# PROBLEM SET # 1

1. Peter is an officer of Joy Unlimited, Inc., a toy manufacturing company. In December, 2000, Joy Unlimited and Peter came to an agreement concerning his salary for that year and for future years. Joy agreed that Peter was to receive his salary free and clear of any federal income taxes. To accomplish that, Joy agreed to pay to the Internal Revenue Service any federal income tax that Peter incurred because of his salary. Peter’s salary for the calendar year 2000 was $350,000. Peter had almost $70,000 of other income in addition to his salary. The federal income tax on the salary he received from Joy was determined to be $95,000. Peter filed his tax return for the year 2000 on April 14, 2001, and he enclosed a check drawn by his employer, Joy, in the amount of $95,000 plus Peter’s own check for the additional amount of federal income tax that he owed. What was the tax consequence of this transaction to Peter?
2. Jessica is an associate with a large law firm in Chicago. Generally, Jessica’s work period ends at 5:00 PM on weekdays. However, when an assignment needs to be completed within a specified time, and if the assignment cannot be completed within that time if the normal working hours are followed, the firm requires its employees to work as late into the night as is necessary. When that occurs, the law firm purchases dinners from a nearby restaurant and has the meals delivered to the employees at their desks in the firm’s office. Does Jessica have income from the receipt of a meal on the days she works late at the firm? Would it matter to the determination of the tax question whether the law firm ordered the same meal for everyone who was working late or whether the employees were permitted to select their meal from a menu provided by the restaurant?
3. Same facts as Question 2 except that the firm will reimburse an employee for the amount the employee expended to purchase supper in one of several nearby restaurants. Is the reimbursement that Jessica received for the cost of having supper income to Jessica?
4. The same facts as those stated in Question 3 except that Jessica is not required to work late, but she does so “voluntarily.” The firm reimburses its employees for supper costs incurred on days when they work late on projects that are subject to time constraints. Are the reimbursements income to Jessica?
5. Sarah Thomas hired a domestic maid to clean her house, cook meals, wash, iron, etc. In addition to a regular salary, Sarah provides meals for the maid during the period that she is working at Sarah's home. Are these meals income to the maid? Would the maid realize taxable income if Sarah provided breakfast for her when she arrived in the morning, before she commenced work?

1. John Hill is a student at the University of North Carolina. He is employed at the school cafeteria. John receives no cash compensation for his work but receives his meals free. He is required to eat his meals in the cafeteria immediately before mealtime. The average price of a meal is $5.75. What tax consequence to John?
2. An historical society owns a house in Philadelphia that was once owned and occupied by a former president of the United States. During the day, the house is open to the public. The Society is concerned that if the house is left unoccupied at night, it will be burglarized or vandalized. To prevent that from occurring, the Society employs Ralph to live in the house at night. The Society permits Ralph to live in the house with his wife, but he is required to be there only outside of the visiting hours. Outside of visiting hours, Ralph and his wife can occupy any part of the house they wish, including the kitchen; but during visiting hours, they are limited to a part of the house that is not open to the public. Ralph receives no compensation for his services other than the use of the house. What are the tax consequences to Ralph? To Ralph’s wife?
3. George is hired to be the manager of the Ocean View Apartments in Daytona Beach, Florida. The employer requires George to live on the premises of the apartment complex. George informs the employer that he is married, and that he has two young children (ages 2 and 4) who live with him and his wife. In addition, George’s mother-in-law also lives with him, and so does his cat. The employer then offers to rent George a three-bedroom apartment in the complex for a monthly rental of $300. Comparable apartments in the building rent for $2,200 a month. The employer requires George to rent the apartment as a condition of holding his job. George accepts, and he, his wife, two children, mother-in- law, and cat all move into the apartment. George is paid a salary of $5,000 per month. In addition, the employer pays George a cash allowance of $150 a month to pay for meals for George and his family. What amount of gross income does George have because of these transactions?
4. The same facts as those stated in Question 8 except that the employer does not provide George a cash allowance for meals. Instead, the employer permits George and his family to take their meals at a dining room that is on the first floor of the apartment building and is operated by George’s employer for the occupants of the apartments. Although other occupants of the apartments pay a fee for the meals they receive in the Dining Room, George and his family receive their meals without any charge. What is the tax consequence to George and his family?
5. Steve is an employee at Corporation Inc.’s San Francisco office. Corporation Inc. offers Steve a choice of benefits: (a) a monthly parking spot in downtown San Francisco (normally the parking garage charges $150 a month for a monthly spot) or (b) $150 cash per month. What are the tax consequences to Steve if he picks option (a) or option (b)? If Steve chooses option (a), what are the tax consequences if Steve personally pays for the parking spot and Corporation Inc. reimburses Steve for the payment?
6. Peter is a flight attendant with High Sky Airlines. He received a free ticket for a reserved (i.e., not standby) round trip flight on High Sky. The fair market value of the ticket was

$400. Both flights were full and High Sky could have sold the seat to a paying customer. What are the tax consequences to Peter for receiving the ticket?

1. Same facts as Question 11 except that the flights were not full. In fact, there were a dozen or so empty seats on each flight that Peter was on. What are the tax consequences to Peter for receiving the ticket?
2. Huge Corporation owns both High Sky Airlines and Skyline Hotels. Peter, the flight attendant with High Sky Airlines, receives a free “standby” room at a Skyline Hotel as a fringe benefit of his employment. Can Peter exclude the value of the room from income?
3. The University of Michigan is the largest employer in the city of Ann Arbor, Michigan. Without consulting the university, Go Blue Sports Store decides to offer all university employees a 10 percent discount for all purchases at the store. Will the university employees who take advantage of the discount be able to exclude the value of the discount?

# PROBLEM SET #1.5

1. Al Slone owns a house worth $42,000. He is in need of cash and, after a series of sessions with hard driving realtor Joe Babcock, he sells out to Joe for $34,000. What gain does Joe recognize on his bargain purchase?
2. In 1992, Boswell purchased a home in the suburbs on 6 acres of choice land. He paid

$250,000 for the land and the home. The home itself was worth $150,000. In 2001, Boswell sold off 3 acres to Carter for $100,000. Any gain to Boswell on his sale to Carter?

1. Helen is a lawyer who specializes in divorce. Malcolm is a real estate agent. Ralph and Helen have been friends since childhood. In Year One, Helen decided to sell her home, and she contacted Malcolm to represent her. The home was sold, and Helen offered to pay Malcolm for his services. Malcolm refused payment, saying that they had been friends for so long that he did not wish to charge her. Malcolm’s normal fee for selling a comparable house would have been $14,000. Three months later, Malcolm and his wife had a terrible argument and decided to divorce. Malcolm asked Helen to represent him in the divorce, and she did so. The divorce became final in Year Two. Malcolm offered to pay Helen for her services. Helen would have liked to charge Malcolm, but she felt constrained not to charge him because of his refusal to charge her the previous year. Her normal fee for the services involved in Malcolm’s divorce would be $20,000. Helen told Malcolm that there was no charge for her services. What were the tax consequences of these transactions to Malcolm and to Helen?
2. Robert and Susan have a 16 year-old son, Wyatt. They employ Wyatt to mow the lawn, take out the garbage, and clean his bedroom. They pay Wyatt a weekly salary of $20 for these services. In Year One, Wyatt earned $20 from his parents for each week of the year, and he also earned $4,000 for part-time work he did at a local grocery store. What amount of gross income did Wyatt have in Year One?
3. During the period 1961 through 1975 Allen purchased corporate stock. Allen's office was destroyed in a fire in 1999. Also lost in the fire were all of his records containing the dates of purchase and cost of all of his corporate stocks, and these dates and costs cannot be determined. In 2002, Allen sells all of the stocks. Does Allen realize any gain on this sale?
4. Buyer purchased an office building from Seller. Buyer paid Seller One Million Dollars ($1,000,000) for the building, but the terms of the sale permit Seller to occupy the building, rent free, for four years. The fair rental value of the building is $150,000 per year. What are the tax consequences of this transaction to Buyer and to Seller?
5. Susan attends a Detroit Tigers baseball game and sits in the seats near the left outfield. Detroit’s third baseman, Martin May, hits a home run which Susan manages to catch. Luckily for Susan, the home run was number 74 for Martin May for the season, breaking the major league baseball single season home run record. In 1999, Mark McGwire’s 70the home run baseball (which broke the previous home run record) was sold at auction for $3,005,000. What are the tax consequences to Susan for catching the ball?

# PROBLEM SET #2

1. *R* owned an antique vase which had a value of $15,000. *R*’s basis in the vase was $4,000. *T* negligently caused the destruction of the vase when it was being transported to a museum to be displayed on a temporary loan. *T*’s insurer paid *R* $15,000 cash to compensate for the loss of the vase. What amount of that payment is income to *R*?
2. *X* negligently operated his automobile which resulted in *Y*’s suffering physical injuries. *Y* sued *X* for damages. In a decision by the trial judge (sitting without a jury), *Y* obtained a judgment for $1,650,000, which was the total of the specific amounts listed below. *X* paid *Y* the amount of the judgment. What amount of the payment to *Y* is included in *Y*’s gross income?

|  |  |
| --- | --- |
| $525,000 | - for wages that *Y* did not earn prior to the judgment because of her injuries |
| $1,000,000 | - for future wages that the court determined *Y* will not earn because of her injuries |
| $125,000 | - reimbursement of *Y*’s medical expenses |
| $1,650,000 | - Total amount of award |

1. *M* sued *Q* for employment discrimination. *M* obtained a judgment for $300,000 compensatory damages and $600,000 punitive damages. The compensatory damages were for lost income and for emotional harm and mental stress. What amount of that award is included in *M’*s gross income when paid?
2. *Z* sued *K* for personal defamation because of statements that *K* had made about *Z*’s moral character. Z claimed that on account of such statements and the stress caused by them, *Z* suffered headaches, back pain, stomach problems, etc…*Z* obtained a judgment for

$50,000 compensatory damages and $500,000 punitive damages. What amount of that award is included in *Z*’s gross income when paid?

1. *D* was sued by *P* for physical damages caused by *D*’s negligent operation of an automobile. In a decision, *P* obtained a judgment for $1,000,000, which was the total of the specific amounts listed below. *D* paid *P* the amount of the judgment. What amount of the payment to *P* is included in *P*’s gross income?

|  |  |
| --- | --- |
| $500,000 | - for pain and suffering |
| $200,000 | - for emotional harm that P suffered |
| $300,000 | - punitive damages |
| $1,000,000 | - total damages |

1. *D* was sued by *P* for physical damages caused by *D*’s negligent operation of an automobile. The case was tried to a jury, and *D* requested the judge to give the following two instructions to the jury. How should the judge rule?
   1. The judge should inform the jury that *P* will not have to pay any federal income tax on any of the damages they award to *P*.
   2. In determining the amount of income *P* lost because of his injuries, the jury should take into account the amount of income taxes that *P* would have paid on that income, and only the net amount remaining after payment of taxes should be awarded to *P*.
2. Larry was physically injured by David’s negligent operation of an automobile. Larry sued David for damages in tort, and Larry’s complaint listed the following request for damages:

|  |  |
| --- | --- |
| $200,000 | - Loss of income due to the injuries |
| $300,000 | - Emotional harm and pain and suffering |
| $100,000 | - Medical expenses incurred |
| $400,000 | - Punitive damages |
| $1,000,000 | - Total damages requested |

Larry and David settled the law suit by David’s paying Larry $400,000. The settlement did not state how much was paid for the several items for which Larry had requested damages. How much of that $400,000 settlement is included in Larry’s gross income?

