

EXAM NUMBER: _____

**UNIVERSITY OF FLORIDA
COLLEGE OF LAW
FINAL EXAMINATION
TAX II
SPRING SEMESTER, 1998
PROFESSOR WILLIS**

DATE: May 8, 1998
TIME: 9:00 A.M.
TIME LIMIT: FOUR HOURS

Instructions

1. You may consult any written materials you consider helpful.
2. Unless otherwise indicated, all parties are on the cash method of accounting and use the calendar year. All parties are unrelated unless otherwise indicated. All parties are single and not heads of households, unless otherwise indicated.
3. Some questions have space provided for a short answer, such as a dollar amount or a single word (e.g., correct or incorrect). You must write an appropriate answer in such spaces. For example, if a question calls for a dollar amount, anything other than arabic numerals stated in terms of U.S. dollars will be incorrect.
5. This exam is due in my office by 1:15 p.m.
6. Place your exam number or other form of identification at the top of this page.
7. **For all periods**, the AFR is that in effect for May 1998.
8. I will answer no questions prior to the time you turn in your paper.
9. The exam contains TEN questions. You should answer a total of FOUR questions. Each question will be worth 25 points. You must answer TWO of the first THREE questions plus any TWO of the remaining SEVEN questions.

QUESTION ONE

On May 1, 1998, GMAC loaned Ann \$40,000 to purchase a new Seville from a GM dealer, which is a separate legal entity from GMAC. She paid \$5000 down and beginning June 1, 1998, Ann will pay \$1,699.85 per month to GMAC for twenty-four months to pay off the loan. GMAC took a security interest in the automobile. GMAC is an accrual method, calendar year C corporate taxpayer. Below is an amortization of the loan at 1.9% interest, the interest rate stated by GMAC, as prepared by GMAC.

Amortization Schedule					
#/Yr	Date	Payment	Principal	Interest	Balance
	05/01/98	\$0.00	\$0.00	\$0.00	\$40,000.00
1/01	06/01/98	\$1,699.85	\$1,636.52	\$63.33	\$38,363.48
2/01	07/01/98	\$1,699.85	\$1,639.11	\$60.74	\$36,724.37
3/01	08/01/98	\$1,699.85	\$1,641.70	\$58.15	\$35,082.67
4/01	09/01/98	\$1,699.85	\$1,644.30	\$55.55	\$33,438.37
5/01	10/01/98	\$1,699.85	\$1,646.91	\$52.94	\$31,791.46
6/01	11/01/98	\$1,699.85	\$1,649.51	\$50.34	\$30,141.95
7/01	12/01/98	<u>\$1,699.85</u>	\$1,652.13	\$47.72	\$28,489.82
Annual Totals:		\$11,898.95	\$11,510.18	\$388.77	
Running Totals:		\$11,898.95	\$11,510.18	\$388.77	
8/01	01/01/99	\$1,699.85	\$1,654.74	\$45.11	\$26,835.08
9/01	02/01/99	\$1,699.85	\$1,657.36	\$42.49	\$25,177.72
10/01	03/01/99	\$1,699.85	\$1,659.99	\$39.86	\$23,517.73
11/01	04/01/99	\$1,699.85	\$1,662.61	\$37.24	\$21,855.12
12/01	05/01/99	\$1,699.85	\$1,665.25	\$34.60	\$20,189.87
13/02	06/01/99	\$1,699.85	\$1,667.88	\$31.97	\$18,521.99
14/02	07/01/99	\$1,699.85	\$1,670.52	\$29.33	\$16,851.47
15/02	08/01/99	\$1,699.85	\$1,673.17	\$26.68	\$15,178.30
16/02	09/01/99	\$1,699.85	\$1,675.82	\$24.03	\$13,502.48
17/02	10/01/99	\$1,699.85	\$1,678.47	\$21.38	\$11,824.01
18/02	11/01/99	\$1,699.85	\$1,681.13	\$18.72	\$10,142.88
19/02	12/01/99	<u>\$1,699.85</u>	<u>\$1,683.79</u>	<u>\$16.06</u>	\$8,459.09
Annual Totals:		\$20,398.20	\$20,030.73	\$367.47	
Running Totals:		\$32,297.15	\$31,540.91	\$756.24	
20/02	01/01/00	\$1,699.85	\$1,686.46	\$13.39	\$6,772.63
21/02	02/01/00	\$1,699.85	\$1,689.13	\$10.72	\$5,083.50
22/02	03/01/00	\$1,699.85	\$1,691.80	\$8.05	\$3,391.70
23/02	04/01/00	\$1,699.85	\$1,694.48	\$5.37	\$1,697.22
24/02	05/01/00	<u>\$1,699.91</u>	<u>\$1,697.22</u>	\$2.69	\$0.00
Annual Totals:		\$8,499.31	\$8,459.09	\$40.22	
Running Totals:		\$40,796.46	\$40,000.00	\$796.46	

If GMAC reports, for federal tax purposes, the consequences of this loan, without any recomputation for imputed interest, what will be its interest income, from this loan, for 1998?

