost less than one month's rent and deduct the cost of the repairs from the rent when due. § 542(a)(1) ("repair and deduct" remedy).
- The "repair and deduct" remedy is not available for damage caused by the tenant, although it is not exclusive and can be combined with other remedies. § 542(d) and (e).
- Alternatively, the tenant may terminate the lease, vacate the premises, and raise the landlord's breach as a defense in a subsequent eviction action by the landlord for failure to pay rent. §§ 542(a)(3), 550. This is known as the "abandonment" remedy.
- If the defect is more serious than would justify or qualify for use of the repair and deduct remedy, a tenant may (a) withhold some or all of the rent until the landlord makes the repairs, if the condition substantially threatens the tenant's health and safety (the "withhold rent" remedy); or (b) make the repairs and sue the landlord to recover the cost of the repairs and any other related damages (the "repair and sue" remedy). § 542(a)(2) and (4); *Shea v. Willowbrook Prop. LP* (Fr. Ct. App. 2012).
- A landlord has no duty to repair under §§ 540 or 541 if the tenant violates any of several affirmative obligations and the violation contributes materially to the condition or interferes with the landlord's obligation under § 540 to make the necessary repairs. § 543.
- A tenant's statutory affirmative obligations include (1) properly using and operating all electrical, gas, and plumbing fixtures and keeping them in a clean and sanitary condition; and (2) not permitting any person or animal to destroy, deface, damage, impair, or remove any part of the dwelling unit or the facilities, equipment, or appurtenances thereto. § 543.
- In an eviction action alleging a failure to pay rent, if the tenant raises as a defense the landlord's violation of § 540 (breach of the warranty of tenantability), then the court must determine whether a substantial breach of these obligations has occurred. § 550(a).
- "Substantial breach" means the failure of the landlord to maintain the premises in a manner that materially affects a tenant's health and safety. § 550(d).
- If the court finds that a substantial breach has occurred, the court must (i) order the landlord to make repairs and correct the conditions which constitute the breach, (ii) order that the monthly rent be reduced by an appropriate amount until repairs are completed, and (iii) award the tenant possession of the premises. § 550(b).
- To determine the appropriate reduction in rent, a trial court may either (i) measure the difference between the fair rental value of the premises if they had been as warranted and the fair rental value as they were during occupancy in unsafe or unsanitary condition, or (ii) reduce a tenant's rental obligation by the percentage corresponding to the relative reduction of use of the leased premises caused by the landlord's breach. *Burk*.
- If, on the other hand, the court determines that the landlord has not substantially breached § 540, then judgment must be entered in the landlord's favor. § 550(c).

## III. ANALYSIS

Examinees' analyses should include a discussion of the parties' statutory rights and obligations (see above) and their contractual rights and obligations under the lease agreement:

- Whirley's obligation to pay monthly rent of $1,200 (which she has done on a timely basis) (§ 3)
- Whirley's obligation to keep unauthorized animals off the premises (discussed in subsection D below) (§ 8)
- Spears's right to deduct the cost of making non-routine repairs from Whirley's security deposit at the end of the lease (§ 9)
- Either party's right to terminate the lease if the premises become "totally or partially destroyed" (§ 11)
- Whirley's obligation to not leave windows or doors in an open position during inclement weather (§ 14.A(11))
- Whirley's obligation to promptly notify Spears of needed repairs (§ 14.A(12))
- Whirley's obligation to water and maintain the yard (§ 14.B)
- Spears's right to hold Whirley responsible for rent payments due for the balance of the lease term if Whirley vacates the premises before the end of the lease term (§ 16)
- As a preliminary matter, examinees should note that, with the exception of the laundry room damage caused by her dog, Whirley has promptly notified Spears of the conditions. Therefore, she has satisfied her obligation under § 14.A(12) of the lease agreement.

There are four unrepaired conditions: (1) the leaking toilet in the hall bathroom, (2) the broken automatic sprinkler system for the front yard, 3) the leaking sliding glass door and damaged carpet in the guest bedroom, and (4) the baseboard and wall damage in the laundry room caused by her dog.

