THE STATE BAR OF CALIFORNIA
BOARD OF LEGAL SPECIALIZATION

Area of Specialty:
TAXATION LAW

LEGAL SPECIALIST EXAMINATION

Registration & Preparation Packet

Examination Date: October 27, 2015

INTRODUCTION

This packet contains key information you will need to prepare for the legal specialist examination to be given on October 27, 2015.

For full detail, please be sure to visit the examination page as well as your legal specialty page on www.california specialist.org.

This packet contains:

- An Action List for Examination Preparation
- Examination Specification listing topics that may be tested on the examination
- Sample essay questions from past examinations (Multiple-choice questions are not released for practice)
- A fillable examination registration form

2015 EXAMINATION ACTION LIST

Start Today:

1. Registration is in this packet and also at www.californiaspecialist.org.
   a. Early Bird Pricing Ends **September 1, 2015**.
   b. Registration closes **October 1, 2015**.
   c. Choose Oakland Convention Center or Pasadena Convention Center.
2. Review this packet for an overview, and visit the examination and specific specialty pages at www.californiaspecialist.org for more details about the examination and the application you will file afterward.

Know the Examination:

1. Format: Four Hour Morning Session, 8 essays; Approximate 90-minute lunch; Two and One Half Hour Afternoon Session, 75 Multiple-Choice Questions.
2. Examination Topics: See attached Examination Specification for Examination Topics.
3. Examination Practice: Sample essays are enclosed. No multiple-choice questions are released for practice.
4. If you plan to register for an optional preparation class from a commercial provider, be sure to check the schedule right away, as some courses are already underway, and all are designed to accommodate your full-time working schedule. Your specialty page at www.californiaspecialist.org will list all preparation classes reported to the Department of Legal Specialization.

Prepare for Examination Day:

Arrive with enough time to arrive by 7:00 a.m. so that you have registered, found your seat, and started your laptop your laptop computer will be on if you are using one, by the time the examination begins at 7:30 a.m.

Bring only those items allowed on the examination bulletin that will be sent to you when you register.

You may bring one of the following annotated or unannotated code books free from markings, tabs or notations other than your name and contact information. No e-books, printouts or CD-ROMs are allowed.

1. Internal Revenue Code: Income, Estate, Gift, Employment and Excise Taxes Winter 2015 Edition, CCH, ISBN 9780808039396.

2. RIA Complete Internal Revenue Code Spring 2015 Edition, Thomson Reuters, ISBN 9780781104913.

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TAXATION LAW
Examination Specifications

Purpose of the Examination: The Taxation Law Examination consists of a combination of essay and multiple-choice questions. It is designed to verify the applicant's knowledge of and proficiency in the usual legal procedures and substantive law that should be common to specialists in the field as represented by the skills listed below. We recognize that these skills are interrelated, which may require that you apply several skills in responding to a single exam question. Also, the order of the skills does not reflect their relative importance, nor does the skill sequence represent an implied order of their application in practice.

Your answers to the exam questions should reflect your ability to identify and resolve issues, apply taxation law to the facts given, and show knowledge and understanding of the pertinent principles and theories of law, their relationship to each other, and their qualifications and limitations. Of primary importance for the essay questions will be the quality of your analysis and explanation.

Knowledge of the following fundamental lawyering skills may be assessed:

Subject Area 1: Professional Responsibility 1.1 Duties to clients, opposing counsel and the Court 1.2 Bases for attorney's fees 1.3 Circular 230 and standards of practice 1.4 Fee agreements 1.5 Conflicts and dual representation 1.6 Conduct resulting in discipline or sanctions	**Subject Area 2: Taxation Litigation and Procedures** 2.1 Administrative Procedures 2.2 Jurisdiction 2.3 Choice of forum/appeals 2.4 Statute of limitations 2.5 Penalties 2.6 Refunds—administrative claims and litigation 2.7 Collection matters 2.8 Reporting of foreign assets
Subject Area 3: Individual Income Taxation 3.1 Compensation, benefits and other income 3.2 Exclusion from income 3.3 Business and personal deductions 3.4 Characterization of income, gains and losses 3.5 Determination of basis 3.6 Loss limitations 3.7 Charitable deductions 3.8 Grantor trusts 3.9 Reporting of foreign assets	**Subject Area 4: Corporate Income Taxation** 4.1 Formation/Choice of entity 4.2 Operation 4.3 Distributions 4.4 Reorganization/liquidation **Subject Area 5: Partnership and pass-through entity income** 5.1 Formation/Choice of entity 5.2 Operation 5.3 Reorganization/liquidation 5.4 Check-the-box regulations 5.5 Partner and partnership basis
Subject Area 6: Real Estate Taxation 6.1 Acquisition 6.2 Development 6.3 Exchanges, involuntary conversions and dispositions State and local property taxes	**Subject Area 7: Estate, Gift and Fiduciary Income Tax** 7.1 Estate and Gift Tax Planning 7.2 Generation skipping planning 7.3 Marital deduction planning 7.4 Valuation issues 7.5 Includable/excludable items 7.6 Post-mortem planning 7.7 Distributions from estates and trusts

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TAXATION LAW
Sample Essay Questions from Past Examinations

These questions are actual questions from past exams. These questions were designed to be read and answered within 45 minutes, though current examination questions are designed to be read and answered in 30 minutes. No 30 minute essay questions will be released publicly.