1. Wilma was seriously physically injured by George’s negligence. Wilma obtained a settlement from George for the damages she suffered. Wilma’s husband, Harold, sued George for the damages Harold incurred as a consequence of the injuries that Wilma had suffered. Harold obtained a judgment against George for $250,000 for loss of consortium, and another $100,000 for the emotional harm that Harold suffered because of Wilma’s injuries. George paid the judgment. How much of the payment to Harold is included in Harold’s gross income. If any part of the payment is income, should it be included in Harold’s gross income or in Wilma’s?
2. *F* obtained a judgment for compensatory damages against *Z* for physical injuries *F* suffered as a consequence of *Z*’s negligence. The award included $15,000 for interest on the amount of the judgment computed as interest from the time that the complaint was filed until the judgment was entered. An award of that type is sometimes called “pre- judgment interest.” Is the pre-judgment interest excluded from *F*’s gross income? Would interest payable on the judgment for the period between the entry of the judgment and the time when *Z* makes payment be excluded from *F*’s gross income?
3. Your client has a tort claim against *X* Corporation for a physical injury she suffered from the negligence of an employee of *X*. The parties have agreed that *X* is liable and that the amount of your client’s actual damages total $500,000. This figure includes $65,000 in medical expenses, none of which has been deducted by your client. Your client’s other income places her in the 35% marginal tax bracket (the top tax bracket for an individual), and so any income she recognizes from payments she receives from X or from the investment of such payments will be taxed at a 35% rate.

*X* has offered your client a choice of: (1) receiving a lump sum of $500,000 cash, or (2) receiving annual payments of $66,000 for the next ten years. Your client is satisfied that

$500,000 is a good figure for settlement. Your client has told you that if she accepts the

$500,000 lump sum settlement, she will invest that amount with an insurance company to purchase an annuity for a ten-year period. The annuity provided by the insurance company will earn income at a 7% rate, and so your client would receive approximately

$71,250 each year for 10 years. Your client has complete confidence that *X* can and will make the annual payments of $66,000 if she should choose that option, and so risk of nonpayment is not a factor in making her choice.

Which of the alternatives that *X* has offered your client would you advise your client to take?

1. Martha was employed by the Ellsworth Corporation. Martha’s supervisor frequently made lewd comments in her presence and made proposals to her of a sexual nature. Martha filed numerous complaints with her employer about the behavior of her supervisor, but the company took no action. One day, the supervisor pinched Martha’s buttocks. The pinch caused a minor bruise that remained for a few days. Martha sued Ellsworth for permitting the sexual harassment to have continued to take place. The court awarded Martha: $1,000 for the bruise she suffered, $600,000 for the emotional distress that the incident caused, and $2,000,000 punitive damages. Ellsworth paid the award to Martha. Is all or any part of Martha’s award taxable to her? If the pinch had not caused a visible bruise, what part of the award would be taxable to Martha?
2. The same facts as those stated in Question 11 except that Martha and Ellsworth settled her suit. Assume again that Martha had suffered a visible bruise from the pinch. The settlement agreement provided that Ellsworth was to pay Martha $2,500,000 as compensatory damages for her physical injury and emotional harm. The settlement agreement expressly states that no amount is to be paid to Martha as punitive damages. Ellsworth paid Martha the amount that the settlement required. Is any part of the amount that Martha received from Ellsworth taxable to her?

# PROBLEM SET # 3

A “net operating loss” is a term of art and refers to something other than a net loss. See IRC §

172. In answering the questions in Problem # 3, assume that *no* net operating loss carryover is available.

1. *D* owed a business debt of $20,000 to *M*. In Year One, *M* determined that the debt was not collectible, and *M* claimed and was allowed a bad debt deduction of $20,000 on his tax return for Year One. The marginal rate at which the $20,000 that was reduced by that deduction would have been taxed was a 25% rate. In Year Ten, *D* sold the rights to an invention he had created that year for several million dollars. Being then able to repay the debt to *M*, *D* repaid the debt of $20,000. If the $20,000 that *M* received from *D* in Year Ten is included in *M’s* income, it will be taxed at a marginal rate of 35%. How should the $20,000 payment to *M* in Year Ten be treated for income tax purposes? If the statute of limitations on *D*’s debt expired before Year Ten, but *D* voluntarily repaid the debt anyway, how should the repayment be treated for tax purposes?
2. In the year 2002, Rick and his spouse, Marie, filed a joint income tax return in which they correctly reported adjusted gross income of $22,000. Rick and Marie were not entitled to any tax credits for that year. On their joint return for that year, Rick and Marie claimed and were allowed three exemptions for which they properly took a deduction of

$9,150. In addition, Rick and Marie claimed and were allowed an itemized deduction of

$15,000 for a real estate tax payment they made that year. The basic standard deduction for the year 2002 for married taxpayers was $7,950. Since their itemized deductions were greater than the basic standard deduction, Rick and Marie elected to itemize their deductions rather than to use the standard deduction.

Rick and Marie had objected to the local taxing authority that the $15,000 real estate tax levied against them in 2002 was excessive. They had paid that tax under protest and appealed. In 2004, the appeals board agreed that the 2002 real estate tax that was paid by Rick and Marie was excessive and ordered that a refund of $5,000 be paid to them. The refund was duly paid in 2004. Rick and Marie filed a joint income tax return for the year 2004. How much of that $5,000 refund is included in Rick and Marie’s joint income for 2004?

1. The same facts as those stated in Question 2 except that the amount ordered by the appeals board to be refunded to Rick and Marie in the year 2004 was $10,000, and that amount was refunded to them. How much of that $10,000 refund is included in the joint income of Rick and Marie?
2. In Year One, Penny made a gift of unimproved land to the Beth El temple. At the time of the gift, the land had a value of $120,000, and Penny was allowed a charitable deduction of that amount from which she obtained a tax benefit. Penny had a basis of $30,000 in the land, and she had held the land for more than 15 years. Penny gave the land to the temple to permit the temple to construct a building thereon to be used for the religious education of children. In Year Three, the temple abandoned its plan to build a new school building. The temple than returned the land to Penny. The land had a value of

$100,000 when it was returned to Penny. Seven months later, Penny sold the land to an unrelated party for $105,000. What were the tax consequences of the return of the land to Penny and of Penny’s sale of the land to the unrelated party?

# PROBLEM SET # 4

1. Assume *A* purchases stock for $2,000 and gives the stock to his daughter, *D*, at a time when the fair market value of the stock is $4,000. How much gain or loss (if any) is recognized by *D* on a sale to an unrelated person for the following amounts?

(a) $10,000 (b) $3,000

(c) $1,000

1. Assume *B* purchased stock for $5,000 and gave the stock to her son, *S*, at a time when the fair market value of the stock was $2,000. How much gain or loss (if any) is recognized by *S* on a sale to an unrelated person for the following amounts?

(a) $10,000 (b) $1,000

(c) $3,000

1. In Year One, *A* paid $100,000 to purchase 1000 shares of *X* stock. In Year Ten, *A* made a gift of the 1000 shares of *X* stock to *B*. At the date of that gift, the fair market value of the 1000 shares of stock was $35,000. In Year Twenty, *B* made a gift of the 1000 shares of *X* stock to *C*. At the date of that gift to *C*, the fair market value of the 1000 shares of stock was $50,000. In Year Twenty-Four, *C* sold the 1000 shares of *X* stock to an unrelated person for $30,000, which was the fair market value of the stock at that time. What is the amount of loss that *C* recognized on that sale?
2. The same facts as those stated in Question 3 except that the person to whom *C* sold the stocks in Year Twenty-Four was the sister of *C*. What amount of loss that *C* recognized on that sale is deductible?
3. Fred owned 500 shares of stock of the Widget corporation. Fred has a basis in those 500 shares of $80,000. Fred wished to dispose of those shares to his niece, Mary, but he was unwilling to make a gift of the entire value of the stocks. Fred solved that problem by selling the stocks to Mary at a bargain price (i.e., a price that was lower than the value of the stocks). The difference between the value of the stocks and the amount paid by Mary constitutes a gift from Fred. Determine the tax consequences to Fred and to Mary in each of the following alternative circumstances.
   1. Fred sold the 500 shares to Mary for $40,000. The fair market value of the shares at that time was $100,000. Four years later, Mary sold the 500 shares to an unrelated party for $60,000, which was its value at that time.
   2. Fred sold the 500 shares to Mary for $40,000. The fair market value of the shares at that time was $120,000. Four years later, Mary sold the 500 shares to an unrelated party for $100,000, which was its value at that time.
   3. Fred sold the 500 shares to Mary for $100,000. The fair market value of the shares at that time was $180,000. Four years later, Mary sold the 500 shares to an unrelated party for $160,000, which was its value at that time.
   4. Fred sold the 500 shares to Mary for $10,000. The fair market value of the shares at that time was $60,000. Four years later, Mary sold the 500 shares to an unrelated party for $50,000, which was its value at that time.
4. *A* gave *B* stocks in 1976. *A* died in 1980. In 1981, *B* sold the stocks for $10,000. There is no record or evidence of what A’s basis was in the stocks, but it is shown that he purchased them sometime between 1940 and 1951. How is *B*’s gain or loss determined?
5. Your client, an elderly widower, desires to make a present of $20,000 to his son. Your client has three different stocks, any one of which he is willing to use as the corpus of the gift. The stocks have the following basis and fair market value:

|  |  |  |
| --- | --- | --- |
|  | *Basis* | *FMV* |
| A Stock | $30,000 | $20,000 |
| B Stock | $15,000 | $20,000 |
| C Stock | $20,000 | $20,000 |

Which of the three stocks (A, B or C) should your client give to his son?

1. In Year One, Helen made a gift of Blackacre (unimproved land) to her husband, Ralph. Helen had a basis of $100,000 in Blackacre, but its fair market value at the time of the gift was only $75,000. In Year Four, Ralph sold Blackacre to an unrelated party for its then value of $80,000. What was the tax consequence to Ralph of that sale?
2. In Year One, Susan sold Whiteacre (unimproved land) to her husband, Paul. The fair market value of Whiteacre was $190,000, and Paul paid that amount to Susan. In other words, Paul paid Susan an amount equal to the fair market value of the property. Susan’s basis in Whiteacre was $125,000. In Year Six, Paul sold Whiteacre to an unrelated party for $300,000. What was the tax consequence to Susan of her sale of Whiteacre to Paul, and what was the tax consequence to Paul of his sale of Whiteacre in Year Six?

# PROBLEM SET # 5

1. On five days a week, Franklin stands on a corner and begs for money. Franklin is successful at this venture and collects over $40,000 per year. Are the amounts Franklin receives treated as gross income to him?
2. Henry’s nephew, Dennis, told his family that he planned to drop out of college. To induce Dennis to remain in college, Henry promised that he would give Dennis $40,000 if Dennis would graduate from college. Dennis remained in college and did graduate. Henry fulfilled his promise and gave Dennis $40,000. Is any of that payment included in Dennis’s gross income?
3. The same facts as those stated in Question 2 except that when Dennis graduated, Henry reneged on his promise and refused to pay. Dennis sued Henry and obtained a judgment for the $40,000 which had been promised to him. Henry paid the judgment. Is any of the payment included in Dennis’s gross income?
4. Paula received welfare payments from the State of Utopia to support her and her three minor children. Are those payments included in Paula’s gross income? Would it affect your answer if Paula received the payments under a welfare program in which the recipients of payments are required to provide services?
5. Hillary is a candidate for election to a federal office. A testimonial dinner is held to raise money for her campaign. The dinner raises $450,000 which amount is turned over to Hillary to assist in financing her campaign. What are the tax consequences to Hillary?
6. Randolph has worked for five years as an employee of his father in his father’s real estate business. This year, Randolph married, and his father gave him a wedding gift of

$150,000. Is any of that amount included in Randolph’s gross income?