The possible remedies available to a tenant in Whirley's position include (1) repair and deduct, (2) make the repairs herself and sue the landlord for damages, (3) abandon the premises, or (4) withhold some or all rent until the landlord makes necessary repairs. § 542. However, as discussed below, not all of these options are available for each of the four unrepaired conditions.

The following analysis is organized by unrepaired condition, but examinees could also organize their analyses according to each of the above remedies and discuss the unrepaired conditions as they relate to each potential remedy.

### A. Leaking Toilet

- The client interview summary and the emails between Whirley and Spears establish that the toilet in the hall bathroom has been leaking for five months, the leak has gotten worse, and Spears has failed to repair the toilet. Whirley has to keep a bucket behind the toilet to catch the dripping water and empty it twice a day, and sometimes the toilet doesn't flush because of the leak.

- A landlord must maintain plumbing facilities "in good working order." Fr. Civil Code § 541(2). A leaking, partially inoperable toilet cannot be said to be "in good working order." *See, e.g.*, *Burk* (broken thermostat and leaking shower constituted a substantial breach of the warranty of tenantability).
- Examinees should note that Whirley has an affirmative duty under Civil Code § 543 to "properly use and operate all . . . plumbing fixtures and keep them as clean and sanitary as their condition permits," but that there is no evidence that Whirley breached that duty. Rather, the toilet developed a leak and Whirley has acted responsibly by not only reporting the leak to Spears (over and over again) but also by putting down a towel and a bucket to ensure that the leak does not damage the bathroom floor or walls.
- The estimated cost to fix the leak is $200—well below Whirley's monthly rent of $1,200. Moreover, her emails demonstrate that Whirley has given Spears more than 30 days' notice, thus satisfying the "reasonable time" requirement in § 542(a) and (c).
- Therefore, Whirley is entitled to have her handyman fix the toilet and then deduct the $200 cost from her next month's rent. While she could also choose to abandon the house and be discharged from paying rent under the lease, per § 542(a)(3), examinees should note that she wants to stay in the house because it is close to her work and in a good neighborhood with limited rental options. The "withhold rent" remedy is not available because the condition is not serious enough to justify withholding rent and not making the repair. Nor can she make the repair and then sue Spears, since the repair cost is less than one month's rent. Therefore, "repair and deduct" is her best option for addressing the leaking toilet.

**B. Broken Automatic Sprinkler System**

- About three months into the lease, the automatic sprinkler system for the front yard stopped working due to the control box malfunctioning. *See* client interview summary; email correspondence. Whirley now has to manually water flower beds two or three times a week. This requires her to stand outside for 15 to 20 minutes to make sure the flower beds are properly watered, which is inconvenient—indeed, "a real hassle" per her email to Spears dated March 31, 2016.
- The lease agreement expressly imposes responsibility for watering and maintaining the yard upon Whirley (§ 14.B). However, the lease agreement is silent as to who is responsible for making repairs to the automatic sprinkler system.
- Outdoor sprinkler systems are not included in the list of conditions for which a landlord is responsible under Civil Code § 541. Nor is it likely that a broken automatic sprinkler system would pose a material threat to health and safety under § 550, and thus its nonoperative condition does not signify a breach of the warranty of tenantability.
- The court in *Burk*, citing *Gordon*, noted that "a tenant is not entitled to a reduction in rent for *minor* violations that do not materially affect a tenant's health and safety" (emphasis added). Nor do conditions that are cosmetic or "matters of convenience" breach the warranty. *Burk.* A broken automatic sprinkler system would likely be considered merely an inconvenience.

- Because a landlord is not required to maintain an outdoor sprinkler system under Civil Code § 541 and failure to do so does not constitute a breach of the warranty of tenantability, and because Whirley is responsible under the lease for watering and maintaining the lawn, she probably has no recourse against Spears with regard to the broken sprinkler control box.
- The estimate to repair the sprinkler control box is $300. This is below the dollar limit for the "repair and deduct" remedy, but that remedy is not available. Therefore, if Whirley wants a working sprinkler system, she will have to pay for the repair herself and may not deduct the cost from her rent.

