

2006 Tax Court Non-Attorney Admission Examination

2006 TAX COURT NON-ATTORNEY ADMISSION EXAMINATION

Instructions

Four hours will be allowed to answer all of the questions in the examination. Each question has been allocated a specific number of minutes (see the notation in parenthesis at the beginning of each question). Each question will be weighted according to the time allocated to the question.

Write your answers legibly in ink in the bound answer book/s furnished you for this purpose. Write your examination number on the cover of each answer book that you are given, as well as on your examination. Identify each answer by the same number as the question. Remove no pages from your bound answer books; you are being furnished loose sheets of paper for you to use as scratch paper.

This examination is designed to test your overall knowledge of Tax Court Rules of Practice and Procedure, Federal taxation, the law of evidence, and rules of professional responsibility. The examination consists of four parts. Each part will be graded separately, and you must show your proficiency with respect to each part of the examination. The first part (60 minutes) deals with the Tax Court Rules of Practice and Procedure; it contains 21 questions and 4 pages. The second part (96 minutes) deals with substantive Federal income, gift, estate, and generation-skipping transfer taxation; it contains 29 questions and 7 pages. The third part (60 minutes) deals with the rules of evidence applicable in the Tax Court; it contains 5 questions and 2 pages. The fourth part (24 minutes) deals with legal ethics rules applicable to practice before the Tax Court; it contains 6 questions and 2 pages. Make sure that your examination is complete; you are responsible for any omissions from the examination.

ANSWER THE QUESTIONS IN EACH OF THE FOUR PARTS OF THE EXAMINATION IN ANSWER BOOKS SEPARATE FROM THE ANSWER BOOK/S CONTAINING ANSWERS TO THE OTHER THREE PARTS OF THE EXAMINATION.

The only reference materials permitted to be with you during the examination (each of which is provided to you) are (1) a copy of the Internal Revenue Code, (2) a copy of the Rules of Practice and Procedure of the Court, and (3) the ABA Model Rules of Professional Conduct. You are to refer to and apply these materials in taking the examination. You also may bring with you and use a calculator.

Clarity and conciseness of expression will be a significant factor in grading your examination. Answer only the questions that are asked.

Do not inquire of the proctor regarding the examination questions. If you think a question contains an ambiguity, state the ambiguity, resolve the ambiguity by stating a reasonable assumption in your answer, and then answer the question based upon your assumption.

UNLESS OTHERWISE INDICATED, ASSUME ALL TAXPAYERS USE THE CASH METHOD OF ACCOUNTING AND ARE CALENDAR YEAR TAXPAYERS. ALL STATUTORY REFERENCES ARE TO THE INTERNAL REVENUE CODE. UNLESS OTHERWISE STATED, ASSUME ALL EVENTS OCCUR DURING 2006 AND ANSWER ALL QUESTIONS AS TO THE 2006 TAXABLE YEAR. UNLESS DIRECTED TO THE CONTRARY, ANSWER EACH QUESTION INDEPENDENT OF THE FACTS OF THE OTHER QUESTIONS.

The proctor will tell you when you may begin the test, and you will be given a warning 5 minutes before the examination is over. When time is called, put your pen down. Absolutely no extension of time is permissible. When the time for completion of your examination has elapsed, turn in to the proctor this examination, your answer books, and the materials furnished to you. If you complete the examination early, you may turn in the materials and leave.

**PART ONE
PRACTICE AND PROCEDURE
(60 minutes)**

ANSWER THE QUESTIONS IN THIS PART OF THE EXAMINATION IN ANSWER BOOKS SEPARATE FROM THE ANSWER BOOKS CONTAINING ANSWERS TO OTHER PARTS OF THE EXAMINATION

In this Part One of the Examination, the taxpayer is referred to as "TP," and the Internal Revenue Service is referred to as "IRS." The spouse of TP is referred to as "Spouse."

Question P-1. (9 minute/s)

Determine whether the Tax Court has jurisdiction in each of the following situations. **State YES or NO** as to each subpart of the Question.

