

ID # \_\_\_\_\_

**Individual Taxation**

Massachusetts School of Law- Spring 2010  
Professor McLellan

**MIDTERM EXAM**

PLEASE READ THE INSTRUCTIONS CAREFULLY BEFORE BEGINNING THE EXAM.

Instructions:

1. This exam makes up 40% of your class grade for the semester.
2. Write your id number for identification on the top of this page of the exam.
3. You have 2 hours and 30 minutes to complete this exam. As a guideline, you may spend 12 minutes per question, and then you will have approximately 30 minutes left to review your answers.
4. This is an open book exam. You may use your text book, the income tax code, and your notes. You may not use commercial outlines. You may use a calculator.
5. This exam is a short-answer exam; most questions require a one word or very short response.
6. Each answer is worth 4 points.
7. You do not need to provide rationale for your answers or support your answers with legal authority, such as Internal Revenue Code sections, Treasury regulations, and cases, unless specifically asked.
8. If you feel that it is necessary, you may indicate or suggest the need for additional facts to answer a question, but briefly explain why you believe additional facts are necessary and the result of assuming them. Do not answer questions that were not asked.
9. Except as otherwise indicated, you may assume that all taxpayers use the cash receipts and disbursements method of accounting and use the calendar year as their taxable year. Any mention of the tax consequences refers to the U.S. federal income tax consequences.

1. A lives in the 2<sup>nd</sup> Circuit and has received a notice of deficiency from the IRS. There are similar cases in the 2<sup>nd</sup> circuit court of appeals which held in A's favor. There is a Tax Court case where the outcome was not in A's favor. If A is in Tax Court, would A be likely to win or lose?
  
2. Friends of waitress come into her restaurant and order a meal. They leave an extra large tip. Is the tip income to waitress? Briefly state why or why not.
  
3. Are the following includable in employee's gross income? (Assume discounts are less than the gross profit percentage.) **Cite a relevant code section for at least 2 of your answers.**
  - a) Employee charges the cost of materials for a presentation at work on her credit card and gets reimbursed by her employer.
  
  - b) Employee of Big Burger chain gets a discount in all Big Burger stores across the country.
  
  - c) Big Burger employee gets a discount in movie theaters as part of a reciprocal program to spur the local economy.
  
  - d) Employer provides a dinner to employees who work late on Friday night.
  
  - e) Employer gives employee \$50 gift certificate each month to encourage eating lunch at a nearby diner instead of the mall across town.

4. Student receives a \$6,000 scholarship for college.

Is it income if it is for tuition?

Is it income if it is for books and supplies?

Is it income if it is used to pay for the student meal plan?

5. Husband purchases an annuity for life for his wife. He puts in \$500,000 so she will get payments of \$30,000 per year for the rest of her life. Her life expectancy is 25 years. How much of each payment is taxable as income?

6. If husband and wife in #6 above get divorced, can husband deduct any of the \$30,000 yearly payments as alimony? Briefly state why or why not and cite relevant code section(s).

7. Owner purchases land in 2006 with \$20,000 cash and an \$80,000 mortgage. In 2007, Owner constructs a house on the lot which cost \$150,000 to build. Owner lives in the house for 2 years and then sells it in 2009 for \$300,000. How much gain or loss does owner realize? How much gain or loss will the owner recognize for tax purposes?

8. Debtor owes Credit Card Company \$65,000. Debtor has \$15,000 cash and land worth \$20,000 and no other debts or assets. Credit Card Company agrees to discharge the debt for \$15,000. What are the income tax consequences to Debtor and does the transaction affect debtor's basis in the land?

9. Driver was involved an auto accident. Driver sued and won a \$60,000 personal injury award. Indicate which of the following payments are taxable to driver:

\$20,000 reimbursement for medical bills

\$30,000 reimbursement for future medical bills

\$10,000 for psychiatric care due to fear of driving as a result of the accident

10. A buys stock for \$100 in 1965. A gives stock to B in 1975 when it is worth \$50. B leaves stock to C in will in 1995 when it is worth \$250. C gives stock to D in 2005 when it is worth \$500. D sells to E this year for \$450. Who has income and how much?

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Instructions:

1. This exam makes up 30% of your class grade for the semester.
2. Write your id number for identification on the top of this page of the exam.
3. You have 1 hour and 20 minutes to complete this exam. As a guideline, you may spend 8 minutes per question, and then you will have approximately 20 minutes left to review your answers.
4. This is an open book exam. You may use your text book, the income tax code, and your notes. You may not use commercial outlines. You may use a calculator.
5. This exam is a short-answer exam; most questions require a one word or very short response. Please give a more detailed response to question 3.
6. Each answer is worth 4 points, except for question 4 which has an extra credit component. There are at total of 3 extra credit points built into the exam. You are starting the exam having already earned 4 points.
7. You do not need to provide rationale for your answers or support your answers with legal authority, such as Internal Revenue Code sections, Treasury regulations, and cases, unless specifically asked.
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1. Country Doctor makes a visit to Farmer Joe because he isn't feeling well. Country Doctor usually charges \$100 per visit. Does Country Doctor have income in the following situations? If so, how much?
  - a) Farmer Joe gives the doctor 10 chickens for the visit. We don't know how much the chickens are worth.
  
