

**Exemplify Password:**

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**INCOME TAX I  
FALL 2024  
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 using Exemplify. No credit will be given for anything written on this set of questions. Only your electronic answer file 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 2024, 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)**

In 2024, Mack, a real estate tycoon, buys an office building in Urbtown, along with the underlying land, for \$5,000,000. To come up with the money needed to make the purchase, Mack withdraws \$300,000 from his own savings and borrows the other \$4,700,000 from a bank, Banco. Mack grants Banco a first mortgage on the land and building. By its terms, the loan is nonrecourse; in the event of a default, Banco's only remedy is to take ownership of the building. The loan requires Mack to pay interest at a market rate every month; only a small amount of principal needs to be paid, however, for the first three years that the loan is outstanding.

On his personal income tax returns for 2024, 2025, and 2026, Mack takes a total of \$600,000 of depreciation deductions with respect to the building. Assume that this depreciation was calculated correctly. Along with the depreciation, Mack's routine expenses of operating the building exceed the income he receives from renting it to the tenants each year.

The demand for office space in Urbtown dwindles, and at the start of 2027, Mack's land and building have a combined fair market value of only \$4,100,000. The balance on Mack's loan at the start of 2027 is \$4,600,000. Mack defaults on the loan at that point, and Banco immediately forecloses on, and takes possession of, the property. As a result of this action, Mack has no further obligation on the loan.

Mack also owns, free and clear of any mortgages or other encumbrances, a commercial property known as Country Place. Country Place, located in Treeville, is a collection of retail shops. Mack leases the space in Country Place to the shop operators. In March 2024, Country Place is destroyed by a wildfire. Fortunately, Mack has fire insurance on the property. The insurance company pays Mack \$10,000,000 in cash, which is the fair market value of Country Place at the time of the fire. Immediately before the payment is received, Mack has an adjusted basis in Country Place of \$3,000,000. Mack uses the \$10,000,000 received from the insurance company to make needed repairs and improvements on his rental properties in other states.

In October 2026, Mack buys Shopspot, a strip mall in a different neighborhood in Treeville, for \$8,000,000, most of which Mack borrows from a business associate, Doris. Mack leases the space in Shopspot to various retailers, a restaurant, and a medical clinic.

Mack pays substantial sums of state and local taxes each year. In 2024, he pays \$600,000 in property taxes on his rental properties, and another \$25,000 of property taxes on his personal residence. Also in 2024, Mack pays state and local sales taxes of \$22,000 on purchases of goods for use in connection with his real estate business, and another \$8,000 of state and local sales taxes on personal purchases. He also pays \$100,000 a year of state income taxes in 2024.

What are the federal income tax consequences to Mack 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)**

Lyn is employed as an associate attorney at a large law firm, Firmco. Lyn spends about half her time at Firmco providing legal services to one of Firmco's clients, Company. Lyn's work on matters involving Company has been highly successful. Company is wholly owned by Tami. Lyn and Tami were members of the same college sorority, although many years apart, and the two of them occasionally socialize outside of work.

Around holiday time one year, Tami sends to Lyn an envelope containing tickets for two front-row seats and backstage passes to an upcoming concert featuring a world-famous pop star, Speedy. The tickets and passes could be sold on the open market for \$20,000. Enclosed with them is a note from Tami to Lyn that reads simply, "In appreciation." Lyn asks Firmco's managing partner, Paige, whether Lyn can keep the tickets and passes, in light of Firmco's rule stating that all personal service compensation must be turned in to the firm. Paige tells Lyn that she should keep the tickets and passes. "You deserve it," Paige says. Lyn is not a big fan of Speedy, and would not pay more than \$100 to see the show, but she and a fellow Firmco associate do attend, taking selfies with Speedy backstage afterward.

Lyn frequently works from home, where she lives by herself. She has a room in her rented apartment that she uses exclusively for the practice of law on behalf of Firmco. Lyn works more hours at home than she does at the Firmco offices. The room makes up about one-sixth of the space in her unit. Lyn's monthly rent for the unit is \$3,000. She also pays \$30 a month for renter's insurance. Firmco does not reimburse Lyn for any of these amounts.

After years of allowing associates to work remotely as much as they wish, Firmco announces that all associates must report to the Firmco offices at least two days a week. To make this policy more palatable, Firmco opens a cafeteria on one floor of its office suite, where meals are served to the associates, free of charge, 12 hours each weekday. Because all but the most expensive restaurants in the vicinity have closed, many of the associates, including Lyn, take advantage of the free food, which is quite good.

Lyn's aunt, Agnes, dies, bequeathing to Lyn three paintings created by an artist named Penny. Years ago, Agnes bought the three paintings as a package from the then-starving Penny for \$5,000. Penny has since become quite famous, and the paintings' values have skyrocketed. At the time Agnes dies, the set of three works has a fair market value of \$100,000. Two years after Agnes dies, Lyn sells the smallest of the three paintings for \$40,000. Lyn holds on to the other two.

What are the federal income tax consequences to Lyn 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)**