- (a) Does the Tax Court have jurisdiction with respect to the amount of Subtitle C employment taxes with respect to a pleading filed by the person for whom the services are performed?
- (b) Petitioner claims a §6512(b) overpayment for the years in issue before the Court attributable to §6611(a) overpayment interest. Does the Tax Court have jurisdiction as to the overpayment claim?
- (c) Petitioner asserts that the IRS improperly failed to suspend the imposition of interest as required by §6404. Does the Tax Court have jurisdiction with respect to such an action?
- (d) Does the Tax Court have jurisdiction to determine a deficiency that exceeds the amount of the deficiency determined in the IRS statutory notice of deficiency?
- (e) Does the Tax Court have jurisdiction to determine that TP overpaid income tax in the year properly before the Tax Court pursuant to a statutory notice of deficiency and a TP petition?
- (f) TP was an officer of a corporation that failed to pay FICA and employee income tax withholdings to the government. The IRS determined that TP was liable for the "trust fund" amounts as a responsible person under §6672 and initiated a collection action against TP. An IRS appeals office issued a determination notice rejecting TP's settlement offer, which had proposed monthly installment payments by TP, and the IRS notified TP that TP could file for a redetermination in federal district court. TP filed a Tax Court petition. Does the Tax Court have jurisdiction with respect to the petition regarding liability under §6672?
- (g) TP, who provides tax advice to other persons, received from the RS a notice and demand for penalty pursuant to §6694(a). TP petitioned the Tax Court to challenge the penalty. Does the Tax Court have jurisdiction?
- (h) The IRS issues to TP a statutory notice of income tax deficiency and also for an addition to tax pursuant to §6662(b). TP petitioned the Tax Court to dispute the deficiency amount and the addition to tax. Does the Tax Court have jurisdiction as to the addition to tax?

- (i) TP's spouse did not report as income on their year 1 joint return amounts that the spouse had embezzled from spouse's employer. After the embezzlement was discovered, TP and spouse filed an amended tax return for year 1 that reported the embezzlement income. TP then applied to the IRS for relief from joint and several liability under § 6015(f). The IRS issued a notice of determination denying TP's request, and TP filed a petition with the Tax Court under § 6015(e) to review the IRS determination. TP and the IRS stipulated that no relief is available to TP under §§ 6015(b) and (c). TP's petition was a "nondeficiency stand-alone" petition; "nondeficiency" because the IRS accepted the amended return as filed and asserted no deficiency against TP, and "stand-alone" because TP's claim for innocent spouse relief was made under § 6015 and not as part of a deficiency action or in response to an IRS decision to begin collecting TP's tax debt through liens or levies. Does the Tax Court have jurisdiction with respect to TP's petition?

Question P-2. (4 minute/s)

TP is physically present in the United States at all relevant times. On April 10, 2006, the IRS mailed to TP at an address in the United States a notice of deficiency (bearing the date of April 10, 2006) regarding TP's 2004 income tax liability. The notice states that the last day on which a petition may be filed is July 7, 2006. TP received the notice on April 15, 2006. What is the last day on which TP timely can file a petition with the Tax Court?

Question P-3. (3 minute/s)

State whether one or more than one petition must be filed in the following situations assuming that the taxpayer/s wish to invoke Tax Court jurisdiction:

- (a) Taxpayer receives three separate statutory notices of deficiency for income taxes, one each for three different taxable years, with all notices mailed on the same date.
- (b) TP and Spouse file their income tax returns as married filing jointly. TP and Spouse receive a statutory notice of deficiency for their joint 2005 income tax return.
- (c) TP and Spouse file their income tax returns as married filing separate. TP and Spouse each receive a statutory notice of deficiency for their individual 2005 income tax returns.

Question P-4.

- (a) (2 minute/s) Briefly describe and discuss the "timely-mailing-is-timely-filing" rule of § 7502(a) as it applies to a Tax Court petition.
- (b) (2 minute/s) Briefly describe and discuss whether a postmark applied by a private postage meter will cause an envelope mailed to the Tax Court to qualify for § 7502(a).

Question P-5. (1 minute/s)

Explain the significance of a Tax Court petition being silent with respect to one or more issues raised in the deficiency notice.

Question P-6. (1 minute/s)

Explain the proper method/s of amending a petition that previously was filed with the Tax Court.

Question P-7. (2 minute/s)

(a) Under what circumstances is a Tax Court case "deemed at issue"?

(b) What is the procedural significance of the "deemed at issue" status of a Tax Court case?

Question P-8. (2 minute/s)

Describe the process required of the parties by the Tax Court regarding pre-trial discovery and requests for admission.

Question P-9. (3 minute/s)

State the periods within which any permitted formal discovery must be conducted in a Tax Court case.

Question P-10. (2 minute/s)

Define and explain the significance of the phrase "stipulation for trial" in Tax Court proceedings.