1. Patricia worked as a domestic servant for the Hawthorne family for over 30 years. On the death of Frances Hawthorne, she made a bequest of $50,000 to Patricia in appreciation of the loyal service that Patricia had provided. At the time of Frances’s death, Patricia was still in her employ. Is any of that bequest included in Patricia’s gross income? Would it affect your answer if Patricia had retired two years before Frances died?
2. In 2004, Oprah Winfrey gave her audience free Pontiac automobiles. As reported by Fortune Magazine:

Oprah Winfrey, one of the world's richest entertainers, surprised her fans Monday by giving each of her 276 audience members a new car to celebrate the premiere of her show's 19th season.

The billionaire talk show host told the audience that everybody will get a new Pontiac G-6 midsize 2005 sports sedan. Winfrey screamed and jumped up and down on the stage, shouting: "Everybody gets a car! Everybody gets a car!"

Assume Oprah told the winners that not only do they get the cars, but they are tax-free since they are gifts. As an IRS representative, briefly respond to Oprah’s statement.

1. Peter Strzok was fired from his position in the FBI because of comments he made about President Trump. A GoFundMe account was established to obtain donations to reimburse Strzok for the legal fees he incurred and the income he lost because of his termination. GoFundMe charges processing fees for using it to collect donations. The fund collected more than $450,000 for Strzok. Is any of the amount that was collected taxable income to Strzok?

# PROBLEM SET # 6

1. Professor Jones wrote a scholarly article on the subject of philosophy. A non-profit philosophical organization chose that article as the best publication on philosophy in the last decade, and the organization made an award to Jones of $5,000 in recognition of his work. Jones had not submitted the article to the organization or otherwise entered a contest. The article was chosen by the organization on its own initiative. Is the award included in Jones’s gross income?
2. Peter Smith, a high school senior, entered a contest sponsored by General Electric. The contest required the submission of a science project. Peter won first prize. The prize Peter received was a scholarship for four years to any college that Peter attended. The scholarship paid the amount of Peter’s tuition, fees, books, supplies, and room rental. The scholarship also provided Peter with a monthly cash amount for each month he was in school to pay for his meals and incidental expenses. Peter attended Cornell University and graduated in four years. What is the tax consequence to Peter? If Peter is taxable on any of the scholarship, in what years is he taxable?
3. Fred Stone is an employee of the Winston corporation. Winston has established a fund to provide a four-year college scholarship each year to a child of an employee. The child is chosen based on academic performance in high school. In Year One, Fred’s daughter Mary was chosen to receive the scholarship. Mary enrolled in the University of Michigan in Year Two, and the scholarship specified that it was to pay for her room and board and tuition for each of her four years as a student of the university. At the time that Mary was awarded her scholarship, the fund that Winston had created to secure the payment of the expenses was more than sufficient. Is any of the scholarship included in Mary’s or Fred’s income? If so, which of those two includes the amount in income and in what years?
4. Helen entered a TV quiz show contest. Helen won: (1) a new refrigerator with a retail value of $400, (2) a boat with retail value of $7,000, and (3) a box of Corn Flakes cereal every three months for so long as Helen lives. What amounts are included in Helen’s gross income and when?
5. Paula was admitted to Rocky University to pursue a Ph.D. in Classics. The tuition for the program was $30,000 a year, but Paula was given a $20,000 discount because she taught a class to undergraduate students. Is the discount taxable income to Paula?
6. Ruth competed in the Olympic Games and won a gold medal which had a fair market value of $2,700. In addition, the United States Olympic Committee awarded her a prize of $800 cash for winning her event. Ruth’s AGI for that year was $37,000. What amount of the prizes Ruth received is included in her gross income?

# PROBLEM SET # 7

1. Fred borrowed $5,000 from the Friendly National Bank. The terms of the loan provided for adequate interest payments. Fred is not an employee or otherwise related to the bank. Is any of the loan included in Fred’s gross income?
   1. Two years after the loan was made, the bank agreed to accept a payment of

$3,000 in satisfaction of the loan, even though Fred was solvent. The bank determined that it was not worth the cost and difficulty it would incur in seeking to collect the full $5,000 owed to it. What was the tax consequence to Fred?

* 1. The same facts as those stated in Question 1(a) except that the lender was Fred’s father instead of a bank. What was the tax consequence to Fred in that case?
  2. The same facts as those stated in Question 1(a) except that the bank did not offer to accept a lesser amount and no part of the loan was ever repaid. The statute of limitations for a suit to collect the loan expired in June of Year Five. Did Fred recognize any income, and, if so, in what year?

1. Martha purchased an oil painting from Rhoda, an art dealer. The price for the painting was $40,000. Martha paid Rhoda $10,000 cash plus Martha’s promissory note in the amount of $30,000, bearing adequate interest. Martha subsequently complained that Rhoda had made false and misleading statements about the painting. Rhoda denied those claims. After some negotiation and threats of litigation, Rhoda agreed to accept a new promissory note from Martha in the amount of $15,000 in exchange for the original note on which $30,000 was still owing. The terms of the new note were identical to those of the original note except that the face amount of the new note was a lesser figure. What was the tax consequence to Martha?
2. The Zion Baptist church of Willsboro initiated a fund raising campaign to obtain the funds to build a new church. Rupert Walters made a written pledge of $35,000 to the church. Subsequently, Rupert went to the officers of the church and asked them to reduce his pledge to $10,000 because he had suffered significant business losses in the interim, although he was solvent. Under local state law, a promise to make a contribution to a charitable organization is enforceable by the charity regardless of whether the obligor received consideration for the promise. Nevertheless, the officers of the church accepted

$10,000 from Rupert and cancelled the remaining $25,000 of his obligation. What was the tax consequence to Rupert? Would it affect your answer to that question if the church officers had agreed to cancel $25,000 of Rupert’s pledge because they were under the mistaken belief that they had no right to enforce Rupert’s promise since no consideration was given for his promise?

1. Rachel owns and operates a boutique retail dress shop in Columbus, Ohio. In Year One, she bought a line of dresses from a French manufacturer for 4,000 Euros. She bought the dresses on credit, and so she made no cash payment and owed the manufacturer the Euros. At the time she purchased the dresses, 4,000 Euros were worth $6,000 in U.S. dollars. By March of Year Two, the Euro had fallen in value as compared to U.S. dollars, and so Rachel was able to purchase 4,000 Euros for only $3,000 in U.S. currency. Rachel then paid the 4,000 Euros she had purchased for $3,000 to the French manufacturer in satisfaction of her debt. What was the tax consequence to Rachel of this transaction?
2. In Year One, Paul opened a gourmet restaurant in Grand Rapids, Michigan. Paul hired a prominent chef for the restaurant and contracted to pay the chef a salary of $20,000 per month. The term of the contract was 5 years. In its first two years of operation, the restaurant did not produce the amount of income that Paul had anticipated. Consequently, Paul was unable to pay the chef the entire amount of salary that was owing to him under the contract. By the end of Year Two, Paul owed the chef $25,000 for wages that had not been paid. Despite these disappointments, the chef was convinced that the restaurant would prosper in the immediate future. In Year Three, Paul asked the chef to forgive the

$25,000 of unpaid salary, and Paul promised to meet the payroll thereafter. The chef agreed, and the $25,000 debt was cancelled in July of Year Three. Paul reports his income from the restaurant on the accrual method of accounting, and the chef reports his income on the cash receipts and disbursement method of accounting. What are the tax consequences to Paul of the cancellation of the $25,000 debt in each of the following alternative circumstances?

* 1. On his tax returns for Years One and Two, Paul had accrued and deducted the

$25,000 of unpaid salary, and Paul obtained a tax benefit from those deductions.

* 1. In his tax returns for Years One and Two, Paul had erroneously failed to claim a deduction for the unpaid salary.
  2. In his tax returns for Years One and Two, Paul had taken deductions for the unpaid salary, but Paul had obtained no tax benefit from those deductions.

1. In Year One, Sylvia borrowed money from the Friendly National Bank. The debt was not secured, but Sylvia was personally obligated to repay it. At the beginning of Year Four, the unpaid balance of Sylvia’s debt to the bank was $60,000. Sylvia had no other debts. The only assets that Sylvia had were $23,000 cash and an acre of unimproved land with a fair market value of $12,000. Sylvia’s basis in the land was $28,000. Sylvia had no net operating losses or capital losses in Year Four, and she had no loss carryovers to that year. In March of Year Four, the bank cancelled $50,000 of Sylvia’s debt in exchange for Sylvia’s payment of $20,000 cash to the bank. Thus, the bank forgave $30,000 of the debt. After that payment, Sylvia had $3,000 cash, and the unimproved land; and the outstanding balance of her debt to the bank was $10,000. What was the tax consequence to Sylvia of the cancellation of $30,000 of her debt? As of January 1 Year Five, what basis does Sylvia have in the land that she owns?

# PROBLEM SET # 8

1. In Year One, George had taxable income of $80,000. George’s marginal rate of federal income tax for that year was 30%, and $25,000 of George’s taxable income was taxed at that 30% marginal rate. George’s total federal income tax for Year One was $18,000. Consequently, the average rate of George’s tax for Year One was 22.5%. Part of George’s $80,000 taxable income was a commission of $25,000 that George received that year from his employer for sales that George initiated.

In Year Four, George’s employer discovered that George had received commissions for sales that should have been credited to another employee. After some negotiations, George and his employer agreed that George should have received a commission of only

$10,000 in Year One, and George returned the excess $15,000 to his employer. The overpayment to George created a debt that he owed to the employer, and the statute of limitations for repayment of that debt had not expired when George repaid the amount to the employer. In Year Four, without taking the repayment of the commission into account, George had taxable income of $40,000. $30,000 of that income was taxable at a federal income tax rate of 15%, and the remaining $10,000 was taxable at a 20% federal income tax rate. What was the tax consequence to George of the repayment of $15,000 of the Year One commission? Would it affect your answer if the statute of limitations on George’s obligation to repay the $15,000 had expired before the employer discovered the error, but George had nevertheless repaid that amount?

