

PERSONAL INCOME TAXATION
Professor John Orcutt
Fall Semester 2020

FINAL EXAM – TAKE HOME
December 8, 2020

INSTRUCTIONS:

- Exam format.** This is an open-book, take-home examination. You will have access to your textbooks, notes, and other resources. However, you may **not** consult with anyone about the questions or the answers. You must solely produce your own work.
- Time limit.** This is a 6-hour examination and is worth 200 points (or 90% of your final grade). The examination consists of nine questions.

Question	Possible Points	Question	Possible Points
Q1	30	Q6	20
Q2	30	Q7	20
Q3	20	Q8	20
Q4	10	Q9	40
Q5	10	TOTAL	200

- Exam numbers only.** The grading of examinations is anonymous. So, you must write your examination number on the examination and your blue book. **YOU MAY NOT WRITE YOUR NAME ON ANYTHING. YOU MAY ONLY USE YOUR EXAM NUMBER.**
- Labeling your answer document.** Label your answer document with: exam number course name final and professor (no commas, dashes, etc.).

Example: 000 Personal Income Taxation Final Orcutt
- Emailing the document back to the Registrar.** Place the same “label” in the subject line for your email. 000 Personal Income Taxation Final Orcutt
- Sanitize your document.** If using Word for your document, please sanitize it prior to sending.
- Organization counts.** Please remember that organization, persuasiveness, neatness, and legibility all count in determining your grade on the answers. To improve the organization of an answer, you may wish to quickly outline the answer on a separate sheet of paper prior to writing your full answer in the blue book or on your laptop.
- Possible typos or errors.** I have tried my best to write and proofread the exam so there are no distracting typos or other errors. However, I may not have been totally successful. If you believe there is a typo or other error that makes it difficult to answer a particular question, please point out the error in your answer and explain any assumption you used to answer the question.

Good luck on the examination!

DETERMINING THE TAX LIABILITY FOR A TAXPAYER
(Questions 1 through 5 are collectively worth 100 points)

Background Information for Questions 1 through 5:

Hong is an associate at the Dewey Cheatham & Howe law firm (“DCH”). Hong is unmarried and has one dependent child who lives with her 100% of the time. Hong’s daughter is 5 years old. Hong is not a widow.

The following are her particulars. Please assume you are receiving this information, and doing this analysis, for Hong’s 2021 tax return.

- (a) Her salary was \$175,000.
- (b) DCH refurbished its law library. Due to the refurbishment, DCH had extra bookcases. DCH gifted Hong a bookcase with a fair market value of \$500.
- (c) Hong received a \$9,000 Rolex watch from one of her corporate clients with a note stating: “Thank you for your excellent work!”
- (d) Hong frequently takes on pro bono assignments. She recently represented a group of foster kids, and the local newspaper wrote a big story about her work. Moved by Hong’s work, one of the newspaper’s readers sent Hong a \$100 gift certificate with a note stating: “Thank you for your tireless work on behalf of those who most need it!”
- (e) Hong provides tutoring services as a sole proprietor to generate additional income. Hong collected \$9,000 of revenues from her students during the year.
- (f) Hong’s bank account generated \$500 of interest.
- (g) Hong was promoted to senior associate. As a result, she received a bigger office, and DCH spent \$3,000 furnishing and decorating her office.
- (h) Hong sold \$4,000 worth of ABC stock. Hong acquired the stock in 2017 for \$10,000.
- (i) Hong spent \$2,000 for workbooks, supplies, and a dedicated internet line for her tutoring services.
- (j) Hong spent \$500 to advertise her tutoring services.
- (k) Hong owns a swanky downtown condominium. She paid \$5,000 of interest on her mortgage.
- (l) Hong paid \$3,000 of interest on a home-equity loan that she used to buy a new car.
- (m) Hong paid \$5,000 of real property taxes on her condominium.
- (n) Hong paid \$500 of personal property taxes on her car.
- (o) Hong paid \$9,000 of state income taxes.
- (p) Hong paid \$3,000 for home insurance on her condominium.
- (q) Hong paid \$1,200 in utility charges for her condominium.
- (r) Hong used a 200 square foot room in her 2,000 square foot apartment as a home office. Please assume she used the home office exclusively and regularly for her tutoring service business. Hong generally tutors her client in her home office. If Hong’s condominium were depreciable, her annual depreciation would have been \$10,000.
- (s) Hong donated \$500 of cash to various public charities.
- (t) DCH withheld \$36,000 in federal income taxes for Hong.

Your assignment

When answering the following questions, please provide support for all of your work. Additionally, if you decide to leave out any of the above particulars from Hong's tax analysis, please explain why you are doing so. Finally, please use the 2021 tax rates and standard deduction schedule that are set out in Revenue Procedure 2020-45, available here (<https://www.irs.gov/pub/irs-drop/rp-20-45.pdf>). Please also use Revenue Procedure 2020-45 when considering tax credits (if any).

You are helping Hong with her 2021 tax return.

Question 1 (worth 30 points)

Please calculate Hong's gross income.

Question 2 (worth 30 points)

Please calculate Hong's adjusted gross income.

Question 3 (worth 20 points)

Please calculate Hong's taxable income.

When answering Question 3, do not consider section 199A and do not apply it.

Question 4 (worth 10 points)

Please calculate Hong's pre-credit tax liability.

Question 5 (worth 10 points)

Please calculate Hong's final tax liability.

