

Exemplify Template Password:

**Income Taxation I
Bogdanski**

Fall 2018

WRITE YOUR EXAM NUMBER HERE: _____

**FINAL EXAMINATION
(Three and a half hours)**

INSTRUCTIONS

This examination consists of 36 multiple-choice questions (Questions 1 through 36) and two essay questions (Questions 37 and 38). An hour and a half (90 minutes) is recommended for the multiple choice questions, and two hours is recommended for the two essay questions (one hour per essay question).

In determining grades, each multiple choice question will count for 1 point, and each essay question will count for 24 points. Therefore, you should budget your time according to the allocation just given. Experience has shown that failure to budget one's time appropriately can result in a drastic lowering of one's overall grade on this examination.

For the multiple choice questions, you must submit your answers using Exemplify. You may write the answers to the essay questions either on Exemplify or by hand. If you choose to write the essay answers by hand, you must write them in the bluebook(s) you have been provided, and return the bluebook(s) along with the hard copy of the essay questions.

At the end of the exam, all students must return the hard copy of the essay questions in the envelope in which it came. However, no credit will be given for anything written on the hard copy of the essay questions. Only your electronic answer file (and bluebook(s), if any) will be graded.

For the multiple choice questions, choose the best answer to each question posed. Choose one, and only one, answer to each question. Although an incorrect answer earns no credit, there is no penalty for an incorrect answer on the multiple choice questions, so it is in your interest to answer every question, guessing if necessary.

In the essay questions, pay close attention to the final portion, or "call," of each question. Failure to respond to the matters called for will result in a low score for the question. On the other hand, discussion of matters outside the scope of the call of the question will not receive credit. In your essays, be sure to explain as thoroughly as possible your answers to the questions posed. Your reasoning, discussion, and analysis are often as important as any particular conclusion you reach.

Unless otherwise specified, assume that all of the transactions and events described in the questions take place in 2018, all taxpayers described in the questions are individuals, and they report their income on the cash method and the calendar year for federal income tax purposes. Any references to the "Code" mean the Internal Revenue Code of 1986, as amended.

QUESTION 37
(One hour)

Miles owns and operates Now, a nightclub in a large metropolis. Fire inspectors from the city government regularly visit Now, and they frequently cite Miles for alleged violations of the local building code. Miles hires a prominent attorney, Bettina, to advise Miles on his rights, as a property and business owner, in dealing with the city. Miles pays a substantial fee to Bettina for this advice.

During the holiday season, Miles sends Bettina a case of expensive whiskey, along with a note that reads, "To my good friend and advisor, with warm regards." The whiskey has a fair market value of \$3,500 at the time Miles transfers it to Bettina. Miles purchased the whiskey at wholesale the previous year for \$2,500, and Miles deducted the cost as a business expense at that time.

The visits from the fire inspectors continue for many months, with new violations being asserted on each visit. Tiring of this routine and perceiving that he is being singled out for unfair treatment, Miles offers Charles, the head fire inspector, a \$10,000 cash bribe, which Charles accepts. At that point, the visits from the inspectors cease.

On a slow night at Now, Miles meets an artist, Vivek. Miles allows Vivek to use space upstairs from Now as an art studio and storage space. Miles does not require Vivek to pay cash rent. However, Vivek transfers to Miles three murals for installation on the walls of Now. Miles considers the murals to have a value of \$5,000 each, but on an open public market, the murals would sell for \$12,000 each.

What are the federal income tax consequences *to Miles* of each of the transactions and events just discussed, with *and* without any available elections? Be sure to discuss the amount, timing, and character (ordinary or capital) of *each* item of income, gain, loss, deduction, or credit, and the basis of Miles's property, at each stage of the transactions.

Discuss.

(End of Question 37)

QUESTION 38
(One hour)

Felicia, a wealthy individual, establishes an irrevocable trust. The terms of the trust specify that all of the income from the trust is to be paid to Felicia's adult son, Junior, annually for the rest of Junior's life. Upon Junior's death, the trust is to terminate and the assets held in the trust are to be distributed to Junior's children. Felicia reserves the power, in Felicia's complete discretion during Junior's lifetime, to substitute Felicia's sister, Sarah, as the income beneficiary of the trust, in place of Junior, but Felicia never exercises this power. The trust corpus is invested in corporate bonds, and in the first year, the trustee (a bank) collects interest on the bonds and immediately distributes this income to Junior.

Felicia owns stock in a closely held corporation, XYZ. Felicia's adjusted basis in the XYZ stock is \$120,000. Felicia sells all of her XYZ stock in an arm's-length transaction to an unrelated purchaser, Portia, for \$200,000, payable \$80,000 down and \$20,000 a year for six years thereafter, plus interest at a market rate, payable annually. At the closing of the sale, Portia delivers to Felicia a check for \$80,000 and a promissory note for \$120,000, reflecting the terms of the sale transaction.

Felicia also owns Yellowacre, a parcel of vacant real estate. Felicia's adjusted basis in Yellowacre is \$30,000. Felicia sells Yellowacre to her daughter, Darya, for \$50,000 cash. At the time of the sale, the fair market value of Yellowacre is \$200,000.

One day while running personal errands, Felicia is injured in an automobile accident caused negligently by Nili. Felicia threatens to sue Nili for damages, including lost wages, pain and suffering, and medical expenses. Felicia demands \$100,000 in cash as damages. Nili's liability insurer offers Felicia an alternative deal: \$8,000 a year for the rest of Felicia's life, which at the time of the offer has an expected duration (determined by actuarial tables) of 20 years. Felicia accepts the insurance company's proposal and collects the annual cash payments of \$8,000.

What are the federal income tax consequences *to Felicia* of each of the transactions and events just discussed, with *and* without any available elections? Be sure to discuss the amount, timing, and character (ordinary or capital) of *each* item of income, gain, loss, deduction, or credit, and the basis of Felicia's property, at each stage of the transactions.

Explain.

(End of examination)