

**FINAL EXAMINATION**  
**FEDERAL INCOME TAX (LAW 838B)**  
**PROFESSOR STANLEY**  
**SPRING 2008**

1. This examination is three (3) hours long.
2. There are two parts to this exam. There is, however, no formal restriction of time between the parts, and you may allocate the time as you deem best.
  - **Part I consists of 25 Multiple Choice questions. Each question in this Part is worth four (4) points, with the total of all multiple-choice questions worth 100 points or one-half of the examination.** Part I should consume approximately 90 minutes of the allotted time. The answers are to be marked on the ParScore answer sheet form provided using pen or pencil and following the instructions on that form. If you change your answer, place a clear X through the wrong answer and mark the correct answer. A machine will score the exam and any ambiguities will be counted as a wrong answer.
  - **Part II consists of one essay question, worth 100 points, for a total of one-half of the examination.** You should allocate 90 minutes to the essay question. Make sure you answer the questions that are asked, and include your reasoning and analysis as well as your conclusion. If you use Examsoft, please use a 12-point font and double space. If writing, please answer the essay question in the blue books provided to you, writing only on the right side of the page. Please use a blue or black ink pen.
3. This is an open book examination, and you may use any of the following written materials (with or without your hand-written notations): the Internal Revenue Code, Treasury Regulations, your casebook, your class notes, the class power point slides, and any self-prepared outlines, either handwritten or printed. You may use a calculator. You may use scratch paper provided by the Proctor. You may **not** use any notes or outlines that are commercially prepared or prepared by another member of the class or another student unless they are the joint work product of you and the other student. You may **not** use your computer other than in conjunction with ExamSoft. No other materials are permitted.

4. Read the essay questions *carefully* and explain the reasons for your answers, showing each step in your analysis and any computation necessary to resolve the issue. Address all reasonable arguments supporting your position. Credit will be given based on your ability to identify and analyze the relevant issues. If you find it necessary or appropriate to assume facts not given, please state them. Ignore any non-income tax issues (e.g., estate and gift taxes, state taxes). READ, THINK, and ORGANIZE before you write.
5. Unless otherwise indicated, all parties are unrelated individuals, are on the cash receipts and disbursements method of accounting, and use the calendar year.
6. All topics listed on the course syllabus may be tested on this examination.
7. Internal Revenue Code sections, Treasury regulations and case names may be cited where known. Citations may include the entire case name or an identifiable abbreviation. Unless otherwise indicated, all "Section" references are to the Internal Revenue Code of 1986, as in effect on December 31, 2007.
8. Write your exam number on your exam envelope. Put your student exam number at the top of this page, each page of questions, ParScore answer form and each blue book. **Do not** use your name, student ID number or Social Security Number on any exam materials.
9. At the conclusion of the exam, return all exam materials to the exam envelope and submit it to the Proctor. **Do not** seal the envelope. Students who do not return all exam materials at the end of the exam may not be graded.

**Good Luck!**

**Thanks for being such a great class!**

## PART II – Essay Question

(100 points total – Suggested time: 90 Minutes)

Sebastian is an admired professor of art history, now retired from Leland University. In the last two years, he has been appraising fine art. He started out just appraising art owned by his friends, but now he's trying to get paying customers. In addition, this year Sebastian agreed to be a visiting professor at Hopkins School of Fine Art ("HSFA"). HSFA is in another state about 1,000 miles from Leland. He agreed to teach two courses in the spring semester (January to May 2008) and two courses in the fall (August to December 2008). Sebastian scheduled his appraisals during breaks so as not to interfere with his teaching commitments.

Sebastian rented an apartment near HSFA, which cost \$2,000 per month. He used the second bedroom in the apartment exclusively and regularly as a home office to prepare for his classes at HSFA and to conduct the office work (research and report writing) for the appraisals. He purchased new computer equipment and furniture for the home office for a total cost of \$3,000. Although HSFA gave him an office at school for his use, it was cold and noisy and he found he could get much more work done at home – he used the school office only occasionally to meet with students. And though he could – and did – walk to school every day, he also rented a car for the months he was teaching at HSFA, which cost him \$5,000 (but it was cheaper than cab fare).

Sebastian was actually quite pleased to be away from Leland (his hometown) because he was in the middle of a nasty divorce from his soon to be ex-wife Maggie. The two remaining issues stalling the divorce: (1) who would get to keep the family mansion, and (2) whether Maggie was entitled to share in their substantial fine art collection. After many months of negotiation, and many hundreds of dollars in legal fees, the two decided to sell the house and split the profits, and Sebastian agreed to transfer to her art works with a total value of \$100,000. He's not quite sure, but thinks he will transfer to her five pieces now worth \$100,000 that he purchased long ago for less than \$500 total; alternatively, he could transfer to her one large painting he purchased last year for \$100,000.

Over the summer, Sebastian returned to Leland and had to stay in a hotel since Maggie was still in the house; however, he kept his apartment near HSFA because he was returning to teach that fall. As he had done for the last 30 years, he attended a national conference of art historians held at the world-renowned Five Seasons Hotel in Honolulu, Hawaii, for five days in August 2008. HSFA did not reimburse Sebastian the \$4,000 cost of attending the conference (of which \$2,500 was for the hotel), since he was only a visiting professor.

Sebastian wasn't too worried about all these expenses – after all, he received \$120,000 compensation from HSFA, and his appraisals yielded another \$40,000 that year. Sebastian's flew stand-by for free using a "family pass" from his nephew, who worked for a regional airline. The airfare to Leland was \$100 each way, which was about one-third of the normal cost. Sebastian ended up using the "family pass" to return to Leland 10 times in 2008, sometimes for the purpose of conducting an appraisal and sometimes because of the divorce proceedings.

Sebastian has hired you to explain the tax consequences of his activities in 2008. He needs an item-by-item legal explanation of the tax treatment of all of these issues. Since his divorce was finalized in September 2008, he will be filing his 2008 return as a single person.

**END OF THE EXAM**