1. The same facts as those stated in Question 1. George’s employer was in a marginal federal income tax bracket of 30% in Year One, and she was in a marginal federal income tax bracket of 50% in Year Four. The employer did not pay the other employee the $15,000 of commission owing to her until Year Five, and since the employer used the cash receipts and disbursements accounting method, she got no deduction for that payment until Year Five. What was the tax consequence to the employer from receiving the return of the $15,000 of George’s commission in Year Four?
2. The same facts as those stated in Question 1 except that in Year One, George’s deductions were so large that he had a net loss of ($20,000) for that year, and his tax return showed a net loss of ($20,000). George’s loss did not constitute a net operating loss or a capital loss, and so George could not carry the loss forward or back to other taxable years. Consequently, if George had not received the $15,000 of commissions that were erroneously paid to him, he would have reported a loss of ($35,000) on his tax return for that year, but there would have been no effect on his tax liability. What was the tax consequence to George of repaying the $15,000 to his employer in Year Four?
3. The same facts as those stated in Question 1 except that the amount of commission that was erroneously paid to George in year one was only $2,000. In Year Four, George repaid to the employer the $2,000 of commissions he had erroneously received in Year One. What was the federal income tax consequence to George of making that $2,000 repayment?
4. Mary Walters is the sole proprietor of a wholesale business that is engaged in selling appliances. In Year Two, one of Mary’s customers was overbilled by $6,000 because of a clerical error of an employee of Mary’s, and the customer paid that bill. In Year Four, the customer discovered the error, requested Mary to return the $6,000 overpayment, and Mary did so. Mary was in a marginal federal income tax bracket of 50% in Year Two, but she was in a marginal federal income tax bracket of 30% in Year Four. What was the tax consequence to Mary of returning the overpayment?
5. Franklin Jones was the president and sole shareholder of Win All, Inc. In Year One, Franklin received a salary of $250,000. Upon auditing the corporation’s Year One tax return, the IRS determined that the maximum reasonable salary for Fred was only

$180,000, and consequently the excess $70,000 paid to him in Year One was a nondeductible dividend. (See Treas. Reg. § 1.162-8). The denial of the deduction would increase the corporation’s tax liability for Year One. The corporation litigated that issue with the IRS, but in Year Five, the Tax Court held that the Service was correct and that

$70,000 of the “salary” paid to Franklin was excessive. The corporation did not appeal that decision, and Franklin promptly paid $70,000 to the corporation as a return of the excessive compensation. What was the tax consequence to Franklin of making that repayment in the following alternative circumstances?

* 1. In Year One, Franklin and the Win All corporation executed a contract that required Franklin to return any part of his salary that was determined by the IRS or by a court to be excessive compensation.
  2. There was no contractual agreement between Frederick and the corporation for Frederick to return the excessive element of any salary paid to him.
  3. The contract between Franklin and the Win All corporation that is described in paragraph (a) above was executed in Year Three, which was prior to the audit of the corporation’s tax return. The contract covered salary paid to Franklin by the corporation prior to and subsequent to its execution.

1. Margaret was employed as the manager of a retail clothing store. In June of Year One, Margaret discovered a very attractive investment opportunity that promised to turn over a substantial profit in a short period of time. To take advantage of that opportunity, Margaret needed to invest $40,000, but she had no funds available, and she could not borrow that amount. In order to make the investment, Margaret took $40,000 from the retail store and hid her action by altering the store’s books. Margaret was confident that the investment would turn over with a profit within a year, and she fully intended to repay the $40,000 to the store as soon as she had the funds to do so. In Year One, Margaret was in a 30% marginal federal income tax bracket. On January 5, Year Two, Margaret sold her interest in the investment for $46,000. The profit of $6,000 that she earned thereby was less than she had anticipated, but she was satisfied. On January 8, Year Two, Margaret returned the $40,000 to the store, and altered the books to explain how that $40,000 suddenly appeared in the store’s accounts. Unfortunately for Margaret, her actions were discovered by her employer on January 26, Year Two, and she was fired on that date. Margaret was charged and convicted of a crime. She was sentenced to two years in prison. Without taking the repayment of $40,000 into account, Margaret had taxable income of $4,000 in Year Two.
   1. What were the tax consequences to Margaret of taking the $40,000 from the store in year One, and of the return of the $40,000 to the store in Year Two? What effect would it have on your answer if Margaret had repaid the $40,000 to the store in December of Year One instead of in January of Year Two?
   2. What were the tax consequences to the retail clothing store (an incorporated organization) of Margaret’s actions? In answering this question, see IRC § 165(c)(3), (e).

# PROBLEM SET # 9

**In answering these questions, if a nonrecognition election is available, assume that it was or will be made.**

1. Hilton purchased unimproved land. Hilton paid $40,000 cash for the land and took it subject to a $100,000 mortgage. Hilton did not assume personal liability to pay the mortgage. What is Hilton’s basis in the land?
2. Smith owned Blackacre (unimproved land) which he held for investment. Smith had a basis of $200,000 in Blackacre. In each of the exchanges described below, determine the amount of gain or loss that was *realized* by Smith, and the amount of gain or loss that Smith *recognized*. Also, determine Smith’s basis in the properties he received in the exchanges. All of the exchanges were at arms’ length, and so it is presumed that properties of equal value were exchanged. Smith is not related to the persons with whom he exchanged properties. There were no encumbrances on Blackacre or on any of the properties Smith received in the exchanges.
   1. Smith exchanged Blackacre for a warehouse that he then used in his business. The fair market value of the warehouse was $600,000.
   2. Smith exchanged Blackacre for a commercial franchise (the right to use a trade name like McDonalds or Dominos) that had a value of $400,000. Smith used the franchise to conduct a business.
   3. Smith exchanged Blackacre for an office building having a value of $500,000 plus $100,000 in cash. Smith used the office building in his business.
   4. Smith exchanged Blackacre for an office building having a fair market value of

$450,000 plus 1000 shares of stock of the *X* corporation having a value of

$150,000. Smith used the office building in his business.

* 1. Smith exchanged Blackacre for Greenacre (unimproved land) having a value of

$80,000 plus 100 shares of *Y* stock having a value of $50,000. Smith held Greenacre and the *Y* stock as investments.

* 1. Smith exchanged Blackacre for Greenacre (unimproved land) having a value of

$180,000. In addition, Smith received in the exchange $40,000 in cash and 100 shares of *Z* stock having a value of $60,000. Smith held Greenacre and the *Z* stock as investments.

1. Mark had a basis of $250,000 in Redacre (unimproved land) which he held as an investment. Mark had a basis of $20,000 in 100 shares of stock of the *X* corporation. The fair market value of Redacre was $395,000, and the fair market value of the 100 shares of *X* stock was $5,000. Mark transferred Redacre and the 100 shares of *X* stock to Joan in exchange for which Joan transferred Greenacre (unimproved land) to Mark. The fair market value of Greenacre was $400,000 and Joan had a basis of $230,000 in Greenacre. Mark held Greenacre as an investment. Mark and Joan are not related. What basis does Mark have in Greenacre? What basis does Joan have in Redacre? Did Mark or Joan recognize any gain or loss on that exchange?
2. Lane had a basis of $800,000 in an apartment building he owned. The apartment building had a fair market value of $1,210,000 and was subject to a mortgage of $250,000. Scott had a basis of $650,000 in an office building he owned. The office building had a fair market value of $1,260,000 and was subject to a mortgage of $370,000. Neither Lane nor Scott had any personal liability to repay the mortgage debt on their respective properties, and so those mortgages were nonrecourse debts. Lane and Scott each held his building in connection with his real estate rental business. Lane and Scott are not related.

Lane transferred the apartment building to Scott in exchange for which Scott transferred to Lane $70,000 cash and the office building. Lane took the office building subject to the

$370,000 mortgage debt thereon, and Scott accepted the apartment building from Lane subject to the $250,000 mortgage debt on that property. Land and Scott held the buildings they received in the exchange for business use.

* 1. What amount of gain or loss did Lane and Scott *realize* and what amount of gain or loss did they *recognize* from the exchange?
  2. What basis does Lane have in the office building he acquired in the exchange, and what basis does Scott have in the apartment building?

1. Paula owns a dress shop. Through an error in buying, Paula discovers that she has an oversupply of maternity dresses, and a shortage of cocktail dresses. Paula mentions her problem to John, who is the owner of another dress shop. John offers to swap 20 cocktail dresses with a value of $10,000 for 50 maternity dresses of equal value. Paula agrees, and the exchange takes place. Paula had a basis of $6,000 in the maternity dresses that she exchanged. Paula and John are not related. Did Paula *recognize* a gain on that exchange?
2. Renee collects paintings for a hobby. Renee does not hold the paintings as investments. One of the paintings that she acquired is titled the “Blue Girl,” and Renee had purchased that painting in Year One for $3,000. At all times in the following questions, the fair market value of the painting was $5,800.
   1. Renee transferred the Blue Girl painting to an unrelated art collector in exchange for a painting by a different artist having a value of $6,000. How much gain (if any) did Renee recognize on that exchange?
   2. The Blue Girl painting was destroyed by a fire caused by the negligence of Peter. To compensate Renee for the loss, Peter offered her a painting from his collection, and Renee accepted the offer. The value of the painting that Renee received from Peter was $6,000. Renee and Peter are not related parties. How much gain (if any) did Renee recognize?
   3. The same facts as those stated in Question 6(b) except that Peter gave Renee

$5,800 cash to compensate her for her loss. A month later, Renee purchased another painting for $5,500. Renee made no other purchases of paintings for the next four years. How much gain (if any) did Renee recognize?

* 1. The same facts as those stated in Question 6(b) except that the painting that Peter gave Renee to compensate her for the loss had a value of only $2,000. Nevertheless, Renee accepted that painting as full compensation. Did Renee recognize a gain or loss?

1. Melvin owned a building in a run-down area of Detroit, and he held that property as an investment. Melvin had a basis of $50,000 in the building. Melvin read an article in a local newspaper that the city planned to condemn an area that included his building. Melvin telephoned the mayor who confirmed the newspaper report. Melvin then purchased unimproved land in Ann Arbor at a cost of $65,000, which he held as an investment. Eight months later, the city of Detroit did condemn Melvin’s building and paid him $70,000 as compensation for the condemnation. Is Melvin entitled to nonrecognition of the gain he realized on the condemnation? What is Melvin’s basis in the land he purchased in Ann Arbor?
2. Hicks wished to acquire Blackacre (an apartment house) from Leslie. Hicks and Leslie are not related. Leslie had a basis of $85,000 in Blackacre which had a fair market value of $212,000. Leslie refused to sell the property to Hicks, but she offered to exchange Blackacre for a lot in another part of town if Hicks would purchase that lot and construct an office building on it in accordance with specifications that Leslie would provide. Hicks agreed. Hicks purchased the lot at a cost of $40,000, and he had the building constructed according to Leslie’s plans at a cost of $165,000. Hicks then deeded the lot and building to Leslie in exchange for her deeding Blackacre to Hicks. What were the tax consequences of those transactions to Hicks and to Leslie?
3. Arthur owned a truck that was used exclusively in his self-employed business. On January 6, 2019, Arthur transferred the truck to an automobile dealership as part payment for a new truck. Arthur’s basis in the transferred truck was $8,000, and its fair market value was $15,000. The price for the new truck was $50,000. In payment for the new truck, Arthur paid $35,000 cash and the old truck. What was the tax consequence of Author’s acquisition of the new truck?

# PROBLEM SET # 10

1. In Year One, Mona, a single mother and 35 years old, had adjusted gross income of

$30,000. Compute the amount of medical deduction allowable to Mona in each of following circumstances. In answering these questions, assume that Mona itemizes her deductions, and that all of the payments described below were made in one taxable year.

* 1. Mona paid premiums for medical insurance covering her and her 4-year old daughter whom she supports. The premiums she paid for that year amounted to $2,800. In that same year, Mona paid $125 to a dentist for dental work she incurred.
  2. In addition to the payments noted in (a), Mona paid $300 to purchase medicines that were prescribed by Dr. Jones for Mona’s daughter. Mona also paid $20 for pills providing pain relief, which pills were neither prescribed nor required to be prescribed by a physician. Mona also spent $20 for an electric toothbrush, and $5 for toothpaste.

