Name: KEY

Accounting 385/685: Introduction to Taxation, Spring 2020
Exam 1

Instructions: **No cell phones or computers during the exam, not even on the desk, and not at any time. <u>You will need to remain in the room, in your seat until the exam is over, even if you finish early</u>.** Also, you will need to turn in your page of notes, which should also have your name on it.

Note that there are two longer problems at the end of the test worth a considerable number of points.

Problems are worth the number of points indicated. Partial credit is available on all problems and **TO RECEIVE FULL CREDIT SHOW ALL WORK NEEDED TO ARRIVE AT YOUR ANSWER AND/OR PROVIDE AN EXPLANATION FOR YOUR ANSWER.**

1. **<u>7 Points</u>**: Lem purchased 100 shares of RealRealEstate.com Corp. on January 1, this year, for $50 per share. On June 2, this year, Lem purchased an additional 50 shares for $2,000. Later, changing his mind, on June 30, Lem sells 25 of the shares he purchased in January for $40 per share. What is Lem's recognized loss on this sale?

2

Lem's sale was at a loss: Cost/share = $50, SP/share = $40, on June 30

But, replaced stock sold at loss within 30 days of sale (June 2)

→ wash sale, No loss recog'd.

5

2. **<u>5 Points</u>**: Bob Brown's aunt Barbara gave him a house. At the time of the gift, the house had a fair market value of $320,000 and his aunt's adjusted basis was $200,000. His aunt paid a gift tax of $50,000 on the house. Assume that the taxable gift, net of gift tax exclusion, was $305,000. What is Bob's basis in the house if he later sells it for $260,000?

Gift: No gn/loss recog'd. Built-in gn = 320,000 (FMV) − 200,000 (Basis) = 120,000

Taxable gift = 305,000 ≠ gift tax = 50,000.

4

Donee's Basis = donor's basis + gift tax adjustment

$$= 200{,}000 + \underbrace{50{,}000 \times \frac{120{,}000}{305{,}000}}_{19672} = 219672$$

1

gain on later sale = 260,000 (SP) − 219672 (Adj. Basis) = 110,328

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3. **10 Points**: Arthur Austen's investment land has an adjusted basis of $100,000. This year, the federal government for the construction of a new highway condemns one-third of it. The authorities replaced the condemned portion of his property with other qualified property with a fmv of $150,000 and also give him $25,000 of severance damages. What is Arthur's basis in the remaining old property? What is Arthur's basis in the new replacement property?

(1) Condemnation of 1/3 of the property.

~~#fmv~~ fmv replacement 150,000

(3) 1/3 Basis of old prop <33,333>

real'd gn 116,666

2 qualified replace → Ø recog'd gn.

or just same as old 1/3.

Replacement basis = fmv − def'd gn = 150,000 − (116,666 − 0) = 33,333 5

(2) Basis, retained 2/3 = 2/3 orig Adj. Basis − severance damages = 66667 − 25,000 = 41,667

3

10 MAX

4. **15 Points**: Five-year property costing $25,000 was placed in service on January 10 of the current year. Assume neither bonus depreciation nor Code Sec. 179 is elected and the mid-quarter convention applies. If it is sold next year, for $15,000, on July 10, what is the realized and recognized gain from the sale?

5

Purchase JAN. → 1st Qtr → 7/8 of year

2020 depr.: 25000 × 1/5 × 2 × 7/8 = 8750

.35

5

2021 dep: sAle date july 10, owned Jan 1 → July 10 → 5/8

= (25000 − 8750) × 1/5 × 2 × 5/8 = 4062.50

2

Sale SP 15000

Adj. Basis <12187.5>

2812.50

3

Adj. Basis, at sale =

Cost 25,000

2020 dep <8750>

2021 dep <4062.50>

12187.50

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5. **8 Points**: Brenda Baines sells land to Carla Chandler who pays $165,000 cash and also gives Brenda a car with an adjusted basis of $115,000 and a fair market value of $45,000. The car was subject to a $20,000 liability, which Brenda assumed and Brenda's land was subject to a $15,000 mortgage which Carla assumed. What is the fmv of Brenda's property?

Rule, No gifts → fmv given = fmv rec'd.

