

ST. MARY'S UNIVERSITY SCHOOL OF LAW

Federal Income Tax LW7376
Professor G. Flint

FINAL EXAMINATION
Fall 1996

INSTRUCTIONS
ESSAY—3 Pages

ALL ANSWERS ARE TO BE WRITTEN ON THE BLUE BOOKS PROVIDED WITH THIS EXAMINATION.

There are four questions of equal value. The time for completing the examination is three hours.

1. This examination is "open book." You may use your casebook, statutory supplement, and classnotes. Use of calculators is permitted.
2. Be sure to answer the specific question that is asked. Information supplied relating to some unasked question will not increase your score and consumes your time needed to answer the asked questions.
3. If additional facts are necessary to resolve an issue, specify what additional facts you believe to be necessary and why they are significant. You may not make an assumption that changes or contradicts the stated facts.
4. Quality, not quantity, is desired. Think through and briefly outline your answers before you begin to write.
5. Write legibly. Be sure to formulate your answers in complete sentences and paragraphs with proper grammar. Failure to do so will result in an appropriately lower score.
6. Do not seek an interpretation of language in the questions from anyone. If you sense ambiguity or typographical error, correct the shortcoming by shaping the question in a reasonable way and by recording your editorial corrections in your answer.

Under the Honor Code, when you turn in this examination, you affirm that you have neither given, received, nor obtained aid in connection with this examination, nor have you known of any one so doing. If you cannot make this affirmation, you shall note such fact on your examination and must immediately advise the Dean of the reason therefor.

EXAM NUMBER

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1. Arunah Hubbell, a member of Suem and Stickem, P.C., eight years ago decided to provide for the day when he will no longer desire to fight in the courtroom. So at age 50 he purchased a deferred annuity for \$300,000 from some of his PI winnings. This annuity grows at 6% each year and is expected to pay out \$54,000 beginning the year after he turns age 62 for 20 years.

Arunah Hubbell's retirement plan, however, had one flaw. His spend-thrift wife, Ruth Maria (Smith) Hubbell has spend so much that now Arunah Hubbell needs to find some cash quickly to cover his bills in the amount of \$50,000. Arunah Hubbell is considering the possibility of borrowing against the equity in his annuity interest free, or from the firm as a salary advance for one year at 10% interest, and has entered your associate's office at Suem and Stickem, P.C., for financial advice. You are one of the business lawyers in the firm. You know that Arunah Hubbell's children are independent adults, that Arunah Hubbell uses the standard deduction in computing his income taxes, and that his net as a member is \$200,000 annually. What is your advice and its reasoning.

2. John Gilmore, a senior litigation partner at Silk Stocking Law Firm, is selling his Brazos Bottom Farm that he bought 10 years ago for \$100,000. The buyer does not have enough money to pay the asking price this year. He needs financing and is considering obtaining a three-year loan from a local insurance company. John Gilmore is considering providing seller financing. The deal presently proposed is either a sales price of \$273,000 or \$100,000 down and \$100,000 each in the next two years. John Gilmore has entered your office for advice. You are an associate in the firm's tax section. You know that John Gilmore is single, has no dependents, uses the standard deduction in computing his income taxes, and that his net as a partner is \$200,000 annually. The applicable Federal rate is 10%. What is your advice and its reasoning.

3. Marion Gasaway has a sizeable investment account in street name with a local brokerage house. Whenever he needs funds he just margins a portion of the account. He presently has the account fully invested in marginable stock. The broker loan rate currently is 10%. Marion Gasaway's current broker loan amounts to \$60,000. The account also currently generates \$20,000 in annual dividend income.

Marion Gasaway also has a Visa account that his spouse, Mary Angeline (Rogers) Gasaway, has driven up to \$20,000 with her extravagant spending on clothes and other household items. The Visa account charges interest at 19%. So Marion Gasaway has been thinking of writing a check against his margin account to pay off the Visa account in order to pay less interest.

Marion Gasaway also wants to purchase a limited partnership interest in a partnership that operates an apartment complex. The partnership is offering bank loans bearing a 12% interest rate. For Marion Gasaway the interest payment would amount to \$12,000. Marion Gasaway's share of the partnership

income for the current year would be \$3,000 but the partnership will make no distributions this year. Again Marion Gasaway is considering of purchasing the partnership interest by writing a check against his margin account so he will pay less interest.

But at a cocktail party one of Marion Gasaway's doctor friends indicated this might not be a wise thing to do taxwise. Consequently, Marion Gasaway has entered your office, an associate at Silverspoon & Assoc., P.C., for advice on his course of action. You know that Marion Gasaway is married, has two dependents, itemizes his deductions in computing his income taxes (typically in the amount of \$20,000), and that his salary as a dentist is \$150,000 annually. What is your advice and its reasoning.

4. Some commentators urge that the current income tax system should be scraped for an expenditure tax system, that is, where an entity's or individual's federal tax would be based on what was spent. The idea is to encourage saving, making such moneys available for investment, which in turn would provide jobs. The current income tax code has some features of this expenditure tax. What are they, how do they operate, and do they achieve the desired goal.