

**FINAL EXAMINATION  
FEDERAL INCOME TAX (LAW 838B)  
PROFESSOR STANLEY  
SPRING 2007**

1. This examination is three (3) hours long.
2. There are three parts to this exam. There is, however, no formal restriction of time between the parts, and you may allocate the three hours as you deem best.
  - **Part I consists of 25 Multiple Choice questions. Each question in this Part is worth six points, with the total of all multiple-choice questions worth 150 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 two essay questions, the first worth 100 points and the second worth 50 points, for a total of one-half of the examination.** You should allocate 90 minutes to the essay questions. 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, 2006.
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 #1**  
(100 points total – Suggested time: 60 Minutes)

Carla, a wife and mother of two, strongly believes in physical fitness. For many years, she has been a volunteer aerobics instructor at the local YMCA in San Francisco. She teaches three classes each week to a large group of women and receives no salary. Concerned about the growing problem of childhood obesity, Carla volunteered to develop an exercise class for children at the YMCA which combined simple aerobic dance moves with popular children's songs and called the class "Wiggle Workout." By the end of 2006, it was one the YMCA's most popular classes.

In January 2007, while continuing to teach her classes at the YMCA, Carla decided to make a DVD of her Wiggle Workout routine. She started a website and sold copies of the DVD over the Internet, but sales were initially slow. However, when Carla appeared as a guest on a national morning TV show demonstrating the Wiggle Workout with some cute youngsters, sales soon skyrocketed! Throughout the year she made many guest appearances at local stores where the DVD was sold, visited children's after-school programs around the state to demonstrate the routine, and even took on some clients for personal training, which she conducted at her home. Carla's gross income from all of these sources in 2007 totaled \$100,000. Carla ultimately sold all of the rights to the DVD to the Jazzercise Corporation several years later. Although Carla had no time to consult an accountant, she meticulously kept track of all of her expenditures, as set forth below:

1. Costs for producing the DVD, including renting producing facilities, hiring the videographer and editor, and mass producing copies of the DVD.
2. Costs for improving her image, including Botox injections to remove facial wrinkles and Lasik eye surgery so that she would no longer need eyeglasses.
3. Costs for marketing the DVD, including a graphic designer to design the packaging, a webmaster to design of a website, and setting up an Internet payment service to process orders made by credit card.
4. Travel, meals and lodging costs for (a) her two-day trip to New York City to appear on the TV show, and (b) local day trips (within and outside of the San Francisco metropolitan area) for demonstrations of the workout.
5. Costs for setting up her spare room to accommodate her personal training clients, including purchase of weights and equipment.

**Advise Carla regarding the tax treatment of the expenses she incurred in 2007 with regard to the Wiggle Workout venture.**

## ESSAY QUESTION #2

(50 points total – Suggested time: 30 Minutes)

Based on true events . . .

In Fall 2006, Trent Woslum, a National Guardsman who was deployed in Iraq, got an e-mail from his wife. She'd been contacted by the TV show "Extreme Makeover: Home Edition," which wanted to do a big renovation of their southern California home—free of charge. The show executed a 10-day lease of the Woslum home agreeing to pay \$50,000 rent in the form of flat-screen TVs, furniture, and appliances valued at \$50,000. By mid-December the family had a fully renovated home with all new furniture, appliances, and even a backyard baseball diamond. The estimated value of the improvements was \$250,000.

It is common knowledge that lottery winners or TV game-show participants must pay taxes on their winnings, but the show's producers told the Woslums that they owed no taxes on any of the goods or services they received.

**Explain the statutory bases for the show's position that the Woslums owe no Federal income taxes on account of their involvement with the show, and why you agree or disagree. Ignore any tax benefits that might accrue because Trent Woslum was on active military service. Okay . . . one clue: IRC § 109.**

**END OF THE EXAM**