

**Exemplify Password:**

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**INCOME TAX I  
FALL 2023  
BOGDANSKI**

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

**INSTRUCTIONS**

This examination is in two parts. Part One consists of 36 multiple-choice questions (Questions 1 through 36). Part Two consists of 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 essay questions (one hour per essay question).

At the end of the three and a half hours, you must turn in this set of questions in the original envelope in which this set came. **You must submit all your answers to Questions 1 to 36 using Exemplify.** You may answer Questions 37 and 38 using Exemplify, or by writing in one or more authorized exam booklets. If you choose to write your essay answers by hand, you must enclose the booklet(s), along with this set of questions, in the envelope. No credit will be given for anything written on this set of questions. Only your electronic answer file, and your exam booklet(s) (if any), will be graded.

Use of any electronic device during this exam, other than a device on which you are taking the exam using Exemplify, is strictly prohibited. If you need it, the calculator function in Exemplify is activated.

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 noted for each part of the exam. 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, 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 2023, all taxpayers described in the questions are individuals and U.S. citizens, and all taxpayers described in the questions 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.

**PART TWO – ESSAY QUESTIONS**  
**(Two hours)**

**QUESTION 37**  
**(One hour)**

During her lifetime, Grace gives her niece, Natalia, some stock in Pubco, a corporation, as a birthday present. Grace bought the Pubco stock two years earlier for \$10,000; the fair market value of stock at the time of the gift to Natalia is \$8,000. A few months after Natalia receives the gift, Natalia sells the Pubco stock on the public market for \$7,500 cash.

Natalia owns and operates a modestly profitable landscaping business. Natalia borrows \$500,000 from a bank to finance the purchase of a new vehicle and some new equipment, all for use exclusively in the business. In the first year the loan is outstanding, Natalia pays the bank \$40,000 of interest and \$10,000 of principal on the loan.

Natalia uses a bedroom in her house as the office for the landscaping business. Natalia owns the house, which is her principal residence. Natalia pays casualty insurance premiums and property taxes on the house; she also makes monthly payments on a mortgage loan that she used to buy the house. In addition, Natalia pays to have all of the rooms in the house, including the office, re-painted.

Natalia is seriously injured in an audience stampede at a concert. Natalia sues the promoter of the concert for gross negligence and reckless misconduct. Natalia seeks \$2,000,000 damages for lost wages, medical expenses, and pain and suffering. She also seeks punitive damages of \$10,000,000. Under applicable law, Natalia is entitled to keep any punitive damages awarded. Before the lawsuit goes to the trial, Natalia and the promoter reach a settlement, under which the promoter pays Natalia \$1,500,000 cash to settle all of Natalia's claims. As part of the settlement, Natalia agrees not to make any statements to members of the media regarding the case.

What are the federal income tax consequences to Natalia 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 each item of property, at each stage of the transactions and events.

Discuss.

**(End of Question 37)**

**QUESTION 38**  
**(One hour)**

Jay is a retired dentist, a real estate investor, and a part-time musician. One of Jay's music gigs is a series of shows at monthly parties thrown by a custom bicycle builder, Spike. Instead of paying Jay cash for his performances, Spike transfers to Jay a luxury custom bicycle with a fair market value of \$15,000. Jay would never pay that much for a bicycle, which he thinks is an overpriced extravagance, but he accepts the bicycle as the sole compensation for his performances. Jay rides the bike for recreation for a little more than a year; then Jay sells the bike to an unrelated purchaser on an internet auction site for \$8,000.

Jay holds for investment a large tract of undeveloped land just outside the city limits. The local public school district, a political subdivision of the state, approaches Jay and expresses an interest in locating a new high school on some of the land owned by Jay. Jay donates several acres of land to the school district, knowing that the construction of the school will require the school district to build a road, and pay to have utilities extended, to the school site. These improvements will greatly enhance the value of the rest of the tract, which Jay retains. At the time of the contribution, the fair market value of the donated land is \$2,000,000; Jay's adjusted basis in the donated land immediately before the gift is \$1,300,000.

Jay owns another vacant parcel of land, Blackacre, in another state. Jay has also been holding Blackacre as an investment. Jay's adjusted basis in the property is his cost, \$1,000,000. He owns Blackacre free and clear of any mortgages, liens, or other encumbrances. Jay sells Blackacre to an unrelated purchaser, Paul, on an installment basis for a total purchase price of \$2,000,000. At the closing, Paul pays Jay \$400,000 cash and issues to Jay a promissory note for \$1,600,000. The promissory note calls for Paul to pay Jay \$400,000 of principal each year for four years, plus interest on the unpaid balance at a market rate.

What are the federal income tax consequences to Jay 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 each item of property, at each stage of the transactions and events.

Explain.

**(End of examination)**