Exam

Name________________________________

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

1) A sole proprietor is required to use the same reporting period for both business and individual tax information. 1) ________

Answer: True False

2) S corporations are flow-through entities in which S income is allocated to shareholders. 2) ________

Answer: True False

3) S corporations must allocate income to shareholders based on their proportionate stock ownership. 3) ________

Answer: True False

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

4) Business assets of a sole proprietorship are owned by 4) ________

A) a member. B) an individual. C) a stockholder. D) a partner.

Answer: B

5) Identify which of the following statements is <u>false</u>. 5) ________

A) A sole proprietor is considered to be an employee of the business.
B) A sole proprietorship is a separate taxable entity.
C) A solely owned corporation is a sole proprietorship.
D) All of the above are false.

Answer: D

6) Which of the following is an advantage of a sole proprietorship over other business forms? 6) ________

A) low tax rates on dividends
B) tax-exempt treatment of fringe benefits
C) the deduction for compensation paid to the owner
D) ease of formation

Answer: D

7) Which of the following statements about a partnership is true? 7) ________

A) A partnership is a taxpaying entity.
B) Partners are taxed on distributions from a partnership.
C) Partners are considered employees of the partnership.
D) Partners are taxed on their allocable share of income whether it is distributed or not.

Answer: D

8) Demarcus is a 50% partner in the DJ partnership. DJ has taxable income for the year of $200,000. Demarcus received a $75,000 distribution from the partnership. What amount of income related to DJ must Demarcus recognize? 8) ________

A) $100,000 B) $200,000 C) $75,000 D) $37,500

Answer: A

9) Which of the following statements is incorrect? 9) ________
A) In a limited partnership, all partners participate in managerial decision making.
B) Limited partners' liability for partnership debt is limited to their amount of investment.
C) In a general partnership, all partners have unlimited liability for partnership debts.
D) All of the above are correct.

Answer: A

10) Identify which of the following statements is true. 10) ________
A) Regular corporation and S corporation are synonymous terms.
B) A partner is generally considered to be an employee of the partnership.
C) Regular corporation and C corporation are synonymous terms.
D) All of the above are false.

Answer: C

11) Which of the following statements is correct? 11) ________
A) S shareholders are only taxed on distributions.
B) An owner of a C corporation is taxed on his or her proportionate share of earnings.
C) S shareholders are taxed on their proportionate share of earnings whether or not distributed.
D) S shareholders are taxed on their proportionate share of earnings that are distributed.

Answer: C

12) Identify which of the following statements is true. 12) ________
A) If a C corporation does not distribute its income to its shareholders annually, double taxation cannot occur.
B) C corporation operating losses are deductible by the individual shareholders.
C) Capital losses incurred by a C corporation can be used to offset the corporation's ordinary income.
D) All of the above are false.

Answer: D

13) Bread Corporation is a C corporation with earnings of $100,000. It paid $20,000 in dividends to its sole shareholder, Gerald. Gerald also owns 100% of Butter Corporation, an S corporation. Butter had net taxable income of $80,000 and made a $15,000 distribution to Gerald. What income will Gerald report from Bread and Butter's activities? 13) ________

A) $35,000 B) $100,000 C) $95,000 D) $180,000

Answer: B

14) Which of the following statements is incorrect? 14) ________
A) S corporation losses can offset shareholder income from other sources.
B) S corporation income is taxed to shareholders when earned.
C) S corporations must allocate income and expenses to their shareholders based on their proportionate ownership interest.
D) The number of S corporation shareholders is unlimited.

Answer: D

15) Which of the following statements is true? 15) ______

A) C corporation shareholders are taxed based on their proportionate share of income.
B) Shareholders in a C corporation can use C corporation losses to offset shareholder income from other sources.
C) Distributions of C corporation income are not taxable.
D) C corporation losses remain in the C corporation and can offset capital gain income from other years.

Answer: D

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

16) Nathan is single and owns a 54% interest in the new NT Partnership, a calendar-year entity. The NT Partnership reports $100,000 of profits for its first year. Assuming Nathan is taxed at a 35% marginal tax rate on the additional income, how much tax does Nathan owe if the NT Partnership does not distribute any of its profits to him?

Answer: Nathan owes tax on 54% of NT Partnership's profits whether they are distributed or not to him. Thus, he owes 35% of $54,000, or $18,900.

17) In January of the current year, Rae purchases 100% of Sun Corporation stock for $30,000. Sun Corporation reports taxable income of $25,000 in the current year, on which it pays tax of $3,750. None of the remaining $21,250 is distributed to Rae. However, on January 1 of the next year, Rae sells her stock to Lee for $51,250. What are the tax consequences to Rae of the sale?

Answer: Rae must report a capital gain of $21,250 ($51,250 - $30,000). Thus, Sun Corporation's profit is taxed twice —once at the corporate level and again at the shareholder level when the stock is sold.

18) What are the tax consequences to Whitney who owns 50% of Museum Corporation, a qualifying S corporation that is a calendar-year entity, if Museum Corporation reports $60,000 of taxable income? How would your answer change if Museum Corporation reported a $40,000 loss?

Answer: Whitney must pay taxes on $30,000, his 50% share of Museum Corporation's income, whether it is distributed to him or not. Museum Corporation pays no corporate income taxes. If Museum Corporation reports a $40,000 loss, Whitney's $20,000 share of the loss reduces his taxable income.

19) The tax disadvantages of the C corporation form of doing business include "double taxation." What is meant by the term "double taxation" as used in this context?

Answer: Double taxation occurs when corporate earnings are distributed as dividends to the shareholders. Since the corporate earnings have already been taxed at the corporate level, the shareholders must pay personal income tax as a second tax when the earnings are distributed as dividends. Double taxation can also occur when the stock is sold or exchanged and the portion of the gain attributable to the accumulated earnings is taxed as capital gain.

20) Jane and Joe plan to go into business together. They plan to incorporate the business. What tax issues should they consider when deciding whether or not to elect S corporation status?

- Are their individual marginal tax rates lower or higher than a C corporation's marginal tax rates?
- Do they anticipate profits or losses in the first few years of business?
- Will the corporation generate any capital gains or losses?
- Do they plan to withdraw money from the corporation?
- Will they want or need fringe benefits?
- Do they plan to use a calendar year end or a fiscal year end?

Answer: S corporations generally are exempt from taxation. Income flows through and is taxed to the shareholders. The shareholders' marginal tax rates may be lower than a C corporation's marginal tax rate. Losses flow through to shareholders and can be used to offset income earned from other sources unless limitations apply. This feature is particularly important to corporations just beginning their operations. Passive loss and basis rules may limit loss deductions to shareholders. Because income, loss, and other pass-through items retain their character when they flow through to the shareholders, individual shareholders are taxed on capital gains as though the individual earned the gains. An individual may be able to offset those gains with capital losses from other sources or have them taxed at the appropriate capital gain tax rate. Shareholders generally can contribute money to or withdraw money from an S corporation without gain recognition. Shareholders are taxed only on the annual income of the S corporation. Corporate profits are taxed only at the shareholder level. Shareholders are taxed on all of an S corporation's current year profits whether those profits are distributed or not. Tax-free corporate fringe benefits generally are not available to S corporation shareholders who are employed by the business. Fringe benefits provided by an S corporation are deductible by the corporation and taxable to the shareholder. S corporations generally cannot defer income by choosing a fiscal year for the S corporation other than a calendar year unless the S corporation can establish a business purpose for a fiscal year or unless it makes a special election.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

21) The check-the-box regulations permit an LLC to be taxed as a C corporation. 21) ______

Answer: ✔ True False

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

22) Identify which of the following statements is false. 22) ______

A) Once an election is made to change its classification, an entity cannot change again for 60 months.
B) A business need not be incorporated under state or federal law to be taxed as a corporation.
C) The check-the-box regulations permit an LLC to be taxed as a C corporation.
D) Under the check-the-box regulations, an LLC that has only two members (owners) must be taxed as a partnership.