**C. Guest Room Sliding Door and Carpet**

- The guest bedroom sliding door/carpet problems are the most serious and costly conditions.
- It is unclear exactly what is wrong with the door and how the problem occurred. According to the client interview summary, there is a half-inch gap between the bottom of the door and the door frame but it is not known how that occurred. Whirley denies using the door, but doesn't know if one of her guests may have used it or done something that caused the leak.
- Civil Code § 541 imposes a duty on Spears to provide "[e]ffective waterproofing and weather protection of roof and exterior walls, including unbroken windows and doors." Conversely, the lease imposes a duty on Whirley to not leave windows or doors open during inclement weather (§ 14.A(11)). She is also obligated to prevent anyone from damaging or impairing any part of the dwelling, per Civil Code § 543(3).
- If Spears failed to waterproof the door frame and keep the door from leaking, then he has breached the warranty of tenantability (§ 540) and violated Civil Code § 541. *See Burk* (water damage to walls and floors caused by leaking roof and windows violated the warranty of tenantability). If, on the other hand, one of Whirley's guests damaged the door, then Whirley would be in violation of the lease agreement and Civil Code § 543.
- The cost to replace the door, door frame, insulation, and rotten carpet is $1,800, well in excess of Whirley's monthly rent of $1,200. Thus, regardless of who is at fault for the condition of the door, the "repair and deduct" remedy is not available to Whirley.
- One could argue that the damage to the guest bedroom has resulted in a partial destruction of the house under § 11 of the lease agreement and that Whirley might thus be entitled to vacate with three days' written notice. But she doesn't want to move, and it is questionable whether a condition that renders one of eight rooms unusable qualifies as "destruction" of a portion of the premises. If not, then Whirley would be liable for rent through the end of the lease term pursuant to § 16 of the lease agreement.
- The door and carpet need to be replaced, and Whirley has made clear that she doesn't want to move. She thus has two options: (1) withhold an appropriate portion of her rent until Spears makes the repairs (she cannot withhold her entire rent because the house is not completely "untenantable"), or (2) pay the cost to restore the guest bedroom and file an action against Spears seeking reimbursement for the cost of the repairs and any other damages she may have. Both options involve some risk, as discussed below.

Option 1: Withhold Rent

- If Whirley chooses to withhold a portion of rent, there are two ways to determine the amount of the reduction: (1) measure the difference between the fair rental value of the premises if they had been as warranted and the fair rental value as they were during occupancy in unsafe or unsanitary condition, or (2) reduce the tenant's rent by the percentage corresponding to the relative reduction of use of the leased premises caused by the landlord's breach. *Burk*.
- In her email correspondence with Spears, Whirley makes the point that she should not be paying rent for a three-bedroom house when all she is getting is a two-bedroom house due to the guest bedroom's condition. The client interview indicates that the average rent for a two-bedroom house in the same area would be $1,000, or $200 a month less than what she now pays.
- Thus, if she opts to withhold rent, she should pay $1,000/month until the repairs are made.
- If Whirley decides to withhold some of the rent, then Spears could file an eviction action seeking to force her to vacate and pay back rent and awarding Spears possession of the house.
- If the court were to find that a substantial breach of the warranty had occurred, it would likely (i) order Spears to make repairs and correct the conditions which constitute the breach, (ii) order that monthly rent be limited to the reasonable rental value of the premises (thereby likely ratifying the reduced rent that Whirley would have been paying), and (iii) award Whirley possession of the house.
- However, if the court were to determine that Spears has not substantially breached Civil Code § 541 or the warranty of tenantability (i.e., that one or more of Whirley's guests caused the problem with the door), then it would enter judgment in favor of Spears.

Option 2: Repair the Guest Bedroom and Sue Spears

- In Whirley's situation, the "repair and deduct" remedy is not available, but "repair and sue" is.
- In *Shea*, the tenant sued his landlord seeking to recover rent he had paid for the apartment and out-of-pocket expenses relating to insect infestation.
- There, the landlord contested the amount of damages. The trial court awarded the tenant $400 in damages for the cost of the motel room that he rented during an infestation, but denied his claim for the rent paid during the tenancy. The appellate court affirmed.
- Although the condition in the guest bedroom is serious and interferes with guests visiting, Whirley has not yet incurred any out-of-pocket expenses. Examinees should note that to recover out-of-pocket expenses, she would need to have documentation of the expenses, such as receipts. *Shea.*
- One benefit of making the repairs now is that the guest bedroom will be usable again. In addition, by making the repairs, Whirley will avoid the risk of a possible eviction. The disadvantages of this option include the up-front out-of-pocket cost to Whirley and the possibility that she will not obtain reimbursement from Spears if she sues him and loses.