  - b) Farmer Joe gives the doctor, a long-time friend, a hand-made wood carving which is worth about \$10. Briefly explain your reasoning.
  
2. Elvis decides to rent out an apartment in his two-family home. He makes an arrangement with his friend to take \$200 per month rent in exchange for living on the first floor. His friend also gives him approximately \$1,000 worth of pirated movies and other illegally obtained merchandise each month. Does Elvis have income? If so, how much?

Elvis could rent the second floor apartment for \$800 per month, but he doesn't because he lives there one month out of the year. The rest of the year, the second floor is vacant. Should Elvis report any income associated with the second floor? If so, how much?

3. Tony works for a software company. He is currently installing and customizing a software program for a client's business. The client is so pleased with the quality of Tony's work, they give him a gift of a ski weekend get-away. The client offered the gift in the hopes that Tony would come to work for him. Tony makes it clear that he intends to stay with his current employer. The client insists that Tony take the tickets anyway. Tony finally accepts and enjoys the trip with his best friend. Does Tony have income? Briefly explain your answer utilizing any relevant cases or code sections.



4. *Citing two relevant code sections will earn you one extra-credit point:*

Terry works for a copy center and is an animal rights activist. She occasionally makes copies on her break for meetings and demonstrations. She never asks her employer for permission, but assumes it is OK because other employees do the same. Should she report the cost of the copies as income?

The copy store owner also owns the coffee shop next door. All copy store employees get a 10% discount on coffee. The gross profit percentage for the coffee shop is 25%. Do the copy shop employees have reportable income when they purchase coffee? Please explain your answer briefly.

5. Each year, a group of college students get together and have a mock awards ceremony for a person or company whose music is the most offensive. The prize of \$1,000 comes with a night of humiliation which the angry award winner suffers through and then leaves. Does this year's winner have to report the \$1,000 as income? Briefly state why or why not.

6. Madeleine gives her niece a painting that she thought would look nice in her apartment. She bought it at a yard sale for \$20 and when she was wrapping it up, she realized that the painting was by a local artist that had become famous. The painting is really worth about \$30,000. Does Madeleine have income?

The niece decides to sell the painting several years later to a friend for \$20,000. How much gain or loss does the niece have, and what is the friend's basis?

7. Marsha and Greg are divorced but are still living together in order to care for their young children. Greg pays Marsha alimony in accordance with their divorce decree. He pays \$30,000 in year one; \$25,000 in year two; and \$15,000 in year three. He moves out beginning in year three because they really don't get along and he is dating someone else. For each year, who has to include the alimony payments as income?

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5. This exam is a short-answer exam; most questions require a one word or very short response. Please limit your answers to three sentences or less. Each answer is worth 4 points.
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1. Mindy buys an antique jewelry box at auction for \$200. When Mindy arrives home, she discovers \$10,000 in gold coins in a secret compartment. Does Mindy have income? If so, when and how much?
2. Pete owns a horse farm with 10 stables. Each year he rents out 7 stables for \$10,000 each. He uses the remaining 3 stables for his own horses. The IRS says he owes \$100,000 per year in income. Are they correct? If not, how much does he owe?
3. Jen won a medical malpractice suit and received \$100,000 for injuries that she sustained plus \$50,000 for emotional distress. Does she have income? If so, how much?

4. Indicate whether the following are income, a gift, or neither:

A) John leaves his favorite law professor \$10,000 in his will.

B) John names Tom as Executor of his will and leaves him \$10,000 for his services.

C) Same as (B) above, except that Tom never pays himself.

5. Gary specializes as an image consultant to political figures and sells designer clothes. He gives his employees a special 50% discount on two outfits per year to encourage them to dress for their position. He grosses about 2 million per year and has expenses of 1.5 million. An employee buys a \$200 suit for \$100. Does she have income? If so, how much?

6. Chris buys a \$400,000 house with \$100,000 cash and \$300,000 recourse mortgage. The house drops in value to \$250,000 and he has only paid interest on the mortgage (he still owes \$300,000). If the mortgage company agrees to take the house in exchange for releasing Chris from the mortgage, does he have income? If so, how much?

7. Jeff has a painting that he purchased from a gallery for \$3,000. It is now worth \$10,000 and Julie is absolutely in love with it. She offers to trade him a stock that she purchased for \$8,000 and is now worth \$11,000. If they make the trade, who has income? How much?
  
8. In a separation agreement, Jeff agrees to pay Julia \$24,000 per month in alimony. The agreement states that about \$4,000 of the \$24,000 will go towards the children's educational expenses. How much income do they each report?