

# **Bus 225H – Taxation of Property Transactions**

## **Professor Nellen**

**Early Spring 2009**

|                         |   |
|-------------------------|---|
| <b>Office Location:</b> | Main campus: BT 955   |
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| <b>Office Hours:</b>    | 20 minutes before and after class and by appointment; you can also email your instructor with questions                   |
| <b>Class Days/Time:</b> | Mondays 1/5, 1/12, 1/26, 2/2, 2/9, 2/16, 2/23<br>Tuesday 1/20<br>Saturdays 1/31 and 2/21                                  |
| <b>Prerequisites:</b>   | Bus 223A – Tax Research   |
| <b>Course website</b>   | <a href="http://www.cob.sjsu.edu/nellen_a/bus225H_reading.html">http://www.cob.sjsu.edu/nellen_a/bus225H_reading.html</a> |

### **Course Description**

Tax aspects of property transactions: real estate, intangibles, tangible property. Other topics include Corn Products, Arkansas Best, Arrowsmith court doctrines, passive activity losses, like kind exchanges and involuntary conversions, patents, and franchises, etc.

### **Student Learning Objectives**

- To understand the various definitions relevant to the taxation of property transactions.
- To understand the various types of tax rules that can apply to the purchase, creation, ownership and disposition of property.
- To learn considerations in advising on the tax treatment and planning options for property transactions.
- To critique various proposals that would change a current rule on the taxation of property.

## Required Readings

The reading materials are available online at:

[http://www.cob.sjsu.edu/nellen\\_a/bus225H\\_reading.html](http://www.cob.sjsu.edu/nellen_a/bus225H_reading.html)

You will also need access to either RIA Checkpoint or CCH (available from your instructor).

## Grading

Grades will follow the pattern of 90% or higher for an A, 80% or higher for a B, 70% or higher for a C, etc. Plus and minus grades will be used for scores within two percentage points of the grade breakpoint.

| Assignment         | Points |
|--------------------|--------|
| Quizzes (2)        | 20     |
| Research questions | 100    |
| Final exam         | 80     |
| Total              | 200    |

## Professor Nellen's Philosophy for Graduate Tax Study

- The best way to learn the material is to actually apply it.
- Students can learn from working with fellow students in small groups to try to solve problems and come up with solutions and planning ideas. Everyone thinks and approaches problems differently and has something to offer to the group.
- Students must come to class prepared in order to get the most of out class discussions and to be an effective group member.
- Signing up for a class means that the student is committed to devoting the requisite time to successfully complete the course and contribute to class discussions. Missing a class should be a rare and unusual event.
- Graduate-level study should be challenging!

## University Policies

### Academic integrity

Students should know the University's Academic Integrity Policy that is available at

[http://www.sa.sjsu.edu/download/judicial\\_affairs/Academic\\_Integrity\\_Policy\\_S07-2.pdf](http://www.sa.sjsu.edu/download/judicial_affairs/Academic_Integrity_Policy_S07-2.pdf)

Your own commitment to learning, as evidenced by your enrollment at San Jose State University and the University's integrity policy, require you to be honest in all your academic course work. Faculty members are required to report all infractions to the office of Student Conduct and Ethical Development. The website for Student Conduct and Ethical

Development is available at  
[http://www.sa.sjsu.edu/judicial\\_affairs/index.html](http://www.sa.sjsu.edu/judicial_affairs/index.html)

Instances of academic dishonesty will not be tolerated. Cheating on exams or plagiarism (presenting the work of another as your own, or the use of another person's ideas without giving proper credit) will result in a failing grade and sanctions by the University. For this class, all assignments are to be completed by the individual student unless otherwise specified. If you would like to include in your assignment any material you have submitted, or plan to submit for another class, please note that SJSU's Academic Policy F06-1 requires approval of instructors.

Be sure to read the following additional information on academic integrity and avoiding plagiarism from Professor Nellen at:

[http://www.cob.sjsu.edu/nellen\\_a/ClassInfo.html#Integrity](http://www.cob.sjsu.edu/nellen_a/ClassInfo.html#Integrity)

### **Campus Policy in Compliance with the American Disabilities Act**

If you need course adaptations or accommodations because of a disability, or if you need to make special arrangements in case the building must be evacuated, please make an appointment with me as soon as possible, or see me during office hours. Presidential Directive 97-03 requires that students with disabilities requesting accommodations must register with the DRC (Disability Resource Center) to establish a record of their disability.

