

In recent years the Indiana Bar Exam questions that are tax related have dealt with the following issues. Some, but not all, questions had both income and estate or gift tax issues presented in the same fact pattern. Some had estate planning or business planning issues intertwined with other tax related questions. Be alert to the possibility that multiple disciplines may be presented in one question. The following is an unscientific rundown of the issues in no particular order.

What is income -5

Basis -6

Damage awards -1

Cancellation of debt income-1

Hobby vs. business -1

Alimony -2

Estate tax -4

Special use valuation -1

Capital gain on sale of residence -2

Gift tax exclusions and exemptions 2

Gift vs. income-1

Gambling earnings -1

Capital gains -2

(1) In this situation, both the client and the lawyer have income in the amount of \$500. The Internal Revenue Code defines gross income very broadly. Gross income is all income from whatever source derived unless specifically exempted. Receiving services is included in income. When services are exchanged for other services, the value of each service is presumed to be the same. The lawyer performed \$500 worth of services; thus the value of the drywalling is presumed to be worth \$500. In this situation, the client received legal services worth \$500 and the lawyer received work in his basement worth \$500. Thus, both have income in the amount of \$500.

(2) Section 104 deals with the exclusion from income of damage awards that arise out of "personal physical injuries." If the injury is a result of such an event, all of the damage awarded, with the exception of punitive damages, is excluded from income. It makes no difference that the amount is arrived at as a result of a settlement instead of an award by the court or a jury. In the fact situation at hand the medical expenses of \$2,400 and lost wages of \$1,200 are excluded. The problem arises because the settlement is unallocated. Rev. Rul. 58-418 addressed the allocation the Service may make between the compensatory damage portion and the punitive damage portion of an unallocated settlement award. The Service noted that the taxpayer's complaint constituted the best evidence available to determine the proper allocation. Applied to this situation the balance of the settlement proceeds would be taxable as punitive damages. Note that the facts situation states that there was pain and suffering. If an amount had been allocated to that in the award, it would have been excluded as well.

(3) In this situation the contestant would have \$30,200 in gross income. The Internal Revenue Code defines income very broadly, and includes prizes in the definition of gross income. The amount of income is equal to the fair market value of the goods received. Thus, winning an automobile worth \$25,000 results in \$25,000 of income. Likewise, winning a trip worth \$4,200 results in \$4,200 of income. The fair market value of cash is equal to the amount of cash; thus the contestant also has \$1,000 of income. In certain well-defined situations, prizes are not included in income. Deductions and exclusions from income are to be construed narrowly. Prizes won will not be included in income if the prize was received due to scientific, literary, or similar achievement and the prize is donated to charity. Winning a game show is not like winning the Nobel Prize, and there is no indication that the contestant plans on donating the prizes. Thus, the contestant has \$30,200 in income.

(4) In this situation, the individual would have \$6 million of income. Lottery winnings are similar to prizes in that both are included in income. The individual should also qualify for a charitable deduction. Charitable deductions are limited to either 50% or 30% of gross income depending on the charity receiving the gift and the form of the gift. Any charitable deductions disallowed may be carried forward to following tax years. The Methodist church and United Way qualify as charitable entities providing assistance to candidates running for office. In this situation, the individual should be entitled to a \$3 million deduction, unless the church or United Way only qualify for a 30% deduction. Then, any unused deduction may be carried forward.