1. Phil has an asthmatic condition that adversely affects his heart. Phil’s doctor advised him to purchase an air conditioning system for his home. Phil pays $400 for an air conditioning unit and pays another $30 to have it installed in a window in his bedroom. Without regard to the floor on deducting medical expenses, are any of the payments that Phil made deductible? If instead of a window unit, Phil had paid $2,600 to purchase a central air conditioning unit and have it installed in his house, would that cost be deductible?
2. Mike has an ulcer. His doctor requires him to go on a diet of bland foods that must be specially prepared. As a result of his special diet, Mike’s weekly food bill is $20 greater than it was before he went on that diet. Can Mike deduct the extra cost he incurs?
3. Ted is advised by his doctor to join Alcohol Anonymous. Ted joins and spends $15 per week on transportation to and from the AA meetings. Are those costs deductible? Would those costs be deductible if Ted had not been advised by a doctor to join AA, but instead Ted had joined on his own initiative?
4. To alleviate a heart condition, Kelly’s doctor advises her to leave Virginia and live temporarily in Arizona until her condition improves. Kelly goes to Tucson, rents an apartment there, and lives there for four months at which time her condition is much improved.
   1. Are Kelly’s transportation expenses of moving from her residence in Virginia to Tucson and return deductible?
   2. Are Kelly’s expenses for meals and lodging in Tucson deductible?
   3. If Kelly traveled by car to Tucson and return, could she deduct the cost of her meals and lodging incurred en route?
5. Donald is admitted to a hospital for an operation. He spends two weeks in the hospital and pays a bill to the hospital of $40,000, which includes the cost of his food and room. Is all of that $40,000 amount deductible?
6. William has an illness the symptoms of which are relieved by marijuana. Pursuant to a physician’s prescription, William purchased marijuana at a pharmacy. The purchase and use of marijuana for medicinal purposes is permitted by the laws of the state in which William resides, but is prohibited by the federal Controlled Substance Act. Does William’s cost of purchasing the marijuana qualify as a deductible medical expense? See Rev. Rul. 97-9.
7. Matilda is a devout Christian Scientist. Matilda becomes ill, and she seeks the services of a Christian Science practitioner to remove her symptoms. The practitioner talks with Matilda and prays with her to remove the spiritual blight that they believe to be the source of her symptoms. Is the cost that Matilda incurred in obtaining the services of the Christian Science practitioner deductible as a medical expense?
8. Henry has been working long hours for some time, and he becomes lethargic. At Henry’s annual medical check-up, his doctor becomes concerned that Henry’s run-down condition will lead to a serious medical problem for him. The doctor tells Henry that he needs to take time off from work and go on an extended vacation. The doctor recommends that Henry take a cruise. Henry does so, and his condition improves greatly. Is the cost of the cruise deductible as a medical expense?

1. Peter smoked a pack of cigarettes a day. Peter became concerned that his continuing to smoke would be harmful to his health. In order to end his craving for cigarettes, Peter joined a program, conducted by a psychologist, designed to break the habit of smoking. The program was successful, and Peter no longer smokes. Peter chose to enter the program on his own initiative and was not advised to do so by a doctor. Is the cost that Peter incurred to participate in the program deductible as a medical expense? See Rev. Rul. 99-28.
2. Do the premiums for the following insurance policies qualify for medical expense deductions?
   1. The insurer will pay the policyholder $400 per week during a period in which the policyholder is disabled.
   2. The insurer will reimburse the policyholder for medical expenses incurred by the policyholder or his spouse. In addition, in the event of the policyholder’s death, or loss of sight, the insurer will pay a specified amount to the policyholder or his estate.
3. Gladys is covered by a medical reimbursement insurance plan provided by Blue Cross. Gladys paid the premiums for the policy herself. In Year One, Gladys incurred and paid medical expenses totaling $5,600. Blue Cross paid Gladys $5,000 to reimburse her for most of those expenses. Gladys had adjusted gross income of $48,000 in Year One.
   1. Is any part of the $5,000 reimbursement included in Gladys’s gross income?
   2. The same facts as those stated above except that the premiums for the Blue Cross insurance policy were paid jointly by Gladys and her employer (each paid half of the premiums). The employer paid part of the premiums as a fringe benefit to Gladys. Was the employer’s payment of one-half of the premiums included in Gladys’s gross income? Was any part of the insurer’s reimbursement of $5,000 included in Gladys’s gross income?
   3. The same facts as those stated in Question 12(b) except that Gladys did not receive a reimbursement from the insurer in Year One. In her tax return for Year One, Gladys claimed and was allowed a medical expense deduction of $800. Gladys could not deduct $4,800 of the $5,600 of medical expenses she paid in that year because of the 10% floor on the deduction of medical expenses. In Year Two, Gladys received $5,000 from Blue Cross as reimbursement for part of the medical expenses she incurred and paid in Year One. What amount (if any) of that reimbursement is included in Gladys’s gross income in Year Two?

**PROBLEM SET # 11**

1. In a written separation agreement, *H* agreed to pay *W* $30,000 in cash one month after their divorce decree provided that *W* is living at that date. The agreement expressly states that *H* has no liability to make any other payments to *W* during her life or after her death. The parties are divorced, and *H* made the required payment of $30,000 in Year One. Did *W* recognize income from receiving that payment in Year One? Did *H* recognize income in the subsequent year because of having made that payment?
2. Pursuant to a divorce, *H* and *W* execute a written separation agreement under which *H* agrees to permit *W* to remain for life, rent free, in their former home which is owned by *H* alone. *H* also agrees to make any required mortgage payments on the house for so long as *W* is living. The mortgage payments are $4,000 per year. The agreement expressly provides that *H* has no obligation to make any payments to *W* (or on her behalf) during her life or after her death, other than the mortgage payments during her life. Does *W* recognize any income when *H* carries out the terms of that agreement after their divorce?
3. In Year One, Ralph and Jane were divorced. The divorce decree requires *H* to pay any medical bills that Jane incurs at any time after the divorce decree is issued. Ralph has no obligation to make any other payments. Two years after the divorce decree was issued, Jane incurred medical expenses totaling $14,000, and Ralph paid those expenses in accordance with the divorce decree. What were the tax consequences of that payment to Ralph and Jane?
4. *W* owns a declining term life insurance policy insuring the life of *H*. *H* and *W* divorce, and the divorce decree requires *H* to pay the premiums on the declining term life insurance policy until the death of either *H* or *W*. *H* is not required to make any other payments to or on behalf of *W*. In Year One, after the divorce, *H* paid the premium of $3,000 on the policy. What was the tax consequence of that payment?
5. *H* and *W* executed a written separation agreement under which *W* agreed to pay *H* the following amounts in the indicated calendar years:

Year One – $200,000

Year Two – $120,000

Year Three – $70,000

Year Four – $50,000

and $50,000 for each year thereafter for the rest of *H*’s life. No other payments are to be made, and no payments are to be made after *H*’s death. *H* and *W* lived for more than 10 years after their divorce. *W* made timely payments to *H* of all the payments required by the agreement. What were the tax consequences to the parties of the payments made in Year One through Four?

1. Robert and Ellen divorced in Year One. The divorce decree required Robert to establish a trust and contribute stocks having a value of $400,000 to the trust. The trust provided Ellen an annual annuity of $25,000 for so long she lived. Upon Ellen’s death, any assets remaining in the trust are to be distributed to Robert of to his estate. No payments were required to be made other than the settlement of the trust and the distributions from the trust. Immediately after the divorce decree was issued, Robert established the trust and transferred to the trustee appreciated stocks having a value of $400,000. What was the tax consequence of Robert’s transfer of appreciated stocks to the trust? What were the tax consequences of the annual payments of $25,000 that the trust made to Ellen?
2. Michael and Roberta are divorced. They have one child, Stanley, who is ten years old. Stanley lives with Roberta. Michael and Roberta’s divorce instrument requires Michael to pay Roberta $30,000 “alimony” per year, to be reduced to $18,000 when Stanley reaches the age of 19. How much of the $30,000 payment will qualify as alimony?
3. Same facts as Question 7 except that the divorce instrument states that annual “alimony” payments will be $30,000, to be reduced to $18,000 on a date nine years in the future. This happens to be Stanley’s 19th birthday although no mention of Stanley is made in the divorce instrument. How much of the $30,000 payment will qualify as alimony?

**PROBLEM SET # 12**

1. Are the following losses, which occurred in a disaster area in a year that was a federally declared disaster for that area, deductible subject to applicable floors on the deduction for casualty and theft losses?

(a) Some trees and shrubs in the yard of John’s residence were uprooted by a tornado and died.

(b) A storm, in the middle of a cold winter, caused a power failure in the area in which Martha and her family reside, and so Martha’s home had no heat or lights for five days. Martha and her family moved into a suite at a motel for that five-day period. Is the cost of renting the suite at the motel deductible?

(c) The front porch of Mark’s residence became unsafe to use because of rust. Mark incurred a cost to replace the porch. Does Mark qualify for a deduction? If the porch had become unsafe due to damage caused by termites, would Mark qualify for a deduction?

(d) Allen owned an automobile that he used for personal, nonbusiness purposes. While driving the automobile, the automobile was badly damaged by a collision with another car, and the collision was caused by Allen’s negligence. Is any of the damage to Allen’s car deductible?

(e) The same facts as those stated in Question 1(d). Allen did not have liability insurance. Because of his negligence, Allen was required to pay the owner of the other car an amount equal to the loss of value that the other car suffered. Is Allen’s payment deductible by him?

(f) Sue stored her fur coat in a closet. Moths ate holes in the coat, and it became worthless. Is Sue’s loss deductible?

(g) Pat’s home was burglarized, and valuable pieces of jewelry were found to be missing. The jewelry had been used by Pat for personal wear. Is Pat’s loss deductible?

(h) Hilda wore a valuable diamond ring. One day, she discovered that the diamond that had been in the ring was gone. The setting in the ring had given way, and the diamond had fallen out. Hilda had not noticed that when it occurred. A search for the diamond was to no avail. Is Hilda’s loss deductible?

1. Owen purchased an automobile in Year One for $30,000, and Owen used the vehicle only for personal, non-business purposes. In Year Three, the automobile was demolished and rendered worthless when a tree fell on it. Immediately before the accident, the fair market value of the automobile was $20,000, and its value after the accident was zero. Owen’s adjusted gross income (AGI) for Year Three was $80,000. In Year Three, Owen had a valuable painting that was stolen. Owen’s basis in the painting was $30,000, but its fair market value was $75,000. The painting was insured and Owen received $75,000 from the insurer in Year Three to compensate for the theft. Owen held the painting for personal use. Owen did not itemize his deductions for Year Three but used the Standard Deduction. What amount of deduction is Owen allowed for the damage to his car?
2. The same facts as those stated in Question 2 except that Owen used the automobile exclusively in his self-employed business. Owen’s adjusted basis in the automobile immediately before the accident was $22,000 (his adjusted basis is the difference between his original cost of $30,000 and the depreciation deductions allowable to him while he held the car). What amount of deduction is allowable to Owen because of the destruction of his car?
3. If, in Questions 2 and 3 above, Owen’s automobile had not been destroyed by the accident, and if its fair market value immediately after the accident was $5,000, what amount of deduction for the damage to the car would be allowable to Owen in Question 2 and in Question 3?
4. In Year One, Bert purchased a house that he used as his home. Bert paid $250,000 for the property. Over time, the neighborhood in which the house was located deteriorated, and consequently the value of the house fell. In Year Ten, Bert moved out of the house and rented it to Richard for a fair amount of rent. Bert and Richard are not related. The fair market value of the house at the time that Bert rented it was $130,000. The value of the house continued to fall, and six months after renting the property, Richard offered to buy it from Bert for $110,000. Bert accepted the offer and sold the house for that price. What amount of deduction (if any) can Bert take because of that sale?
5. In Year One, Myra purchased improved commercial real estate for $400,000. Myra intended to use the property as the base from which to conduct her advertising business. Of the $400,000 that Myra paid for the building, $250,000 was attributable to the land and the remaining $150,000 was attributable to the building. After moving into the building, Myra discovered that it was not satisfactory for her purposes. Consequently, five months after purchasing the property, Myra paid $80,000 to have the building razed, and she paid another $300,000 to construct a new building on the land. All of those costs were incurred and paid in Year One. What amount of these costs is deductible by Myra?
6. In Year One, Alice incurred a personal casualty loss of $35,000 from a hurricane. The loss took place in a disaster area in a federally declared disaster. In that same year, Alice incurred a personal casualty loss of $12,000 in an area that was not a disaster area. Also, in that same year, Alice had a personal casualty gain of $10,000 for damage suffered in the disaster area. To what extent can Alice deduct the $12,000 personal casualty loss she suffered in the area that was not a disaster area?