Whirley's Choice of Remedies

- Ultimately, Whirley will have to decide whether to withhold a portion of her rent or make the repairs to the guest bedroom herself and then sue Spears for damages.
- There is no "right" decision with regard to the two options. Both have advantages and disadvantages. If examinees discuss the benefits and risks of each option, as set forth above, then they should receive full credit for this portion of their analysis regardless of which option they ultimately recommend for the client.

**D. Baseboard and Wall Damage in Laundry Room**

- The client interview summary states that Whirley keeps her dog, Bentley, in the laundry room while she is at work. Recently, Whirley discovered that Bentley had sneaked along the side of the washing machine next to the wall and chewed away a two-foot strip of the baseboard and areas of the wall above the baseboard. Whirley has since moved the washing machine closer to the wall to prevent Bentley from reaching the chewed area.
- Whirley has not mentioned the damaged laundry room baseboard and wall to Spears because she just noticed it, and she isn't sure who is responsible for repairing it.
- Examinees should note that the lease agreement prohibits Whirley from having unauthorized animals on the premises. Without a written agreement between the parties permitting Whirley to keep a dog, she would be in violation of § 8 of the lease agreement regardless of whether Bentley had caused any damage. She would owe Spears $25 per day for each day that Bentley was at the house, and Spears could have Bentley removed from the house.
- Whirley says that she and Spears entered into a separate written "Pet Addendum" to the lease agreement and that she will provide a copy at her next meeting with the partner. Thus, the issue of whether Bentley is authorized or unauthorized probably won't be a factor, but it is definitely a loose end that needs to be tied up.
- Section 8 of the lease agreement provides that Whirley is responsible for any damage "caused by any unauthorized animal" (emphasis added). But that doesn't absolve her from responsibility for damage caused by an authorized animal, because Civil Code § 543 prohibits Whirley from allowing "any . . . animal" (whether or not authorized) to cause damage to the premises. Therefore, the damage caused by the dog is clearly Whirley's responsibility, not Spears's.
- Whirley has two options: (1) repair the baseboard and wall herself and pay the cost; or (2) leave the condition unrepaired with the expectation that the damage is not "normal wear and tear" and that Spears will make the repairs at the end of the lease and deduct the cost from her $1,200 security deposit, per § 9 of the lease agreement.
- A big advantage of repairing the wall herself is that Whirley can choose who makes the repairs and thus control the cost. Also, the repairs will be made now, not later. If she waits until the end of the lease for Spears to make the repair, he may charge her more than she would have paid.

- The total cost of the repairs is only $300, per the handyman estimate, and the damage caused by Bentley is clearly Whirley's responsibility. Her best bet would be to have the repairs made now.

## IV. CONCLUSION

Examinees should conclude that (i) "repair and deduct" is Whirley's best option with regard to the toilet leak in the hall bathroom; (ii) she probably cannot compel Spears to repair the outdoor sprinkler system, but is not obligated to fix it herself; (iii) she has two options with regard to the guest bedroom sliding door and carpet (withhold a portion of her rent or make the repairs herself and sue Spears to recover damages), both of which have advantages and disadvantages; and (iv) she is clearly responsible for repairing the baseboard and wall damage caused by her dog and should make the repairs now rather than allowing Spears to make the repairs at the end of the lease and deduct the cost from her security deposit.

# *July 2016*
# *MPT-2 Point Sheet:*
# *Nash v. Franklin Department of Revenue*

**Nash v. Franklin Department of Revenue**

**DRAFTERS' POINT SHEET**

This performance test requires the examinee to write a persuasive argument. Specifically, it requires the examinee to write a brief to a tax court judge, arguing that a taxpaying couple has the right under Franklin law to claim deductions for certain business expenses, including the business use of a room in their home. Franklin law uses the federal Internal Revenue Code and regulations to calculate Franklin income tax liability.