Answer: D

23) Identify which of the following statements is true. 23) ______

A) Under the check-the-box regulations, an LLC that has one member (owner) may be disregarded as an entity separate from its owner.
B) A new LLC that is owned by four members elects to be taxed under its default classification (as a partnership) in its first year of operations. The entity is prohibited from changing its tax classification at any time in the future.
C) An unincorporated business may not be taxed as a corporation.
D) All of the above are false.

Answer: A

24) Three members form an LLC in the current year. Which of the following statements is <u>incorrect</u>? 24) _______

A) The LLC's default classification under the check-the-box rules is as a partnership.
B) The LLC can elect to be taxed as a C corporation with no special tax consequences.
C) If the LLC elects to use its default classification, it can elect to change its status to being taxed as a C corporation beginning with the third tax year after the initial classification.
D) The LLC can elect to have its default classification ignored.

Answer: C

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

25) On January 20 of the current year, a group of ten individuals organize an LLC to conduct an ink-making business in Florida. This year, the LLC is an eligible entity under the check-the-box regulations. How will the LLC be taxed?

Answer: The owners may elect to have the LLC taxed as a corporation. However, if they do not make the election, the LLC will be taxed as a partnership.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

26) There are no tax consequences of a partnership converting to a C corporation. 26) _______

Answer: True ✔ False

27) Section 351 applies to an exchange if the contributing shareholders own more than 50% of a corporation's stock after the transfer. 27) _______

Answer: True ✔ False

28) The transferor's basis for any noncash boot property received in a Sec. 351 transaction is the boot's FMV reduced by any unrecognized gain. 28) _______

Answer: True ✔ False

29) A corporation must recognize a loss when transferring noncash boot property that has declined in value and its stock to a transferor as part of a Sec. 351 exchange. 29) _______

Answer: True ✔ False

30) If a corporation's total adjusted bases for all properties transferred exceed the total FMV of the properties, the corporation's bases in the property is limited to FMV if no election is made. 30) _______

Answer: ✔ True False

31) The assignment of income doctrine does not apply if the transferor in a Sec. 351 exchange in which no gain is otherwise recognized transfers substantially all the assets and liabilities of the transferor's trade or business to the controlled corporation. 31) _______

Answer: ✔ True False

32) Upon formation of a corporation, its assets have the same bases for book and tax purposes. 32) _______

Answer: True ✔ False

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

33) Identify which of the following statements is true. 33) _______

A) The repeal of Sec. 351 would result in more existing businesses being incorporated.

B) The exchange of stock for services rendered is not a taxable transaction.

C) Section 351 was enacted to allow taxpayers to incorporate without incurring adverse tax consequences.

D) All of the above are false.

Answer: C

34) Identify which of the following statements is true. 34) _______

A) Section 351 applies to property transfers in exchange for stock.

B) Section 351 applies exclusively to the formation of a new corporation.

C) Section 351 only applies to individual transferors.

D) All of the above are false.

Answer: A

35) For Sec. 351 purposes, the term "property" does not include 35) _______

A) cash.

B) services rendered.

C) accounts receivable.

D) inventory.

Answer: B

36) Rose and Wayne form a new corporation. Rose contributes cash for 85% of the stock and Wayne contributes services for 15% of the stock. The tax effect is 36) _______

A) Wayne must report the FMV of the stock received as capital gain.

B) Rose and Wayne are not required to recognize their realized gains.

C) Wayne must report the FMV of the stock received as ordinary income.

D) Rose and Wayne must recognize their realized gains, if any.

Answer: C

37) Identify which of the following statements is true. 37) _______

A) If a taxpayer transfers property and services as part of a transaction meeting the Sec. 351 requirements, all of the stock received is counted in determining whether the property transferors have acquired control.

B) A transferor's gain or loss that goes unrecognized when Sec. 351 applies is permanently exempt from taxation.

C) If a taxpayer transfers property and services as part of a transaction meeting the Sec. 351 requirements, the nonrecognition of gain or loss will apply to the services.

D) All of the above are false.

Answer: A

38) Jermaine owns all 200 shares of Peach Corporation stock valued at $50,000. Kenya, a new shareholder, receives 200 newly issued shares from Peach Corporation in exchange for inventory with an adjusted basis of $40,000 and an FMV of $50,000. Which of the following statements is correct? 38) _______

A) The transaction results in $10,000 of ordinary income for Kenya.

B) No gain will be recognized by Kenya.

C) Kenya may defer the recognition of any tax until the stock is sold.

D) The transaction results in $10,000 of capital gain for Kenya.

Answer: A

39) Identify which of the following statements is true. 39) _______

A) Only transfers to newly created corporations qualify for Sec. 351 treatment.
B) If a shareholder receives stock with an FMV greater than the FMV of the property exchanged in a Sec. 351 transaction, the excess FMV may be considered a gift from one shareholder to another shareholder.
C) To qualify for Sec. 351 treatment, control is defined as more than 50% ownership of the voting stock, and more than 50% of all other classes of stock.
D) All of the above are false.

Answer: B

40) Barry, Dan, and Edith together form a new corporation; Barry and Dan each contribute property in exchange for stock. Within two weeks after the formation, the corporation issues additional stock to Edith in exchange for property. Barry and Dan each hold 10,000 shares and Edith will receive 9,000 shares. Which transactions will qualify for nonrecognition? 40) _______

A) Only the first transaction will qualify for nonrecognition.
B) Only the second transaction will qualify for nonrecognition.
C) Because of the step transaction doctrine, neither transaction will qualify.
D) Both transactions will qualify under Sec. 351 if they are part of the same plan of incorporation.

Answer: D

41) In accordance with the rules that apply to corporate formation, which one of the following features does <u>not</u> make an issue of preferred stock "nonqualified"? 41) _______

A) The stock is limited and preferred as to dividends.
B) The dividend rate on the stock may not vary with interest rates, commodity prices, or other similar indices.
C) The corporation is either required to redeem the stock or is likely to exercise a right to redeem the stock.
D) The shareholder can require the corporation to redeem the stock.

Answer: B

42) Under Sec. 351, corporate stock may include all of the following <u>except</u> 42) _______

A) qualified preferred stock.
B) nonvoting stock.
C) stock warrants.
D) voting stock.

Answer: C

43) Matt and Sheila form Krupp Corporation. Matt contributes property with an FMV of $55,000 and a basis of $35,000. Sheila contributes property with an FMV of $75,000 and a basis of $40,000. Matt sells his stock to Paul shortly after the exchange. The transaction will 43) _______

A) qualify with respect to Sheila under Sec. 351 whether Matt qualifies or not.
B) qualify under Sec. 351 only if an advance ruling has been obtained.
C) not qualify under Sec. 351.
D) qualify under Sec. 351 if Matt can show that the sale to Paul was not part of a prearranged plan.

Answer: D

44) Brad forms Vott Corporation by contributing equipment, which has a basis of $50,000 and an FMV of $40,000 in exchange for Vott stock. Brad also contributes $5,000 in cash. If the transaction meets the Sec. 351 control and ownership tests, what are the tax consequences to Brad? 44) _______

A) He recognizes a $10,000 loss.
B) He recognizes a $5,000 gain and a $10,000 loss.
C) He recognizes neither a gain nor a loss.
D) He recognizes a $5,000 loss.

