

**COURSE:** Federal Income Tax - SAMPLE EXAM

**PROFESSOR:** C. Johnson

**DATE OF EXAM:**

- 1) This is an open book exam. You may use any materials.
- 2) Write your exam number here >\_\_\_\_\_. Please also write your exam number on each sheet of exam paper.
- 3) This exam consists of \_\_\_ pages including this page and the affidavit at the end. Please count the pages. If your exam does not contain \_\_\_ pages including this page and the affidavit please see the proctor at once. Do not forget to sign and return your affidavit sheet separately.
- 4) There are \_\_\_ questions on this exam. You must answer them all.

Special Instructions: The number of points each question is worth and the recommended time for each question is written at the top of each question. Please pace yourself.

**Please write the answers to Question 1 in the space provided directly on the exam.**

Please begin each question on a new sheet of paper.

- 5) If a question is ambiguous, please make appropriate assumptions.
- 6) You will be given 3 hours (time) to complete this exam. You will not be given extra time at the end of the exam to put your exam and page numbers on your answers.

At the end of the exam, all writing must cease the examination must be turned in at once. Failure to comply with the published examination procedures and instructions of the proctor may violate applicable sections of the Loyola Code of Student Conduct.

- 7) When you have completed the exam please do the following:
  - a) staple this page and all of the exam pages to the top of your answer pages and turn them in;
  - b) return all unused exam paper to the proctor;
  - c) return a signed copy of the honor affidavit;
  - d) leave the area of the exam quietly. Do not distract others who may be taking exams.

Question 1

Sample Short Answer Questions

(2 pts each - 2 minutes per answer)

(A) Why should a taxpayer be required to reduce an asset's "adjusted basis" as the asset is depreciated?

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(B) Is a security deposit income for a landlord?

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(C) Why should payments for child support not be deductible?

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## Question 2

(15 points - 25 minutes)

John (“J”) owns one acre of unimproved land (the “Land”). J paid \$80,000 for the Land. The Land now has a fair market value of \$100,000. J bought the Land for investment. Bill (“B”) owns a vacant lot (the “Lot”) in downtown Chicago. B purchased the Lot six months ago for \$60,000. The Lot now has a fair market value of \$70,000. B uses the Lot as a parking lot for his business customers. J agrees to transfer the Land to B in exchange for the Lot and \$30,000 in cash from B.

Please set forth the tax consequences for the events in this question for B and J.

### Question 3

(5 points - 10 minutes)

Compare and contrast the similarities and differences between the “no-additional-cost service” fringe benefit and the “qualified employee discount” fringe benefit.

## Question 4

(15 points - 25 minutes)

In 1990, Dad gave his son (“S”) land (the “Land”) with an adjusted basis of \$10,000 and a fair market value of \$8,000. S used the Land as a parking lot for his employees. In 1992, when the property had appreciated to \$25,000, S borrowed \$20,000 from the Bank on a non-recourse basis and gave the Bank a mortgage in the Land. In 1995, when the fair market value of the Land went down to \$15,000, S discontinued making payments on the Loan to the Bank and transferred the Land to the Bank. After receiving the Land, the Bank discharged the remaining liability of S to the Bank. S is solvent.

(A) Describe the tax consequences to S of S transferring the property back to the Bank;

(B) Describe the tax consequences to S of S transferring the property back to the Bank assuming the same facts except that the Bank had recourse to S for any loan payment deficiency in addition to the Bank’s rights under the mortgage; and

(C) Describe the tax consequences to the Bank under (A) and (B) above.

## Question 5

(5 points - 15 minutes)

Dr. Mark (“Mark”) is a surgical medical resident in a hospital. Patient B (“B”) is a Saudi Arabian prince who was cared for by Mark while he was in the hospital. Mark is paid a salary by the hospital. Upon being discharged, and after paying his hospital bill, B gives Mark a rolex watch (the “Rolex”) with a fair market value of \$3,000 with a note telling Mark that he has appreciated their friendship. After giving the Rolex to Mark, B immediately leaves the country for Saudi Arabia. B is completely cured of his ailment and it is unlikely that Mark and B will ever see each other again.

What are the tax consequences to Mark regarding his receipt of the Rolex?

## Question 6

(15 points - 25 minutes)

Seller (“S”) purchased a machine to be used in his trade or business in 1990 for \$800,000. S has taken depreciation on the machine in the amount of \$300,000. B sells the machine in 1995 for 1,000,000 to Purchaser “P”. P agreed to pay S \$200,000 on the purchase date and \$200,000 each year thereafter on the anniversary date of the sale for four years.

Describe the tax consequences to S regarding the sale of the machine to P.

### Question 7

(5 points - 10 minutes)

Hank (“H”) and Wendy (“W”) were divorced after 5 years of marriage.

Approximately nine months after the divorce was final, W, an art dealer, offers to purchase a painting owned by H for \$10,000. H had purchased the painting 10 years ago for \$1,000. W pays H \$10,000 for the painting. Two years later, W sells the painting to Dan for \$5,000.

(A) Describe the tax consequences for both H and W of the sale of the painting by H to W; and

(B) Describe the tax consequences to W of her sale of the painting to Dan.

## Question 8

(10 points - 20 minutes)

On January 1st, 1995, Widget Corporation (“Widget”) makes a demand loan to its shareholder (“S”) in the amount of \$100,000 (the “Loan”). The Loan bears interest at the rate of five percent and is payable on December 31st of each year in the amount of \$5,000. S uses the proceeds from the Loan to purchase a home. The applicable federal rate is ten percent. Ten percent compounded semi-annually is \$10,250.

Describe the tax consequences of the events in this question at the end of 1995 for both Widget and S.

### Question 9

(5 points - 10 minutes)

Developer (“D”) has employed Salesman (“S”) to sell residential home sites. As a bonus for S’s exceptional performance, D transferred a residential homesite lot (the “Lot”) to S on April 1, 1995. D had purchased the Lot in 1993 for \$10,000 and it had fair market value of \$20,000 on the date of transfer. S holds the Lot for six months intending to build his personal home on the site. Because of a new job opportunity, however, S sells the Lot to Ellen for \$15,000.

Describe the tax consequences of the events in this question for D and S.

## Question 10

(10 points - 15 minutes)

Peter (“P”), a wealthy lawyer, purchases a rental building (the “Building”) in January of 1995. P hires a manager (“M”) to manage the Building. P tells M that M is to make all of the decisions regarding the building and that M should send him a check at the end of the year in the event that the building made any money. In 1995, the Building has \$10,000 of gross rental receipts and \$36,000 of ordinary and necessary expenses. In 1996, the Building has gross rental receipts of \$30,000 and ordinary and necessary expenses of \$25,000.

Please discuss the tax consequences to P regarding the Building in 1995 and 1996.

## Question 11

(5 points - 10 minutes)

Please discuss conceptually why discharge of indebtedness for a debtor and finding “treasure trove” should be considered gross income under the Internal Revenue Code. Assume that neither the Internal Revenue Code nor any Treasury Regulations expressly discuss whether the discharge of indebtedness for a debtor or the finding of treasure trove constitutes gross income.