Sample Question #1

Frank is an 87-year old widower in very poor health, but there is good reason to believe that he may live at least another three (3) years, if all goes well. He has no family other than his very healthy unmarried daughter Cindy, his sole heir. Both Frank and Cindy are U.S. citizens residing in California. Frank shows you the following list of his assets:

Frank's Financial Information Table

	Column A Fair Market Value	Column B Adjusted Basis	Column C Unrealized Gain (Col A less Col B)	Column D Property Tax Assessed Value
Cash and Personal Property	$225,000	$200,000	$25,000	N/A
Frank's House	$500,000	$100,000	$400,000	$80,000
Triplex Apartment Rental	$275,000	$50,000	$225,000	$50,000
TOTALS	**$1,000,000**	**$350,000**	**$650,000**	**$130,000**

Frank tells you that: (a) all of his properties are located in California, (b) he has no mortgages or other debt, and (c) he has made no prior taxable gifts. Frank would like to transfer his house to Cindy, but he has not yet done so and seeks your advice. Frank tells you, and you are to assume, that property values are going to remain stable and not change at least well past Frank's death, and that Cindy has agreed that Frank can continue to live alone in the house as his principal residence without paying rent until his death (unless you advise otherwise), and Cindy will pay the real property taxes and other expenses of owning the house. Following the end of Frank's occupancy of the house, Cindy intends to occupy the house as her principal residence.

A. Discuss the estate and gift tax aspects of Frank's transferring the house to Cindy as a gift versus leaving it to her as a bequest.

B. **Discuss the positive and negative income tax aspects of Frank's transferring the house to Cindy as a gift versus leaving it to her as a bequest.**

C. **If Frank should die before he transfers any real estate, discuss what the California real property tax consequences to Cindy will be when she inherits the house and triplex.**

Sample Question #2

In December 1999, Francisco, a real estate developer, was introduced to Sally who owns a large farm (10,000 acres). Francisco and Sally are and have been U.S. citizens and California residents for their entire respective lives. Sally inherited the farm from her mother in 1975. Upon the audit of her mother's estate, the estate tax value of the farm was confirmed by the IRS to be $200,000.

At the close of 1999, the fair market value of the farm property in its highest and best use (as developed real estate) was appraised at $2,000,000. All acres of the farm are of equal value and remain so. The farm property was subject to a mortgage of $200,000 with recourse by the lender only against the property.
In December of 1999, Francisco suggested that he and Sally form a limited partnership. Since Sally did not wish to participate in the day-to-day management of the partnership, Francisco suggested that he be the sole general partner and Sally be the sole limited partner.

On January 2, 2000, the two individuals formed a California limited partnership known as Creekside Estates, Ltd. ("Creekside"). Immediately thereafter, Sally as the sole limited partner contributed her farm (all 10,000 acres) to Creekside subject to the $200,000 mortgage. Francisco contributed no capital to the partnership.
Under the limited partnership agreement, Francisco as the sole general partner receives only a subordinated net profits interest of 50 percent determined after Sally has been allocated priority net profits equal to 10 percent simple annual return on her contributed capital amounts based on fair market value of the farm on date of contribution to the partnership. The other 50 percent of residual net profits (after reduction for the priority profits share of Sally) is allocated to Sally. The computation period for the priority profits share begins January 1, 2000 and ends on December 31 of the year the entire project is sold.

On February 1, 2000, Creekside obtained a loan of $3,000,000 from a local bank recourse only against the assets of the partnership. On the same day, using a portion of the bank loan proceeds Creekside paid off the $200,000 mortgage against the farm. Immediately thereafter, the remainder of the bank loan was drawn down and U.S. Treasury bonds are purchased at face with the drawn loan proceeds of $2,800,000.
By the end of 2001, the entire 10,000 acres were subdivided and developed by Creekside. The cost of development including any expenses required to be capitalized was entirely funded from the net proceeds from the sale of the Treasury Bonds at face. All of the costs of development were capitalized. The interest income derived from the Treasury bonds not required to be capitalized was exactly offset by currently deductible general administration expenses.

In 2002, Creekside sold all the developed real estate in separate sales. Creekside made no sales in any year except 2002. The combined gross receipts from all of the sales of the 10,000 acres net of closing costs were $8,000,000. All currently deductible general administration expenses for 2002 including interest expense were exactly offset by miscellaneous income derived by the partnership in 2002. The loan balance owed to the bank remains at $3,000,000.

A. **Determine and discuss the Federal income tax consequences to Francisco upon the receipt of a net profits interest in the limited partnership in 2000.**

B. **Determine and discuss the Federal adjusted tax basis of Sally with respect to her limited partnership interest immediately after the contribution of the farm to the limited partnership before the borrowing by the limited partnership from the bank.**

C. **Determine and discuss the effect of the borrowing by the limited partnership from the bank on the Federal adjusted tax basis of each partner in his or her partnership interest immediately after the borrowing.**

D. **Determine and discuss the Federal income tax consequences to each of the partners of the sales by Creekside of the 10,000 acres in 2002**.