Answer: C

45) If an individual transfers an ongoing business to a corporation in a Sec. 351 exchange, the individual must recognize any realized gain 45) _______

A) if the FMV of the property exchanged exceeds the FMV of the stock received.
B) if the transferor receives property other than stock.
C) only if the adjusted basis of the property transferred is less than the FMV of the stock received.
D) both A and B above

Answer: B

46) Carmen and Marc form Apple Corporation. Carmen transfers land that is Sec. 1231 property, with an adjusted basis of $18,000 and an FMV of $20,000 in exchange for one-half of the Apple Corporation stock. Marc transfers equipment that originally costs $28,000 on which he has taken $5,000 in depreciation deductions. The equipment has an FMV of $25,000 and he receives one-half of the stock and a $5,000 short-term note. The transaction meets the requirements of Sec. 351. Which statement below is correct? 46) _______

A) Carmen recognizes a $2,000 Sec. 1231 gain and Marc recognizes $5,000 as ordinary income.
B) Carmen recognizes a $2,000 Sec. 1231 gain and Marc recognizes a $5,000 Sec. 1231 gain.
C) There is no recognized gain or loss.
D) Carmen recognizes no gain and Marc recognizes $2,000 as ordinary income.

Answer: D

47) Identify which of the following statements is true. 47) _______

A) The character of the gain recognized by the transferor when boot is received in a Sec. 351 transaction depends on the type of boot received.
B) The receipt of property other than stock by the transferor will trigger the recognition of gain or loss under Sec. 351.
C) The definition of stock under Sec. 351 includes stock rights and warrants.
D) All of the above are false.

Answer: D

48) Identify which of the following statements is true. 48) _______

A) If more than one asset is transferred by the transferor in a Sec. 351 nonrecognition transaction, the transferor is assumed to have received a proportionate share of the stock, cash, and other boot property for each property transferred based upon the assets' relative FMVs.
B) The transferor's basis for any noncash boot property received in a Sec. 351 transaction is the boot's FMV reduced by any unrecognized gain.
C) To determine a shareholder's basis in a single class of stock received in a Sec. 351 exchange, the FMV of the stock received must be known.
D) All of the above are false.

Answer: A

49) Identify which of the following statements is true. 49) _______

A) The adjusted basis of stock received in a Sec. 351 transaction is computed by deducting the deferred loss from the FMV of the stock received.

B) If stock and boot property are both received in a Sec. 351 exchange, the transferor must allocate the total basis in the contributed property between the stock and boot property based on the relative FMVs of the stock and the boot property.

C) The holding period for stock received in a Sec. 351 transaction in exchange for a capital asset begins on the day after the date of the exchange.

D) All of the above are false.

Answer: D

50) Jerry transfers two assets to a corporation as part of a Sec. 351 exchange. The first asset has an adjusted basis of $70,000 and an FMV of $50,000. The second asset has an adjusted basis of $70,000 and an FMV of $150,000. The FMV of the stock received is $180,000, and he also receives $20,000 cash. The realized and recognized gain on the second asset is 50) _______

A) $80,000 realized; $20,000 recognized. B) $10,000 realized; $10,000 recognized.

C) $80,000 realized; $15,000 recognized. D) $20,000 realized; $10,000 recognized.

Answer: C

51) Max transfers the following properties to a newly created corporation for $90,000 of stock and $10,0(in a transaction that qualifies under Sec. 351. 51) _______

	Asset One	Asset Two	Asset Three
FMV	$30,000	$45,000	$25,000
Basis	35,000	40,000	20,000

Max's recognized gain is

A) $3,000. B) $5,000. C) $10,000. D) $7,000.

Answer: D

52) Cherie transfers two assets to a newly-created corporation. The first asset has an adjusted basis of $40,000 and an FMV of $50,000. The second asset has an adjusted basis of $35,000 and an FMV of $25,000. Cherie receives stock with an FMV of $66,000 and $9,000 cash. Cherie must recognize a gain of 52) _______

A) $6,000. B) $10,000. C) $5,000. D) $4,000.

Answer: A

53) Henry transfers property with an adjusted basis of $90,000 and an FMV of $100,000 to a newly-formed corporation in a Sec. 351 exchange. Henry receives stock with an FMV of $80,000 and a short-term note with a $20,000 FMV. Henry's recognized gain is 53) _______

A) $10,000. B) $20,000. C) $5,000. D) $0.

Answer: A

54) Henry transfers property with an adjusted basis of $95,000 and an FMV of $100,000 to a newly formed corporation in a Sec. 351 exchange. Henry receives stock with an FMV of $85,000 and a short-term note with a $15,000 FMV. Henry's basis in the stock is 54) _______

A) $95,000. B) $100,000. C) $90,000. D) $85,000.

Answer: D

55) A shareholder's basis in stock received in a Sec. 351 transaction is 55) _______

A) decreased by liabilities assumed by the corporation.
B) increased by the gain recognized by the corporation.
C) increased by the FMV of boot received from the corporation.
D) decreased by the gain recognized by the transferor.

Answer: A

56) Jeremy transfers Sec. 351 property acquired three years earlier having a $100,000 basis and a $160,000 FMV to Jeneva Corporation. Jeremy receives all 200 shares of Jeneva stock having a $140,000 FMV, and a $20,000 90-day Jeneva note. What is Jeremy's recognized gain? 56) _______

A) $160,000 B) $0 C) $60,000 D) $20,000

Answer: D

57) Carolyn transfers property with an adjusted basis of $50,000 and an FMV of $60,000 in exchange for Prime Corporation stock in a Sec. 351 transaction. Carolyn's basis in the stock is 57) _______

A) $0. B) $50,000. C) $60,000. D) $10,000.

Answer: B

58) Ralph transfers property with an adjusted basis of $65,000 and an FMV of $70,000 to Lake Corporation in a Sec. 351 transaction. Ralph receives stock worth $60,000 and a short-term note having a $10,000 FMV. Ralph's basis in the stock is 58) _______

A) $60,000. B) $75,000. C) $65,000. D) $70,000.

Answer: A

59) Sarah transfers property with an $80,000 adjusted basis and a $100,000 FMV to Super Corporation in a Sec. 351 transaction. Sarah receives stock with an $85,000 FMV and a short-term note with a $15,000 FMV. Sarah's basis in the stock is 59) _______

A) $80,000. B) $95,000. C) $100,000. D) $85,000.

Answer: A

60) The transferor's holding period for any stock received in exchange for a capital asset 60) _______

A) includes the holding period for the property transferred.
B) begins on the day of the exchange.
C) begins on the day after the exchange.
D) none of the above

Answer: A

61) The transferor's holding period for any boot property received in a Sec. 351 stock exchange 61) _______

A) begins on the day of the exchange.
B) begins on the day after the exchange.
C) includes the holding period for the boot transferred.
D) is the same as the holding period of the stock received in the exchange.

Answer: B

62) Beth transfers an asset having an FMV of $200,000 and an adjusted basis of $150,000 to ABC Corporation in a Sec. 351 transaction. Beth receives in exchange ABC common stock having an FMV of $175,000 and Zeus Corporation common stock (a capital asset) having an FMV of $25,000 and a basis of $10,000 to ABC Corporation. ABC Corporation must recognize 62) _______

A) a $50,000 capital gain. B) no gain.
C) a $15,000 capital gain. D) a $25,000 capital gain.

Answer: C

63) Chris transfers land with a basis of $40,000 to Webb Corporation in exchange for 100% of Webb's stock. At the date of the transfer, the land had a $30,000 fair market value. Absent an election by Chris, Webb's basis in the land is 63) _______

A) $40,000.
B) $30,000.
C) $35,000.
D) none of the above

Answer: B

64) Chris transfers land with a basis of $40,000 to Webb Corporation in exchange for 100% of Webb's stock. At the date of the transfer, the land had a $30,000 fair market value. Chris makes an election to reduce his basis in Webb's stock to $30,000, so Webb's basis in the land is 64) _______

A) $35,000.
B) $40,000.
C) $30,000.
D) none of the above

Answer: B

65) The transferee corporation's basis in property received in a Sec. 351 exchange is 65) _______

A) the transferor's basis for the property plus gain recognized by the transferee corporation.
B) the transferor's basis for the property plus gain recognized by the transferor.
C) the FMV of the property received.
D) the transferee corporation's basis in the stock exchanged.