$165,000, CAR fmv = 45,000 − $\underset{}{\overset{\text{debt}}{20,000}}$ = 25,000 net fmv

CC ⟶ B

⟵ MORT 15,000

fmv = $165,000 + (45000 − 20000) + 15,000 = 205,000

2 CAR 3 mort. relief to Brenda's benefit 3

6. **6 Points**: A fire destroyed Carl Cramer's business automobile. Carl originally paid $44,000 for the automobile and up to the time of the fire had been allowed $10,000 in depreciation. Within three months the insurance company replaced the old automobile with a new one with fmv of $35,000. What is the basis of the new automobile for purposes of computing depreciation?

Adj Basis = 44,000 (cost) − 10,000 (dep) = 34,000

2 direct replacement, New car, fmv = 35,000, for old, Qualified replacement

① real'd gn = fmv new − Adj Basis, old =
1,000 = 35,000 − 34,000

3

② Basis = basis in old = $34,000

2 (= fmv − def'd gn = 35,000 − ($\overset{\text{real'd gn}}{1,000}$ − $\overset{\text{recog'd gn}}{0}$) = 34,000
1000

either, or both, is fine.

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7. **10 Points**: Mason Container Co., a calendar year taxpayer, which is undergoing an IRS audit, purchased and put into service a 3-year depreciable property for $3,100,000 this year on December 15, which was its only purchase of depreciable property. Mason wanted to take the largest possible first-year tax deduction related to this property. Compute the largest tax deduction possible related to this business equipment. (Be certain to consider the Section 179 deduction and assume that no bonus depreciation was elected. Use the current rates and numbers as per the Master Tax Guide.)

MAX §179 : 1,020,000 (or ~~2,559,000~~ 1,040,000)

Phaseout begins: 2,550,000 (or 2,559,000

2,590,000

100% in-service in 4th Qtr → mid-Qtr applies

1

max §179 − Phaseout

~~550,000~~

§179 = 1,020,000 − (3,100,000 − 2550000) = 470,000

Reg. dep, 3-year, 4th Qtr, mid-Qtr 5

2,630,000

(3,100,000 − 470,000) × 1/3 × 2 × 1/8 = 219167 3

dep. cost

.083

Total: ~~219167~~ 219167 + 470,000 = 689167 1

8. **10 Points**: a fire destroyed Paul Peterson's warehouse, which he had been renting to the XYZ Corporation, on November 23, last year. Paul purchased the warehouse years ago for $920,000. Its adjusted basis at the time of the fire was $550,000 and its fmv was $2,200,000. He received a $1 million insurance payment on March 5, last year. On December 15, this year, Paul spends $900,000 to buy another warehouse, which he also will rent out. How much gain or loss must Paul recognize? What is his basis in the new warehouse?

Warehouse: Basis 550,000, fmv 2,200,000 − destroyed

Ins $ = 1,000,000, spends $900,000

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① Real'd gain: → Invol. conversion applies

3 $1,000,000 − 550,000 = $450,000

Ins. $ — Basis — real'd gn.

② Recog'd gn = lesser of real'd gn or $ rec'd and not properly reinvested.

real'd gn

3 = lesser of $1,00,000 or 450,000 = 100,000

$ not spent,

only invested $900K of $1 mill

gn real'd — gn recog'd

2 ③ Basis, replacement, = Cost − def'd gn = 900,000 − (450,000 − 100,000) = 550000

350,000

Note: Time period is not too long

2 Replacement is qualified, same use, prop.

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9. **25 Points**: The Lennox manufacturing firm places the following property in service this year:

	QTR	% yr.			
Light machines	3	3/8	3 yr	(July 3)	$1,090,000
Specials tools	4	1/8	5 yr	(October 10)	$1,680,000
Office furniture	1	7/8	7 yr	(February 10)	$410,000
					3,180,000

You are preparing their tax return, and Lennox has decided to take no bonus depreciation and to claim the maximum section 179 expensing, in addition to the maximum MACRS depreciation. What is the largest combined amount of deduction that they may obtain on account of these properties this year? Be certain to show the calculation of depreciation expense for each asset in addition to any other work needed to solve this question, and use the rules as per the Master Tax Guide.

