TAXATION OF CORPORATIONS AND SHAREHOLDERS

Professor Davis

Spring 2006

Time Limit: 3 Hours

Instructions:

After completing this exam do NOT discuss it with anyone—including with students who have taken the exam with you. Due to a later administration of this examination, fairness requires that no one discuss the questions. Any breach of this security will be pursued as academic dishonesty and an honor code violation.

Write all your answers in the Bluebooks provided. Write you exam number on each bluebook. You must return this examination with your bluebook. Write your exam number in the upper right hand corner of this examination.

This is a three hour examination consisting of five questions. At the beginning of each question, the recommended maximum time is indicated. The grading of the questions will be weighted accordingly.

Answer the questions in the order presented. Write legibly and in complete sentences. Do not abbreviate except for abbreviations that we have commonly used in class.

Your answers should be concise and to the point. Answers should include the analysis that leads to your conclusions. A clear and logical explanation of the issues and the reasons for your answer is more important than a simple conclusive answer. Some, but not all, of the questions have a single clearly correct answer. Where numerical answers are called for, it is imperative that you explain your statutory analysis as well as give the numerical answer. Make certain that you apply the law to the facts. Do not merely recite rules of law.

Question I
45 Minutes

Skippy and Buffy have been conducting separate preppy dressing consulting services in Oxford as sole proprietorships for several years. They have decided to combine their businesses in the Pink Shirt Inc. (PSI) corporation. Each of them received 10 shares of common stock.
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Skippy, who has operated his business on the cash method, contributed the following assets.

Assets	Basis	F.M.V.	
Accounts Receivable	0	60,000	
Office Equipment	15,000	40,000	(original cost 70,000)

In addition, PSI assumed $55,000 of accounts payable from Skippy's sole proprietorship and a $25,000 purchase money loan on the office equipment.

Buffy, who operated her business on the accrual method, contributed the following assets:

Assets	Basis	F.M.V.
Accounts Receivable	60,000	60,000
Land	50,000	40,000

In addition, PSI assumed $55,000 of accounts payable from Buffy's sole proprietorship and a $25,000 purchase money loan on the land.

As permitted by section 448(b)(2), PSI has elected to use the cash method. Following incorporation, it collected all the accounts receivable and paid all of the accounts payable.

What are the tax consequences to Skippy, Buffy, and PSI?

Question II
60 Minutes

Animal Foods, Inc. (AFI) has 100 shares of stock outstanding and an accumulated earnings and profits of $50,000. Panola Processing Corp. (PPC) owns 90 of the shares with a basis of $250,000. Maslin (an individual) owns the other 10 shares. She has a basis of $100,000 in her shares. Pet Depot Corp. (PDC) wants to purchase the stock of AFI. The parties agree that $1,000,000 would be a fair purchase price for the 100 shares of AFI. PDC, however, only has $600,000 to use for the purchase. In addition, PDC is not interested in AFI's horse and cattle food processing plant. The plant has a F.M.V. of $400,000 and a basis of $50,000. The parties, therefore, are considering structuring the transaction in the following way. AFI will sell the horse and cattle food plant to a third party and distributed the $400,000 of proceeds from the sale to its shareholders. PPC will receive $360,000 and Maslin will receive $40,000. PPC and Maslin then will sell their shares to PDC. PPC will receive $540,000 and Maslin will receive $60,000 in return for their shares.

What are the tax consequences for the parties if the transaction is structured as described above? How could the deal be restructured to improve the results for both PPC and for Maslin?

Question III
25 Minutes

Poole owns 25 shares and Lynch owns 50 shares of common stock of X Corp., which has 75 outstanding shares. X Corp. has 20,000 of accumulated earnings and profits and no current earnings and profits from operations. On April 15th, X Corp. distributed $30,000 of cash to Poole. On September 15th X Corp. distributed to Lynch land with a basis of $15,000 and a fair market value of $60,000. What is the amount of the dividend received by each of the shareholders?

Question IV
30 Minutes

Y Corp. has 100 shares of common stock outstanding. Fifteen shares are owned by A. Forty shares are owned by Z Corp., and A owns 60 of the 100 outstanding shares of the 100 outstanding shares of the stock of Z Corp. The remaining 45 shares of the stock of Y Corp. are owned by the ABC Partnership, in which A is a one-third partner. What are the tax consequences of a redemption of 10 of A's Y. Corp. shares?

Question V
20 Minutes

The Lafayette Development Corp. (LDC) has 100 shares of common stock outstanding. Mills owns 60 shares with a basis of $200,000 and Leech owns 40 shares with a basis of $500,000. LDC owns two parcels of land and has $200,000 in cash.

The basis and F.M.V. of the parcels are:

Asset	Basis	F.M.V.
Parcel #1	400,000	600,000
Parcel #2	500,000	200,000

Parcel #1 has been held by LDC for 6 years and has been rented out to a farmer during that time. Parcel #2 was contributed in a section 351 transaction 18 months ago by Mills and Leech when its F.M.V. was $400,000 and its adjusted basis was $520,000.

What are the tax consequences if LDC distributes Parcel #1 to Mills and Parcel #2 and the cash to Leech in complete liquidation of LDC?