

FINAL EXAMINATION
FEDERAL INCOME TAX
PROFESSOR G. FLINT

ESSAY
PLEASE READ CAREFULLY

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

There are four questions of equal value (time and percent indicated). 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 answer 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.

I.
(25% — 45 minutes)

Arunah Hubbell, an associate at Suem and Stickem, P.C., fancies himself an astute investor. For calendar 1997 he has made a number of trades through his brokerage firm of Chauncy Belden Smith Incorporated listed in the following table:

| <u>Security</u> | <u>Date bought</u> | <u>Price bought</u> | <u>Date sold</u> | <u>Sale Price</u> |
|-----------------|--------------------|---------------------|------------------|-------------------|
| 1 T-bond 8% | 04/03/96 | \$920.00 | 05/08/97 | \$960.00 |
| 200 IBM | 03/05/96 | 45.00 | 02/06/97 | 105.00 |
| 500 Sears | 03/18/97 | 65.00 | 10/18/97 | 45.00 |
| 300 Kodak | 10/22/97 | 61.00 | 10/26/97 | 66.00 |
| 200 Caterpillar | 08/10/96 | 63.00 | 10/21/97 | 44.00 |
| 1 S&P future | 11/04/97 | 927.00 | 11/11/97 | 957.00 |

The treasury bond has a \$1000 face and pays interest on January 1 and July 1. Dividends on the stock are paid on January 1, April 1, July 1, and October 1 in the amounts of \$1.50 per share for Kodak and Caterpillar, \$0.90 per share for Sears, and \$0.30 per share for IBM. Arunah Hubbell executes these transactions by computer, so Chauncy Belden Smith Incorporated charges \$10 for each trade, regardless of whether the transaction is for bonds, stocks, or futures.

Unfortunately, Arunah Hubbell never did well with arithmetic problems in school. So he has hired you, an associate at Silver Stocking Law Firm, to prepare his tax return for \$300. Your investigation of Arunah Hubbell's tax picture reveals that he is in the 28% marginal tax bracket and has a long-term capital loss carry forward of \$200. In what ways has this trading affected Arunah Hubbell's income tax. Show and explain your work.

II.
(25% — 45 minutes)

Bateson Crampton and Rachel Maria Jewell, two other associates at Suem and Stickem, P.C., fancy themselves as real estate investors. They have formed a partnership with Bateson Crampton owning 60% to Rachel Maria Jewell's 40%. Bateson Crampton performs all the leg work, hiring of workers, and preparing the documents. They have purchased a rent house near the local university for \$50,000 on April 3, 1997. They paid down \$10,000 from their partnership. The remaining \$40,000 they borrowed from Jan Groot Bank, paying \$400 in origination fees and \$500 in closing costs. The loan bears interest of 8%, payable annually on December 31. The principal is to be paid at the end of five years. The house already had a tenant who pays rent of \$800 per month. Yard work has been averaging \$30 per month. The one repair for 1997 cost \$350. The tax statement for 1997, for which the partnership pays its pro rata portion, valued the underlying land at \$10,000 and listed taxes of \$1500.

Because you did such a fantastic job for Arunah Hubbel, Bateson Crampton has also decided to hire you to prepare the partnership tax return. How will this partnership tax return affect the income taxes of both Bateson Crampton and Rachel Maria Jewell, who are in the 20% and 15% marginal tax brackets for the year 1997. Show and explain your work.

III.

(25% — 45 minutes)

Davis Flint, one of the senior partners, has entered office at Silver Stocking Law Firm. He wants to know whether he should convert his IRA into a Roth IRA. The Roth IRA was recently added to the tax code. It provides for nondeductible contributions in the same amounts as for IRA's, but after five years there are no restrictions on withdrawals and no taxes on withdrawals. While the contributions are in the Roth IRA they earn tax free. In a regular IRA withdrawals before age 59 1/2 are penalized with a 10% excise tax, all withdrawals are subject to the income tax, and withdrawals must start at age 70 1/2, but can be withdrawn over your life expectancy. To convert, the amount in the IRA is subject to the income tax without any excise tax. If the conversion occurs in 1998, the income tax can be paid over four years.

Davis Flint wants to know whether he would be better off converting his IRA or leaving it as a regular IRA. Davis Flint's marginal tax bracket is 28% and the amount in the IRA is \$150,000. Davis Flint is age 53 and plans never to retire (bad news for associates and junior partners). The life expectancy of one aged 71 is 15 years. What is your advice? Show and explain your work.

IV.

(25% — 45 minutes)

Your first legal job is as a staff member of U.S. Senator John Gilmore of New York. Your first assignment is to recommend to the Senator changes to the Internal Revenue Code. What changes would you recommend for what reasons? Provide support for your reasons.