



**MAXIMUM TIME: 4 HOURS**  
**MAXIMUM POINTS: 100**  
**DECEMBER 15, 1998**

### 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 and name of this course (Taxation) in the appropriate spaces on your **bluebook**. Please do this now.
3. *Thank you for putting your exam number 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 1997 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. Answer the multiple choice questions in Part II on your copy of the exam.
5. Read the instructions for each part carefully and follow those instructions.
6. 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 1998 are fully 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: 40)**

*Instructions.* Answer the following four (4) questions 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.**  
**(Maximum points: 10; maximum lines: 14)**

*Question 1.* A national news magazine recently ran a story in which it was suggested that all job-hunting expenses are deductible. Why is this suggestion incorrect? Give as many good reasons as you can think of, with references to authorities.

**B.**  
**(Maximum points: 10; maximum lines: 21)**

*Question 2.* Frederick, a high-level executive, negotiated the following package with his new employer, an upscale department store, before he began work at their corporate headquarters on January 1, 1998:

- (1) \$150,000 of annual salary.

- (2) As a signing bonus, the company agreed to reimburse him for a car of his choosing, up to \$30,000. Frederick bought a Lexus on February 5, 1998 for \$30,000 and the firm immediately reimbursed him in full.
- (3) Free parking at corporate headquarters for the Lexus. (Other employees pay \$170 per month for the parking.)
- (4) The use of a large corner office with a window at the corporate headquarters. The office contains an elegant desk, bookcase, file cabinet, side table, and chairs. (Just before Frederick started work, the company spent \$5,000 furnishing the office.)
- (5) Free lunches every day in the cafeteria at the corporate headquarters where he works. The cafeteria only offers an "all you can eat" buffet lunch. Other office staff members pay \$8 for the buffet lunch on days they choose to eat in the cafeteria. Frederick ate lunch there 100 days in 1998.

Frederick received all of the above benefits. Which of them are included in Frederick's gross income, in what amounts, and why? If any of these benefits are excluded from gross income, why are they excluded?

C.

**(Maximum points: 10; maximum lines: 14)**

*Question 3.* Eddy is a lobster fisherman, living in Maine. During the lobster season, which runs from April to June, he goes out at around 5 a.m. each morning in his boat to haul his lobster traps, often in cold and stormy weather. He gets back to shore around 11: a.m. He then takes the lobsters he has caught to the local lobster pound, where he sells them for the going rate. In the typical season, Eddy earns around \$30,000 from lobster fishing. He does not work during the rest of the year, except for the occasional odd job. At his home, he stores some fishing gear in his basement during the off season. He also has a shed near his home in which he stores the lobster traps. He does not use the shed or the relevant portion of the basement for any other purpose. On his tax return, Eddy has claimed a deduction for depreciation on the shed and on that portion of his basis in his house allocable to the part of the basement used for storing his fishing equipment. On audit, the IRS denied the deductions, asserting that no income-producing activities were conducted in the basement or the shed. Are the depreciation deductions proper? Discuss, with references to the Code and any relevant case law.

D.

**(Maximum points: 10; maximum lines: 14)**

*Question 4.* The Fairmont Hotel in San Francisco, which was built in 1907, paid \$3 million this year to replace an entablature consisting of five-foot high unreinforced terra cotta and concrete parapets and overhanging cornices around the entire roof perimeter. The parapets and cornices were in good condition and had not deteriorated significantly since they were installed in 1907. They were replaced solely because they failed to comply with a new city earthquake ordinance that had been adopted to increase the safety standards applicable to such appurtenances. The engineering team hired by the hotel to rectify the problem

replaced the cornices and parapets with ones made of reinforced concrete laced with glass fiber. The cornices and parapets were attached to the hotel using welded connections instead of wire supports. Is the \$3 million deductible? Explain, with references to the Code and to relevant case law.

## II. Multiple Choice (maximum points: 60)

*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 2.5 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 Omitted]