Question P-11.

TP receives (prior to trial) from the IRS various requests for admission.

{a} (1 minute/s) Describe TP's duties of response to the requests.

(b) (1 minute/s) Describe the consequences to TP that may result from failing to comply with the requests.

Question P-12. (2 minute/s)

Describe the appropriate process by which a party in a Tax Court proceeding may seek to obtain a copy of a document in the possession of the other party.

Question P-13. (1 minute/s)

Discuss the circumstances under which the Tax Court will grant a continuance with respect to a case scheduled on a trial calendar of the Tax Court.

Question P-14. (1 minute/s) I

If counsel for a petitioner in a Tax Court case knowingly and recklessly advances frivolous arguments as to the petitioner's tax liability and thereby unreasonably and vexatiously prolonging the proceeding, may such counsel be liable for the excess costs, expenses, and attorneys' fees reasonably incurred by the government because of such conduct?

State YES or NO.

Question P-15. (3 minute/s)

The Chief Judge may assign a Special Trial Judge to try a case before the Tax Court.

Describe the Tax Court Rules applicable to the findings of fact and conclusions of law of the Special Trial Judge.

Question P-16. (3 minute/s)

Certain Tax Court cases qualify for special "small tax case" procedures under the Tax Court Rules.

Briefly describe the most fundamental parts of these procedures.

Question P-17. (6 minute/s)

Sections 6320 and 6330 prescribe certain "due process" rights of taxpayers.

Describe and discuss these rights.

Question P-18. (2 minute/s)

The IRS filed a Federal tax lien in Florida (Florida lien) and mailed to TP a Notice of Federal Tax Lien Filing and Your Right to a Hearing Under §6320 (lien notice #1) regarding TP's unpaid taxes for the years in dispute. TP did not submit to the IRS a request for an administrative hearing with regard to the Florida lien. Three months later, the IRS filed a Federal tax lien in Illinois (Illinois lien) and mailed to TP a lien notice (lien notice #2) for the same years in dispute. In response to lien notice #2, TP then filed with the IRS Appeals office a request for administrative hearing. The IRS eventually mailed to TP a decision letter for the years in dispute, which stated that the due process hearing request was not timely filed. TP then filed with the Tax Court a petition for lien or levy action challenging the IRS decision letter. Does the Tax Court have jurisdiction under §6330(d)(1)(A)?

State YES or NO.

Question P-19. (5 minute/s)

A joint federal income tax return generally involves joint and several liability, but a spouse (or former spouse) may qualify under the Internal Revenue Code for relief from joint and several liability.

Describe and discuss the qualification requirements and the relief available.

Question P-20. (2 minute/s)

TP's year 1 tax return reported total tax of \$x, but the \$x amount was not previously paid and was not remitted with the return. The IRS assessed the \$x amount and demanded payment. The IRS then issued to TP a notice of intent to levy. TP timely requested a hearing pursuant to §6330, and subsequently the

IRS issued to TP a notice of determination upholding the proposed collection action. TP then timely petitioned the Tax Court for review, and the IRS moved for summary judgment asserting that TP, who reported the \$x amount of tax on TP's tax return, is precluded from challenging the accuracy of that amount at a §6330 hearing.

How should the Tax Court rule as to the motion for summary judgment?

Question P-21. (2 minute/s)

Explain the proper method for counsel, who has entered an appearance in a Tax Court case, to withdraw from the representation.

PART TWO
SUBSTANTIVE TAX LAW
(96 minutes)

ANSWER THE QUESTIONS IN THIS PART OF THE EXAMINATION IN ANSWER BOOK/S SEPARATE FROM THE ANSWER BOOK/S CONTAINING ANSWERS TO OTHER PARTS OF THE EXAMINATION

In this Part Two of the Examination, the taxpayer is referred to as "TP," and the Internal Revenue Service is referred to as "IRS." The spouse of TP is referred to as "Spouse." For purposes of Part Two, ignore all inflation adjustments prescribed by the Internal Revenue Code as to fixed-dollar amounts.