Sample Question #3

John and Jane Jones (husband and wife) own an undivided 75% interest in the 250-space Sunny Mobile Home Park (the "Park"), and Sam and Sue Smith (husband and wife) own a 25% interest in the Park. Both families are California residents. The Park is located in California. The pertinent financial data relating to the park is as follows:

Tax Basis of Land		$1,500,000
Cost of Improvements	$2,000,000	
Depreciation on Improvements	(1,200,000)	
Basis of Improvements		800,000
Basis of Land and Improvements		$2,300,000
Non-Recourse Note Secured by First Trust Deed on Mobile Home Park		$5,000,000
Annual Income and Expenses:		
Income from Rentals		$1,000,000
Operating Expenses	($ 300,000)	
Interest	(350,000)	
Depreciation	(60,000)	
Total Expenses		($ 710,000)
Taxable Income		$ 290,000
Annual Cash Flow:		
Income from Rentals		$1,000,000
Operating Expenses	($ 300,000)	
Capital Expenditures	(50,000)	
Principal and Interest on Loan	(390,000)	

Total Disbursements	(<u>$ 740,000</u>)
Cash Distributed to Owners	<u>$ 260,000</u>

The Joneses and Smiths have each reported their share of the income and expense on their individual income tax returns, and have never filed a partnership tax return with respect to this property. The four owners are between 60 and 80 years old, have several children and grandchildren, and would like to dispose of the entire property in approximately 10 years. Their objectives include a desire to transfer assets to their children and grandchildren with a minimal tax (income, property, estate and gift) burden, while retaining at least 80% of their current cash flow from the property.

They believe that the cash available for distribution will increase at the rate of 5% per year and the current value of $10 million will also increase at the rate of 5% per year. The current loan may be prepaid without penalty, does not have a Due on Transfer provision, and in non-recourse. The Joneses and Smiths seek your advice and want to know the reasons for your recommendations.

A. What recommendation should be made to help the parties further their objectives? Discuss.

B. If the Mobile Home Park was owned by a C Corporation in which the Joneses owned 75% of the stock and the Smiths owned 25% of the stock, what recommendations should be made to help the parties further their objectives? Discuss

<u>Sample Question #4</u>

Mr. Slater's commercial warehouse was completely destroyed by a fire on July 15, 2001. The warehouse was tenantless and not in use, but Mr. Slater happened to be inside the warehouse doing an inspection at the time of the fire. Mr. Slater was able to escape, but broke a leg, suffered smoke inhalation, and burned both hands as he made his escape before the building collapsed. Mr. Slater was only partially recovered from his injuries on July 15, 2003, when he received a settlement of $3,000,000 from his insurance company. Additional information about Mr. Slater's commercial warehouse and settlement is set forth below:

Fair market value of warehouse (immediately prior to fire)	$2,000,000
Allocation of settlement proceeds to warehouse	$2,000,000
Allocation of settlement proceeds to personal injuries	$1,000,000
Cost of warehouse	$1,250,000
Accumulated depreciation warehouse (immediately prior to fire)	$ 400,000

Mr. Slater used $1,000,000 of the settlement proceeds to construct a new commercial warehouse, $1,000,000 to acquire publicly-traded stock, paid his outstanding medical bills, which were substantial, and is holding the balance of the settlement proceeds in cash as a reserve for future medical expenses.

A. **Mr. Slater comes to you during December of 2003 to discuss the taxation of his settlement. Discuss how the settlement proceeds of $2,000,000, which are properly attributable to the loss of the warehouse, should be treated for federal income tax purposes.**

B. **Mr. Slater is also interested in discussing the taxation of the $1,000,000 settlement proceeds attributable to his personal injuries. Assume that Mr. Slater's medical bills were $500,000 and that he is likely to require additional medical attention in the future due to the nature of his injuries. Discuss the taxation of this component of Mr. Slater's settlement.**

C. **The IRS audits Mr. Slater's 2003 U. S. Individual Income Tax Return, rejects the positions taken with respect to both the warehouse and personal injury settlement, and issues a statutory notice of deficiency. Mr. Slater visits you again to ask what his procedural options are. What do you tell him and what is your recommendation?**

Sample Question #5

Richard and Susan Harris, husband and wife, own 100% of Harris Construction Company, a California corporation engaged in the development of commercial property. Harris Construction Company has a 401(k) plan. Richard is a full time employee of Harris Construction Company and has approximately $300,000 in his 401(k) plan as of December 31, 2003. Susan does not work and has never worked at Harris Construction Company.

Richard Harris has a 50% community property interest in the shares of Harris Construction Company and will reach age 70½ during 2003. He has no plans to retire, but would like to meet with you to discuss retirement planning.

Harris Construction Company generally employs a minimum of fifty-five (55) workers. Ten (10) of the workers, including Richard Harris, have been properly characterized as employees of Harris Construction Company for employment tax purposes at all times. The remaining forty-five (45) workers are construction workers. The IRS has recently examined the 2001 Form 1120 U.S. Corporation Income Tax Return of Harris Construction Company and determined that all of the construction workers, who have been characterized as independent contractors for federal employment tax purposes, should have been characterized as employees. Harris Construction Company was established in 1970 and has consistently characterized all of its construction workers as independent contractors since the inception of the business.