Answer: B

66) Identify which of the following statements is true. 66) _______

A) A corporation must recognize a loss when transferring noncash boot property that has declined in value and its stock to a transferor as part of a Sec. 351 exchange.
B) Section 351 provides for nonrecognition of gain for the transferee corporation when it distributes appreciated land that is boot property to a shareholder.
C) The transferee corporation's holding period for assets acquired in an exchange meeting the Sec. 351 requirements includes the transferor's holding period for the property.
D) All of the above are false.

Answer: C

67) Mario and Lupita form a corporation in a transaction coming under Sec. 351. Lupita transfers property with an adjusted basis of $150,000 and an FMV of $200,000 in exchange for one-half of the stock. The property has an $80,000 mortgage, which the corporation assumes. Lupita has a recognized gain of 67) _______

A) $100,000.
B) $80,000.
C) $50,000.
D) $0.

Answer: D

68) Mario and Lupita form a corporation in a transaction coming under Sec. 351. Lupita transfers property with an adjusted basis of $150,000 and an FMV of $200,000 in exchange for one-half of the stock. The property has an $80,000 mortgage, which the corporation assumes. The corporation's basis in the property is 68) _______

A) $80,000.
B) $200,000.
C) $130,000.
D) $150,000.

Answer: D

69) Lynn transfers land having a $50,000 adjusted basis, an $80,000 FMV, and $10,000 cash to Allied Corporation in exchange for 100% of Allied's stock. The corporation assumes the $70,000 mortgage on the land. Which of the following statements is correct? 69) _______

A) Lynn recognizes no gain and the stock basis is $60,000.
B) Lynn recognizes a $10,000 gain and the stock basis is zero.
C) Lynn recognizes no gain and the stock basis is $50,000.
D) Lynn recognizes a $10,000 gain and the stock basis is $60,000.

Answer: B

70) Identify which of the following statements is true. 70) _______

A) When a transferor exchanges a mortgaged property under Sec. 351 and the amount of the mortgage is greater than the transferor's basis in the property, the transferor's basis in the stock received will be equal to the basis the transferor had in the mortgaged property.
B) The transferee corporation's acquisition or assumption of liabilities in excess of the total adjusted bases of the properties transferred by a transferor results in a gain recognition by the transferor.
C) When forming a corporation, the accounts payable of a transferor's business are not liabilities for gain computation purposes if the transferor's business uses the accrual method of accounting.
D) All of the above are false.

Answer: B

71) Martin operates a law practice as a sole proprietorship using the cash method of accounting. Martin incorporates the law practice and transfers the following items to a new, solely owned corporation. 71) _______

	Adjusted Basis	FMV
Cash	$10,000	$ 10,000
Equipment	80,000	100,000
Accounts receivable	0	120,000
Accounts payable (deductible expenses)	0	60,000
Note payable (on equipment)	50,000	50,000

Martin must recognize a gain of ________ and has a stock basis of ________:

A) $20,000; $40,000
B) $20,000; $30,000
C) $0; $40,000
D) $0; $30,000

Answer: C

72) Silvia transfers to Leaf Corporation a machine she had purchased a year ago for $50,000. The machine has a $40,000 adjusted basis and a $55,000 FMV on the transfer date. $10,000 in depreciation was claimed by Silvia prior to the transfer. Silvia receives all 1,000 shares of Leaf Corporation stock worth $50,000 and a two-year note with a $5,000 FMV. What is the amount and character of the recognized gain or loss? 72) _______

A) $5,000 capital gain
B) $15,000 capital gain
C) $15,000 ordinary income
D) $5,000 ordinary income

Answer: D

73) Jeremy operates a business as a sole proprietorship. The proprietorship uses the cash method of accounting. He decides to incorporate and transfers the assets and liabilities of the sole proprietorship to the newly formed corporation in exchange for its stock. The assets, which include $10,000 of accounts receivable with a zero basis, have a basis of $20,000 and an FMV of $40,000. The liabilities include accounts payable of $12,000, which will be deductible when paid, and a note payable on medical equipment of $7,000. Jeremy's basis for his stock is 73) _______

A) $13,000. B) $8,000. C) $20,000. D) $40,000.

Answer: A

74) Colleen operates a business as a sole proprietorship. She purchased a computer for $10,000 last year. The computer is five-year recovery property for MACRS purposes and is depreciated under the regular MACRS rules. This year, Colleen incorporates the business and transfers the computer to the new corporation on July 20. The depreciation on the computer for this year allocable to the sole proprietorship is 74) _______

A) $1,600. B) $500. C) $1,333. D) $1,868.

Answer: A

75) Identify which of the following statements is true. 75) _______

A) A corporation receiving property in a Sec. 351 exchange can select any MACRS depreciation method for the asset.
B) The transferor must recapture depreciation when exchanging Sec. 1245 property in all transactions coming under Sec. 351.
C) When depreciable property is transferred to a corporation in a Sec. 351 exchange in which no gain is recognized, the corporation must continue to use the transferor's depreciation method and recovery period for the property.
D) All of the above are false.

Answer: C

76) Identify which of the following statements is true. 76) _______

A) The assignment of income doctrine does not apply if the transferor in a Sec. 351 exchange in which no gain is otherwise recognized transfers when a sole proprietor transfers substantially all the assets and liabilities of the transferor's trade or business to a controlled corporation.
B) The assignment of income doctrine is a legislative requirement that income be taxed to the person who earns it.
C) The assignment of income doctrine requires a cash method of accounting for a transferor/shareholder to recognize income when accounts receivable are transferred by the shareholder to the corporation in a Sec. 351 exchange in which no gain is otherwise recognized.
D) All of the above are false.

Answer: A

77) A medical doctor incorporates her medical practice, which is operated as a sole proprietorship. The proprietorship uses the cash method of accounting. Among the assets contributed to the new corporation are unrealized receivables worth $40,000. The receivables are collected by the corporation. Which of the following statements is correct? 77) ______

A) The $40,000 of receivables is included as ordinary income in the corporation's income tax return when collected.

B) The $40,000 of receivables is included as ordinary income on the doctor's personal income tax return when collected by the corporation.

C) The $40,000 of receivables is included as ordinary income in the corporation's income tax return at the time of incorporation.

D) The doctor must include the $40,000 as ordinary income in her personal income tax return at the time of incorporation.

Answer: A

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

78) Maria has been operating a business as a sole proprietorship for several years. She needs additional capital and wants to incorporate her business. The assets of her business (building, land, inventory, and so on) have a $400,000 adjusted basis and a $1.5 million FMV. Maria is willing to exchange the assets for 1,500 shares of Metro Corporation stock, each having a $1,000 FMV. Bill and John are each willing to invest $500,000 in Maria's business and will each receive 500 shares of stock. Why is Sec. 351 important to Maria? Does it matter to Bill and John?

Answer: If not for Sec. 351, Maria would recognize a gain on the incorporation of her business. She has a $1.1 million ($1.5 million - $400,000) realized gain on her contribution of the proprietorship's assets to a new corporation in exchange for 60% of its outstanding shares. However, under Sec. 351, she recognized none of the gain. Section 351 does not affect Bill and John as they are each simply purchasing 20% of the new corporation's stock for $500,000 cash. They do not realize or recognize any gain whether Sec. 351 applies or not.