① Is mid-Qtr mandatory? 4^{th} Qtr invest = 1,680,000, 1-4 Qtrs

1,090,000
1680000
410000
3180000

2

$\frac{1,680,000}{3180000} = 52.8\%, > 40\% \rightarrow$ yes. mid-Qtr is required

② 1^{st} yr dep rates for each asset

8

Light machines: $\frac{1}{3} \times 2 \times \frac{3}{8} = .25$

special tools : $\frac{1}{5} \times 2 \times \frac{1}{8} = .05$ ← lowest rate, take §179 here

furniture : $\frac{1}{7} \times 2 \times \frac{7}{8} = .25$

Max 179 expense, 2019, is 1,020,000 (projected to be 1,040,000 in 2020) either is ok.

Investment limit, before reduction, is, 2019, 2,550,000 (2020 projection = 2,590,000)

③ Max §179 = 1,020,000 (or, 1,040,000), after phaseout...

$= 1,020,000 + \underbrace{(2,550,000 - 3,180,000)}^{-630,000} =$ ~~1,650,000~~ 390,000

(or 2,559,000) 3

④ MAX 1^{st} yr dep.

		Reg dep	§179
2	Light machines: $(1,090,000) \times \frac{1}{3} \times 2 \times \frac{3}{8}$ =	272500	0
5	Special tools: $(\overbrace{1,680,000 - 390000}^{1,290,000}) \times \frac{1}{5} \times 2 \times \frac{1}{8}$ =	64500 ~~322500~~	390000
4	furniture : $(410,000) \times \frac{1}{7} \times 2 \times \frac{7}{8}$ =	102500	0
		439,500	390,000
	TOTAL	829,500	

25 MAX

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30 MAX

10. **30 Points**: Mary and Margaret are exchanging business properties. Mary is transferring to Margaret her apartment building with a fmv of $300,000 and a basis of $800,000. In addition, she is transferring her business car with a fmv of $80,000 and a basis of $20,000. In return, Margaret is transferring to Mary her farm. It has a fmv of $500,000 and a basis of $200,000 and is subject to a mortgage of $160,000. In addition, Margaret is paying Mary $40,000 in cash.

Determine each person's: realized gains or losses, recognized gains or losses, and basis in all assets received. Finally, suggest how to restructure the transaction to increase the tax benefits, or reduce the tax costs, to any and all parties. Be certain to show all your work on this problem.

my LK: Fmv 300,000, Basis 800000
NLK: Fmv 80,000, Basis 20,000 → mT

← LK: Fmv 500,000 Basis 200,000
mort 160,000 $ 40,000

Eq Fmv? yes
(2) 300 + 80 = 500 - 160 + 40

Real'd gn	my	mT
Fmv LK rec'd	500,000	300,000
$ rec'd	40,000	—
Fmv NLK rec'd	—	80,000
Basis given	<820,000>	<200,000>
mort assumed	<160,000>	+ $160,000
" relief	—	
$ pd	—	<40,000>
	<440,000>	300,000

(8)

Recog'd gn	my	mT
Fmv NLK given	80,000	
Basis " "	<20,000>	
	60,000	
$ rec'd	~~40,000~~	

(2)

← Note & comment or -2

not recog'd as no real'd gn, only real'd loss.

Excess debt relief	my	mT
debt relief	—	160,000
debt assumed		<0>
$ pd		<40,000>
		120,000
Fmv NLK rec'd	—	80,000
gn recog'd	60,000	200,000

(3) (2)

Basis, add-up	my	mT
fmv NLK rec'd	—	80,000
Basis given	820,000	200,000
gn recog'd	60,000	200,000
$ pd	—	40,000
$ rec'd	<40,000>	—
debt relief	—	<160,000>
" assumed	160,000	—
Fmv NLK rec'd	—	<80,000>
	1,000,000	200,000

(1) (6)

Basis, def'd gn	my	mT
Fmv LK rec'd	500,000	300,000
real'd gn	<440,000>	<200,000>
recog'd "	<60,000> +	100000
	<500,000>	
	$500,000	<100,000>
	1,000,000	200,000

(3)

Planning:
Goal: ded. loss for my & tax-def'd gn for mT
→ 3 party exchange.

Still an issue: fmv's of LK differ by 200,000.
(1) if my & mT agree, my can invest 200,000 in her prop. → fmv = 500,000.
(2) remove car from transaction
(3) mT pays off her mort and pays No $ to my

(6)

OR: my finances improvement with debt, mT pays no $, borrows $40,000
No car
So her mort. Balance, 200000 (= 160 + 40) equals my's mort bal. (after borrowing 200,000 to invest in her prop)