



**LEX 7816-001**  
**Maximum Time: 4 hours**  
**Maximum Points: 100**  
**December 11, 2001 at 6:15 p.m.**

### Instructions

1. Your copy of this examination *must be returned to the proctor* before you may leave the examination room. Do **not** remove staples from your copy of the examination and do **not** put your name or information on your personal status (i.e., graduating senior, graduate student) anywhere on the exam.
2. **Write your examination number in the upper right hand corner of this cover sheet in the space provided.** Also put your examination number, the name of this course (Taxation), and the name of the instructor (McIntyre) in the appropriate spaces on your **bluebook**. Please do this now.
3. *Thank you for putting your exam number and other information in the appropriate spaces.* This is an **open book** examination. You are expected to have with you your copy of the casebook, supplemental materials, a 2000 or later edition of the Internal Revenue Code ("Code"), and the Income Tax Regulations. You are permitted to have any books, notes, commercial outlines, or other materials you have used during the course. You may use a pocket calculator.
4. This examination has two (2) parts. The answers to Part I go in your bluebook. Answers to the multiple choice questions in Part II go on your copy of the exam. Read the instructions for each part carefully and follow those instructions.
5. Certain assumptions are stated below which are applicable to all questions in Parts I and II unless a question explicitly asks you to make some other assumptions.

#### **Note To Proctor:**

*All copies of the Examination MUST be returned to you by the end of the examination period. Please check carefully to be sure you can account for all copies. Persons allowed to leave the examination room **for any reason** must leave their copy of the examination with you to hold until they return.*

## **Assumptions Applicable to Parts I and II**

Unless a question specifies otherwise, make the following assumptions in answering the questions in Parts I and II of this examination:

1. Taxpayers are using the cash method of accounting and are not eligible to use any of the special accounting rules, such as those provided for farmers.
2. Taxpayers are using the calendar year as their taxable year.
3. Except for the transactions described in the questions, no transactions relevant to the answers have occurred during the relevant taxable years.
4. Technical terms and words of art are used in their exact tax sense.
5. The tax acts of 1986 through 2000 are fully effective and the 2001 tax act is not effective.
6. All taxpayers are solvent.
7. Taxpayers have properly taken the amount of depreciation indicated.
8. All taxpayers are single.
9. All expenditures can be substantiated.
7. All taxpayers are itemizing their personal deductions rather than claiming the standard deduction.
8. The possible effects on tax liability of any floors, ceilings, or phase-outs that might apply to specific itemized deductions are to be ignored.
9. The taxpayers have not made any special elections, such as, for example, an election not to be governed by the installment method, but they have complied with all necessary reporting and filing requirements.
11. All transactions occur at arm's length.
12. All capital assets have been held for more than 18 months.

**I. Essay**  
**(maximum points: 25)**

*Instructions.* Answer the two (2) questions below in your bluebook. Write in ink on every other line (double space), do not write on the back side of any page, and **do not write in the margins**. Observe the maximum space limitations. *You will suffer a grade penalty, proportionate to the offense, for exceeding the space limitations.* (As a practical matter, a penalty is not imposed for exceeding the limits by two lines or less.) One page of a bluebook, double spaced, is 14 lines.

*Note on Handwriting:* A person with normal-sized handwriting typically gets about 10 to 12 words per line. Make an appropriate adjustment if your handwriting is unusually large or small. Please, do not count your words.

**Note to typists:** Put your exam number in the upper right hand corner of each page of your answer sheets. Number your answers clearly and observe the space limits. One handwritten line of normal size writing is equivalent to 1 line of a typed page (8½" × 11") with 1½ inch margins (pica) or 2 inch margins (elite). This notice is typed with a pica font (Courier 12 point) and has 1½ inch margins.

**A. Medium-Length Essay**

**(Maximum points: 15; maximum lines: 2 blue book pages (28 lines), double spaced)**

Eddy has been selling grilled sausage at Detroit Tigers baseball games for over ten years. When the team played at Tiger Stadium, Eddy had a portable stand where he cooked the sausage. He set up his operations just off the sidewalk on public property and was not bothered by anyone. When the team moved to its new digs at Comerica Park, Eddy had difficulty finding a place to set up his stand. He tried a couple of locations and was forced to move on by the police, who claimed he was violating local zoning rules.