Richard Harris has also asked to meet with you to discuss the Harris Construction Company employment tax case. He has received a Notice of Proposed Adjustments from the IRS examining agent and would like to discuss strategy.

Irrespective of the employment tax controversy, Susan Harris would like to establish a private foundation during 2003. The private foundation would provide support to qualified charitable organizations throughout the community where the Harris family has lived for many years. Richard and Susan Harris will have adjusted gross income of $2,000,000 at December 31, 2003.

Richard and Susan Harris intend to contribute cash of $500,000 or stock of Harris Construction Company with a value of $500,000 to the newly established private foundation. Richard and Susan Harris have a basis of $2,500 in the shares of stock that would be contributed to the foundation.

A. What advice should you provide to Richard Harris about his 401(k) plan?

B. Discuss your approach to the Harris Construction Company employment tax case.

C. Which asset should be contributed to the private foundation? Discuss.

Sample Question #6

Joe and Betty (husband and wife) purchased all of the stock in Minimarket, Inc., a C Corporation, as tenants in common for $100,000, on January 1, 2000. At the time of the purchase, the corporation had the following balance sheet:

Assets		
Cash		$ 10,000
Equipment:		
Cost	$110,000	
Depreciation	(20,000)	
Total Equipment		$ 90,000
Total Assets		$100,000
Liabilities		$ 0
Capital		
Capital Stock	$ 1,000	
Retained earnings	$ 99,000	
Extra Value re: Appreciation		
		$100,000

On May 1, 2003, Joe and Betty agreed to dissolve their marriage. The only mention of the Minimarket, Inc. stock in the property settlement agreement read as follows: "Betty shall receive $50,000 in exchange for her Minimarket, Inc. stock." On July 1, 2003, Minimarket, Inc. issued its check to Betty for $50,000 and Betty gave Joe her stock certificate and a stock power signed in blank. In January 2004, Joe sold all of his Minimarket stock for $50,000 to an unrelated third party. Between January 1, 2000 and January 2004, Minimarket operated at a break-even and did not pay any dividends.

A. What is the amount and nature of Betty's taxable income as a result of the foregoing transactions? Discuss.

B. What is the amount and nature of Joe's taxable income as a result of the foregoing transactions? Discuss.

C. What, if anything, could the parties have done to change the tax consequences without changing the non-tax economic result? Discuss.

Sample Question #7

Byron and Betty Smith, husband and wife, have come to you for estate planning and tax advice. They have four adult children and no other children, living or deceased. Each of their children is married. They have four minor grandchildren. They last revised their estate plan in 1999 upon the advice of their long time estate and trusts attorney, now deceased. They are vaguely aware of changes to the estate and gift tax law and seek your advice on whether their plan should be updated.

They are both in their early seventies, are lifelong California residents, and have been married for fifty years. All of their assets are community property, except for certain marketable securities that Byron inherited a year ago. The Smiths' net worth is $14,000,000.00 per the following financial statement, which reflects current fair market values for their assets, all owned free and clear:

	Husband's Separate Property	Wife's Separate property	Community property	Total Assets
Principal residence	0	0	$1,500,000	$1,500,000
Cash & marketable securities	$2,000,000	0	$10,500,000	$12,500,000
Total	$2,000,000	0	$12,000,000	$14,000,000

They recount the following advice received with regard to estate planning strategies:

A. Their prior attorney advised them to give $10,000 per year to each of their four grown children, the four spouses of their children, and four minor grandchildren. They have been giving a combined total of $120,000 per year, split equally among their children, the spouses of their children, and their grandchildren, for all years since 1999 through and including 2005. They wish to continue annual giving but want to make sure they are maximizing tax-free gifts to such persons.

B. Based on the advice of their prior attorney, they made a gift in 1999 of a community property asset worth $1,200,000 divided equally among their children. These gifts were adequately disclosed on timely filed gift tax returns for 1999 filed by each of Byron and Betty. Each spouse reported taxable gifts of $600,000 for the year. No prior or subsequent taxable gifts had been made.

C. After making the gifts described in paragraph B in 1999, they restated their revocable living trust (which holds all of the assets described above). As restated, the trust provides that, upon the death of the first spouse to die, the amount of the deceased spouse's remaining lifetime exemption (meaning the amount of such spouse's property that could pass free of estate taxation) would be distributed outright to their children in equal shares. The balance of the deceased spouse's assets would pass to a QTIP trust. The surviving spouse's share of the trust property would be distributed to a revocable Survivor's Trust. Upon the death of the surviving spouse, the QTIP Trust and the Survivor's Trust would be distributed to the Smith's children in equal shares. The Smiths wish to make sure that the surviving spouse is well provided for.

1. Are the Smiths maximizing annual gifts to their children and grandchildren? Discuss any other gifts that they could make this year and/or in the future without using any of their lifetime exemption.

2. **Discuss whether the Smiths have any remaining lifetime exemption and discuss any additional gifts that could be made this year and in future years without causing payment of gift taxes.**

3. **Assume that Byron would predecease Betty in 2005 or a subsequent year. Address whether and how their estate plan could or should be amended to maximize the assets available to Betty as the surviving spouse.**

Sample Question #8

On January 2, 2004, Al and Barbara formed a California limited liability company known as Admedia, LLC (the LLC) under California law. Prior to the formation of the LLC, each individual member as a sole proprietor had conducted his or her own separate advertising and media business, which was profitable. Neither of them personally have any net operating loss carry forwards. No election has or will be made for the LLC under the check-the-box regulations.

