



# The State Bar of California

## **2023 LEGAL SPECIALIST EXAMINATION Preparation Packet**

**Examination Date: October 24, 2023**

Legal Specialization Area:  
**TAXATION LAW**

This packet contains key information you will need to prepare for the 2023 Legal Specialist Examination:

- Examination Action Plan
- Exam specifications listing topics that may be tested
- Free sample essay questions (multiple-choice questions are not released)

For full details, please visit [Exam Information](#).

## 2023 LEGAL SPECIALIST EXAMINATION ACTION PLAN

### A. Start Today:

1. **Register** for the Legal Specialist Examination today in the [Admissions Applicant Portal \(Applicant Portal\)](#). Registration closes on **September 15**.
2. **Review** this packet for an overview and visit [Becoming a Certified Specialist](#) for eligibility requirements, current exam information, and other important dates and deadlines.

### B. Know the Exam:

1. **Format:** The Legal Specialist Examination is a single-day exam that consists of eight short essay questions and 75 multiple-choice questions and tests whether an attorney has a proficient understanding of the key laws, rules, and procedures applicable to that area of law.
2. **Exam topics:** See enclosed exam specifications.
3. **Exam practice:** See enclosed sample essay questions. No sample answers are available for the essay questions, and no multiple-choice questions are released for practice.
4. **Ensure that your laptop is ready before exam day:** Applicants should take the two mock exams on the laptop that they will use on exam day **prior** to exam day.
5. **Other certification requirements:** Review the other task, education, and experience requirements in the post-exam application for initial certification. You may have already met many of the requirements, or you can continue to meet them through January 31, 2027.

### C. Prepare for Exam Day

1. **Applicants must login into the exam by the posted password release time of 8:00 a.m.** so that you have enough time to verify your identification and start your laptop.
2. **Items allowed in the exam room:**  
Please review the [exam bulletin](#) for a list of items that are allowed in the exam room before the exam.

While most applicants will not be allowed to bring reference books into the exam room, those taking the exams in the following four specialty areas have the option to bring in one of the following code books if they wish to do so (annotated or unannotated version):

- **Bankruptcy Law:** Bankruptcy Code and Rules
- **Estate Planning, Trust & Probate Law:** California Probate Code

- **Immigration & Nationality Law:** Immigration & Nationality Act only (NOT regulations)
- **Taxation Law:** Internal Revenue Code only (NOT regulations)

## TAXATION LAW Examination Specifications

**Purpose of the Exam:** The Taxation Law Legal Specialist 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:

<p><b>Subject Area 1: Professional Responsibility</b></p> <p>1.1 Duties to clients, opposing counsel, and the Court</p> <p>1.2 Bases for attorney’s fees</p> <p>1.3 Circular 230 and standards of practice</p> <p>1.4 Fee agreements</p> <p>1.5 Conflicts and dual representation</p> <p>1.6 Conduct resulting in discipline or sanctions</p>	<p><b>Subject Area 2: Taxation Litigation and Procedures</b></p> <p>2.1 Administrative Procedures</p> <p>2.2 Jurisdiction</p> <p>2.3 Choice of forum/appeals</p> <p>2.4 Statute of limitations</p> <p>2.5 Penalties</p> <p>2.6 Refunds—administrative claims and litigation</p> <p>2.7 Collection matters</p> <p>2.8 Reporting of foreign assets</p>
<p><b>Subject Area 3: Individual Income Taxation</b></p> <p>3.1 Compensation, benefits and other income</p> <p>3.2 Exclusion from income</p> <p>3.3 Business and personal deductions</p> <p>3.4 Characterization of income, gains and losses</p> <p>3.5 Determination of basis</p> <p>3.6 Loss limitations</p> <p>3.7 Charitable deductions</p> <p>3.8 Grantor trusts</p> <p>3.9 Reporting of foreign assets</p>	<p><b>Subject Area 4: Corporate Income Taxation</b></p> <p>4.1 Formation/Choice of entity</p> <p>4.2 Operation</p> <p>4.3 Distributions</p> <p>4.4 Reorganization/liquidation</p>
<p><b>Subject Area 5: Partnership and pass-through entity income</b></p> <p>5.1 Formation/Choice of entity</p> <p>5.2 Operation</p> <p>5.3 Reorganization/liquidation</p> <p>5.4 Check-the-box regulations</p> <p>5.5 Partner and partnership basis</p>	<p><b>Subject Area 6: Real Estate Taxation</b></p> <p>6.1 Acquisition</p> <p>6.2 Development</p> <p>6.3 Exchanges, involuntary conversions and dispositions</p> <p>6.4 State and local property taxes</p>

<b>Subject Area 7: Estate, Gift &amp; Fiduciary Income</b>	
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<b>Tax</b>	
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| 7.1 | Estate and Gift Tax Planning                          |  |
| 7.2 | Generation skipping planning                          |  |
| 7.3 | Marital deduction planning and Portability            |  |
| 7.4 | Valuation issues                                      |  |
| 7.5 | Includable/excludable items                           |  |
| 7.6 | Post-mortem planning                                  |  |
| 7.7 | Taxation of and distributions from estates and trusts |  |

**TAXATION LAW**  
**Sample Essay Questions**

Below are actual questions from past examinations. 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.