79) Phil and Nick form Philnick Corporation. Phil exchanges cash and other property for 900 shares (90% of the outstanding shares) of Philnick stock. Nick performs accounting services in exchange for 100 shares of Philnick stock worth $10,000. What are the tax consequences from forming the Philnick Corporation to Phil and Nick?

Answer: Phil's exchange of assets for stock qualifies for Sec. 351(a) treatment, thus is tax-free. Nick's exchange of services for stock is not tax-free under Sec. 351. Thus, Nick must recognize $10,000 of ordinary income, the FMV of the Philnick stock received. Nick's basis in the Philnick stock received is $10,000, its FMV.

80) In which of the following independent situations is the Sec. 351 control requirement met?

a) Jane transfers property to Jet Corporation for 75% of Jet Corporation's stock, and Susan provides services to J Corporation for the remaining 25% of Jet Corporation stock.

b) Paul transfers property to Pride Corporation for 60% of Pride's stock, and Bob transfers property worth $15,0 performs services worth $25,000 for the remaining 40% of Pride's stock.

c) Herb and his wife Carolyn each have owned 50% of the 100 outstanding shares of Wykert Corporation stock was formed three years ago. In the current year, their daughter, Cindy, transfers property to Wykert Corporation newly issued shares of Wykert stock.

d) John and Pam develop a plan to form PJ Corporation on May 2 of this year. John transfers property worth $5 for 50 shares of PJ Corporation stock. As part of the single plan to incorporate, Pam transfers $50,000 cash for 50 s of PJ Corporation stock on July 1.

e) Assume the same facts as in Part (d), except that John has a prearranged plan to sell 30 of his shares to Steven September 1.

Answer: a) Not met. Transferors of property receive only 75% and they do not have 80% control.

b) Met. Bob transferred more than a nominal amount of property. The 80% control test is met since all of stock is counted for this purpose.

c) Not met. Cindy owns only one-third of the stock immediately after the exchange. No attribution occu from Cindy's parents to Cindy.

d) Met. John and Pam own 100% of PJ Corporation. The transfers do not have to be simultaneous.

e) Not met. John had a prearranged plan to sell a sufficient amount of shares to cause the control require not to be met.

81) Frans and Arie own 75 shares and 25 shares of Vogel Corporation stock, respectively. There are no other owners. Frans transfers property with a $30,000 adjusted basis and a $50,000 FMV to Vogel Corporation in exchange for an additional 25 shares of Vogel stock. Does this property-for-stock exchange qualify for Sec. 351 treatment?

Answer: Yes. Since Frans owned 80% (100 ÷ 125) of the Vogel stock and is in control of Vogel Corporation, Frans does not recognize any gain on the exchange.

82) For the last four years, Bob and Ellen have each owned 100 of the 200 outstanding shares of Racer Corporation's stock. Bob transfers land having a $10,000 basis and a $30,000 FMV to Racer for an additional 30 shares of stock, and Ellen transfers $2,000 for an additional two shares of stock. What is the amount of gain or loss that Bob must recognize on the exchange? If the transaction does not comply with the Sec. 351 requirements, how can it be made to comply?

Answer: Bob must recognize $20,000 ($30,000 - $10,000) of gain on the exchange. Since Ellen only contributed cash, she does not recognize any gain or loss. If Ellen obtained additional stock worth at least 10% of the value of the stock she already owns (i.e., at least 10 shares worth $10,000), her stock would be counted for control purposes and then Sec. 351 would apply. Alternatively, if Bob acquired sufficient stock to own 80% of the outstanding stock after the exchange, Sec. 351 would also apply. If Sec. 351 applies, Bob will recognize no gain on the exchange.

83) Dan transfers property with an adjusted basis of $50,000 and an FMV of $100,000 to a newly formed Sun Corporation in exchange for 500 shares of Sun stock, which is one-half of the outstanding Sun stock. His daughter, Sylvia, transfers property with an adjusted basis of $25,000 and an FMV of $50,000 for the other 500 shares at the same time. What are the tax consequences of the two transfers, assuming all the requirements of Sec. 351 are met?

Answer: No gain or loss is recognized by either Dan or Sylvia. However, since the stock was not received in proportion to the relative FMVs of the properties contributed, the IRS may attempt to reconstruct the transaction in the form that Dan has received 667 shares of stock and made a gift of 167 shares to his daughter Sylvia. Dan's basis in his 500 shares of stock is $37,538 [(500/667) × $50,000 basis in property transferred]. Sylvia's basis in her 500 shares is $37,462 [$25,000 basis in property transferred + ($50,000 - $37,538) basis in the shares received as a gift from Dan].

84) Tanicia owns all 100 shares of Midwest Corporation's stock, valued at $100,000. Gwen owns property that has a $15,000 adjusted basis and a $100,000 FMV. Gwen contributes the property to Midwest Corporation in exchange for 100 shares of newly issued Midwest stock. Does Sec. 351 apply to Gwen's exchange? What is the amount of her realized gain or loss? How much is recognized?

Answer: Section 351 does not apply because Gwen owns only 50% of the Midwest stock after the exchange and is not in control of Midwest Corporation. Gwen has a realized gain of $85,000 ($100,000 - $15,000), all of which must be recognized.

85) Abby owns all 100 shares of Rent Corporation's stock, valued at $10,000. Bart owns property that has a $1,500 adjusted basis and a $10,000 FMV. Bart contributes the property to Rent Corporation in exchange for 100 shares of newly issued Rent stock. Abby transfers additional property worth $10,000 for an additional 10 shares of newly issued Rent stock too. Does Sec. 351 apply?

Answer: Both Abby and Bart are transferors, so Sec. 351 does apply. Neither Abby nor Bart recognizes any gain on the exchange.

86) Anton, Bettina, and Caleb form Cage Corporation. Each contributes appreciated property worth $10,000 for one-third of the Cage stock. Before the exchange, Anton arranges to sell his stock to Darma as soon as he receives it. Does Sec. 351 apply?

Answer: No, this prearranged plan means Anton, Bettina, and Caleb do not have control immediately after the exchange, so Sec. 351 does not apply.

87) South Corporation acquires 100 shares of treasury stock for $10,000. The next year, South reissues the 100 shares for land having a $15,000 FMV. What is the amount of gain or loss realized by South Corporation, and how much is recognized?

Answer: South realizes a $5,000 ($15,000 - $10,000) gain on the exchange. None of it is recognized.

88) Azar, who owns 100% of Hat Corporation, transfers land having a $50,000 FMV and a $30,000 adjusted basis to Hat. In return, Azar receives additional shares of Hat common stock having a $40,000 FMV and Cap Corporation common stock having a $10,000 FMV. The Cap Corporation common stock, a capital asset, has a $2,500 basis on Hat's books. What is Azar's realized and recognized gain? Does Hat Corporation recognize a gain on the stock transfer to Azar?

Answer: Azar realizes a $20,000 ($40,000 + $10,000 - $30,000) gain on the land transfer, of which $10,000 must be recognized. Hat Corporation recognizes a $7,500 capital gain ($10,000 - $2,500) when transferring the Cap Corporation stock to Azar.

89) Yolanda transfers land, a capital asset, having a $70,000 adjusted basis and a $125,000 FMV plus $10,000 cash to Jazz Corporation in exchange for all its stock. Jazz Corporation assumes the $100,000 mortgage on the land. The mortgage assumption has no tax avoidance purpose and has the requisite business purpose. What is the amount of Yolanda's realized gain or loss? How much is recognized and what is its character? What is Yolanda's basis in the Jazz stock?