*** * * END OF HONG QUESTIONS * * ***

THREE SHORTER-ANSWER QUESTIONS

When answering the following questions, please provide support for all of your work.

Question 6 (worth 20 points)

Arlene is a single taxpayer who does not qualify as a surviving spouse or head of household. Before the transactions described in this question, Arlene had ordinary “taxable” income of \$200,000. The “taxable” qualifier is meant to indicate Arlene’s income for the year after accounting for any appropriate deductions (such as the standard deduction).

Arlene made the following stock sales in 2021:

Stocks	Sales price	When purchased	Purchase price
Alpha, Inc.	\$10,000	2017	\$3,000
Beta, Co.	\$2,000	2017	\$7,000
Cat, Inc.	\$1,000	May 2021	\$7,000
Delta, Co.	\$5,000	June 2021	\$2,000

Arlene also sold a collectible painting that she purchased in 2015 for \$1,000. Arlene sold the painting for \$6,000 in 2021.

Please answer the following questions:

- What are Arlene’s capital gains or losses from her 2021 transactions?
- Please assume you are receiving this information, and doing this analysis, for Arlene’s 2021 tax return. What is Arlene’s final tax liability? Please assume Arlene had no tax credits. Please use the 2021 tax rates and maximum capital gains rates that are set out in Revenue Procedure 2020-45, available here (<https://www.irs.gov/pub/irs-drop/rp-20-45.pdf>).

Question 7 (worth 20 points)

Juanita is a lawyer in Beta Travel Corp.’s (“BTC”) corporate headquarters. Beta provides Juanita with the following perks:

- BTC provides Juanita with a cell phone and a laptop for business use. Juanita also uses her employer-provided cell phone and laptop for personal matters.
- BTC provides its employees with free travel on Beta airline flights when flying on a standby basis. The air-travel perk also applies to employee family members.
- BTC provides its employees with a 20% reduction when eating at Beta-owned restaurants. The restaurant perk also applies to employee family members.

Please answer the following questions.

- Does BTC’s provision of the cell phone and laptop qualify as gross income for Juanita? Please explain.
- Juanita’s husband, Bill, and Juanita’s mother, Alicia, recently took advantage of the air-travel and restaurant perks. Bill and Alicia flew standby to San Francisco. Their seats normally would have cost \$500 each. Did the free plane tickets generate any gross income for Juanita? Please explain.
- During Bill’s and Alicia’s trip, they ate at a Beta-owned restaurant. Their restaurant bill would have been \$500, but they were only required to pay \$400. Did the meal discount generate any gross income for Juanita? Please explain.

Question 8 (worth 20 points)

Aaron owns a second home ("Home 2") that he rents out occasionally. Home 2 is not Aaron's principal residence. During the current year Aaron spent 25 days at Home 2 and rented it for 75 days at a fair rental value of \$200 per day. Aaron incurred the following expenses during the year with respect to Home 2:

Realtor's fee for managing the property	\$2,000
Real estate taxes	\$6,000
Maintenance expenses	\$1,000
Utilities	\$1,500
Home insurance	\$500
Depreciation (if allowable)	\$12,000

Please answer the following questions:

- (a) Is Home 2 a "dwelling used as a residence" under section 280A?
- (b) What is Aaron's gross rental income from Home 2?
- (c) How much, if any, of the above expenses may Aaron deduct for the current year?
Please show and explain your work. Please use the Proposed Treasury Regulation Approach. You do not need to use the *Bolton* approach.
- (d) Aaron is considering selling Home 2. If Aaron sells Home 2, would he be able to take advantage of section 121 and exclude up to \$250,000 of gain from the sale?
Please explain.

ONE LONGER ESSAY QUESTION

Question 9 (worth 40 points)

Candace (a single taxpayer who does not qualify as a surviving spouse or head of household) operates a business as a sole proprietor. She purchased three pieces of equipment during the last five years.

Equipment purchased	Purchase Price	Depreciation Deductions Taken
1. A commercial truck purchased in 2020	\$40,000	\$40,000
2. A forklift purchased in 2017	\$70,000	\$50,000
3. An industrial machine purchased in 2017	\$100,000	\$60,000

The following events took place in 2021.

1. Candace sold the truck for \$15,000.
2. Candace sold the forklift for \$45,000.
3. Candace sold the machine for \$125,000.

Additionally, Candace had a net section 1231 loss of \$5,000 in 2020.

Your questions:

- (a) Candace purchased the commercial truck last year, yet she has already been able to deduct 100% of the purchase price through depreciation. How was she likely able to do that? Please explain. **(Worth 5 points)**
- (b) The U.S. Tax Code contains several provisions that allow for accelerated depreciation. Accelerated depreciation is often described as a tax incentive for stimulating the U.S. economy. How does accelerated depreciation stimulate the U.S. economy. Please explain. **(Worth 5 points)**
- (c) Assume you are answering this question for Candace's 2021 tax return. Before accounting for the above equipment transactions, Candace had \$250,000 of ordinary "taxable" income for her 2021 tax return and zero long-term capital gains. The "taxable" qualifier is meant to indicate Candace's income for the year after accounting for any appropriate deductions (such as the standard deduction). What is Candace's final tax liability for her 2021 tax returns? You may assume that no tax credits are available to Candace. Please show and explain your work. **(Worth 25 points)**
- (d) What is the rationale for the U.S. Tax Code's depreciation recapture provisions? Please explain. **(Worth 5 points)**

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END OF EXAM

**Thank you for letting me teach you Tax!
Have a wonderful semester break!!!**