**PROBLEM SET# 13**

1. Are the following expenses deductible?

(a) Nick is a recent graduate of the Chicago Law School, and he has passed the New York state bar examination. Nick contacted three large New York City law firms, and they agreed to interview and consider him for a position as an Associate. At his own expense, Nick flew to New York City, stayed at a hotel for several days while he was interviewing, and had his meals in restaurants. Nick was not reimbursed for his expenses. Can he deduct any of those expenses in the following alternative circumstances?

(i) Nick did not receive any job offers from those interviews.

(ii) Nick got an offer from one of the firms, and he accepted it.

(iii) Nick did not get an offer from any of the firms, but one of the firms reimbursed him for his expenses. Is the reimbursement included in Nick’s gross income?

(b) Will obtained a secretarial job through an employment agency, and Will paid the agency $600 (one week’s salary) for securing the job. Is that payment deductible?

(c) Mark is a litigation partner at the Levin law firm. He spent $4,000 on suits and ties that he wears only to conduct trials. Is that lost deductible? What is the tax consequence if the firm reimburses Mark?

(d) Helen, who works as a nurse at a hospital, purchases a nurse’s uniform. Helen is required to wear the uniform when she is on duty. The hospital reimburses Helen for the cost of the uniform. Can Helen deduct the cost?

1. Larry purchased a house in Year One for $350,000. Larry lived in the house and used it as his residence until Year Five. In Year Five, Larry moved out and listed the house with a real estate agent for rent or sale at the purchaser’s or renter’s option. At the time of the listing, the fair market value of the house was $380,000. The agent was not successful in renting or selling the house until Year Seven when it sold to an unrelated person for $320,000. Can Larry deduct the loss he suffered on the sale in Year Seven?

(a) Can Larry deduct maintenance costs he incurred between Years Five and Seven when the house was on the market for rent or sale?

(b) If Larry offered the house only for rent, and did not offer it for sale, could he deduct maintenance expenses he incurred between Years Five and Seven?

1. The same facts as those stated in Question 2 except that the real estate agent was successful in renting the house in Year Five for a fair rental, and the fair market value of the house when Larry listed it in Year Five was $280,000. During the period, Years Five to Seven, when the house was rented, Larry claimed and was allowed depreciation deductions totaling $20,000 for the house. In Year Seven, Larry sold the house for $270,000. What amount of gain or loss did Larry recognize on that sale?
2. Are the following expenses deductible?

(a) The fees that Susan paid her lawyer to represent her in litigation in which Susan sought a divorce and alimony from her husband. Would it matter to the determination of deductibility whether Susan was successful in that litigation?

(b) The same facts as those stated in Question 4(a) except that the divorce decree required Susan’s husband to pay Susan’s legal fees. Are those payments deductible and by whom?

(c) Randolph and Jennifer got a divorce. Before the law suit was filed, the parties, through their lawyers, negotiated and executed a settlement agreement. Randolph paid his lawyer’s fees for tax advice he gave Randolph concerning the terms that he should seek to obtain in the settlement agreement and for drafting the agreement. Are any of those fees deductible?

(d) Hilbert and Phyllis decided to marry. Both parties had children and grandchildren from a prior marriage, and both were wealthy. They consulted a lawyer to have him draft an antenuptial agreement, which they executed. Is the lawyer’s fee deductible?

**PROBLEM SET # 14**

1. Joseph teaches Japanese as a self-employed tutor. During the summer of Year Two, Joseph traveled to Japan and spent two months there immersing himself in the language and culture of the country. Can Joseph deduct his transportation and living costs?
2. Mary Lane is a professor of Archaeology at Holy Cross University. During the summer period of Year One, when Professor Lane has no teaching duties, she traveled to Jordan and conducted an expedition that uncovered archaeological data that formed the basis of a scholarly article that she subsequently wrote and published in a learned journal. Professor Lane paid for her own expenses in traveling, conducting the expedition, and for meals and lodging in Jordan. She was not reimbursed. Can she deduct those expenses?
3. Henry is a self-employed consultant. Henry owns a home and resides in Ann Arbor. Each year, for 10 months, Henry lives in Ann Arbor and commutes to his office in Detroit. Two months of each year, Henry visits a Florida client in Miami. Henry rents an office in Miami while he is there. Henry lives in a hotel in Miami for those months and takes a taxi from the hotel to his office and return each workday. Henry’s wife and children do not accompany him when he is in Miami. What expenses can Henry deduct?
4. Paul resides with his family at his home in Detroit. He works during the day as a self-employed gardener. Each workday, Paul drives from his residence to his workplace in Ypsilanti. In the evenings, Paul moonlights by working as a security guard at a warehouse in Detroit that is located three blocks from Paul’s residence. At the end of his workday in Ypsilanti, Paul drives directly to the warehouse in Detroit. Paul’s wife prepares a meal for Paul which he takes with him in a brown bag when he goes to the warehouse. When his work at the warehouse is finished, Paul drives the three blocks to his home and goes to bed. Are any of Paul’s transportation expenses deductible?

(a) If, instead of driving directly to the warehouse from his job in Ypsilanti, Paul were to stop at a diner en route and have dinner, would that effect his right to a deduction for his transportation expenses? Would the cost of the dinner be deductible?

(b) If, instead of driving directly to the warehouse, Paul were to drive home first, have dinner, and then drive from home to the warehouse, would any of his transportation expenses be deductible?

**PROBLEM SET # 15**

1. Are the expenses of institutional advertising deductible?
2. Martha is the president and major stockholder of a publicly held corporation, and her name is also the name of the corporation. The corporation’s business has been very profitable. The value and success of the corporation’s business rests on Martha’s personal reputation. The federal government has accused Martha of insider trading and of lying to the investigators. While Martha professes her innocence, the scandal has damaged the corporation’s profitability and reduced the value of the corporation’s stock. The government has offered to settle the issue with Martha by her paying a fine of $2,000,000. To terminate the bad publicity that the charges against Martha have generated and the harm that it has caused the corporation, the corporation urged Martha to accept the settlement, and the corporation will pay the fine. Martha accepts the government’s offer, and the corporation pays the fine. What are the tax consequences to Martha and to the corporation of the payment of the fine?
3. In Question 2, if Martha rejected the settlement offer and instead litigated the issue with the government, could she deduct the legal fees she incurred in litigating the issue?
4. Hilda works as a CPA partner for a large accounting firm. She decided to go to law school in order to improve her skills in her accounting work. Hilda had no intention to practice law. Hilda enrolled as a student in the Notre Dame Law School, and she earned a J.D. degree. Can Hilda deduct the tuition she paid to Notre Dame?
5. Pluto, Inc. is a corporation engaged in the retail furniture business. Pluto has three shareholders who hold the indicated percentages of Pluto’s outstanding stock.

Peter - 40%

Paul - 40%

Mary - 20%

All three shareholders work as employees of the corporation. In December of every year, Pluto declares a bonus for Peter, Paul and Mary that is divided among them in the following proportions: 40% for Peter, 40% for Paul, and 20% for Mary. Each year, the total amount of bonus payments made by Pluto is approximately equal to the net profit of the corporation exclusive of the bonus payments. Can the corporation deduct the bonus payments it makes to its three employees?

1. Marina practiced law as a partner in a law firm in the State of New Jersey. Marina was offered a position as a partner in a law firm in Atlanta. The salary and professional opportunities in the Atlanta job are much greater than she had in New Jersey. Marina accepts the Atlanta offer. To prepare for taking the Georgia bar examination, Marina pays $400 to take a bar review course on Georgia law. Marina pays a fee of $100 to take the Georgia bar exam. After passing the exam, Marina paid a fee of $200 to be admitted to the Georgia bar. Are any of Marina’s expenses deductible?

**PROBLEM SET # 16**

In answering the questions below, ignore IRC §§ 168(k), 179 and 280F.

1. On January 1, 1971, John paid $30,000 for a new machine that he used in his business. The machine had a useful life of five years. The estimated salvage value of the machine at the end of its useful life was $5,000. Since the machine was purchased before § 168 was adopted, that section is not applicable to the machine’s purchase. John did not elect to take a deduction under § 179. Compute the amount of depreciation deduction allowable to John for the taxable year 1972 under each of the following methods of depreciation.

(a) Straight line.

(b) 200% declining balance.

2. On February 24, 2016 (that is prior to the current § 168(k)), Helen purchased a used machine for use in her business at a cost of $20,000, and she immediately placed it in use in her business. The machine has a 5-year recovery period, and Helen elected to depreciate the machine on the straight-line method. Helen did not elect to take a deduction under § 179 nor did she elect any bonus depreciation under the old version of § 168(k). Helen made no other purchases that year. Assuming that Helen continued to use the machine in her business, what amount of depreciation deduction is allowable to Helen for 2016, 2017, and 2021?

3. The same facts as those stated in Question 2 except that Helen did not elect to depreciate the machine on either the straight line or the 150% declining balance method. What amount of depreciation deduction is allowable to Helen for Year One, Year Two, and Year Six?

4. The same facts as those stated in Question 3 except that the machine was purchased on November 1, Year One. Assuming that Helen continued to use the machine in her business, what amount of depreciation deduction is allowable to Helen for Year One, Year Two, and Year Six?

5. The same facts as those stated in Question 2. Helen miscalculated the amount of her depreciation deductions, and so she claimed depreciation deductions of $3,500 in Year One, and $6,000 in Year Two. On January 1, Year Three, Helen sold the machine for $15,000. Helen did not claim any depreciation deduction for the machine for Year Three. Is any depreciation deduction allowable to Helen for Year Three? What is the amount of gain Helen recognized on the sale of the machine for $15,000 in Year Three?

6. On April 12, 2021, Morris purchased a machine and he immediately places that machine in use in his business. The cost of the machine was $40,000. What is the maximum amount of 2021 deduction that Morris can take on account of purchasing the machine? What is the maximum deduction Morris can take in 2022?

1. Sarah purchased the assets of a going business. The contract of sale allocated $120,000 of the purchase price to the purchase of the goodwill of the business. Can Sarah take depreciation deductions for that goodwill?
2. In 2021, Ferris purchases two assets for use in his business. The first property was acquired on March 1, 2021 and Ferris immediately uses the property in his business on that date. The cost of the property was $30,000 and the property is considered “5-year property” for purposes of § 168. The second property was acquired on December 1, 2021 and Ferris immediately uses the property in his business on that date. The cost of this property was also $30,000 although the property is considered “10-year property” under § 168.   
     