Answer: Yolanda has a realized gain of $55,000 ($125,000 - $70,000). Even though Yolanda does not receive any boot, she must recognize a $30,000 ($100,000 - $70,000) capital gain, the amount by which the liabilities assumed by Jazz Corporation exceed the basis of the land and the cash transferred by Yolanda. Yolanda's the Jazz stock is $0.

Yolanda's basis in the land transferred	$ 70,000
Plus: Cash transferred	10,000
Gain recognized	20,000
Minus: Boot received (liabilities assumed by Jazz)	($100,000)
Yolanda's basis in the Jazz Stock	$ 0

90) Zoe Ann transfers machinery having a $36,000 adjusted basis and a $70,000 FMV for all 100 shares of Zeema Corporation's stock. Before the transfer, Zoe Ann used the machinery in her business. She originally paid $50,000 for the machinery and claimed $14,000 of depreciation before transferring the machinery. Zoe Ann recaptures no depreciation on the transfer and the recapture potential is transferred to Zeema Corporation. Zeema sells the machine for $66,000 after it had depreciated the machine an additional $4,000. What is Zeema's gain on the machine and what is its character?

Answer: Zeema must recognize a $34,000 ($66,000 - $32,000) gain on the sale. Of this gain, $18,000 is ordinary income recaptured under Sec. 1245. The remaining $16,000 is Sec. 1231 gain.

91) On July 9, 2008, Tom purchased a computer (five-year property for MACRS purposes) for $6,000, which he used in his sole proprietorship. He claimed $1,200 (0.20 × $6,000) of depreciation for 2008. On February 9, 2009, he transfers the computer and other assets of his sole proprietorship to Brewer Corporation in exchange for Brewer stock in a transfer qualifying under Sec. 351. What is the amount of depreciation for 2008 claimed by Tom? What is the amount of depreciation for 2009 claimed by Brewer Corporation? What is Brewer's basis in the computer on the date of transfer?

Answer: Brewer Corporation must use the same MACRS recovery period and method that Tom used. Depreciation for 2009 is $1,920 (0.32 × $6,000), which is allocated between Tom and Brewer Corporation. T computer is considered to be held by Tom for one month and by Brewer Corporation for 11 months. There Tom claims $160 and Brewer claims $1,760 in depreciation for 2009. On February 9, 2009, Brewer's basis ir computer is $4,640.

Original cost of computer	$6,000
Minus 2008 depreciation taken by Tom	(1,200)
2009 depreciation taken by Tom	(160)
Adjusted basis on transfer date	$4,640

92) Reba, a cash basis accountant, transfers all of the assets and liabilities of her practice to Able Corporation in exchange for all of Able Corporation's stock. The assets include $20,000 of accounts receivable. What is the Corporation's basis in the receivables? Will the corporation be taxed on the receivables, as they are collected?

Answer: Able Corporation's basis in the receivables is zero as the corporation will include the receivables in income as they are collected.

93) Discuss the impact of the contribution of cash as part of a Sec. 351 exchange.

Answer: Cash is treated as property when it is contributed. No gain or loss is recognized by the transferor when a contribution of cash is made. Stock received by a transferor who contributes cash for the stock has his shares counted for purposes of the 80% control test.

94) This year, John, Meg, and Karen form Frost Corporation. John contributes land purchased as an investment four years ago for $15,000 that has a $30,000 FMV in exchange for 30 shares of Frost stock. Meg contributes machinery (Sec. 1231 property) purchased four years ago and used in her business having a $35,000 adjusted basis and a $30,000 FMV in exchange for 30 shares of Frost stock. Karen contributes services worth $20,000 in exchange for 20 shares of Frost stock.

a) What is the amount of John's recognized gain or loss?

b) What is John's basis in his Frost shares? When does his holding period begin?

c) What is the amount of Meg's recognized gain or loss?

d) What is Meg's basis in her Frost shares? When does her holding period begin?

e) How much income, if any, must Karen recognize?

f) What is Karen's basis in her Frost shares? When does her holding period begin?

g) What is Frost Corporation's basis in the land and the machinery? When does its holding period begin? How Frost Corporation treat the amount paid to Karen for her services?

Answer: a) Since Sec. 351 does not apply because 25% (20 shares out of 80 total shares) of the stock is issued for se John must recognize $15,000 of capital gain.

b) John's basis in his shares is $30,000 and his holding period begins on the day after the exchange date.

c) Meg recognizes a $5,000 Sec. 1231 loss.

d) Meg's basis in her shares is $30,000 and her holding period begins on the day after the exchange date.

e) Karen must recognize $20,000 of ordinary income.

f) Karen's basis in her shares is $20,000. Her holding period begins on the day after the exchange date.

g) Frost Corporation has a $30,000 basis in the land and a $30,000 basis in the machinery. Its holding peri each asset begins on the day after the exchange date. The services, if capitalized, would have a $20,000 bas services may be amortizable if they are organizational or start-up expenditures.

95) This year, John, Meg, and Karen form Frost Corporation. John contributes land purchased as an investment four years ago for $25,000 that has a $30,000 FMV in exchange for 30 shares of Frost stock. Meg contributes machinery (Sec. 1251 property) purchased four years ago and used in her business having a $50,000 adjusted basis and a $30,000 FMV in exchange for 30 shares of Frost stock. Karen contributes services worth $15,000 and $5,000 cash in exchange for 20 shares of Frost stock.

a) What is the amount of John's recognized gain or loss?

b) What is John's basis in his Frost shares? When does his holding period begin?

c) What is the amount of Meg's recognized gain or loss?

d) What is Meg's basis in her Frost shares? When does her holding period begin?

e) How much income, if any, must Karen recognize?

f) What is Karen's basis in her Frost shares? When does her holding period begin?

g) What is Frost Corporation's basis in the land and the machinery? When does its holding period begin? How Frost Corporation treat the amount paid to Karen for services?

Answer: a) Since Sec. 351 would apply to the exchange, John would not recognize any gain or loss.

b) John's basis is $25,000. His holding period begins in his year of purchase four years ago.

c) Meg does not recognize any loss.

d) Meg's basis is $50,000. Her holding period begins in her year of purchase four years ago.

e) Karen must recognize $15,000 of ordinary income.

f) Karen's basis for her shares is $20,000 and her holding period begins on the day after the exchange dat

g) Frost Corporation's basis in the land and machinery are $25,000 and $30,000, respectively. Because Me contributed loss property, unless an election is made, the basis in the loss property must be reduced to FM the corporation. Frost's holding period for the land begins four years ago. Frost's holding period for the machinery begins the day after transfer to Frost Corporation. The services, if capitalized, would have a $15,000 basis. The services may be amortizable if they are organizational or start-up expenditures.

96) On May 1 of the current year, Kiara, Victor, Pam, and Joe form Newco Corporation with the following investmer

Property Transferred

Transferor	Asset	Basis to Transferor	FMV	Number of common shares issued
Kiara	Land	$12,000	$30,000	
	Building	38,000	70,000	400
	Mortgage and the land & building	60,000	60,000	
Victor	Equipment	25,000	40,000	300
Pam	Van	15,000	10,000	50
Joe	Accounting Services	0	10,000	100

Kiara purchased the land and building several years ago for $12,000 and $50,000, respectively. Kiara has claimed straight-line depreciation on the building. Victor also received a Newco Corporation note for $10,000 due in thre The note bears interest at a rate acceptable to the IRS. Victor purchased the equipment three years ago for $50,00(also receives $5,000 cash. Pam purchased the van two years ago for $20,000.

a) Does the transaction satisfy the requirements of Sec. 351?

b) What are the amounts and character of the reorganized gains or losses to Kiara, Victor, Pam, Joe, and Newco Corporation?

c) What is each shareholder's basis for his or her Newco stock? When does the holding period for the stock beg

d) What is Newco Corporation's basis for its property and services? When does its holding period begin for eac property?