Question S-1. (6 minute/s)

TP purchased unimproved real property, Blackacre, in 1998 for cash of \$250,000. In 2000, TP encumbered the property with a mortgage to secure a loan to the taxpayer of \$100,000; the proceeds of the loan were used by TP to purchase investment securities. On December 31, 2004, when TP's basis in the property was \$250,000, TP sold the property to Buyer according to the following terms: (1) Buyer paid TP \$200,000 cash at the closing, (2) Buyer assumed the mortgage indebtedness on the property of \$100,000, and (3) Buyer executed a promissory note payable to TP in the total amount of \$300,000. The promissory note provided for a principal payment to TP of \$100,000 on the anniversary date of the sale in each of the three years following the year of sale. The promissory note required the payment of interest at 6% compounded annually, and the note had a fair market value of \$290,000. TP received the required \$100,000 payment of principal on the note in December 2005, and on January 1, 2006, TP transferred the note (then with a fair market value of \$185,000) to TP's grandchild as a gift.

Quantify and discuss the 2005 and 2006 tax consequences to TP according to §§ 453 and 453B.

Question S-2. (7 minute/s)

State the amount (without any further explanation), if any, of each of the following items that constitutes gross income to TP (unless a question asks for other information) (answer each part below separately).

- (a) Salary from employer of \$140,000 (\$110,000 net to TP after federal income tax withholding).
- (b) End-of-year bonus paid by employer on December 20, 2006, in the gross amount of \$20,000 (\$15,000 net to TP after federal income tax withholding).
- (c) Payment by employer to creditor of TP of \$3,000 in satisfaction of a debt owed by TP.
- (d) \$1,000 daily commuting cost allowance paid to TP for driving TP's automobile to work (with only TP in the vehicle).

- (e) Pursuant to employer's Employee Discount Program, TP purchased property from employer at a discount. The retail price for the property was \$4,000, and TP paid \$2,200. For the relevant period (employer's prior taxable year), employer's sales were \$4,000,000, and employer's cost of goods sold was \$2,400,000.
- (f) Free coffee at work provided by employer (value per year is \$300).
- (g) \$4,000 received from the American Red Cross as a victim of a hurricane to cover TP's unreimbursed medical, temporary housing, and transportation expenses incurred as a result of flooding from a hurricane.

Question S-3. (1 minute/s)

On October 15 TP purchased a beat-up chair at an auction for \$10. After bringing home the chair, TP asked TP's neighbor, an antique dealer, the value of the chair. The neighbor estimated the value of the chair to be \$5,000. While cleaning the chair, TP discovered a gemstone in one of the chair cushions. On October 29, TP took the gemstone to a jewelry appraiser, who opined that the gemstone, was worth \$20,000. TP retained ownership of the chair and the gemstone during all of the current year. Does TP realize gross income in the current year with respect to the chair?

State YES or NO.

Question S-4. (1 minute/s)

Same facts as Question S-3. Does TP realize gross income during the current year with respect to the gemstone?

State YES or NO.

Question S-5. (1 minute/s)

TP was injured on January 2 in an automobile collision. TP suffered physical injury to TP's body and also emotional distress associated with the physical injuries. To cope with the emotional distress, TP visited a psychiatrist during the current year and incurred costs of \$18,000. TP takes a court judgment against the defendant, and the judgment is paid by the defendant on December 15. The damages awarded were as follows: (1) \$150,000 compensatory damages for physical injury to the body of TP, (2) \$300,000 punitive damages for physical injury to the body of TP, and (3) \$18,000 compensatory damages for the emotional distress. State the amount of gross income with respect to the \$150,000 compensatory damages for the physical injury to the body.

Question S-6. (1 minute/s)

Same facts as Question S-5.

State the amount of gross income with respect to the \$300,000 punitive damages for physical injury to the body.

Question S-7. (1 minute/s)

Same facts as Question S-5.

State the amount of gross income with respect to the \$18,000 compensatory damages for the emotional distress.

Question S-8. (3 minute/s)

In 2000, TP and Spouse purchased for \$200,000 (paid in cash) a residence as TP's and Spouse's principal residence. TP and Spouse own and occupy the property as their principal residence until they sell the property on September 6, 2006, for \$850,000. Neither TP nor Spouse has ever owned another residence.

Explain the amount of the gain recognized with respect to the sale of the residence in 2006 if TP and Spouse file a joint return for 2006.

Question S-9. (1 minute/s)

TP receives as a gift from TP's uncle an artwork with a fair market value of \$15,000 and an adjusted basis to the uncle of \$5,000. Uncle paid a gift tax of \$1,500 with respect to the transfer to TP.

State the amount of gross income to TP.

Question S-10. (2 minute/s)

Same facts as Question S-9.

