1970

Taxation of Partnerships, Estates, & Trusts: Final Examination (May 23, 1970)

William & Mary Law School

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Instructions: In each of the following questions assume that all parties are on the cash basis, calendar year method of accounting unless otherwise noted.

QUESTION 1: (40 min.)

"D" died on March 30, 1966. He had a will which provided as follows:

"All of my estate I leave in trust for my wife for her life. All trust income shall be distributed to my wife not less than semi-annual. In addition, my trustee in his sole discretion may distribute principal not to exceed $1,000 per year to my wife for her health and welfare. On the death of my wife the trustee shall distribute the corpus of the trust to my only son, Robert"

"I appoint "E" executor of my estate"

"I appoint "T" trustee"

The estate received $20,000 of dividend income in the taxable year 1966. The estate had no expenses and made no distributions. In 1967 the estate received $18,000 of dividend income and $2,000 of taxable interest prior to June 30, 1967. On June 30, 1967, the estate paid from principal an executor's fee of $5,000 and an attorney's fee of $5,000 and funded the trust with the net estate. The trustee, T, invested all the funds in bonds, however, no interest income was received until February 15, 1968. The trust made no distributions in 1967.

Questions:

2. Compute the gross income, distributable net income, the distribution deduction, and taxable income of the estate and trust for the year 1967.

3. Discuss the tax consequences to D's wife as a result of these transactions for the years 1967 and 1968.

QUESTION 2: (30 min.)

"G" created an irrevocable trust which provides that the income is to be divided among his three sons, "A", "B" and "C", one-third each. Each son upon attaining the age of 21 is to receive one-third share of the corpus and accumulated income. If he does not attain age 21, his share shall be divided between his brothers if they attain age 21. Otherwise, that share shall go to C's wife. The trustee has the power to invade corpus for the benefit of "A", "B" and "C", but this power is limited to the extent of one-third of the corpus allocable to each beneficiary. In 1968 distributable net income and trust income was $60,000. On December 31, 1968, the trustee distributed $18,000 of current income to "A", "B" and "C". (A total distribution to all three of $54,000). In addition, the trustee made a distribution to "A" of stock from corpus, which had a basis of $4,000 and a fair market value of $8,000.

Questions:

1. What amount of income must be reported by "A" as a result of the transactions set forth above?

2. If on July 1, 1969, "A" sold the stock to "C" for $10,000, what would be the nature and amount of gain or loss to "A"?

QUESTION 3: (40 min.)

F created an irrevocable trust for the benefit of his mother, "M", his son, "S", and a charity, "C". The trust was to continue for a term of 12 years at the end of which time the corpus would revert to "F". The trust instrument provided, that the first $10,000 of trust income shall be distributed to "M" and the balance...
shall be paid to "C" or "S" as the trustee in his discretion shall determine. However, in no event shall any trust income be accumulated.

In 1968 the trust had the following receipts and expenses:

<table>
<thead>
<tr>
<th>Receipts</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxable Interest</td>
<td>$10,000</td>
</tr>
<tr>
<td>Tax Exempt Interest</td>
<td>$10,000</td>
</tr>
<tr>
<td></td>
<td>$20,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment fee charged to</td>
<td>$2,000</td>
</tr>
<tr>
<td>corpus, for counseling with</td>
<td></td>
</tr>
<tr>
<td>respect to the taxable bonds</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$2,000</td>
</tr>
</tbody>
</table>

The trustee distributed $10,000 to "M", $5,000 to "C" charity, and $5,000 to S.

Questions:

1. Compute the gross income, distributable net income, distribution deduction and taxable income of the Trust for the year 1968. Also identify the amount and nature of income reportable by "M" and "S".

2. How would your answer change if there was no investment fee and in addition to the other income the trustee sold some unproductive stock and had a capital gain of $10,000?

QUESTION 4: (10 min.)

Richard Richman died, leaving a vast estate. He bequeath the estate as follows:

"To my brother Charles $10,000."

"All the rest and residue of my estate to be divided between
my brother Charles and my brother George."

Estate administration will require some time. Several years will pass before the estate will be closed. Charles is in need of money and would like an immediate distribution of $40,000.

What suggestion would you make to Charles?

QUESTION 5: (60 min.)

In 1962 "A", "B", "C" and "D" created a partnership to which they each contributed $10,000 in cash. The partnership agreement provided that the partners would share equally all profits and losses. Since 1962 the partners have withdrawn only earnings but all of their distributive shares of earnings have been withdrawn. The partnership has borrowed money from time to time, but all of the loans have been repaid, except for those noted on the balance sheet. The balance sheet as of January 1, 1970, is as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
<td>Basis</td>
</tr>
<tr>
<td>No. 1</td>
<td>30</td>
</tr>
<tr>
<td>No. 2</td>
<td>9</td>
</tr>
<tr>
<td>No. 3</td>
<td>4</td>
</tr>
<tr>
<td>No. 4</td>
<td>0</td>
</tr>
<tr>
<td>No. 5</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>48</td>
</tr>
</tbody>
</table>

(a) Item No. 1 is cash
(b) Item Nos. 2 & 3 fall within section 751(d).
(c) Item No. 4 is an unrealized receivable.

"D" retired as of January 1, 1970, and the partnership has in accordance with the partnership agreement paid to him in liquidation of his interest in the partnership the sum of $20,000 and has assumed his share of the liabilities. The partnership agreement provided that a retiring partner was to receive his share of book value of the assets plus $2.00 for his share of the goodwill.
Questions:

1. Discuss the tax effects to "D" as a result of this transaction. Indicate not only the amount of income or loss but the nature.

2. Discuss the effect of the transaction on the basis to the remaining partners of their interest in the partnership.

3. Discuss the effect of the transaction on the basis of the partnership assets with respect to the remaining partners.

4. Would the result in this problem be any different if "A", "B", "C" and "D" were brothers?

5. How would "D's" treatment of the transaction have changed if the individual partners "A", "B" and "C" had purchased his partnership interest from him under the same terms?

6. If the partnership in this question was on a fiscal year method of accounting (you may assume for the purpose of the rest of the problem that it is on a calendar year method) would that give you any clue to the taxable year of the other partners? - Same question, only the partnership is on the calendar year method.