\$ _____

If you represent GMAC, do you advise it to report, for 1998, this amount of interest income, or a greater or lesser amount? [circle one]

The above amount.

A greater amount.

A lesser amount.

If you advise Ann, what is her basis in the automobile on May 1, 1998?

\$ _____

Assume that you represent GM and GMAC in the year 2002. The two entities file a consolidated return (and have done so for all prior years). You discover that GMAC reported the original amount you stated above as interest income for 1998 and a similarly computed amount for 1999. In addition, GMAC reported interest from many thousands of similar transactions in a similar fashion for many years prior to and including 2002. Assume that 1998 and all prior years are closed for purposes of refund or deficiency. Assume that 1999 and subsequent years are open for both purposes. You also discover that neither GM nor GMAC reported any deduction or loss or reduction in gross income or increase in cost of goods sold from any transaction similar to the one described above for any year prior to or including 2002.

The government is now raising questions regarding the reporting by GM and GMAC of the Ann loan, as well as the thousands of similar loans. **What do you think the government is arguing and what do you think you can or should do about it?**

QUESTION TWO

On May 1, 1997, your client paid \$19,000.00 rent for an office building he used in his business. The rent was for nineteen months at \$1,000.00 per month. You have read section 467 and have correctly determined that it is not applicable because the dollar amounts involved are too small.

- a. What are your client's 1997 tax consequences?**
- b. If your client used the accrual method, what would be his 1997 tax consequences?**
- c. If the landlord uses the cash method, what are his 1997 tax consequences?**
- d. If the landlord uses the accrual method, what are his 1997 tax consequences?**

On February 1, 1998, the building burned and your client vacated the premises. The landlord refunded \$10,000.00 to your client and the lease was voided.

- e. What are your client's 1998 tax consequences?**

QUESTION FOUR

Recall the *Zaninovich/Grynberg* division regarding deductibility of pre-paid items by a cash method taxpayer. Suppose you are a judge in a circuit that has not yet spoken on the issue. Which approach would you take? Why? If you believe a third approach is preferable, what would it be?

QUESTION FIVE

The Service has consistently argued that the economic benefit doctrine applies to accounts created in connection with property sales. It has consistently lost such arguments - as in the *Reed* decision. Suppose you are a judge in a circuit that has not yet spoken on the issue. Which approach would you take? Why? If you believe a third approach is preferable, what would it be?

QUESTION SIX

The Ninth Circuit reversed itself in the *Albertson's* case. Suppose you are a judge in a circuit that has not yet spoken on the issue. Which approach - the original decision, or the re-hearing - would you take? Why? If you believe a third approach is preferable, what would it be?

QUESTION SEVEN

The Fifth and Ninth Circuits reject the historic erroneous deduction exception to the tax benefit rule. The Tax Court continues to follow this exception in cases appealable to other circuits. Suppose you are a judge in a circuit that has not yet spoken on the issue. Which approach would you take? Why? If you believe a third approach is preferable, what would it be?

QUESTION EIGHT

The Fourth Circuit - in the *Chertkof* decision - applied the mitigation sections to a matter that involved an estate tax/income tax discrepancy. The Seventh Circuit in the *O'Brien* decision (later followed by the Tenth Circuit in *Hall*) rejected the *Chertkof* approach. Suppose you are a judge in a circuit that has not yet spoken on the issue. Which approach - the original decision, or the re-hearing - would you take? Why? If you believe a third approach is preferable, what would it be?

QUESTION NINE

In 1986, the Tax Court decided the controversial *Allan* decision, which was later affirmed by the Eighth Circuit. The court held that the *Tufts* decision trumped the tax benefit rule. Suppose you are a judge in a circuit that has not yet spoken on the issues involved in *Allan*. Which approach - that of the court or that of the government (rejected by the court) - would you take? Why? If you believe a third approach is preferable, what would it be?

QUESTION TEN

The Tax Court - in its 1993 *Mueller* decision - asserted equitable jurisdiction such that it could apply the doctrine of equitable recoupment. No appellate court has yet agreed. Suppose you are a judge in a circuit that has not yet spoken on the issue (which presently includes all the circuits). Which approach - the traditional view that the Tax Court lacks equitable jurisdiction, or the *Mueller* approach - would you take? Why? If you believe a third approach is preferable, what would it be?