1973


William & Mary Law School

Repository Citation
https://scholarship.law.wm.edu/exams/376

Copyright c 1973 by the authors. This article is brought to you by the William & Mary Law School Scholarship Repository.
https://scholarship.law.wm.edu/exams
I

In two sentences or less, identify or explain:

a) A tax on the failure to distribute income to owners of equity interests.

b) Provision affording residents of common law states income tax parity with residents of community property states.

c) When the term 'over-night' is significant.

d) Edwin Cohen

e) Thin incorporation

II

Mary Q. Contrary, a spinster, gardens as a form of recreation, concentrating all her efforts in growing beautiful roses (most of which she leaves on the bushes to beautify her landscape). From time to time she sells roses to florists who request them of her, but she does no advertising. In 1972 she received $300 from the sale of roses. However, she spent a total of $500 in 1972 on fertilizer, plants, labor, and gardening magazines in the pursuit of her rose growing activities. How do the above mentioned receipts and disbursements affect her tax liability for 1972, assuming she had $5,000 in ordinary income from other sources?

III

Mr. Jones, who is 64 years old, many years ago purchased, for a single premium of $10,000, an annuity which will pay him $3,000 a year commencing at age 65. Jones will be 65 on January 1, 1974, at which time his life expectancy will be 15 years.

a) How will Jones’ tax liability be affected with respect to the above if he dies on June 30, 1973?

b) What portion of the annual payment will be taxable if Jones lives out his life expectancy?

c) What portion of the last three years’ payments will be taxable if Jones lives to be 83 years old, assuming no change in the law?

IV

As Assistant Secretary of the Treasury for Tax Policy, you are asked to recommend income tax amendments or changes which would help accomplish the following. As to each, what would you recommend?

a) Increase consumer spending, thereby stimulating the economy.
b) Encourage persons whose annual income is under $15,000 to purchase straight life insurance, thereby helping assure security to dependents of low and moderate income persons in the event of death of the latter.

c) Encourage states to rely more heavily on state income tax revenues and less heavily on sales tax revenues.

d) Encourage each taxpayer to invest up to $1,000 in American industry.

V

On January 1, 1972, Sam Smith placed in service a machine acquired new at a cost of $10,000 and having a useful life of 5 years, a newly constructed rental apartment building having a useful life of 50 years and costing $100,000, and a newly acquired, but previously used office building which cost him $75,000 and had a remaining useful life of 20 years. Ignoring ADR and section 179:

a) What is the maximum amount of depreciation that can be taken on each item for 1972, and by which method of depreciation is that maximum amount determined?

b) If Smith sells the new machine on January 1, 1973, for $9,000, what amount of gain, if any, will qualify for favorable capital gains treatment?

c) If Smith, on January 1, 1973 exchanges the office building for another office building in a different city, having a value of $78,000, the exchange of buildings being the only consideration involved, what will be Smith's income tax effect and what will be his basis in the new building?

VI

Bruce Elfish and Delilah Hanksiler married in 1955 and have three children. Their marriage is on the rocks. Delilah has instituted divorce proceedings, and they have discussed terms of settlement. Bruce has retained you for legal advice and does not wish to contest the divorce or oppose the wife's custody of the children. Bruce reports to you that Delilah has indicated her willingness to accept either of the following arrangements:

a) Bruce to give to Delilah 500 shares of XYZ stock which cost Bruce $40,000, but which is now worth $80,000, and Bruce to pay Delilah $100 per month for each child until the particular child reaches age 21.
b) Bruce to pay Delilah $600 per month so long as she does not remarry and the children are under 21 years of age, but the payments to reduce by $300 per month upon her remarriage, and to reduce by $100 per month as each child reaches age 21.

c) Bruce to give Delilah $25,000 in cash plus $12,000 per year for 5 years and in addition, to pay $125 per month for each child until such child reaches age 21.

d) Bruce to pay Delilah $200 per month until she remarries, plus $150 for each child until such child reaches age 21.

Assume that Bruce and Delilah own no property jointly, and that in consideration of Bruce's agreeing to the foregoing, Delilah will relinquish all of her marital rights, and that the Court would regard any of the foregoing as a reasonable settlement from the standpoint of Delilah and the children. Advise Bruce as to the advantages and disadvantages of a, b, c, and d in the spaces allowed above. In the space provided below, and assuming that the advise is worth $300, phrase your bill to Bruce for services rendered.

VII

Fred Brown owns, as proprietor, a small building on a two acre lot on which he has conducted an increasingly successful restaurant for many years. He has received a number of offers to buy him out and is considering each. His basis in the business is $70,000, his recapturable depreciation is $15,000, and he estimates the business to be worth $150,000. As to each proposal, advise Fred of the probable tax consequences:

a) Buyer A proposes to offer Fred $150,000 on a cash purchase.

b) Buyer B proposes to pay $30,000 in cash and $120,000 in four annual installments of $30,000 each plus 7% interest annually on the unpaid balance.

c) Buyer C proposes to pay Fred $10,000 in cash plus 15% of the gross income from the business for 10 years. The business grossed $100,000 last year.

d) Buyer D proposes that he exchange his estate at Cape Code, which is worth $150,000 to Fred for Fred's business.
VIII