### **SJSU Writing Center**

The SJSU Writing Center is located in Room 126 in Clark Hall. It is staffed by professional instructors and upper-division or graduate-level writing specialists from each of the seven SJSU colleges. Our writing specialists have met a rigorous GPA requirement, and they are well trained to assist all students at all levels within all disciplines to become better writers. The Writing Center website is located at  
<http://www.sjsu.edu/writingcenter/>

## Course Schedule

The course website has the reading posted for each class meeting.

| Class | Date   | Topics, Research Question Due Dates and Final Exam Date   |
|-------|--------|---|
| 1     | 1/5/09 | Introduction to the course<br>Introduction to the topic<br>What is property?<br>Property classifications<br>Depreciation/MACRS basics<br>Forms of ownership   |
| 2     | 1/12   | Basis <ul style="list-style-type: none"> <li>▪ Basis of property – general and special rules</li> <li>▪ Relevance of debt</li> <li>▪ Capitalization basics</li> <li>▪ Adjustments to basis other than depreciation (credit adjustments, casualty losses, other)</li> </ul> DUE – Research Question #1   |
| 3     | 1/20   | Acquisitions/Dispositions/Other Transfers – Part 1 <ul style="list-style-type: none"> <li>▪ Definitions</li> <li>▪ Calculations</li> <li>▪ Acquisitions</li> <li>▪ What is a sale and its significance?</li> <li>▪ Relevance of debt</li> <li>▪ Abandonment</li> <li>▪ Worthlessness</li> <li>▪ Exchanges</li> </ul> DUE – Research Question #2 and 3 |
| 4     | 1/26   | Effects of Debt on Property Transactions <ul style="list-style-type: none"> <li>▪ Effects of debt related to property</li> <li>▪ COD income and its relevance to property transactions</li> <li>▪ Workouts</li> <li>▪ Planning considerations</li> </ul>  |

|    |      |  |
|----|------|--|
| 5  | 1/31 | <p>Capital Assets</p> <ul style="list-style-type: none"> <li>▪ Definition</li> <li>▪ Significance</li> <li>▪ <i>Corn Products</i> and its progeny</li> <li>▪ Tax policy and capital gains</li> <li>▪ IRC §1202 and §1045</li> </ul>  |
| 6  | 2/2  | <p>Special Types of Assets</p> <ul style="list-style-type: none"> <li>▪ §197 intangibles</li> <li>▪ Domain names</li> <li>▪ Carbon offsets and emission allowances</li> <li>▪ GAAP and IFRS</li> <li>▪ Intangibles and other types of taxes</li> </ul> <p>DUE – Research Question #4</p>   |
| 7  | 2/9  | <p>Acquisitions/Dispositions/Other Transfers – Part 2</p> <ul style="list-style-type: none"> <li>▪ Sale of an entire business</li> <li>▪ Deferred sales – installment sales, OID</li> <li>▪ Loss limitations including §469</li> <li>▪ Related party transactions</li> <li>▪ Rescissions</li> <li>▪ Reporting obligations</li> <li>▪ Leases</li> </ul> <p>DUE – Research Question #5</p> |
| 8  | 2/16 | <p>Special Rules on Exchanges, Conversions and Sales</p> <ul style="list-style-type: none"> <li>▪ §121 sale of a principal residence</li> <li>▪ §1031 like-kind exchanges</li> <li>▪ §1033 involuntary conversions</li> <li>▪ §1041 transfers incident to divorce</li> <li>▪ Other tax-deferred transactions</li> </ul> <p>DUE – Research Question #6</p>                                |
| 9  | 2/21 | <p>Special Rules on Exchanges, Conversions and Sales – continued</p> <p>Property tax basics</p> <p>Review for final exam</p> <p>DUE – Research Question #7</p>   |
| 10 | 2/23 | <p>Final Exam</p>  |

## Research Questions

Be sure to state your authority for your answers. Typically, answers should be 1 – 2 pages in length.