The operating agreement of the LLC applicable for all relevant periods contains clauses that fully satisfy the requirements of Treas. Reg. §1.704-1(b) relating to maintenance as original accounts, making of liquidating distributions strictly in accordance with positive capital account balances, and make up of capital account deficits.

The operating agreement contains the following two clauses:

"Any built-in gain, loss or deductions attributable to any item of property contributed to the limited liability company shall be shared so as to take account of the variation between adjusted tax basis to the LLC and its fair market value at the time of contribution by a member under the "traditional method" as permitted under Treas. Reg. §1.704-3, otherwise under the "traditional method with curative allocation" or, if not permitted under the traditional method with curative allocation, under the remedial allocation method as permitted by applicable Treasury Regulations." "Subject to any other provisions of this operating agreement and as may be required by applicable provisions of the Internal Revenue Code or regulations thereunder, including Treas. Reg. §1.704-1(b), net profits and net losses of company (determined on a book basis) shall be allocated and shared equally among the members."

On January 3, 2004, the two members contributed the following items of property (including cash) to the LLC with adjusted tax basis and fair market values on date of contribution as indicated:

Contributing Member	Description of Property	Adjusted Tax Basis	Fair Market Value
Al	Cash	$300,000	$300,000
Barbara	Computers with photo and film digitizing capabilities	$150,000	$200,000
Barbara	Cash	$100,000	$100,000
Total Tax Basis		$550,000	
Total Fair Market Value			$600,000

Before contribution of the computers to the LLC, Barbara had personally specially “remanufactured” the mother boards of the computers to greatly enhance their high resolution digitizing functions. As of January 3, 2004, the capital account of each member was “booked” to reflect the fair market value of the property contributed by the member.

After the initial contributions by its members, the LLC began to conduct an advertising and media consulting business. The LLC properly elected to use the cash method of accounting and the calendar year as its annual accounting period for both tax and book purposes. Cash flow is expected to be sufficient to cover all expenses and costs. The LLC does not intend to borrow or incur any financial liabilities. For a fee, the LLC produces print ads for magazines and film ads for television. It operates from a “virtual office” and thus incurs no rental or other occupancy expenses.

For the year ended December 31, 2004, the income statement of the LLC under the cash method of accounting properly computed on a Federal income tax and book basis is as follows:

Income Statement of Admedia, LLC
for Period Beginning January 2, 2004 and Ending December 31, 2004

	Federal Tax	**Book**
Income		
Fees collected from clients	$800,000	$800,000
Less		
Employee compensation and related expenses	<$180,000>	<$180,000>
Depreciation of computer (5 years under straight line)	$30,000	$30,000
Federal Tax Net Income	$590,000	
Book Net Income		$580,000

The balance sheet of the LLC for the year ended December 31, 2004 properly computed on both Federal tax and book basis is as follows:

Balance Sheet of Admedia, LLC
for the Year Ended December 31, 2004

		Federal Tax		**Book**
Assets				
Cash		$1,020,000		$1,020,000
Accounts Receivable		0		$100,000
Equipment	-$150,000		$200,000	
Less depreciation	<$30,000>	$120,000	<$40,000>	$160,000
Total Assets – Tax		$1,140,000		
Total Assets – Book				$1,280,000

Liabilities and Equity

	Tax	**Book**
Liabilities	0	0
Capital Accounts (before allocations for 2004)		
A	$300,000	$300,000
B	$250,000	$300,000
Cash Method Earnings for 2004 to be allocated among members	$590,000	$580,000
Uncollected Income for 2004 not yet reportable for tax as income (accounts receivable)		
Liabilities and Equity – Tax	$1,140,000	
Tax Liabilities and Equity – Book		$1,280,000

A. For Federal income tax purposes, determine and support with analysis the allocation between members of Admedia, LLC, of net income (or, as appropriate, items of gross income and deductions) for the year ended December 31, 2004.

B. For Federal income tax purposes, determine and support with analysis the year-end capital accounts balances for each member of Admedia, LLC, as of December 31, 2004.

Sample Question #9

Sunny "the Surfer" is a famous surfing celebrity trusted by surfers and the public for his skills and integrity. He is single, without any close family or designated heirs.

Two years ago, Sunny's father died. Sunny inherited from his father and owns:

A. A portfolio.

B. California real property known as Whiteacre, which is free and clear, as follows:

Whiteacre

Fair Market Value Today	$610,000
Fair Market Value as of the date of death of Sunny's father	$500,000
Difference	$110,000
Description and use of property	Unimproved held for investment

Sunny has received (but not yet accepted) an offer from a highly qualified buyer to purchase Whiteacre at the above fair market value, with closing of escrow to occur in 30 days. Sunny has made no improvements on Whiteacre.

Sunny paid $50,000 for an option to purchase Blueacre, title to be free and clear on closing, for $400,000 (without offset for option fee of $50,000). Blueacre is unimproved California coastal property on which Sunny wishes to build a dive-surf shop.