Bill Smith had a good year in 1972. In January his wife died and he received $20,000 in insurance proceeds on a policy on her life on which he had paid only $5,000 in premiums. Although he was sick in February and was not paid his salary for the three weeks he did not work, having used up all his sick leave in 1971, his employer's Blue Cross Plan for employees paid all of the doctor and hospital bills incurred, which amounted to $600. In addition, Smith had an "income continuation" health policy with New York Life and Health Insurance Company on which Smith paid $10 per month in premiums and this policy paid Smith $500 per week for the 2nd and 3rd weeks of his illness and absence from work. In March Smith, who was a novice poet, sold a collection of poems he had written to a publisher for $3,000. In April Smith was taken to lunch four times by a real estate agent who represented a prospective purchaser of land Smith owned. The agent paid for Smith's meals, which, including martinis, came to $30.00, but Smith did not choose to sell the land. In May Smith got lucky in a poker game and won $200. In June Smith, on a dark rainy night, stopped to help a traveller in distress who had a flat tire. The traveller gave Smith's name and address and offered him $10 as a token of his appreciation, but Smith declined, saying that the "pleasure of helping my fellow man is reward enough". Two days later, however, Smith found $1,000 in cash in an envelope slid under his front door with a note saying "Thanks, a grateful man—since you don't know me, you can't return it to me". In July Smith, on learning that a destitute family's home had just been destroyed by fire, gave $500 to the family anonymously. He also gave $500 to his alma mater. In August, a local civic club, aware of Smith's generosity and community service, had a dinner in his honor, proclaimed him "Citizen", gave him a check for $500 and a two-week paid vacation to Honolulu, which was worth $2,000. Smith gratefully accepted. In September Smith, on a return flight from Honolulu, was involved in a plane crash and was badly shaken up and had minor cuts and wounds. The airline's insurance carrier negotiated a tort claim settlement with Smith and paid him $3,000. In October Smith was told by his employer that he had been ear-marked for promotion and was asked to enroll in an M.B.A. night program at the local university to improve his business and management skills. Smith, who was a junior executive, did so, paying the semester's tuition of $400 out of his own funds. In November Smith, who was now very glad he had not sold the land he owned, discovered that it contained valuable mineral deposits and was worth at least 10 times the $20,000 he had paid for it in 1970. He went to a local finance company and borrowed $20,000, giving a deed of trust on the land as security. In December Smith's employer offered Smith a $1,000 bonus for a job well done, or in the alternative, an additional two weeks vacation with pay to be taken at the end of the month. Smith decided to take the vacation with pay even though he was only making $300 per week, and left for Europe on December 17. While there he met a widowed heiress from Nevada, whom he married on December 23. She unfortunately died three days later without a will and Smith inherited her entire estate, which after death taxes, exceeded $3,000,000. Overcome with sadness, he returned to this country, reported for work on December 29, and repaid the loan to the finance company on December 30.

As to the above events and transactions, note the tax implications to Smith.

January:
A, B, and C, adjoining landowners who want to go into business together to subdivide real estate, convince D to join them in the venture. They decide that on July 1, 1973, they will form a corporation. A, who owns land having a basis of $5,000 and worth $55,000, on June 20, 1973, borrows $10,000 from a bank and gives a deed of trust on the land as security. B owns land having a basis of $30,000, but which is worth only $25,000. C owns land worth $28,000 and having a basis of $10,000. D has $25,000 in cash. On July 1, 1973, A, B, and C each contribute their land to the newly formed corporation and D contributes $25,000 in cash. The corporation issues 25 shares of no-par common stock to each and, in addition, assumes the deed of trust on A's land and pays C $3,000 in cash. Discuss the income tax consequences to A, B, C, and D, and to the corporation, indicating the basis of the stock and assets after the transaction.
Jones owns all the stock in Corporation X, which stock has a basis of $50,000. Corporation X has retained earnings of $85,000, no liabilities, and recapture depreciation of $20,000. Jones estimates the assets of the corporation to be worth $150,000. In declining health, Jones, age 67, wants to get out of the business. Jones' wife is dead and his will leaves everything to his son, age 25. Black has offered Corporation X $151,000 for the assets and in the alternative, has offered Jones $135,000 for his stock. Black is willing to pay cash or buy on time giving notes at 7% interest. Black is also willing to lease all the assets of the corporation for a rental of $15,000 per year for 10 years, if he can have an option to purchase the assets in 10 years at a price of $130,000 on the termination of the lease. The assets of the corporation consist primarily of land and a building used as a restaurant. Discuss the options available to Jones in getting out of the business, pointing out tax considerations pertinent to both Jones and Smith.

Baxter, excluding the impact of the transactions which are described as follows, has, after deductions and exceptions, taxable income of $10,000. Taking into account all the following, what is his taxable income?

a) Sale of ATT stock held 9 months and purchased for $5,000, for $7,000.
b) Sale of automobile used entirely for business since its purchase 2 years ago, having an adjusted basis of $1,200, for $1,000.
c) Sale of IBM stock held 3 months, and costing $4,000, for $6,000.
d) Sale of a persian rug acquired in 1970 for $1,000 and used as a living room rug, for $500.
e) Sale of letter on June 1, 1973, written by General Douglas MacArthur to Baxter's father in 1943, which Baxter inherited from his father in March of 1973, to a collector for $10,000.

Williams, whose income as an accountant is $30,000 a year, believes in year end tax planning and is on the cash basis, did the following in December of 1972:

a) The bills for services he normally sent out in December were held, and not mailed until January 2.
b) A fee of $300, owing to him from an attorney, was cancelled when the attorney, in exchange represented him without charge in a personal real estate acquisition.

c) He asked a client who came in on December 20, 1973, to pay a $100 fee, to come back in January to make payment.

d) He hired his 14 year old son as an office boy on December 17, and paid him $200 per week for 2 weeks over the Christmas vacation.

e) Stock which cost him $2,000 and having a fair market value of $5,000 he gave to his church.

f) Stock which cost him $10,000 he sold to his wife for $3,000, its fair market value.

Assuming a revenue agent will learn of the above matters, are the transactions effective to reduce his tax liability for 1972? Comment in the spaces provided.