State the amount of TP's adjusted basis in the artwork.

Question S-11. (2 minute/s)

TP receives as a gift from TP's grandmother a share of corporate stock with a fair market value of \$10,000 and an adjusted basis to the grandmother of \$14,000. The grandmother paid no gift tax with respect to the transfer to TP.

State the amount of gain or loss realized if TP sells the share of stock for \$9,000.

Question S-12. (3 minute/s)

Describe how §§ 1221, 1231, and 1245 prescribe characterization rules that apply to gain from the sale of depreciable personal property.

Question S-13. (6 minute/s)

In 2000, TP purchased unimproved real property. To acquire the property, TP (1) paid \$500,000 cash at the closing, (2) took the property subject to a preexisting first mortgage debt secured by the property in the amount of \$100,000 (for which TP was not personally liable), and (3) executed a \$200,000 second mortgage indebtedness (for which TP was personally liable) to the seller. In 2004, TP borrowed \$80,000 from a bank, in return for which TP executed a nonrecourse note (no personal liability to TP) and a third mortgage on the real property to secure the \$80,000 debt. The \$80,000 proceeds of the loan were used to purchase investment securities. In 2006, TP received an offer from Buyer to buy the real property, and TP accepted the offer. Buyer (1) paid \$550,000 cash, (2) took subject to the first mortgage debt of \$75,000 (it had been paid down from \$100,000 to \$75,000), (3) assumed the \$200,000 second mortgage debt, and (4) took subject to the third mortgage debt of \$50,000 (it had been paid down from \$80,000 to \$50,000).

- (a) What was TP's basis in the property at the time of acquisition in 2000?
- (b) Describe the federal income tax consequences of the 2004 borrowing and third mortgage transaction.
- (c) Quantify TP's amount realized and any gain or loss realized upon the sale of the property to Buyer in 2006.

Question S-14. (3 minute/s)

TP is engaged in a trade or business activity of making widgets. To assist in the manufacturing process, TP purchases on June 6, 2006, new equipment exclusively for use in TP's widget making business activity. This is the only such equipment purchase TP makes during 2006. TP paid \$100,000 for the new equipment, which has a 168(i)(1) class life of twelve years. TP expects to use the equipment for ten years and estimates that the equipment will have a salvage value of \$15,000 at the end of the ten-year period of use. State the amount of the § 168(a) deduction allowable in 2006 (ignoring § 168(k) and § 179 for purposes of this Question).

Question S-15. (2 minute/s)

In year 1, TP exercised incentive stock options granted by TP's employer. As a result, under §§55(b)(2), 56(b)(3), and 83(a), TP was required to include in his alternative minimum taxable income in year 1 the difference between the exercise price and the fair market value of the shares of stock on the date of exercise. In year 2, TP realized a capital loss from the disposition of the stock acquired by exercise of the options.

Discuss whether the capital loss limitations of §§1211 and 1212 apply for purposes of the alternative minimum tax such that TP may not use the capital losses realized in year 2 to reduce TP's alternative minimum taxable income in year 1.

Question S-16. (2 minute/s)

TP purchased a principal residence on January 1 of the current year at a cost of \$900,000. TP paid \$150,000 down and obtained a purchase money first mortgage loan (secured by the residence) from a bank in the amount of \$750,000. As of January 1, state the total principal amount of the first mortgage indebtedness as to which interest is deductible, assuming that TP is unmarried and owns no other residence.

Question S-17. (2 minute/s)

Same facts as Question S-16. On June 1 of the current year TP has reduced the principal amount of the first mortgage debt on the residence to \$700,000. The fair market value of the residence on June 1 is \$1,000,000. On June 1, TP borrows \$300,000 from a bank, and the debt is secured by a second mortgage on the residence. TP expends the \$300,000 of the second mortgage loan proceeds to add a wing to the residence.

As of June 1, state the principal amount of the second mortgage loan as to which interest is deductible.

Question S-18. (2 minute/s)

During the current year, TP realized the following gains and losses: (1) long-term capital losses of \$18,000, (2) short-term capital losses of \$8,000, (3) long-term capital gains of \$17,000, and (4) short-term capital gains of \$7,000.

State the total amount of capital losses to be allowed to TP for the current year by § 1211.

Question S-19. (3 minute/s)

Will TP be entitled to a § 151(c) dependent exemption-deduction in 2006 for the following persons? For purposes of this question, ignore § 151(d)(3).

State YES or NO.