The File contains the task memorandum; a "format memo"; a one-page Notice of Decision by the Franklin Department of Revenue; and a transcript of testimony in front of the Franklin Tax Court by one of the taxpayers, including both direct and cross-examination.

The Library contains relevant excerpts from three sections of the Internal Revenue Code; relevant excerpts of the corresponding I.R.S. regulations; *Stone v. Franklin Department of Revenue*, a Franklin Tax Court decision addressing the requirements for assessing whether a taxpayer is "engaged in an activity for profit"; and *Lynn v. Franklin Department of Revenue*, a Franklin Tax Court decision addressing how to determine whether a taxpayer has used a portion of his or her home "exclusively" as the principal place of business of a trade or business.

The following discussion covers all the points the drafters intended to raise in the problem.

## I. FORMAT AND OVERVIEW

The assigning partner requests that the examinee draft the legal argument for a post-hearing brief that will be submitted to the tax court. The File includes a separate "format memo" that describes the proper approach to argument.

The format memo offers several pieces of advice to examinees:

- Write briefly and to the point, citing relevant legal authority when offering legal propositions.
- Do not write a separate statement of facts, but integrate the facts into the argument.
- Do not make conclusory statements as arguments, but instead frame persuasive legal arguments in terms of the facts of the case.
- Use headings to divide logically separate portions of your argument. Again, do not make conclusory statements in headings, but frame the headings in terms of the facts of the case.
- Anticipate and accommodate any weaknesses in your case in the body of your argument, and if necessary, make concessions, but only on inessential points.

## II. FACTS

The format memo instructs examinees *not* to draft a separate statement of facts. However, they must integrate the facts thoroughly into their arguments. This section presents the basic facts of the problem. Other facts will appear below in the discussion of the legal argument.

- Joseph and Ellen Nash own 13 acres of land in Knox Hollow, Franklin, which they purchased in 1997.
- Shortly thereafter, they began to sell Christmas trees off a portion of their land. The sales occurred on a cut-your-own basis. They put up a single sign.
- Joseph Nash subsequently started to put more effort into managing the growth of his Christmas trees. He read books on tree management and took a relevant series of courses. He spent one vacation with a Christmas tree farmer to learn more about how to operate an organized farm. The Nashes cleared more land and began to plant more trees, in a more organized rotation, so as to assure available trees for sale in the future.
- Until 2011, they never earned more than $1,000 per year from this activity. They reported all the income from this on their Franklin income taxes, and took no business deductions.
- In 2011, the Nashes decided to increase their investment of time and resources in the Christmas tree farming operation, with a view to making more money through commercial sales. Mrs. Nash retired from her job at this time.
- In the same year, they consulted with the tree farmer who had worked with Mr. Nash earlier and who was going out of business. On his advice, they developed a regular set of records and accounts for managing their operation, which they continue to use to this day.
- Also in 2011, the Nashes set aside one room in their house as a business office. The room has a computer, a desk, two chairs (one of them a recliner), a radio, a television, and a fireplace. The computer connects to the Internet. Mr. Nash testified that his dogs lie in the room with him while he is there, and that he keeps the television on, tuned to the Weather Channel.
- Still in 2011, the Nashes bought new equipment to help them manage a larger crop.
- Over the next four years, the Nashes continued to use and maintain the equipment. They also had to hire help to manage the harvests.
- During each of these five years under review by the Franklin Department of Revenue, the Nashes reported income and claimed deductions as follows:

| | **2011** | **2012** | **2013** | **2014** | **2015** |
|---|---|---|---|---|---|
| Income | $1,500 | $2,000 | $2,000 | $3,500 | $5,000 |
| Deductions | $35,000 | $9,500 | $7,000 | $9,000 | $12,500 |
| Gain/(Loss) | ($33,500) | ($7,500) | ($5,000) | ($5,500) | ($7,500) |

