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Basic Federal Taxation: Final Examination (January 1968)

William & Mary Law School

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FINAL EXAMINATION

1. T paid over one half the support of his 63 year old father who had a gross income of \$900 a year. During the year T paid medical expenses on behalf of his father, the amount being in excess of 3% of T's adjusted gross income.
 - (a) Is T entitled to a medical expense deduction? (T itemizes deductions) (3 points)
 - (b) Is T entitled to a dependency exemption on his father? (3 points)
2. T, a cash basis taxpayer, was not paid his wages for eight weeks preceding his death. Two months after T's death T's executor received these wages. Does T's final return include these wages? Does the estate (income) tax return include it? (5 points)
3. L, an accrual basis taxpayer, leases property to T, also an accrual basis taxpayer. The lease starts on 1/1/67 and runs for 10 years at an annual rental of \$1,000.00. T is required by the terms of the lease to pay the tenth year rent during 1967 (as well as the 1967 rent). How much rental does L include on his 1967 return? How much rental does T deduct on his 1967 return? (2 and 3 points respectively)
4. Your employer pays life insurance premiums on a permanent life insurance policy. You name the beneficiaries. Under what circumstances are the premiums taxable to you? Under what circumstances are they not? (4 points)
5. Your employer pays premiums on a group term life insurance policy. Are the premiums he pays on your behalf taxable? (3 points)
6. A divorce decree provides for alimony payments as follows: \$10,000 upon entry of the decree, \$15,000 a year (including the year of divorce) for 6 years, and \$4,000 a year thereafter for 5 years. During the first 6 years \$2,000 of the \$15,000 is designated as child support payment. How much, if any, of these payments is deductible by the husband. Explain. Be sure to distinguish between the various forms of payment. (7 points)
7. In 1967 you sold your home that cost you \$22,000 for \$27,000. The buyer assumed a \$17,000 mortgage, made a downpayment of \$3,000, and payments of \$1,000 a year principal for 7 years, beginning in 1968. How much gain do you include in your 1967 return? (2 points) How much in any of the next 7 years? Explain. (1 point) If the buyer had paid off the mortgage instead of assuming, how much would you include in your 1967 return? Explain. (2 points)
8. T creates a trust for a term of 15 years, at which time the corpus is to revert in him. At the end of the 14th year the trust is extended for 5 years from the original termination date so that it will have a total term of 20 years. Whose income is the trust income during the first 14 years? (1 point) Whose income is the trust income during the 15th year? (2 points) Whose income is the trust income during the last 5 years? (3 points)
9. W created a trust for her children. She reserved no beneficial interest, no power to revoke, no other power. She did, however, confer on H the power to terminate the trust at any time and take the principal of the trust for his own benefit. H did not exercise the power. Whose income is the income of the trust? (4 points)

10. On 2/5/67 T sold his residence which cost him \$9,500 for a net price of \$17,500. Just prior to the sale he spent \$500 painting the house to make it more saleable. On 8/8/67 he bought a new residence for \$15,000. How much gain does he report in 1967? (5 points) What is the basis of his new residence? (3 points)
11. T comes to your office and, inter alia, gives you the following information in regards to preparing his 1967 income tax return:
- (a) He had an auto accident with his personal auto, auto cost him originally \$3,000, value before accident \$1,800, value after accident, \$1,300, no collision insurance. (3 points)
 - (b) He sold 100 shares of GM stock which he held since 1952 at a gain of \$5,000. (1 point)
 - (c) His yacht which cost him \$12,000 in 1956 was requisitioned by the Government at its fair market value of \$5,000. (2 points)
 - (d) Sold a machine used in his business for 8 years at a gain of \$400 (forget \$1245 for this problem) (2 points)
 - (e) Termites chewed up a porch on his residence, cost of repair-\$3000. (Use IRS view on this matter) (1 point)
 - (f) Summer cottage hit by hurricane. Cost of cottage \$5,000, value before hurricane \$8,000, value after hurricane \$6,000, cost of repair \$2,300. No insurance. (3 points)

How and where on the return will you show these items?

12. T owns 60% of C corporation. T's wife owns 15% of C corporation. C corporation owns 70% of S corporation. T sells a building to S Corp. at a loss of \$1,000. The building was used by T in his trade. Where and how does T deduct this loss on his return? (5 points)
13. Ee works for Er. During the year Ee spent \$150 on reimbursable business expenses but chooses not to ask for reimbursement. Where and how does he deduct this expense on his return? (3 points)
Ee's father owns a huge tract of land which Ee will eventually inherit. The father doesn't earn much money now, although he does earn over \$600. Ee feels obligated to pay the property taxes on this land which amount to \$2,000. Where and how does Ee deduct this payment on his return? (2 points)
14. B, a general practitioner of medicine, takes a course of study in order to become a specialist in pediatrics. C a general practitioner of medicine takes a 2 week course reviewing developments in several specialized fields, including pediatrics, for the purpose of carrying on his general practice. What expenses may B deduct in his tax return in connection with this study? Why? (5 points) What expenses may C deduct? Why? (5 points)
15. T is a construction worker, with no permanent locus of employment, but has to travel from job to job. He maintains his home in Raleigh, N.C. where his family lives. During 1966 he worked 8 months (continuously) at Kinston, N.C. When he took the job he didn't know how long it will keep him in Kinston. He deducted on his tax return the cost of board and lodging at Kinston. Will the deduction be allowed? (5 points)

16. (a) What is the purpose of depreciation? (1 point)
- (b) In what respects is depletion different from depreciation? (1 point)
- (c) At the present time why do business people prefer LIFO method of accounting as opposed to FIFO? (1 point)
- (d) In general terms what does §1245 accomplish? (1 point)
- (e) What is the purpose of the "tax benefit rule"? (1 point)
- (f) Why was it necessary to have specific provisions for loss carry-backs and carry-forwards? (1 point)
- (g) Why the installment sales provisions? (1 point)
17. A borrows \$1,500 from the bank for use in his business. T is guarantor on this note. A fails and T pays off the note. Can T deduct any of it? How much? Towards adjusted gross or from adjusted gross? (3 points)
18. T donated stock that cost him \$1,000 to a college when the market value was \$10,000. What is the maximum deduction he is entitled to? (You'll have to express it on a percentage basis.) (1 point) Disregarding the maximum limitation how much may he deduct? (1 point) Assume that before giving it to the college, T borrowed \$9,500 and pledged the stock to the lender. The college redeemed the stock and sold it for \$10,000. What are the tax consequences to T? (3 points)
19. What is the basis for gain or loss on disposition of property acquired:
- (a) By gift (2 points)
- (b) By inheritance (1 point)
- (c) Upon termination of lease, i.e., lessee's improvements remaining on lessor's land (1 point)
- (d) By raising livestock - cash basis taxpayer (1 point)
- (e) By raising livestock - accrual basis taxpayer (1 point)
20. T sold a building in 1965 and was paid in full. He guaranteed the building against defects for a period of 2 years. In 1966 a serious defect was discovered and in 1967 the matter was settled by a payment of \$1,000 by T. May T amend his 1965 return and deduct the \$1,000 from the profit of that year? Explain. (5 points)
21. T, a married man, comes to your office and tells you that he retired during the current year and is receiving \$100 per month annuity from his employer for the rest of his life, and wants to know how much, if any thereof, is taxable. What information will you need from him before you can answer this question? Explain why you need each item of information. (10 points)