- (a) A, TP's twenty year old unmarried child, resides with TP for the entire year. A works full time and has gross income of \$30,000 in 2006, but all of A's support is provided by TP.
- (b) B, TP's twenty year old child, resides with TP for June, July, and August of 2006 but for all other months is away at college. B has 2006 gross income of \$8,000 from summer employment. TP provides \$24,000 to support B, and B expends \$6,000 of B's own money for B's support.
- (c) C, TP's dependent parent, lives with TP and who has 2006 gross income of \$8,000. TP provides all support.

Question 5-20. (3 minute/s) T

P owns unencumbered real property with an adjusted basis of \$1,000. TP sells the property to Spouse on July 1, 2006, when the fair market value of the property is \$11,000. Spouse pays cash of \$11,000. On December 18, 2006, Spouse sells the real property to a third party for its then fair market value, \$13,000 (in cash).

Briefly discuss the tax consequences to Spouse with respect to the December sale to the third party.

Question 5-21. (3 minutes)

TP and Spouse have one child, Junior. TP and Spouse obtain a divorce and maintain separate households for all of 2006, and Junior resides with TP for two months of 2006 and with Spouse for the remainder of the year. TP can prove that TP provided \$4,000 of support to Junior for 2006.

Describe the circumstances under which TP would be eligible for a § 151(c) dependent exemption-deduction for Junior.

Question 5-22. (9 minute/s as allocated below)

TP and Spouse separated in 2004 and are divorced in 2005. Pursuant to the terms of the divorce settlement agreement, which the divorce court approved and adopted as its order, TP is required to make the following transfers to Spouse:

1. Property settlement payments in 2005:
 - (1) \$125,000 in cash
 - (2) Real property (TP's separate property), which has a value of \$200,000 and an adjusted basis to TP of \$250,000.
2. Spousal support in cash:
 - (1) \$120,000 in 2005
 - (2) \$100,000 in 2006
 - (3) \$80,000 in 2007
 - (4) \$70,000 per year after 2007 until the death or remarriage of Spouse.

The divorce settlement agreement and the court order are silent as to the tax consequences of the various payments. TP makes all required payments.

- (a) (1 minute/s) State the amount of gross income to Spouse as to the 2005 cash payment of \$125,000 as part of the property settlement.
- (b) (1 minute/s) State the amount of gross income to Spouse as to the 2005 transfer of the real property as part of the property settlement.
- (c) (1 minute/s) State the amount of Spouse's adjusted basis in the real property on the date of receipt.

- (d) (1 minute/s) State the amount of gross income to Spouse in 2005 attributable to the \$120,000 cash payment as spousal support.
- (e) (5 minute/s) State the amount of gross income to TP (not Spouse) in 2007 attributable to the spousal support payments made by TP in 2005-07.

Question S-23. (10 minute/s as allocated below)

On January 1, 2006, A and B organize AB Corporation (which is not and will not be an "investment company" under § 351(e)). The following transfers were made to the corporation:

Transferor	Property	Fair Market Value	Adjusted Basis to Transferor
A	Equipment	\$200,000	\$100,000
B	Cash	\$100,000	\$100,000
B	Unimproved real property	\$80,000	\$50,000

The equipment had been purchased in 2000 for use in A's trade or business at a cost of \$250,000, and because of depreciation, the adjusted basis had been reduced to \$100,000 on January 1, 2006. The unimproved real property had been held by B as an investment. In exchange for the contributions of A and B, the corporation issues its common stock, 500 shares to A and 500 shares to B. The fair market value of the stock is \$400 per share; the common stock is the only class of stock authorized and outstanding. In addition to the 500 shares of stock, A receives from AB Corporation \$10,000 of cash, a 1-year note of AB Corporation in the amount of \$4,000 at 7% interest, and a 5-year note of AB Corporation in the amount of \$6,000 at 6% interest. Each note has a fair market value equal to the face amount of the note.

- (a) (3 minutes) Determine A's gain realized, A's gain recognized, and the character of any gain recognized by A.
- (b) (3 minutes) Determine A's adjusted basis in the AB Corporation stock received.
- (c) (2 minutes) Determine the amount of gain recognized by AB Corporation.
- (d) (2 minutes) Determine the adjusted bases of AB Corporation in the properties received from A and B.