Sunny tells you (and you are to assume) that:

A. There is no brokerage commission on the sale of Whiteacre and the total of sales costs on Whiteacre (escrow, title, etc.) chargeable to the seller is $10,000.

B. In addition to the $400,000 option purchase price and the $50,000 option fee, the costs of the improvements to Blueacre (including architectural fees and permits) will be $400,000, but only $15,000 will be incurred before the building permit is issued.

C. The shortest possible time to complete the purchase and obtain approval of building plans on Blueacre will be at least seven months from the date of submission of Sunny's application for approval of such plans and the issuance of a building permit.

D. It will take at least another three months thereafter to build the dive-surf shop on Blueacre.

E. It will not take more than 12 months to obtain plan approval and complete construction on Blueacre.

F. The Surf Shop business will require start-up capital of $600,000 (including inventory, furniture and equipment, advertising and other selling expenses, and general overhead).

1. **What are the income tax consequences to Sunny if he sells Whiteacre for $610,000, assuming that he does not buy Blueacre but merely invests the sales proceeds? Discuss.**

2. **Assume that Sunny used the proceeds to buy Blueacre (after exercising the option to buy Blueacre) to construct the dive-surf shop, using part of his portfolio to pay for the balance of the cost of the improvements.**

   a. **Discuss whether any deferral of the gain on the sale of Whiteacre is applicable or not applicable and the reason for your conclusion.**

   b. **What is the adjusted tax basis in Blueacre (the dive-surf shop property)?**

Sample Question #10

Smith is owner of Whiz, Inc., an S Corporation ("Whiz"). Whiz was formed in 1995 as a computer game developer and was an accrual basis C Corporation until the end of 2001, when an S election was made effective January 1, 2002. Smith had a basis of $200,000 in his Whiz stock on December 31, 2001.

On December 31, 2001, Whiz's balance sheet showed the following:

December 31, 2001	**Book Value**	**Fair Market Value**
Cash	$250,000	$250,000
Accounts Receivable	$400,000	$400,000
Cost of Developed Game Software	$2,000,000	$10,000,000
Less: Amortization	($1,000,000)	
Goodwill	0	$5,000,000
Total Assets	$1,650,000	$15,650,000
Liabilities	$650,000	$650,000
Capital Stock	$200,000	$200,000
Retained Earnings	$800,000	$800,000
Value in Excess of Book		$14,000,000
Total Capital	$1,000,000	$15,000,000
Liabilities and Capital	$1,650,000	$15,650,000

On July 31, 2005, Whiz's balance sheet showed the following:

July 31, 2005	**Book Value**	**Fair Market Value**
Cash	$450,000	$450,000
Accounts Receivable	$450,000	$450,000
Cost of Developed Game Software	$3,000,000	$15,000,000
Less: Amortization	($2,000,000)	
Goodwill	0	$6,000,000
Total Assets	$1,900,000	$21,900,000
Liabilities	$900,000	$900,000
Capital Stock	$200,000	$200,000
Retained Earnings	$750,000	$750,000
Accumulated Adjustments	$50,000	$50,000
Value in Excess of Book		$20,000,000
Total Capital	$1,000,000	$21,000,000
Liabilities and Capital	$1,900,000	$21,900,000

On July 31, 2005, Big Company, whose shares are traded on the New York Stock Exchange, approached Smith with an offer to purchase all of the assets of Whiz for $21,900,000, followed by liquidation of Whiz. Big Company does not want to retain Smith as an employee. Big Company also wants Smith to sign a five year non-competition agreement. Smith is satisfied that the price is reasonable. Big Company has told Smith that it would try to accommodate his concerns about taxes payable as a result of the possible sale.

A. **If the asset sale proceeds as proposed, what are the taxable gains of Whiz and Smith?**

B. **Discuss the alternatives available to reduce the taxes payable by Whiz and Smith and the related benefits and detriments of each of the alternatives to Whiz, Smith, and Big Company.**

Sample Question #11

Mom and Dad own a 2-acre parcel of undeveloped real estate in North Hollywood ("Parcel"). Mom and Dad are in their late 60s and in good health. They have two children (twins), Brandon and Sabrina, finishing up their final year in graduate school. Brandon expects to graduate with a master's degree in Geriatrics. Sabrina expects to graduate with a master's degree in Hospital Administration. In addition to the real estate, Mom and Dad are financially secure and have rental properties and retirement income of approximately $5,000 a month.

Mom and Dad would like to be in a position to get additional cash flow from rental of the property after it is developed.

Brandon and Sabrina have suggested to Mom and Dad that they develop the undeveloped land with a brand new long-term nursing facility. Brandon and Sabrina would assist in managing the construction of the facility and would be the sole managing operators of the nursing home once it was opened for business. Assume that Brandon and Sabrina have sufficient funds to enable them to properly capitalize any entity that will operate the nursing home.

The parcel is worth approximately $4,000,000 and it will take another $3,000,000 to build the facility. A bank is willing to loan Mom and Dad $3,000,000 against the property to build the facility. Once the facility is built, it is estimated to have a fair market value of at least $9,000,000.