1. Sprague Software Company is growing. It plans to expand to the office next door that was recently vacated. It has purchased some special partitions for the new cubicles. The partitions are taller than usual (but don't quite reach the ceiling) and must be specially bolted to the floor. They have a special feature that allows wiring (such as for computers) to be hidden in the partition wall. What is the depreciable life of the partitions? [10 points]
  
2. For 1998, President Clinton's budget included requiring use of the average cost basis for securities. This means that if a taxpayer acquired substantially identical securities, he would determine his basis in any of the securities sold by using the average. For example, if Sam purchased 100 shares of X Corporation stock on June 1, 2008 for \$40 per share and then purchased another 100 shares on December 31, 2008 at \$30 per share, the basis of the shares would be \$35 per share. To determine if the gain or loss from a sale was long-term or short-term, a FIFO approach would be used. This proposal was not enacted.

List and explain two good reasons to support this proposal and two good reasons to oppose it. [10 points]

3. Abigail has a \$3 million investment portfolio. She regularly pays commissions on stock trades to her brokerage firm. She also pays about \$25,000 to an investment adviser who helps her manage her funds. Abigail has been treating the \$25,000 as a miscellaneous itemized deduction but at a recent stockholder's meeting, she overheard someone say such costs should be added to the basis of her stocks via a §266 election. May Abigail do that? Explain. [15 points]
  
4. A few years ago, Brad discovered some domain names, such as [www.business taxation.com/](http://www.business taxation.com/) that had either expired or were unclaimed. He thought some might have value someday so he registered 7 names. Brad had a few listed for sale on eBay, but didn't sell one until October 2008. The sales price was \$5,400 and he had purchased the name for \$800. What is the character of Brad's gain? [15 points]
  
5. Do any of the following activities generate income subject to self-employment tax (§1402) for the individual who owns the property and activity? [15 points]
  - a. Gary owns 1 rental property – a single family residence. He takes care of repairs and gardening. He has no other rentals.
  - b. Samantha owns two condos at Malibu Beach. Tenants tend to stay for a few weeks. Samantha provides daily shuttling of tenants from the rental property

to a nearby shopping mall. She also takes care of the gardening and provides laundry service if tenants ask for it.

- c. Jane owns a self-storage business. Tenants can rent lockers of two different sizes. Jane provides the janitorial services. Tenants are responsible for the security of their stored items. Jane makes sure that the building that houses the storage lockers remains locked.

6. During the current year, Seller sold its business to Buyer. The assets transferred and their basis and FAM at date of sale was:

| Asset                  | Adjusted Basis | FMV       |
|------------------------|----------------|-----------|
| Inventory              | \$56,000       | \$69,000  |
| Supplies               | \$4,000        | \$4,500   |
| Equipment              | \$34,000       | \$78,000  |
| Building               | \$230,000      | \$510,000 |
| Land                   | \$400,000      | \$520,000 |
| Off-the-shelf software | \$0            | \$2,000   |
| In-process R&D         | \$0            | \$34,000  |
| Patent                 | \$0            | \$42,000  |
| Customer list          | \$0            | \$11,000  |

Seller originally paid \$80,000 for the software, \$100,000 for the equipment, \$380,000 for the building, and \$180,000 for the land. Seller created the in-process R&D, patent and customer list.

The parties also entered into a covenant not to compete payable \$25,000 per year over the next 4 years. The total purchase price (excluding the covenant) was \$2,300,000. [25 points]

- Assume that Seller is an S corporation. For each asset transferred, state the amount and character of the gain or loss. Also state which §1060 category (I – VII) that the asset falls within.
- Would your answer to (a) change if Seller were a C corporation? Explain.
- Assume you are a Revenue Agent auditing this transfer. List three important items you would want to look into and why.
- May Seller account for this sale using the installment sale method? Explain how it would or would not work.
- Write a letter to Buyer explaining the additional form they must attach to their return for the year of sale.

7. In 1990, Mr. and Mrs. Smith purchased their first home at a cost of \$30,000. In 2009, they sold the home. What is the tax effect to the Smiths in the following possible scenarios: [10 points]
- a. They sell the home for \$300,000
  - b. They sell the home for \$720,000
  - c. They rent out the house for 1 year prior to selling. The sales price is \$340,000 and they claimed \$1,000 of depreciation prior to sale.
  - d. They rent out the house for 1 year prior to moving into it. The sales price is \$400,000, depreciation claimed was \$1,000 and they lived in the home for 2 years 5 months prior to selling it.