

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 2019, 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)

Reba, a physician, is an employee of a clinic, Clincorp. Clincorp is a corporation. In 2019, Clincorp grants to Reba the option to purchase up to 1,000 shares of Clincorp stock over the next two years at the price of \$50 a share. At the time the option is granted, Clincorp's stock is trading on a public stock exchange at \$50 a share. Reba's option is fully vested.

In 2021, Reba exercises the option, paying \$50,000 for 1,000 shares of Clincorp stock. The stock is fully vested. At the time Reba exercises the option, the Clincorp stock is trading on the public stock exchange at \$80 a share.

In 2023, Reba sells the 1,000 shares of Clincorp stock for \$120,000 cash.

Reba owns some vacant land that she has been holding for investment. Reba's basis in the land is \$500,000, and its fair market value is \$1,500,000. Reba owns the property free and clear of any mortgages or encumbrances. Reba enters into an exchange agreement with Bertha and Sam. Pursuant to the agreement, two events take place: Bertha purchases an apartment building from Sam for \$1,200,000 cash; and then Bertha immediately transfers the apartment building, plus \$300,000 cash, to Reba in exchange for Reba's land. Reba takes over the business of renting out units in the apartment building.

Reba collects art as a hobby. She likes to buy works of artists who are early in their careers. One year, she donates to her local museum, which is a nonprofit educational institution, a sculpture by a famous artist. Reba paid \$500 for the sculpture many years earlier, when the artist was largely unknown; at the time of the donation, the fair market value of the sculpture is \$10,000.

Reba lives in a community with heavy state and local taxes. During 2019, Reba pays the following:

State sales tax	\$ 5,000
State income tax	15,000
Local income tax	3,000
Local property tax	22,000
<i>Total</i>	<i>\$ 45,000</i>

What are the federal income tax consequences *to Reba* 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 Reba's property, at each stage of the transactions.

Discuss.

(End of Question 37)

QUESTION 38
(One hour)

Javier is a highly successful freelance author of children's books. Javier lives in a home that he rents from an unrelated party. The home has a room in which Javier does all of his writing.

Javier has always wanted to try his hand at farming. Javier borrows \$300,000 from a bank, and combines this with \$50,000 from his stock market account to purchase Willowacre, a farm. The loan is a recourse loan secured by a mortgage on Willowacre. Willowacre is mostly farmland, but there are a few small buildings on the property. Javier occasionally makes incidental repairs to the buildings, but no substantial renovations or additions. Javier continues to write books and live in his rented house in the city. He works most weekends at Willowacre. During the week, a neighbor looks after the farm.

In the early years of the farm operation, Javier grows berries on the land, but not profitably – that is, Javier's operating costs from the farm operation exceed his income from berry sales by a substantial amount. Javier decides to change his crop to cannabis. Cultivation of cannabis is prohibited by federal law, but the law of the state in which Willowacre is located allows it. Once again, the farm does not turn an economic profit, even with the change of crops.

Javier is convinced that with several more years' effort, as he learns more about agriculture, he might be able to make the farm marginally profitable. Even if he is unsuccessful, he derives a great deal of enjoyment from being out in the fresh air of the countryside. Javier makes all the principal and interest payments on the bank loan in a timely manner. Javier takes \$10,000 of depreciation deductions with respect to the buildings on the property.

A few years after the crop conversion, still losing money farming, Javier decides to move to a different state. He puts Willowacre on the market, and his real estate agent, Mimi, finds an individual who offers to buy Willowacre from Javier for \$160,000 cash and the assumption of the bank debt. At the time of the sale, the bank debt has an outstanding principal balance of \$240,000. Javier accepts the offer, and the deal closes as just described. At the closing, Javier pays a real estate commission of \$20,000 to Mimi. After taking this amount into account, Javier receives \$140,000 of cash from the transaction.

In a separate sale, Javier sells some aging farm machinery to a junkyard for the machinery's fair market value, \$5,000, paid in cash. At the time he had purchased the machinery (a few weeks after acquiring Willowacre), Javier had deducted the entire cost under section 168(k) of the Code.

What are the federal income tax consequences *to Javier* 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 Javier's property, at each stage of the transactions.

Explain.

(End of examination)