One day, a couple of hours before a baseball game was scheduled to start, Eddy began to set up his stand near the Gem Theatre. A police officer stopped by to inform him that he was not permitted to set up the stand at that location. When the officer left, an individual who had witnessed the scene came up to Eddy and said that he knew a good spot that would not cause problems with the police. He introduced himself as Walton and offered to make arrangements for a finder's fee of \$100 in advance. Eddy gave Walton the \$100. Walton took Eddy up the street a couple of blocks to a large surface parking lot. Walton went over to the parking attendant and had a private discussion and then returned to tell Eddy it was all set. The attendant then came over, introduced himself as Grover, and said he could set up his sausage stand at the edge of the parking lot for ball games under two conditions. First, he needed to pay him (Grover) \$1,000 in cash, and second, he needed to give free sausage to him and other attendants at the lot. Eddy asked how long he would be able to use that location if he paid the \$1,000. Grover said, "For as long as you want — one

year, ten years, a hundred years if you live that long.” Eddy offered to pay \$100 that day and the remaining \$900 at the next game. Grover agreed.

At the next game, Eddy set up his stand at the parking lot location. Grover came over and asked for the \$900, which Eddy gave him. Eddy asked for a receipt, and Grover just smiled and offered his hand. They shook hands and that was that. Eddy set up his stand at the parking lot for the rest of the baseball season. During the season, Eddy grossed \$25,000 from the sale of sausage. His costs for the sausage, rolls, and condiments were \$8,000. He paid \$2,000 for fuel for his stove. The portable stand and equipment were fully depreciated in prior years. Over the season, Eddy gave 100 sausages to Grover and other attendants at the parking lot. Each sausage sells for \$5, and Eddy’s estimated cost per sausage was \$2.

**Question 1.** Eddy always files an honest tax return that is accurate to the best of his abilities. Given his high standards, how should he report:

- (a) The payment of \$100 to Walton?
- (b) The \$1,000 payment to Grover?
- (c) The free sausage given to the lot attendants?

**B. Short Essay**  
**(Maximum points: 10; maximum lines: 10)**

In year 1, Adam purchased a house for \$100,000 and lived in it for over five years. On July 1 of year 6, Adam married Eve and moved into Eve's house. He put his own house up for rent and immediately got a paying tenant. The tenant signed a two-year lease on Adam's property, starting July 1, for \$400 per month. For year 6, Adam's total expenses on the rental for the period of July 1 to December 31 were \$4,400 (\$1,000 in depreciation, \$2,000 in mortgage interest and taxes, and \$1,400 in maintenance and repairs). His total rental income was \$2,400 ( $\$400 \times 6$ ). As a result, Adam had a loss of \$2,000 ( $\$4,400 - \$2,400$ ) on his rental operation. Adam has salary income of \$40,000. Adam intends to rent his former residence indefinitely.

**Question 2.** Read Section 280A of the Code carefully and determine whether Section 280A prevents Adam from utilizing the \$2,000 loss from the rental in year 6 because of his personal use of the residence during the taxable year. Please explain, with appropriate references to the provisions of Section 280A. Do not refer to any other Code sections or to case law. The point of the question is to see if you can read the referenced Code section accurately.

## II. Multiple Choice (maximum points: 75)

*Instructions.* Mark your choice of alternative answers to each question by circling the **letter** of the correct answer on this exam. **Do NOT mark more than one alternative answer or your answer will be scored as incorrect.**

Each question is worth 3 points. No points are taken off for wrong answers. Thus you should guess at the answer if you do not know the answer.

**In answering each question, make the assumptions stated on page two (2) of this exam unless a contrary assumption is stated in the question.**

If you believe that unstated facts are crucial to your answer, or if you believe that a question is ambiguous, go ahead and answer the question as best you can. Then circle the **number** of the **question** on this exam and, *in the space provided on the last page of the exam*, identify the unstated facts or the ambiguities and explain their relevance to the question. If your grounds for challenging a question are well-founded and you have properly shown the relevance of an alleged omission of fact or ambiguity to the answer, you will receive full credit for your answer. There are **no intentional ambiguities** or omissions of necessary facts.

**WARNING:** *If you decide to explain your answer, you do so at your own risk. Your answer to a question will be treated as incorrect if you have challenged that question and your grounds for doing so are unfounded or incorrectly stated even if you have selected the correct answer.*

**[Multiple Choice Questions Not Available.]**