- Mr. Nash testified that they had not yet earned a profit, but that they were running the farm with the intention of earning a profit. The table above lists the losses that they incurred over the five years in question. Note that the losses declined steeply after the first year (which included a major capital investment), but crept upward in 2014 and 2015 (as they began to hire help).
- After 2015, the Franklin Department of Revenue (FDR) notified the Nashes that it would limit the amount of their deductions to the amount of the income earned from the tree farm in each of the last five years. The FDR stated that the Nashes were not engaged in a "trade or business" because the activity indicated the lack of a profit motive. The FDR also stated that the Nashes had not demonstrated that they used the separate room "exclusively" as the principal place of business of a trade or business.
- The Nashes paid the amount assessed and then, representing themselves, filed a request for administrative review within the agency. On May 16, 2016, the FDR issued a decision affirming the original assessment, from which the Nashes (who had now retained counsel) filed a timely appeal to the Franklin Tax Court. A hearing was held on July 21, 2016, at which Joseph Nash testified, and the Tax Court requested post-hearing briefing.

## II. LEGAL ISSUES

The task memo instructs examinees to argue that Mr. Nash's testimony establishes the couple's right to the deductions that they have claimed. The task memo does not identify these issues specifically, but the decision of the FDR does indicate that examinees have two arguments to make: first, that the Nashes are entitled to full deductions for the general expenses of operating the farm as expenses "paid or incurred . . . in carrying on [a] trade or business" under Internal Revenue Code §§ 162 and 183; and second, that the Nashes are entitled to a home office deduction for the use of the separate room in their home. In particular, with respect to the Nashes' claimed deductions for farm expenses, the FDR identified the following factors as supporting its ruling against the Nashes: no profit in the tax years in question, a regular history of losses, no plan to recoup those losses, a history of similar activity without any deductions, and no evidence of operations in a businesslike manner.

The following discussion highlights both the law and the arguments that examinees can make on these facts. As an initial matter, an examinee should note that Franklin law uses the federal tax code in calculating taxable income. Examinees should thus use the federal tax code and regulations in making their arguments. *Lynn v. Franklin Dep't of Revenue* (Fr. Tax Ct. 2013). An examinee should also recognize that, on appeal to the Franklin Tax Court, the decisions of the FDR are presumed to be correct and valid and that the taxpayer has the burden of demonstrating that the challenged order is incorrect. *Stone v. Franklin Dep't of Revenue* (Fr. Tax Ct. 2008). For each issue, the examinee will need to identify which facts overcome this presumption of the correctness of the FDR decision.

**A. "Expenses Paid or Incurred . . . in Carrying on [a] Trade or Business"**

*Legal Standards*

Internal Revenue Code § 162 permits a deduction for "expenses paid or incurred during the taxable year in carrying on any trade or business." At the same time, Internal Revenue Code § 183 provides that, for an "activity not engaged in for profit," a taxpayer's deductions are limited to the amount of the income earned from the activity. Internal Revenue Regulation 26 C.F.R. § 1.183–2 provides an extensive definition of the term "activity not engaged in for profit." It requires a focus on whether "the taxpayer entered into the activity, or continued the activity, with the objective of making a profit." This inquiry focuses on objective factors; the taxpayer's statement of intent receives less weight than these objective factors.

The regulation articulates a non-exclusive list of nine factors to be used in assessing whether an activity is engaged in for profit. It specifically states that no one factor is determinative, that counting of a majority of factors does not control, and that other factors, in addition to the listed ones, may prove relevant. 26 C.F.R. § 1.183–2(b). No one factor or combination of factors is determinative in deciding whether an activity is engaged in for profit.

The discussion which follows assesses the facts of the Nash case against the nine factors listed in the regulation. The Library includes a case, *Stone v. Franklin Dep't of Revenue*, which uses this same method: assessing each individual factor, and then making a determination of how these factors, considered collectively, might lead to a particular conclusion. The tax court in *Stone* reached a conclusion adverse to the taxpayer, so examinees will be called upon to develop arguments that contrast with the arguments in the *Stone* case.