   For valid reasons, Ferris plans to **not** expense the 5-year property under either § 179 or § 168(k) although he does want the maximum deduction he can get for it under the normal MACRS depreciation rules. He does plan to fully expense the 10-year property. He has come to you for advice on whether he should expense the 10-year property under § 179 (which he qualifies for) or § 168(k) or does it not make any difference. What is your advice?

**PROBLEM SET #16A – CAPITAL ASSETS**

1. Investor Irvin bought and sold stock (all capital assets in his hands) at the following dates and prices:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| STOCK | Date Acquired | Basis | Date Sold | Amount Realized |
| A Stock | 7/19/99 | $1000 | 2/27/21 | $5000 |
| B Stock | 4/23/20 | $750 | 4/23/21 | $1000 |
| C Stock | 1/12/15 | $3000 | 8/22/21 | $1500 |
| D Stock | 4/25/21 | $5000 | 5/15/21 | $3000 |

What, if any, were the short-term capital gains, short-term capital losses, long-term capital gains, long-term capital losses? Is there a net short-term capital gain or loss? Is there a net long-term capital gain or loss? What, if any, is the net capital gain (as defined by § 1222(11))? What does this mean for his taxes?

1. Same facts as Question 1, except that Irvin sold the B stock for $4000. What results to the questions above?
2. In Year One, Investor Irene realized a long-term capital gain of $5000 and a short-term capital loss of $9000. Assuming that the loss is deductible, how much can she deduct in Year One?
3. Same facts as Question 3. In Year Two, Investor Irene realized a short-term capital gain of $1000. What are the tax consequences to Irene on account of that sale?
4. In Year One, Investor Ike realized a $3000 long-term capital loss and a $3000 short-term capital loss. What are the tax results to Ike?

**PROBLEM SET # 17**

In answering the questions below, ignore IRC §§ 168(k), 179 and 280F.

1. In April of Year One, John purchased a computer for $20,000. John used the computer in his business. The computer is 5-year property. John elected to depreciate the computer on the straight line method. John deducted $2,000 depreciation for the computer in Year One, and $4,000 depreciation in Year Two. On December 9, Year Three, John sold the computer to an unrelated party for $15,000. John claimed no depreciation on his tax return for Year Three. What is the amount of John’s gain and how is it characterized (i.e., ordinary income, capital gain, or § 1231 gain)?

2. In September of Year One, Bill purchased an automobile for use in his business at a cost of $20,000. Using the straight line method, Bill took a depreciation deduction for the use of the car of $2,000 in Year One. Even before taking the depreciation deduction into account, Bill had a taxable loss of ($1,200) in Year One, and so the depreciation deduction increased Bill’s loss to ($3,200). However, Bill did not qualify for a carryforward or carryback of any of his Year One loss. Bill sold the car to an unrelated person on December 2 of Year Two for $19,000. Bill did not take any depreciation for the car in Year Two. What is Bill’s gain on the sale and how is it characterized?

3. In Year One, Sam purchased a car for use in his business. The car cost $26,000. The car is 5-year property, Sam elected to depreciate the car on the straight line method. Sam deducted $2,600 depreciation for the car on his Year One tax return, and $5,200 depreciation on his Year Two tax return. On February 18, Year Three, Sam gave the car to his nephew, Paul, who used it in his business. The value of the car at the time of that gift to Paul was $20,000. Both Sam and Paul deducted the correct amount of depreciation for the car in their returns for Years One through Four. Paul sold the car for $15,000 to an unrelated person on August 12, Year Four. What amount of depreciation is allowable for Paul to deduct in Year Three? What amount of gain did Sam recognize on making the gift to Paul? What amount of gain did Paul or Sam recognize when Paul sold the car in Year Four, and how is that gain characterized?

4. Bob purchased a tractor for use in his farming business at a cost of $30,000. Bob properly took depreciation deductions for the tractor aggregating $18,000 before he died several years later. At the time of his death, the tractor had a value of $15,000. Bob’s executor did not elect the alternate valuation date for estate tax purposes. Bob devised the tractor to his widow, Frances, who promptly sold it for $15,250. What are the tax consequences to Bob, his estate, and to Frances?

5. On February 4 of Year One, Fred purchased a machine for use in his business. The machine cost $110,000. The fair market value of the machine on April 8, Year Four was $90,000. On that date, Fred sold the machine to his nephew, Carl, for $60,000. Fred deliberately sold the machine to Carl for less than its value because he wanted to benefit Carl. Carl used the machine in his business until December of Year Five when he sold it to an unrelated person for $95,000. The total amount of depreciation for the machine that Fred claimed on his tax returns for the years he held the machine was $75,000, and the total depreciation claimed by Carl on his tax returns was $10,000. You will assume that both Fred and Carl claimed and were allowed the correct amount of depreciation. What are the income tax consequences to Fred of his Year Four sale of the machine to Carl, and what are the income tax consequences to Carl of his Year Five sale of the machine?

6. Same facts as question 5. If Fred had depreciated the machine on the straight line method, would Carl also have been required to depreciate the machine on the straight line method, or could Carl have elected to use the declining balance method?

7. In Year One, Bank cancelled a $20,000 debt that Alan owed to the Bank. Alan was insolvent at that time, and so Alan did not recognize any income from the cancellation of the debt because of § 108(a)(1)(B). Pursuant to § 108(b)(2)(E), because of the cancellation of the debt, Alan’s basis in 1,000 shares of Win All, Inc. stock (a publicly held corporation ) that he owned was reduced from $30,000 to $10,000. In Year Four, Alan sold the 1,000 shares of Win All stock to an unrelated party for $18,000. What was the tax consequence to Alan of that sale?

**PROBLEM SET # 18**

1. In Year One, Roy purchased Blackacre (unimproved land) for $50,000. Blackacre was unencumbered at that time. In Year Ten, Roy borrowed $80,000 from Bank and mortgaged Blackacre as security for the loan. Under the terms of the loan, Roy has no personal liability to repay the loan, and the Bank can collect only by foreclosure on Blackacre in the event of a default.

(a) What was Roy’s basis in Blackacre after the mortgage was effected?

(b) Did Roy recognize any gain when he obtained the nonrecourse loan from the Bank?

(c) If in Year Twelve, Roy sold Blackacre for $18,000 cash and the purchaser took Blackacre subject to the outstanding balance of the mortgage debt, which then was $75,000, what amount of gain would Roy recognize?

(d) Instead, in Year Twelve, the value of Blackacre had fallen to $60,000. The outstanding balance of the debt to the Bank was $75,000. Roy ceased to make payments on the mortgage debt, and so the Bank foreclosed. The property was sold for $60,000 on the foreclosure sale, all of the proceeds of which went to the Bank. How much gain, if any, did Roy recognize on the foreclosure sale?

2. William owned 100 shares of stock of the X Corporation. The stock was pledged to secure a $20,000 loan that William had obtained from the Friendly National Bank. William had no personal liability to repay the loan, which therefore was nonrecourse. In Year Four, William donated the 100 shares of X stock to the Zion Baptist Church, a qualified charity. The church took the stock subject to the $20,000 debt owing to the Friendly National Bank, which debt was secured by the stock. At the time of the gift to the church, the fair market value of the 100 shares of X stock was $60,000, and William had a basis of $36,000 in those 100 shares of stock. William claimed a deduction of $40,000 for the donation to the church (i.e., the difference between the $60,000 value of the stock and the $20,000 encumbrance on those shares). The IRS allowed the deduction.  
  
What amount of income, if any, did William recognize because of making the donation to the church?

**PROBLEM SET # 19**

Unless expressly stated otherwise, all properties in the Questions below were held by the taxpayer for more than one year. Except for Question 7, none of the depreciable assets in the Questions below had any depreciation deduction allowed or allowable; while that is unrealistic, it avoids dealing with recapture of depreciation issues. No expense deduction under § 168(k) or § 179 was taken for any of the properties in the Questions below. In the years involved in Questions 1 through 7 below, there were no “non-recaptured net section 1231 losses,” and so the recapture provision of § 1231(c) does not apply in those Questions. All of the years mentioned in the Questions below began after 1993. The taxpayers in the Questions below had no relevanttransactions other than the ones mentioned in the Questions.

1. Phil held Greenacre and Redacre both of which were realty that he used in his business. In Year One, Phil sold both properties to an unrelated person. Phil recognized a gain of $80,000 on the sale of Greenacre, and he recognized a loss of ($45,000) on the sale of Redacre. How are the gain and loss that Phil recognized characterized?

2. The same facts as those stated in Question 1 except that the gain that Phil recognized from the sale of Greenacre was only $30,000. How are the gain and loss that Phil recognized characterized?

3. In January, Year One, Rebecca purchased a machine to use in her business. Rebecca paid $35,000 for the machine. In September of Year One, Rebecca sold the machine to an unrelated person for $42,000. None of Rebecca’s gain was recapture of depreciation. How is Rebecca’s gain characterized?

4. Steve owned a painting which he hung in his home and held for personal enjoyment (i.e., it was not held as an investment or for business use). In Year One, the painting was stolen, and it was not insured. Year One was a federally declared disaster year. Steve had a basis of $30,000 in the painting, but its fair market value at the time of the theft was $24,000. In Year One, Steve sold a parcel of undeveloped land that he had held and used in his business for a $50,000 gain. Steve’s adjusted gross income for Year One was $80,000. How are the gain and loss that Steve recognized characterized?

5. Melvin owned an apartment building which he used in his business and had depreciated on the straight line method. In Year One, the apartment building was condemned, and Melvin recognized a gain of $25,000 on the condemnation sale. In Year One, Melvin sold an office building to an unrelated person. Melvin had used the office building in his business, and he recognized a loss of ($12,000) on that sale. Melvin’s adjusted gross income for Year One was $100,000. How are Melvin’s gain and loss characterized?

(a) The same facts as above except that in Year One, Melvin also had a painting stolen from him. Melvin had purchased the painting to hang in his office, and so it was purchased for business use and was so used. The painting was stolen from Melvin’s office. Melvin had a basis of $42,100 in the painting, which had a value of $51,000 at the time of the theft. How is the $25,000 gain that Melvin recognized on the condemnation sale of the apartment building characterized?

(b) The same facts as those stated in Question 5(a) except that Melvin recognized a loss of ($32,000) on the sale of the office building, and Melvin sold the office building to a corporation that he controlled, and so IRC § 267(a)(1) and (b)(2) barred Melvin from taking a deduction for the loss he recognized on that sale. How is the $25,000 gain that Melvin recognized on the condemnation sale of the apartment building characterized?

6. Sally had a basis of $175,000 in a house that was situated on leased land. Sally used the house part of the year as a vacation home, and it was not her principal residence. The house was totally destroyed by fire. The insurer paid Sally $400,000 for her loss. Sally did not replace the house by purchasing similar property. How is Sally's gain from receiving the insurance proceeds characterized for tax purposes?

7. In Year One, Don sold depreciable equipment that he had used in his business for a gain of $22,000, of which $16,000 was a recapture of depreciation and taxable under § 1245. In Year One, Don sold realty that he used in his business for a loss of ($10,000). How is the loss that Don recognized characterized?