Mom and Dad will give Brandon and Sabrina each a 15% interest in the parcel, including any improvements for their services, but do not want their children to transfer any of their interest without the parent's consent.

The entire family has come to Lawyer for advice on how to structure the transaction. Assume the following:

A. Lawyer had previously prepared Mom and Dad's Estate Plan;

B. Mom and Dad want to go forward with Brandon and Sabrina's plan but want to make sure that their other assets are protected;

C. The parties expect a tax loss from the nursing home operations for the first year but a substantial net profit for the ensuing years that could fluctuate between $1,000,000 - $2,000,000 a year.

1. **Which members of the family could Lawyer represent in this transaction? Discuss.**

2. **What type of entity or entities should the family utilize for the construction stage and what changes, if any, should be made once the facility is ready to begin its operations as a nursing home? Please set forth the federal, state, and local tax consequences to all the parties for any entity elected. (Assume that there are no problems in representing the entire family in answering this part of the question.)**

3. **If the family were to set up a Family Limited Partnership to manage the construction and ultimate ownership of the parcel and improvements, how should Lawyer advise the partners to operate and manage the partnership such that it will be accepted for tax purposes (income and estate) upon the death of the parents?**

Sample Question #12

Dealmaker, Inc. ("Dealmaker") is a domestic C Corporation with its tax year ending December 31. As of January 1, 2004, it has no earnings or profits. All of Dealmaker's shares are owned by Mr. Deal. The basis in the shares of Dealmaker held by Mr. Deal is $50,000. Mr. Key is a key employee of Dealmaker. During 2004, Dealmaker arranged financing for Startup, Inc., a privately held corporation. Dealmaker received as compensation outright 100,000 shares of Startup, Inc. The shares of Startup, Inc., had no ascertainable value when received by Dealmaker. In the year 2004, Dealmaker had no other taxable income.

With the exception of the two extraordinary transactions described below, Dealmaker had no profits and losses nor changes in its earnings and profits for the taxable year ending December 31, 2005. On January 2, 2005, when the shares of Startup then were worth a total of $250,000, the following two extraordinary transactions took place:

A. Dealmaker transferred 50% of its shares of Startup (50,000 shares) to Mr. Deal.

B. Dealmaker transferred the other 50% of its shares of Startup (50,000 shares) to Mr. Key for $100,000 payable as follows: $5,000 down and Mr. Key's unsecured $95,000 note, payable to Dealmaker, bearing interest computed at the applicable long term federal rate payable interest. Interest is paid annually on December 31st of each year. The entire principal is due at the end of 20 years.

What are the federal and state tax consequences to all parties of:

1. **the 2005 transfer of 50,000 shares of Startup by Dealmaker to Mr. Deal? Discuss.**

2. **the 2005 transfer of 50,000 shares of Startup by Dealmaker to Mr. Key for $100,000 under the terms described above? Discuss.**

Application to take the Certified Legal Specialist Examination

Examination Date: October 27, 2015

Registration Deadline: October 1, 2015

You are eligible to take the examination if you have been practicing in the specialty area since January 2014. Registration with payment will guarantee your space in the test center. Registration fees are non-refundable, non-transferable, and applicable only to the October 2015 administration of the legal specialist examination.

State Bar Number: ____

We will communicate with you via your address, phone, and e-mail as provided in your "My State Bar Profile" under private contact information. To update your profile, visit www.calbar.ca.gov and log on with your State Bar username and password. For assistance with updating your profile, contact Member Services at (888)800-3400.

Examination Registrant's Name: ______________________________________

1. Subject Matter

Examination for which you are registering (Please check one box):

- ☐ Admiralty & Maritime
- ☐ Appellate – Civil
- ☐ Appellate – Criminal
- ☐ Bankruptcy
- ☐ Criminal – State
- ☐ Criminal – Federal
- ☐ Estate Planning, Trust & Probate
- ☐ Family
- ☐ Franchise & Distribution
- ☐ Immigration & Nationality
- ☐ Legal Malpractice
- ☐ Taxation
- ☐ Workers' Compensation

2. Test Center

- ☐ Southern California (Pasadena Convention Center)
- ☐ Northern California (Oakland Convention Center)

3. Choose Handwriting or Laptop/Netbook

Please read the laptop/netbook bulletin available at www.californiaspecialist.org which sets forth the requirements for using a laptop/netbook to take the examination.

I wish to take the essay portion of the examination using the following method (check one):

- ☐ Handwriting
- ☐ Typing on Laptop/Netbook. (Please review and sign the Release of Liability Form on page 3).