*Application of the 26 C.F.R. § 1.183–2(b) Regulatory Factors*

**(1) Manner in which the taxpayer carries on the activity:** The Nashes did not operate their tree farm as a business until 2011. From that point on, they kept records of their activities, and kept books of account concerning their sales and expenses. They received advice from a nearby Christmas tree farmer about managing a larger operation, and followed that advice. This supports an argument that they carried on this activity "in a manner substantially similar to other activities of the same nature which are profitable." 26 C.F.R. § 1.183–2(b)(1). They also changed their approach to the business in 2011 to increase the farm's profitability. *Id*.

The *Stone* case adds several other considerations under this regulatory subsection. The taxpayers in *Stone* had no plan for their business; by contrast, the Nashes have a plan involving the rotation of crops and the reduction of expenses. The taxpayers in *Stone* did not insure their assets; by contrast, the Nashes insured their farming equipment. The taxpayers in *Stone* did no advertising; by contrast, the Nashes maintain good connections with commercial buyers of their trees. Finally, the taxpayers in *Stone* did not pay a salary to themselves or to anyone else; by contrast, the Nashes paid wages to the people they hired to help them during the harvest. Examinees should use these facts to demonstrate that, contrary to the FDR's conclusion, there is ample evidence that the Nashes operate their tree farm in a businesslike manner.

**(2) The expertise of the taxpayer or his advisors:** Mr. Nash both read extensively on tree farming and took courses on forest management. He apprenticed with a nearby farmer and consulted with that farmer upon increasing the activities on his land in 2011. By contrast, the taxpayers in *Stone* lacked formal education in horse breeding and there was no evidence that they had sought or received advice on how to make their horse-breeding business more profitable.

**(3) The time and effort expended by the taxpayer in carrying on the activity:** Mrs. Nash has spent her full time on the activity since 2011, when she retired from her job with the county. Mr. Nash spends summers, weekends, and an unstated amount of additional time on the activity. Thus the facts can be distinguished from those in *Stone*, where both husband and wife had full-time jobs in addition to their horse-breeding business and could not show how their time was spent on the business.

While 26 C.F.R. § 1.183–2(b)(3) states that a profit motive may be indicated by a taxpayer devoting much of his personal time and effort to carrying on an activity, "particularly if the activity does not have substantial personal or recreational aspects," examinees might note that the regulations do not preclude taxpayers from deriving some personal enjoyment from an activity engaged in for profit. *See* 26 C.F.R. § 1.183–2(b)(9). And, while Mr. Nash maintained a full-time job as an associate principal during the relevant period, his testimony that he spends summers, weekends, and additional time during harvest working on the tree farm dovetails with the regulation's statement that support for a profit motive can be found when a taxpayer spends "much of his personal time and effort" on the activity.

**(4) Expectation that assets used in activity may appreciate in value:** No evidence exists in the record about the appreciation in value of the principal assets: the land from which the Christmas trees are harvested and the "inventory" of growing Christmas trees. An examinee might argue that improved tree-farming techniques might produce an increase in value in this "inventory" and in the farm. To this end, the examinee can argue that the value of the business has increased because of the addition of the new (presumably valuable) equipment, the clearing of additional acreage, the practice of planting in rows and providing space for rotation of new seedlings, and other improvements.

**(5) The success of the taxpayer in carrying on other similar or dissimilar activities:** The Nashes have never run a tree-farming business, or any other kind of business, before. An examinee might make an effort to argue this as a neutral factor, especially in light of Mr. Nash's concerted effort to learn the business through coursework, apprenticeship, and consulting. An examinee might also note that the lack of prior business experience would eliminate full deductions for every first-time business owner; given this, this criterion should not weigh heavily against the Nashes.

[NOTE: On the other hand, given that the Nashes informally sold Christmas trees for several years before scaling up their operation in 2011, an examinee could make a plausible argument/interpretation of the facts that the Nashes are familiar with tree farming and have a history of managing their tree farm as a hobby that, while not profitable, produced some income every year.]