**Sample Legal Specialist Examination Question #1**

Husband and Wife owned 100% of Construction Company, a California corporation engaged in the development of commercial property. Construction Company had a 401(k) plan. Husband was a full time employee of Construction Company and had approximately \$300,000 in his 401(k) plan as of December 31, 2003. Wife did not work and has never worked at Construction Company.

Husband had a 50% community property interest in the shares of Construction Company and will reach age 70 during 2003. He had no plans to retire, but would like to meet with Attorney to discuss retirement planning.

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

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

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

Husband and Wife intended to contribute cash of \$500,000 or stock of Construction Company with a value of \$500,000 to the newly established private foundation. Husband and Wife had a basis of \$2,500 in the shares of stock that would be contributed to the foundation.

**A. What advice should Attorney provide to Husband about his 401(k) plan?**

- B. Discuss the approach Attorney should take to the Construction Company employment tax case.**
- C. Which asset should be contributed to the private foundation? Discuss.**

**END OF QUESTION**

## Sample Legal Specialist Examination Essay Question #2

Company 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 Company's shares are owned by Owner. The basis in the shares of Company held by Owner is \$50,000. Employee is a key employee of Company. During 2004, Company arranged financing for Startup, Inc., a privately held corporation. Company received as compensation outright 100,000 shares of Startup, Inc. The shares of Startup, Inc. had no ascertainable value when received by Company. In the year 2004, Company had no other taxable income.

With the exception of the two extraordinary transactions described below, Company 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:

- Company transferred 50% of its shares of Startup (50,000 shares) to Owner.
- Company transferred the other 50% of its shares of Startup (50,000 shares) to Employee for \$100,000 payable as follows: \$5,000 down and Employee's unsecured \$95,000 note, payable to Company, bearing interest computed at the applicable long term federal rate payable interest. Interest is paid annually on December 31<sup>st</sup> 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 the following?**

- A. 2005 transfer of 50,000 shares of Startup by Company to Owner? Discuss.**
- B. 2005 transfer of 50,000 shares of Startup by Company to Employee for \$100,000 under the terms described above? Discuss.**

**END OF QUESTION**

### Sample Legal Specialist Examination Essay Question #3

Father 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, his sole heir. Both Father and Daughter are U.S. citizens residing in California. Father shows Attorney the following list of his assets:

**Father'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
Father's House	\$500,000	\$100,000	\$400,000	\$80,000
Triplex Apartment Rental	\$275,000	\$50,000	\$225,000	\$50,000
<b>TOTALS</b>	<b>\$1,000,000</b>	<b>\$350,000</b>	<b>\$650,000</b>	<b>\$130,000</b>

Father tells Attorney 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. Father would like to transfer his house to Daughter, but he has not yet done so and seeks Attorney's advice. Father tells Attorney, and Attorney assumes, that property values are going to remain stable and not change at least well past Father's death, and that Daughter has agreed that Father can continue to live alone in the house as his principal residence without paying rent until his death (unless Attorney advises otherwise), and Daughter will pay the real property taxes and other expenses of owning the house. Following the end of Father's occupancy of the house, Daughter intends to occupy the house as her principal residence.

- A. Discuss the estate and gift tax aspects of Father's transferring the house to Daughter as a gift versus leaving it to her as a bequest.**
- B. Discuss the positive and negative income tax aspects of Father's transferring the house to Daughter as a gift versus leaving it to her as a bequest.**
- C. If Father should die before he transfers any real estate, discuss what the California real property tax consequences to Daughter will be when she inherits the house and triplex.**

**END OF QUESTION**

## Sample Legal Specialist Examination Essay Question #4

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

Mother and Father would like to be in a position to get additional cash flow from rental of the Parcel after it is developed.

Son and Daughter have suggested to Mother and Father that they develop the Parcel with a brand new long-term nursing facility. Son and Daughter would assist in managing the construction of the facility and would be the sole managing operators of the nursing home once it opens for business. Assume that Son and Daughter have sufficient funds to enable them to properly capitalize any entity that will operate the nursing home.

The Parcel is worth approximately \$4 million and it will take another \$3 million to build the facility. A bank is willing to loan Mother and Father \$3 million 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 million.

Mother and Father will give Son and Daughter 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 Attorney for advice on how to structure the transaction. Assume the following:

1. Attorney had previously prepared Mother and Father's Estate Plan;
2. Mother and Father want to go forward with Son and Daughter's plan but want to make sure that their other assets are protected;
3. 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 -\$2 million a year.

**A. Which members of the family could Attorney represent in this transaction? Discuss.**

**B. 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.)**

- C. 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 Attorney 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?**

**END OF QUESTION**