8. In Year One, Vicki recognized a § 1231 loss of ($75,000) and a § 1231 gain of $30,000. Vicki had no other § 1231 gains or losses in that year or in the preceding five years. In Years Two, Four and Five, Vicki recognized no § 1231 gains or losses. In Year Three, Vicki recognized a § 1231 gain of $36,000. In Year Six, Vicki recognized a § 1231 gain of $20,000. How are the § 1231 gains that Vicki recognized in Years Three and Six characterized?

1. Carl had a net section 1231 loss of ($20,000) in Year One. Carl had a net section 1231 loss of ($10,000) in Year Three. Carl had a net section 1231 gain of $12,000 in Year Five. Carl had a net section 1231 gain of $18,000 in Year Seven. How is Carl’s net section 1231 gain for Year Seven characterized?
2. In Year One, Frank purchased a depreciable asset from Mildred to use in his business. The asset did not operate well, and Frank sold it in Year Two. Frank recognized a loss of ($28,000) on that sale. Also in Year Two, Frank sold unimproved land that he had used in his business for a gain of $25,000. In Year Four, Frank made a claim against Mildred for misrepresentation concerning his purchase of the asset. Mildred settled that claim by paying Frank $28,000 to reimburse him for the loss he incurred. How is that $28,000 payment to Frank characterized?

**PROBLEM SET # 20**

1. Rudy constructed an office building in Year One and leased the building to the United States government on a net, net lease basis for a term of 15 years.

(a) In Year Two, Rudy assigned to his daughter all of the rights Rudy possessed in the lease of the property to the government. This assignment gave the daughter the right to the rental income from the property for the next 14 years and it gave her the right to the possession of the property for any remaining term of the lease if the tenant should default. The daughter did collect the rents from the lease for the next 14 years. Who is taxed on the rental income?

(b) The same facts as those stated in Question 1(a). In Year Three, Rudy conveyed the office building to his brother. Who is taxed on the rents that the daughter collected from the government after that conveyance was made?

(c) The same facts as those stated in Question 1(a). Rudy died in Year Four and devised the office building to his brother. Who is taxed on the rental income that the daughter collects from the government after Rudy’s death?

2. Larry owns a factory building that he leases to Ted for a six-year term.

(a) In the second year of the lease, Larry sells all of his rights in the lease to Herman for $80,000. What is the tax consequence to Larry? When Herman collects rent from Ted, who is taxed on that rental income?

(b) In the second year of the lease, Larry is offered a very attractive price for the factory, but only if he can convince Ted to cancel the lease. Larry and Ted agree that the lease will be cancelled in consideration of which Larry pays Ted $25,000. What is the tax consequence to Ted?

1. On March 14, Year One, Win All, Inc. declared a dividend of $2 per share to be paid on May 3, Year One, to all holders of record of Win All stock on March 21, Year One. George owned 100 shares of Win All stock which had a fair market value of $200 per share immediately before the dividend was declared on March 14. The stock’s value rose as a result of the declaration of the dividend. George had a basis of $50 in each share of his Win All stock, and he had held the stock for more than five years.

(a) On March 15, George sold his 100 shares of Win All stock for $203 per share. How is George taxed on that sale? Who is taxed on the dividend when it is paid on May 3?

(b) Instead, on March 23, Year One, George sold his 100 shares for $203 per share, and as part of that sale, George agreed that the dividend to be paid on May 3 would be paid to the purchaser. Win All stock that was sold ex-dividend on March 23 was selling at $201.50 per share. How is George taxed on the sale, and who is taxed on the dividend when it is paid?

(c) Instead, on March 16, Year One, George made a gift of his 100 shares of stock to his daughter Kelli. Kelli collected the dividend on May 3. Who is taxed on the dividend?

4. Gertrude was appointed the personal representative of the estate of her deceased husband, Rupert. Rupert devised his entire estate to the two children of his marriage to Gertrude. Rupert left nothing to Gertrude because she is a wealthy woman in her own right. Gertrude served as personal representative; and after completing her service, she became entitled to a statutorily set fee of $225,000. When Gertrude was informed of her right to receive that fee, she filed with the Probate Court a formal waiver of her right to the fee, and so Gertrude received no payment for her services. What was the tax consequence of Gertrude’s waiver of the fee?

1. Arthur died in Year One and devised $1,000,000 of stocks and bonds to a testamentary trust. The income from the trust is payable to Arthur's widow, Helen, for her life. At the time of Arthur's death, Helen was 59 years old. On Helen's death, the corpus of the trust is to be paid to Marina (or her estate), who is the daughter of Arthur and his first wife, Paula.   
     
   The regulations provide that in Year One, when Helen was 59 years old, the actuarial factor for valuing Helen's life income interest is .60000. Consequently, under the regulations, the value of Helen's life income interest at the time of Arthur's death was $600,000, and the actuarial value of Marina's remainder interest was $400,000.  
     
   In Year Seven, when Helen was 66 years old, Helen sold her life income interest to Rupert for $530,000. Rupert is not related to Helen or Marina. At the time of that sale, the value of the trust's assets was still $1,000,000, and the actuarial factor for valuing Helen's life income interest was then .50000.   
     
   (a) What was the income tax consequence to Helen of making the sale of her life income interest in Year Seven?  
     
   (b)  In Year Eight, Rupert received distributions from the trust because of his income interest. How is Rupert taxed on those distributions?  
     
   (c) In Year Seven, at the same time that Helen sold Rupert her life income interest, Marina sold Rupert her remainder interest. Does Marina's sale of her remainder interest affect the tax treatment of Helen's sale of her life income interest?

**PROBLEM SET # 21**

1. On March 4, Year Four, Will sold 500 shares of Prancer Corp. common stock for $30,000. Will’s basis in those 500 shares was $10,000. Will also owned 100 shares of Blitzen Corp. common stock having a fair market value of $20,000. Will had purchased the Blitzen shares in Year One, and he had a basis of $40,000 in the Blitzen shares. Will desired to recognize the unrealized decline in value of the Blitzen stock so that he could offset that loss against the gain he recognized on the sale of the Prancer stock. Accordingly, on September 5, Year Four, Will sold the 100 shares of Blitzen stock to an unrelated person for $20,000; and on October 1, Year Four, Will purchased 100 shares of Blitzen stock for $19,000. What were the tax consequences of the two stock sales that Will made? If Will were to sell the 100 shares of Blitzen stock on January 12, Year Five, for $30,000, what would be his gain and how would it be characterized?

2. Hans bought 100 shares of Bilt Rite Inc. common stock for $5,000 in Year One. On September 5, Year Three, Hans sold the 100 shares of Bilt Rite for $6,000; and the next day, he purchased 100 shares of Bilt-Rite common stock for $6,000. What was the tax consequence of Hans’s sale of the 100 shares of Bilt Rite common stock?

3. As of January 1, Year One, Nick owned 100 shares of the stock of Kewbie Corp., which he had purchased several years earlier. Nick’s basis in the stock was $20,000, and its market value was $8,000. On March 5, Year One, when the value of the stock was still $8,000, Nick sold the stock to his sister, Mary for $8,000. What was the tax consequence to Nick of that sale?

(a) On June 10, Year One, Mary sold the 100 shares of Kewbie stock to her brother-in-law. In each of the following two alternative circumstances, what was the tax consequence to Mary of that sale to her brother-in-law?

(1) The purchase price that Mary received for the stock on the June 10 sale was $11,000.

(2) The purchase price that Mary received for the stock on the June 10 sale was $6,000.

(b) Instead of selling the stock, Mary made a gift of the 100 shares to her son, Steve, on January 18, Year Two. On February 14, Year Three, Steve sold the stock to an unrelated person for $11,000. What was the tax consequence to Steve of making that sale in Year Three?

1. Alice owned Blackacre (unimproved land) which she held as an investment. Alice had a basis of $60,000 in Blackacre, but its value had fallen. Alice wished to recognize the unrealized loss she had in Blackacre. On April 5, Year Two, Alice sold Blackacre to an unrelated person for its value of $25,000. On that same date, Alice purchased Whiteacre (unimproved land) for $25,000. Whiteacre was an adjoining lot to Blackacre, and the two lots were virtually identical in every respect except for the slight difference in location. What was the tax consequence to Alice of the sale of Blackacre?

5. In Year Two, Robert sold Blackacre to his brother, John, for its fair market value of $30,000. Robert had a basis of $45,000 in Blackacre. In Year Three, John transferred Blackacre to Helen, an unrelated person, in exchange for Redacre and Blueacre. At the time of the exchange, Blackacre had a fair market value of $30,000, Redacre had a fair market value of $20,000, and Blueacre had a fair market value of $10,000. The exchange qualified for nonrecognition as a like kind exchange under section 1031. In Year Five, John sold Redacre to an unrelated person for its then fair market value of $60,000. What amount of gain did John recognize on that sale in Year Five?

6. Stephanie owned 400 shares of common stock of Tryon corporation, which is a publicly held corporation whose stock is sold on the stock exchange market. On March 12, Year Five, Stephanie instructed her broker to sell her 400 shares of Tryon stock, and the shares were sold on that date for their value of $40,000. Stephanie's basis in the 400 shares of Tryon stock was $100,000. On March 14, Year Five, Stephanie's adult daughter, Megan, purchased through her broker 300 shares of Tryon's common stock for its then value of $32,000. What was the tax consequence to Stephanie of the sale of her 400 shares of Tryon stock on March 12, Year Five? In Year Seven, Megan sold her 300 shares of Tryon stock to an unrelated person for $50,000. What was the tax consequence to Megan of that sale?

7. The same facts as those stated in Question 6 except that instead of Megan's having purchased 300 shares of Tryon's stock, it was Stephanie's husband, Randolph, who purchased 300 shares of Tryon's common stock on March 14, Year Five. What was the tax consequence to Stephanie of her sale of 400 shares of Tryon stock on March 12, Year Five? In Year Eight, Randolph sold his 300 shares of Tryon stock to an unrelated person for its then value of $25,000, what was the tax consequence to Randolph of that sale?

**PROBLEM SET # 22**

1. In Year One, Helga paid a state property tax of $6,500 on her residence. In that year, Helga also paid a state income tax of $8,000, and she paid state sales taxes of $800. Helga paid a federal income tax of $15,000. Helga itemized her deductions for Year One. What amount of her taxes can Helga deduct?
2. Shirley owns an apartment house with six units, all of which are rented. Shirley also owns her own home. In Year One, Shirley paid the following state taxes:

$18,000 – state property tax on the apartment house

$12,000 – state income tax on income from the rental of the apartment

house

$5,000 – state property tax on Shirley’s home

$1,000 – state income tax on dividend income from corporate stocks

$36,000 – Total

What amount of those taxes can Shirley deduct?

1. Fred owns and operates a retail clothing store. In Year One, Fred paid state income tax of $22,000 on the income from that business. In that year, Fred paid a state property tax of $8,000 on the building at which he conducts the business. In that year, Fred paid a state property tax on his home of $7,000. What amount of those taxes can Fred deduct?
2. Robert owns a home on a street that does not have a sidewalk. The city adds sidewalks to the street and assesses a tax of $4,800 on Robert to help pay for the cost of adding the sidewalk. Can Robert deduct the payment of that assessment?
3. Ellen, who reports her income on the cash method, sold her home to Jim on March 3 of Year One, which was not a leap year. Jim reports his income on the cash method. On August 1 of Year One, the state assessed a property tax of $4,000 on the home for the calendar year of Year One. Jim paid that tax on January 5, Year Two. What amount of the tax can Jim deduct? Can Ellen deduct any of the tax?