ST. MARY'S UNIVERSITY
SCHOOL OF LAW

Spring 2007
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 two 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 2006 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. (66 2/3 %--2 hours)

You are an associate for the tax law firm of Stealem & Cheatem, P.C. One of your partners has requested that you prepare the tax return for last year for her brother Davis Flint. Compute Davis Flint's tax. Be sure to provide support for every item.

Davis Flint is an associate at The Blue Blood Law Firm, P.C. Davis Flint was single most of the year, but married Lucy Holmes on October 30. Last year Lucy Holmes was a student in college and earned nothing. All her expenses were paid for by her father. Davis Flint's salary for last year was $60,000.

Davis Flint and his fellow associates last year formed a partnership to invest in real estate. Davis Flint contributed a duplex that he had bought the prior year for $90,000, subject to a loan of 60,000. But last year after being in the partnership for 15 months, Davis Flint sold his partnership interest for $45,000 because the partnership took too much of his time.

In a second investment, Davis Flint purchased $100,000 in 10% bonds (that will mature in 3 years from the date of purchase) last year for $60,000, borrowing $40,000 from his broker for the purchase, paying a commission of $500 and accrued interest of $2,500. After holding the bonds for 9 months, Davis Flint sold them last year for $91,000, paying a commission of $500. The interest received on the bonds last year was $10,000. The margin interest paid last year was $6,000.

In a third investment, Davis Flint purchased $30,000 in stock of a software company located in Hawaii. Davis Flint still holds these shares. In June of last year, Davis Flint went to Kona, Hawaii, for the annual shareholder meeting of the company. Davis Flint returned with a tan since he had spent much time on the beach in the three days after the shareholder meeting. The airfare cost $2,000, the hotel room for five days cost $1,000, meals cost $400, and the rent car cost $200.

In a fourth investment, Davis Flint inherited a mineral interest in an oil well. The royalties paid for last year were $10,000.

To keep track of his investment opportunities, Davis Flint subscribes to the Wall Street Journal, costing $500 last year, and reserves one room in his house for his investment researches. The room is 100 square feet of space in Davis Flint's 14,000 square foot house. The utilities on the house were $6,000. Davis Flint paid $40,000 for his house, borrowing $30,000. The state real estate taxes on the house were $3,000 last year and the mortgage interest was $3,000.

Davis Flint also has a Mercedes that cost him $40,000 two years ago. Mercedes generally last 10 years. Davis Flint uses it to drive to and from his downtown office, a total of 30 miles daily for 200 days last year. Davis Flint also uses the vehicle to ferry contracts around to obtain client signatures and to meet them at the airport and ferry them to the hotel. Davis Flint keeps a log for these trips and they amounted to 1000 miles last year. Davis Flint's total mileage last year was 10,000 miles. Last year the state personalty tax on his car was $100, gas was $2,500, insurance was $900, and repairs were $600.

To impress his supervising attorney and the clients, Davis Flint purchased five custom fitting suits last year for $5,000. The supervising attorneys the year before had fired one associate for inappropriate clothes. Davis Flint also purchased some framed old English deeds for $6,000 to hang on his office wall to impress clients.

II. (33 1/3 %--1 hour)

Gladys Christian has entered your associate's office at The Silk Stocking Law Firm, P.C. She wants you to suggest the best way to minimize the capital gains on the sale of her house. What is your advice? Be sure to provide support.

Gladys Christian and George Christian, her husband, bought a house in San Antonio in 1975 for $65,000. The title was in the name of Gladys Christian and George Christian. Over the years, Gladys Christian and George Christian spent $130,000 on improvements to the house. In 1999 George Christian died and left everything to Gladys Christian. At that time the house was appraised at $350,000. The heirs of George Christian took no action to remove George Christian's name from the mortgage on, or title to, the house. Gladys Christian is now 75 years old and would like to sell the house and move to an assisted living community. Gladys Christian has hired a real estate agent who will sell the house for 6% of the selling price. The house is presently appraised at $600,000. Gladys Christian has paid off the original mortgage to the house, but took out an equity loan of $90,000 to fix the house for sale and provide rental money while the house is being shown. The fix up costs amounted to $70,000. Gladys Christian has been advised by her real estate agent that the taxes on the sale will be about $50,000 and so she will not be able to purchase the assisted living home she desired. Her sole source of income is her Social Security.