Question S-24. (3 minute/s)

TP is a partner in the AB General Partnership, a cash method partnership that owns (1) zero-basis accounts receivable from trade creditors and (2) inventory property (within the meaning of Section 1221(1)) the fair market value of which is in excess of the partnership's adjusted basis in the inventory. TP sells TP's interest in the partnership to an unrelated person.

Describe how §§ 741 and 751 apply to TP with respect to the sale of the partnership interest.

Question S-25. (3 minute/s)

TP is the estate of A, who died in 2005. The estate filed a federal estate tax return that reported as an item within A's gross estate an individual retirement account (which held marketable securities) owned by A. The estate tax return reported a discount to the value of the IRA by the expected federal income tax liability resulting from the distribution of the IRA's assets to the beneficiaries under § 408(d)(1).

Discuss how the Tax Court should rule on whether the discount is appropriate.

Question S-26. (3 minute/s)

Describe the nature and quantity of transfers that a living donor may make free of the gift tax to an individual.

Question S-27. (4 minute/s)

Describe and explain (1) the § 2056(b)(7) qualified terminable interest property marital deduction and (2) the operation of § 2044 and its relationship to § 2056(b)(7).

Question S-28. (5 minute/s)

Section 6662(b)(2) provides an addition to tax with respect to the portion of any underpayment that is attributable to any "substantial understatement" of income tax.

Describe how an individual taxpayer might attempt to avoid this addition to tax if the understatement will be substantial according to §6662(d)(1).

Question S-29. (4 minute/s)

State the limitations period (the "statute of limitations") as to the assessment of tax that applies to the following income tax returns (that are properly, completely, timely, and non-fraudulently filed except as indicated below):

- (a) An income tax return with respect to an incorrect deduction item claimed in the return.
- (b) An income tax return that is not signed by the taxpayer.
- (c) A fraudulent income tax return for year 1 is filed in year 2, and in year 3 a non-fraudulent and correct return for year 1 is filed.
- (d) An income tax return that fails to include required information with respect to a § 6707A(c)(2) listed transaction.

**PART THREE
EVIDENCE
(60 minutes)**

ANSWER THE QUESTIONS IN THIS PART OF THE EXAMINATION IN ANSWER BOOK/S SEPARATE FROM THE ANSWER BOOK/S CONTAINING ANSWERS TO OTHER PARTS OF THE EXAMINATION

For purposes of all evidence questions in Part Three, assume the following facts. Taxpayer (T), a self-employed software designer, has filed a petition with the Tax Court to redetermine a deficiency as set forth in a notice of deficiency for tax year 2005. The alleged deficiency arises from the disallowance of certain claimed business expense deductions, and also due to the late filing of T's 2005 federal income tax return. The Commissioner (C) has answered, both parties have followed all proper pre-trial procedures, and the case is now at trial. Unless otherwise stated, assume that each question calls for relevant evidence - that is, evidence that is material and probative on some issue in the case.

E-1. T calls WA, T's former attorney-accountant, as a witness. WA is not representing T at this hearing and is no longer T's attorney-accountant. T seeks to introduce a financial statement prepared by WA showing receipts and disbursements of T's business for the 4th quarter of 2005. Assume that WA prepared the statement in January 2006 in the regular course of WA's duties as T's attorney-accountant, and that the statement was given to T and only T by WA for T's use in managing T's business. After establishing that the document was so prepared, T asks: "Does this financial statement (T's Exhibit 1) truly and accurately state the financial transactions of T's business for the 4th quarter of 2005?" Assume that, if permitted to answer, WA would answer "yes."

- (a) (8 minutes) C objects on the sole ground that the document is hearsay. Explain how the Tax Court should rule.
- (b) (8 minutes) Explain what additional foundation, if any, could T have laid to make the document admissible.

E-2. Assume the same facts as in Question E-1, except that C objects on the sole ground that the document is inadmissible under the attorney-client privilege.

- (a) (5 minutes) How should the Tax Court rule on this objection, and why?
- (b) (5 minutes) If the Tax Court sustains the objection, what should T do next? Explain in detail the procedure T should follow and why.

E-3 (5 minutes)

On direct examination of T, T's attorney asks T, "Isn't it a fact that you were in Miami, Florida, on January 15, 2006?" (Assume the question calls for relevant evidence.) Does C have any proper objection? If so, what is that objection and why is the question improper? Are there any exceptions to the rule you have just described? If so, list and describe them.