**(6) The taxpayer's history of income or losses with respect to the activity:** This factor and 26 C.F.R. § 1.183–2(b)(7) (below) appear to have been given the most weight in the FDR's decision to deny the Nashes' claimed deductions. It is undisputed that the Nashes have incurred large losses in the last five years. However, an examinee should argue that the loss in the first year was attributable to the heavy start-up investment required, and that income from sales has steadily increased. Note that the examinee cannot make the argument that losses are steadily decreasing, and will have to make an effort to explain the distinct increase in losses in the last two years. Nash's testimony that they had to hire workers to cope with an increased volume of sales provides one explanation. The worsening of the economy, mentioned in his testimony, offers another explanation. Finally, the Nashes sold trees in every year, in contrast to the taxpayers in the *Stone* case, in which over the entire existence of their horse-breeding business, their only income came from the sale of one horse for $4,000.

**(7) The amount of occasional profits, if any, which are earned:** The Nashes have never earned a profit. At the same time, an examinee might argue that, after 2011 (the first year), the scale of the losses in relation to income has become more reasonable, and that (as noted above) income is increasing while deductions/expenses appear to be holding steady or to have specific causes for increasing.

**(8) The financial status of the taxpayer:** Examinees can stress that Mrs. Nash has no other activity and has worked full-time on the farm. As a negative, Mr. Nash has a full-time job, and Mrs. Nash receives a pension from her former full-time job. Their joint income derives from these other sources. Thus this factor cuts against the Nashes—they do not depend on the activity for their own living expenses. Moreover, they realize a significant tax benefit from regular yearly losses. And note that in the regulations, the IRS states that when a taxpayer has significant income from other sources, that may be an indication that an activity is not engaged in for profit, especially if the activity has personal or recreational value for the taxpayer. Examinees might point out that no one factor is determinative, *see* 26 C.F.R. § 1.183–2(b), and that having financial resources to support oneself is not incompatible with engaging in an activity with the intent to make a profit.

**(9) Elements of personal pleasure or recreation:** Mr. Nash testified frequently about how much he and his wife enjoyed the activity of running the tree farm. An examinee will need to argue that 1) the regulations permit the mixing of business and recreational motives without disallowing the deduction, 2) the Nashes have worked hard in developing this business, and 3) Mr. Nash testified that the earning of a profit was one of their goals for the activity. An examinee might also suggest that the regulation does not require the taxpayer to dislike the business as a precondition to granting the deduction.

After a review of these criteria, an examinee will have several ways to summarize and to articulate a persuasive conclusion. While the regulation rejects a "majority of the factors" approach, an examinee might note how many of the factors weigh in favor of the Nashes, especially in contrast to the facts in *Stone*, in which the tax court found that of the nine C.F.R. factors, all but one favored the Department of Revenue.

**B. Home Office Deduction and "Exclusive" Use**

The Franklin Department of Revenue denied the claimed deduction for home office use on the ground that the Nashes had failed to meet their burden of proving that they used the room in question "exclusively" for their trade or business, as required by IRC § 280A(c)(1)(A).

Examinees can argue several favorable facts: the limited equipment in the room, the fact that it stored the books and accounts of the activity, and Mr. Nash's testimony that the room was never used for any other purpose than the business. The FDR attorney's cross-examination of Mr. Nash highlighted the presence of a TV, a radio, a recliner, and a fireplace, and the fact that the Nashes' dogs would be present when the Nashes were working in the room. Examinees should argue that these facts are not inconsistent with "exclusive use," at least in the absence of contrary proof by the FDR. And Mr. Nash explained the reason for the TV and the radio (staying abreast of weather developments).

*Lynn v. Franklin Dep't of Revenue* (Fr. Tax Ct. 2013) is relevant to this issue. *Lynn* deals with two separate spaces, approving a home office deduction for one but not for the other. Examinees can analogize the Nashes' situation to the first space discussed in *Lynn*. However, an examinee should be careful to note the physical differences between the Nashes' room and this first space, which had a separate entrance and a regular use as a client meeting place.

At the same time, the tax court in *Lynn* denied the deduction for use of the second space (the "computer office room" of the taxpayer's apartment) at least in part because the taxpayer failed to provide a sufficiently specific description of the actual uses to which he put the second space, and there was some testimony that the taxpayer made personal use of the room by watching his daughter there. Examinees may want to contrast the specificity with which Mr. Nash has described his use of the home office with the lack of specificity displayed by the taxpayer in *Lynn*.

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