Answer: a) Yes, the transaction meets the requirements of Sec. 351. Transferors of property (Kiara, Victor, & Pam) 88.2% (750/850 = 0.882) of the Newco stock.

b) Kiara must recognize a $10,000 gain, the amount by which the $60,000 mortgage assumed by Newco e the $50,000 basis ($12,000 + $38,000) of all the assets transferred by Kiara. The character of the gain is a Sec 1231 gain. Victor must recognize $10,000 of gain (the lesser of his realized gain of $15,000 on the boot received of $10,000). The gain is ordinary income recaptured under Sec. 1245. Pam realized a $5,000 loss, which is not recognized even though she received cash. Joe must recognize $10,000 ordinary income on compensation for his services. Newco Corporation recognizes neither a gain nor a loss on the issuance of i stock or note.

c) Kiara's basis is zero ($12,000 + $38,000 - $60,000 + $10,000 gain). Her holding period includes her holding period for the land and building. Victor's basis is $25,000 ($25,000 + $10,000 gain - $10,000 boot). His holding period includes his holding period for the equipment. Pam's basis for her stock is $10,000 ($15,000 - $5,000 boot). Her holding period includes the holding period for the van. Joe's basis for his stocl $10,000. His holding period begins on the day after the exchange.

d) Newco Corporation's basis is:

Land	$15,000	[$12,000 + (0.30 × $10,000)]
Building	$45,000	[$38,000 + (0.70 × $10,000)]

The gain is allocated between the two assets based on their relative FMVs. The holding period includes Ki holding period.

Equipment: $35,000 ($25,000 + $10,000).

The holding period includes Victor's holding period.

Van: $15,000.

The holding period includes Pam's holding period.

The $10,000 in accounting services is deductible by Newco Corporation if received subsequent to the start operations. If they are preoperating expenses, they should be analyzed under Sec. 248.

97) Lynn transfers property with a $56,000 adjusted basis and a $100,000 FMV to Florida Corporation for 75 shares o Florida stock. Fred, Lynn's father, transfers property with a $64,000 adjusted basis and a $100,000 FMV to Florida Corporation for the remaining 25 shares of Florida stock.

a) What is the amount of each transferor's gain or loss?

b) What is Lynn's basis for her Florida stock?

c) What is Fred's basis for his Florida stock?

Answer: a) Neither Lynn nor Fred recognizes any gain or loss on the exchange since Sec. 351 applies.

b) Since the exchange is disproportionate, it is likely that Fred has made a gift of 25 shares of Florida stoc Lynn. Lynn's basis in her 75 shares is $88,000 ($56,000 basis in property transferred by Lynn + $32,000 basi 25 shares received from Fred). (This answer assumes no gift taxes were paid by Fred on the transfer.)

c) Fred's basis in his 25 shares is $32,000 [$64,000 - (0.50 × $64,000)].

98) Norman transfers machinery that has a $45,000 basis and a $105,000 FMV and $30,000 in money to Elnor Corpora exchange for 50 shares of Elnor stock. The machinery, used in Norman's business, originally cost him $150,000 ar subject to an $84,000 liability which Elnor Corporation assumes. Kate exchanges $51,000 cash for the remaining 5 of Elnor stock.

a) What is the amount and character of Norman's recognized gain or loss?

b) What is his basis in the Elnor stock?

c) What is Elnor's basis in the machinery?

d) What is the amount and character of Kate's recognized gain or loss?

e) What is Kate's basis in the Elnor stock?

f) When do Norman and Kate's holding periods for their stock begin?

Answer: a) Norman's realized gain is $60,000 [($51,000 + $84,000) - ($45,000 + $30,000)]. He must recognize $9,000 gain, the amount by which the liability transferred ($84,000) exceeds the basis of all property transferred by Norman ($45,000 + $30,000).

b) Norman's basis for his Elnor stock is 0 ($45,000 + $30,000 - $84,000 + $9,000 gain).

c) Elnor's basis in the machinery is $54,000 ($45,000 + $9,000).

d) Kate does not recognize any gain or loss.

e) Kate's basis is $51,000.

f) Norman's holding period includes his holding period for the machinery. Kate's holding period starts (day after the exchange.

99) What is the impact on a transferor if a Sec. 351 exchange involves the assumption of the shareholder's liabilities by the corporation?

Answer: The general rule is that the assumption does not invalidate the Sec. 351 exchange. The liabilities that are assumed are not considered to be boot (Sec. 357(a)). If the assumption or acquisition of any of the liabilities fails to have a business purpose or has a tax avoidance purpose, then all of the liabilities are considered to be money (Sec. 357(b)). Gain is recognized equal to the lesser of the realized gain or money received. If the amount of liabilities assumed or acquired exceeds the adjusted basis of the property transferred, then gain must be recognized in the amount of the excess (Sec. 357(c)).

100) Michael contributes equipment with a $25,000 adjusted basis and a $40,000 FMV to Miller Corporation for 25 of its 50 shares of stock. His son, Michael Jr., contributes $10,000 cash for the remaining 25 Miller shares. What tax issues should Michael and his son consider with respect to the stock acquisitions?

Answer:
- Does the property transfer meet the Sec. 351 requirements?
- Have Michael and his son transferred property?
- Are the transferors in control of the corporation following the transfer?
- Do the transferors receive transferee corporation stock?
- Does the property contribution/receipt of stock as outlined in the facts reflect the true nature of the transaction? Or has a gift or other event occurred?
- What is each shareholder's recognized gain?
- What is each shareholder's basis for his stock?
- What is each shareholder's holding period for his stock?
- If a gift has occurred, has Michael made a taxable gift to his son? (This question could be rewritten for other than a gift — e.g., repayment of a loan.)
- What is Miller Corporation's basis for the property received from Michael?
- What is Miller Corporation's holding period for the property received from Michael?

The contribution is tax-free since it meets all the Sec. 351 requirements, and Michael and Michael Jr. own all the Miller stock. Michael Jr. receives a disproportionate amount of stock compared to his $10,000 capital contribution. It appears that the transaction should be recast so that Michael receives 40 shares of stock, each valued at $1,000. He then gifts 15 shares to Michael Jr. The gift leaves each shareholder with 25 shares of stock. Neither shareholder recognizes any gain, and Michael takes a $25,000 adjusted basis for the 40 shares he receives. He recognizes no gain on the transfer of 15 shares to Michael Jr., and $9.375 [(15/40) × $25,000] of his basis accompanies the gifted shares. Michael's basis for his remaining 25 shares is $15,625 ($25,000 - $9,375). Michael, Jr.'s basis for his 25 shares is $19,375 ($10,000 + $9,375).

101) Stu Walker has owned all 200 shares of Lance Corporation's stock for the past six years. This year, Megan Jones contributes property with a $100,000 basis and a $160,000 FMV for 160 newly issued Lance shares. At the same time, Stu contributes $30,000 in cash for 30 newly issued Lance shares. What tax issues should Megan and Stu consider with respect to the stock acquisitions?

Answer:
- Does the property transfer meet the Sec. 351 requirements?
- Have Stu and Megan transferred property?
- Does the fact that Stu controls Lance Corporation prior to the transfer change the general Sec. 351 rules
- Are the transferors in control of the corporation following the transfer?
- Do the transferors receive transferee corporation stock?
- What is each shareholder's recognized gain?
- What is each shareholder's basis for his or her stock?
- What is each shareholder's holding period for his or her stock?
- Does Lance Corporation recognize gain when it issues its stock?
- What is Lance Corporation's basis for the property received from Megan?
- What is Lance Corporation's holding period for the property received from Megan?