E-4. Assume that the financial statement prepared by WA described in Question E-1 is eventually admitted into evidence, and that WA testifies that the statement "truly and accurately states the financial transactions of T's business for the 4th quarter of 2005." WA completes testifying and is excused from the hearing. T presents the remainder of T's evidence and rests. C, during C's case, offers into evidence a properly authenticated letter from WA to T, dated February 1, 2006, in which WA states, "As you requested, I changed some of the figures in the 4th Quarter 2005 report to improve the 'bottom line.'" The letter then goes on to detail the figures that were changed. T objects to the admission of the letter. Assume that no evidentiary privilege applies to this letter.

- (a) (8 minutes) If T objects on the ground that the letter is hearsay, should that objection be sustained? Why or why not? Discuss.
- (b) (5 minutes) Can the letter be admitted under the rule of completeness? Discuss.
- (c) (8 minutes) Disregarding the hearsay issue, can the letter be admitted to impeach WA's testimony or to impeach the financial statement itself? Discuss.

E-5. (8 minutes)

Assume that, in T's case, one of the issues is whether T's 2005 income tax return was timely filed. As some evidence that it was, T offers to testify and to introduce other evidence that T invariably filed every federal income tax return from 1980 through 2004 on time. Is this evidence relevant and admissible as some evidence that T's 2005 return was timely filed? Discuss.

**PART FOUR
LEGAL ETHICS
(24 minutes)**

ANSWER THE QUESTIONS IN THIS PART OF THE EXAMINATION IN ANSWER BOOK/S SEPARATE FROM THE ANSWER BOOK/S CONTAINING ANSWERS TO OTHER PARTS OF THE EXAMINATION

Question LE- 1-A. (3 minute/s)

A devised a transaction designed to save federal income taxes and convinced Nora Lee to enter into the transaction. A also prepared all the documentation for the transaction. Lee subsequently was audited and received a notice of deficiency in tax with respect to this transaction, which she intends to contest in Tax Court. Can A represent Lee in this proceeding?

Briefly explain your answer.

Question LE-1B. (2 minute/s)

Does the answer change if Lee consents to A's representation?

Briefly explain your answer.

Question LE-1 C. (3 minute/s)

Suppose in the alternative that A represents the promoter P who designed the transaction and sold it to several investors, including Lee. Can A represent Lee in the deficiency matter?

Briefly explain your answer.

Question LE-1-D. (2 minute/s)

A located the properties that were used to carry out the transaction. If A is likely to be called as a potential witness in the deficiency litigation, can A represent Lee if he obtains a waiver from Lee? Briefly explain your answer.

Question LE-1 E. (3 minute/s)

If P had previously revealed information to A in confidence about the transaction that would be helpful in representing Lee, may A use this information in the representation of Lee if P consented to A's representation of Lee?

Briefly explain your answer.

Question LE-2. (3 minute/s)

B represents Pablo Rodriguez in a Tax Court proceeding that would be appealed to the Sixth Circuit. After submitting the brief on behalf of Rodriguez, B discovers a decision of the Fifth Circuit that is directly contrary to her client's position in this matter. The government's brief fails to mention the case.

What action, if any, must B take and why?

Question LE-3. (2 minute/s)

C was retained by the CEO of ABC Co. to represent the company in Tax Court litigation. After being retained to represent ABC Co. and as counsel for ABC Co., C has discussions with counsel for the IRS about the litigation. C learns that counsel for the IRS has contacted the CEO of ABC Co., who has information relevant to the litigation, without notifying C.

Explain whether such contact by the IRS counsel with the CEO is proper.

Question LE-4. (2 minute/s)

D represents Maryellen Sutton in a Tax Court proceeding involving deficiencies with respect to her sole proprietorship. As part of the pre-trial process, the government lawyer offers a settlement. D is surprised by the settlement offer and has never discussed with Sutton the possibility of settling the case. D believes the government's offer should be accepted but Sutton is out of the country on vacation. Can D agree to and sign the stipulation of settled issues?

Briefly explain your answer.

Question LE-5. (2 minute/s)

E, a member of the Smith, Jones, and Baker law firm, represents Paper Co. in intellectual property dispute against Scissors Co. Scissors Co. has requested F, another member of the Smith, Jones, and Baker firm, to represent it in Tax Court litigation. Can F accept the representation?

Briefly explain. 0020

Question LE-6. (2 minute/s)

Does the answer to Question LE-5 change if E's representation of Paper Co. in the intellectual property dispute ended two years ago?

Briefly explain.