ST. MARY'S UNIVERSITY
SCHOOL OF LAW

Fall 2006
Exam No. __________

FINAL EXAMINATION
FEDERAL INCOME TAXATION
PROFESSOR G. FLINT
ESSAY
PLEASE READ CAREFULLY

ALL ANSWERS ARE TO BE WRITTEN ON THE BLUE BOOKS PROVIDED WITH THIS EXAM. BE SURE TO NUMBER EACH RESPONSE.

There are three questions (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 class notes. Use of cell-phones, calculators and laptops and other electronic devices is not permitted.

2. **Be sure to answer the specific question that is asked. No question asks for a general recitation about a topic from you notes.** Information supplied relating to general material from your notes or some unasked question will not increase your score and consumes you 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 question 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 correction in your answer.

Under the Honor Code, when you turn in this examination, you affirm that you have neither given, received, not 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 therefore.

NOTE FOR ALL QUESTIONS--For purposes of those items that are adjusted annually by the Treasury Department to reflect inflation, use the numbers on the 2005 tax return provided with the syllabus. Also use the tax rates contained in the version of the Internal Revenue Code contained in the Supplement. Assume a federal rate of 10 %.

I. (50 %--1 ½ hours)

Davis Flint is an associate in a law firm, making $60,000 for the 2005 year. In his spare time he invests in stocks and bonds. One investment was in his client, John Hartt Incorporated, a public company. When John Hartt Incorporated was incorporated, Davis Flint obtained 1000 shares in return for property valued at $1000 but for which Davis Flint had purchased earlier for $500. Davis Flint had received stock options (in return for guaranteeing a $1000 debt of John Hartt Incorporated for two years) back in 2001 to purchase 1000 common stock of John Hartt at $1 per share of common stock. John Hartt Incorporated went public in 2004. In 2001 John Hartt Incorporated sold its common stock in a non-public offering at $1 per share. By January 2005 John Hartt Incorporated's common stock sold as high as $30 per share. So Davis Flint exercised all his stock options in January 2005. In February 2005 Davis Flint purchased 2000 shares of common stock of John Hartt at $40 per share, paying a $24 commission. In March of 2005 John Hartt Incorporated had a 5 for 4 stock split. Davis Flint felt rich now, so he subscribed to Value Line Investment Magazine for a year at $600. Davis Flint also went to the John Hartt Incorporated shareholder meeting held in Houston in April 2005, staying in the Ananiah Carll Hotel for 2 nights at $200 per night after spending $400 on airfare roundtrip, eating his meals at the hotel for a total of $350, and leasing a car for $40 per day for 2 days. In May 2005 John Hartt Incorporated announced that it needed to restate its financials to properly reflect a lesser income. The common stock nose-dived. Davis Flint managed to sell all his shares of common stock for $10 per share, with a $24 commission, in June of 2005.

Davis Flint has entered your office at Wetaxem and Upayem, P.C., seeking advice on what his tax will be for the year 2005. What is your advice? Be sure to provide reasons and support such as relevant code sections, regulations, and case law.

III. (25%--3/4 hours)

Clement Gasaway purchased a single-premium annuity when he was 50 for \$100000. The annuity will pay \$1000 per month when Clement Gasaway reaches age 65. When Clement Gasaway reaches age 65, IRS regulations say he is expected to live to age 85. When Clement Gasaway reached age 57 in 2005 he needed to borrow against \$50,000 form the annuity to met living expenses that year. At that time the cash value of the policy was \$140,000.

Clement Gasaway has entered your office at the Silk Stocking Law Firm, P.C., seeking advice on what his rights and obligations under this transaction are so that he correctly prepare his tax return for 2005. What is your advice? Be sure to provide reasons and support such as relevant code sections, regulations, and case law.

II. (25%--3/4 hours)

In March 2004 Arunah Hubbell contributed an apartment complex to a partnership. Arunah Hubbell's basis in the complex was $100,000. The fair market value of the complex at the time was $200,000. Moses Smith and Joseph Baker, the other two partners in the partnership, contributed similar complexes also with a fair market value of $200,000 in which they had basis of $100,000 and $75,000 respectively. Each partner would share income and expenses at a one-third rate. Moses Smith would to take care of all the work in operating the three apartment complexes under a contract with the partnership for 10% of the rents. For the 2005 year, Moses Smith collected $100,000 in rents for the partnership and paid $10,000 to various repairmen and lawn mowers, property taxes of $18,000, and legal fees of $5000 for forcible entry and detainer lawsuits, all for the partnership. In December 2005, Arunah Hubbell sold his partnership interest to Benjamin Rockwell for $300,000.

Arunah Hubbell has entered your office at the Blue Blood Law Firm, P.C., seeking advice on what his taxable income will be from this partnership so he will know how much he can invest in his next investment. What is your advice? Be sure to provide reasons and support such as relevant code sections, regulations, and case law.