4. Payment Options

The following payment is enclosed (check one):

- ☐ Enclosed Check made payable to The State Bar of California
- ☐ Enclosed Money Order made payable to The State Bar of California
- ☐ MasterCard or Visa (complete and sign the credit card authorization form on the last page)

5. Source

How did you learn about the legal specialization program? (check all that apply)

- ☐ A colleague
- ☐ State Bar Website
- ☐ Information booth at conference: ______________________________
- ☐ Mailing or e-mail to State Bar of California section members
- ☐ California Bar Journal
- ☐ Other: ______________________________

The undersigned states:

- I am an active member of The State Bar of California.
- I understand that the examination is the first step in the certification process and that if I am successful on the examination, I will be required to file an application for certification with the appropriate fee demonstrating compliance with all other requirements of the legal specialization program, including education, tasks and experience, and recommendations, on or before April 27, 2017 before my application can be considered by the California Board of Legal Specialization.
- I am aware that the requirements for becoming a certified specialist are set forth in the Rules and Standards available at www.californiaspecialist.org and that the California Board of Legal Specialization recommends that I review these rules prior to applying to be sure that I can meet the requirements by January 31, 2019, if I have not fulfilled these requirements prior to taking the examination. After that date, the examination results will no longer be valid and I will need to take the examination again to continue with the recertification process.
- I understand that the program is self-funded, and, if certified, I will be required to pay an annual fee and to recertify every five years, though I will not need to take the examination again.
- I understand that any and all fees related to this examination are non-refundable, non-transferrable, and applicable only to the 2015 Legal Specialization examination and not any future examination.
- I understand that failure to make a truthful disclosure of any fact or item of information required may result in denial of my registration, revocation of my certificate of specialization, if granted, or referral to disciplinary investigation by The State Bar of California.

I have carefully read the foregoing and declare, under penalty of perjury under the laws of The State of California, that the information I have provided is true and correct.

Executed on ____________________ at ______________________________________ , California
(Date) *(City and/or County)*

Signature ____
(Please print and manually sign this document or use Adobe's e-signature function.)

Before mailing, please check to see if you have:

1) Answered all questions.
2) Signed this registration application and if you plan to use a laptop, the Release of Liability.
3) Enclosed payment or filled in the attached credit card authorization form.

Mail or fax application and payment to:

Mail: Department of Legal Specialization
The State Bar of California
180 Howard Street
San Francisco, CA 94105
-or-
Fax (with Credit Card Payment Page):
415-538-2180.

You will receive an e-mail confirmation and receipt when your application has been processed.
THANK YOU!

CALIFORNIA BOARD OF LEGAL SPECIALIZATION

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RELEASE OF LIABILITY – LAPTOP COMPUTER PROGRAM

I, ___________________________________ , acknowledge that the California Board of Legal Specialization of the State Bar of California (Board) is allowing examination applicants to use personal laptop computers with pre-installed SofTest software from ExamSoft (Software) to take examinations administered by the Board. I understand that the use of personal laptop computers is offered by the State Bar of California (State Bar) as a convenience to me and that the State Bar does not warrant or guarantee said Software. I agree to bear sole responsibility for the use of said Software and I hereby release the State Bar (its Board of Trustees, officers, agents, representatives and employees, as the same may be constituted now and from time to time hereafter), including the Board, from all liability, claims, damages, or demands for personal injury or property damage, arising from or related to my use of a personal laptop computer during the examination. I further acknowledge that the State Bar does not warrant or guarantee the Software nor does it accept any liability in the event there is a technical or mechanical failure of the personal laptop computer and all associated equipment, Software and/or associated materials during administration of an examination, the uploading of my examination answers, or in the printing of my examination answers.

I will accept the use of SofTest under the provisions of the ExamSoft click license at the ExamSoft website and agree to be bound by its terms and conditions. By my election to use a personal laptop computer to take an examination administered by the Board, I also agree to begin or continue the examination by handwriting in the event there is any malfunction, or issue with access to, the computer, Software, electrical system or such other items associated with administration of the examination; and, understand I will not receive a refund of the fees I paid to use my laptop computer if any of these events should occur. I agree: 1) that I will exit the exam file upon the conclusion of each examination session; 2) that I will not attempt to access my exam file(s) following the examination for the purpose of altering my answers; 3) that I will upload the exam file(s) that contain the examination answers, which I completed during the examination, by the published deadline; 4) that a deduction of ten scaled points will be taken from my total written scaled score if I fail to upload my answer file(s) by the published deadline and, 5) that I will receive a grade of zero (0) for each answer not uploaded timely if I fail to upload my answer file(s) within two (2) weeks of the published deadline.

Date of Examination Administration: October 2015 Legal Specialist Examination

Bar Number: ____

Applicant Name (please print): ____

Applicant Signature: ____

(Please print and manually sign this document)

Date: ____

The State Bar of California
Board of Legal Specialization
Legal Specialist Examination
Payment Page

Bar Number: ______________________________

Name: ______________________________

Legal Specialization Examination Fees if valid payment is received between

September 2, 2015 and October 1, 2015: (please select one)

☐ **$600** - Examination registration without laptop fee

☐ **$750** - Examination registration with laptop fee (applies to Registrants who wish to type the essay portion of the exam on their laptop/notebook rather than handwrite answers)

Payment Options:

☐ Check made payable to The State Bar of California

☐ Credit Card – Complete and return Credit Card Authorization below

Credit Card Authorization:

☐ Visa

☐ MasterCard

Only Visa and MasterCard credit cards are accepted.

Credit Card Number: ______________________________

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Name on Card: ______________________________

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Signature: ______________________________ Date: ______________

(Please print and manually sign this document)

By my signature on this document, I hereby authorize The State Bar of California to charge my Visa or MasterCard account for the amount that I have entered in the "total" box above. Registration fees are non-refundable, non-transferable, and applicable only to the Legal Specialist Examination to be administered in October 2015.