The property transfer meets all the Sec. 351 requirements. Stu and Megan are considered to own all 390 of Lance shares immediately after the exchange. Stu's contribution of cash for stock is not considered to be a nominal amount, according to the IRS rules for private letter rulings (i.e., it equals or exceeds 10% of the value of Stu's prior stock holdings) and permits his stock to be counted toward the 80% minimum stock ownership for control. Megan recognizes no gain on the asset transfer and takes a $100,000 basis for the Lance shares she receives. The holding period for the Lance shares includes her holding period for the property transferred. Lance recognizes no gain when it issues its stock and takes a $100,000 basis for the property.

102) On April 2 of the current year, Jana transfers land with a basis of $140,000 and a fair market value of $120,000 to Amish Corporation in exchange for all of its stock. She had originally acquired the land on December 1, 2002. What tax issues arise from the exchange?

Answer:
- Does the property transfer meet the Sec. 351 requirements?
- Has Jana transferred property?
- Is Jana in control of the corporation following the transfer?
- What is Jana's recognized gain?
- What is Jana's basis for her stock?
- Should Jana elect to take a reduced basis in the stock so that Amish will have a $140,000 basis in the la
- What is Jana's holding period for her stock?
- Does Amish Corporation recognize gain when it issues its stock?
- What is Amish Corporation's basis for the property received from Jana?
- What is Amish Corporation's holding period for the property received from Jana?

The property transfer meets all the Sec. 351 requirements. Neither Jana nor Amish has gain or loss on the exchange. Jana can elect to take a basis of $120,000 in the Amish stock and Amish will have a $140,000 bas the land. If no election is made, Amish will have a basis of $120,000 in the land and Jana's basis in the stock is $140,000. If Amish has a basis of $120,000 in the land, its holding period for the land will begin on the day after the exchange. If Amish takes Jana's basis of $140,000 and Jana reduces her basis in the stock, Amish's holding period for the land begins on December 2, 2000. Jana's holding period for the stock includes the period for which she held the land.

103) Joan transfers land (a capital asset) having a $20,000 adjusted basis to Jet Corporation in a transaction qualifying Sec. 351. In exchange, she received 50 shares of Jet Corporation common stock valued at $50,000, a $15,000 Jet Corporation bond due in 10 years, and a $10,000 Jet Corporation note due in 3 years. What tax issues should Joar consider with respect to the transfer?

a) What is the amount of Joan's realized gain or loss? What is the amount of Joan's recognized gain or loss? Wh character of Joan's recognized gain or loss?

b) What is Joan's basis in her stock? What is Joan's basis in the bond? What is Joan's basis in the note?

c) What is Jet Corporation's basis in the land?

Answer: a)

Amount realized ($50,000 + $15,000 + $10,000)	$75,000	
Minus: Basis in land	(20,000)	
Realized gain	$55,000	
Boot received (bond and note)		$25,000
Gain recognized (capital gain)		$25,000

b) Basis of stock and ten-year bond:
Basis of stock: $20,000 + $25,000 - $25,000 = $20,000
Basis of bond: $15,000 (FMV)
Basis of short-term note: $10,000 (FMV)

c) Basis of land to Jet Corporation is: $20,000 + $25,000 = $45,000.

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

104) The City of Springfield donates land worth $250,000 to Deuce Corporation to induce it to locate in Springfield and provide 1,000 jobs for its citizens. How much gross income must Deuce Corporation recognize because of the land contribution, and what is the land's basis to Deuce Corporation? 104) ______

A) $0 income; $250,000 basis
B) $250,000 income; $0 basis
C) $250,000 income; $250,000 basis
D) $0 income; $0 basis

Answer: C

105) The City of Portland gives Data Corporation $60,000 cash and land worth $100,000 to induce it to move. The cash was not spent during the 12 months following contribution. The contribution results in 105) ______

A) a zero basis in the land and a $60,000 basis reduction in other assets.
B) income recognition in the amount of $160,000 to the corporation at the time of contribution.
C) income recognition in the amount of $60,000 to the corporation 12 months after the time of contribution.
D) a zero basis in the land and $60,000 ordinary income to the corporation 24 months after the time of contribution if the cash is not used to purchase an asset.

Answer: B

106) Mr. Big, a nonshareholder, who is not a customer, potential customer, governmental entity, or civic group, contributes $60,000 cash and land worth $100,000 to induce Carrie Corporation to relocate to his municipality. Carrie Corporation spent $50,000 of the cash within the first 12 months of his contribution to purchase machinery. The contribution results in 106) ______

A) Carrie Corporation recognizes no income as a result of the contribution, the land and machinery have a basis of zero.
B) Carrie Corporation recognizes no income as a result of the contribution, the land has a basis of zero, and the machinery has a basis of $50,000.
C) Carrie Corporation recognizes no income as a result of the contribution, the land has a basis of $100,000, and the machinery has a basis of $60,000.
D) Carrie Corporation recognizes $160,000 of income.

Answer: A

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

107) Ra Corporation issues a twenty-year obligation at its $1,000 face amount. Rames purchases the obligation for $1,000 on the issue date. Due to a decline in interest rates, Ra calls the obligation by paying $1,010 to each of the holders of the twenty-year obligations. What is the tax treatment of the $1,010 by Ra and Rames?

Answer: Rames will recognize a $10 capital gain on the repayment of the debt instrument. Ra will deduct the $10 premium paid as interest expense.

108) The City of Seattle gives Dotcom Corporation $120,000 cash and land worth $200,000 to induce it to relocate to Seattle. Dotcom Corporation did not spend the cash during the 12 months following the contribution. What are the tax consequences to Dotcom Corporation with respect to the contribution?

Answer: $320,000 income is recognized. Dotcom Corporation's basis in the land is $200,000.

109) The City of Providence owns 100% of Triple A Baseball Corporation, a minor league baseball team in their community. The City donates land worth $125,000 to Triple A Corporation so the major league team will not revoke the City's minor league franchise. How much gross income must Triple A Corporation recognize because of the land contribution, and what is the land's basis to Triple A Corporation?

Answer: The corporation recognizes no income and the land has a $0 basis.

110) What is the tax treatment for a contribution of capital to a corporation by a nonshareholder who is not a customer, potential customer, government entity, or civic group?

Answer: The corporation does not recognize income as a result of the capital contribution. The basis of any property contributed by a nonshareholder is zero. The basis of property acquired with a money contribution made by a nonshareholder must be reduced by the amount of the contributed money used toward the purchase. Any money that was contributed and not spent during the 12 months following the contribution reduces the basis of other assets. The order of reduction is: First, depreciable property; then amortizable property; then depletable property; and finally, all other property.

111) Sarah has advanced money to her corporation. What tax issues should she consider with respect to this money?

Answer:
- Is it equity capital or debt?
- Is there a written unconditional promise to pay on demand or on a specific date a certain sum of mone return for an adequate consideration in money or money's worth, and to pay a fixed interest rate?
- Is the debt subordinate to or preferred over other indebtedness of the corporation?
- What is the ratio of debt to equity?
- If debt, is the debt convertible into stock?
- What is the relationship between holdings of stock in the corporation and holdings of the interest in question?

It is important to distinguish between capital and debt. Interest paid with respect to a debt instrument is deductible by the payor corporation, whereas dividends paid are not.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

112) Any losses on the sale of Section 1244 stock are ordinary. 112) ______

Answer: True ✓ False

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

113) Ralph and Yolanda purchased 20% of the initial offering of Major Corporation common stock for $150,000. Major Corporation is a qualifying small business corporation and the stock qualifies as Sec. 1244 stock. Ten months later, Major Corporation files for bankruptcy and the shareholders are notified that the stock is worthless. Ralph and Yolanda, who are married and file a joint return, have a 113) ______

A) $150,000 capital loss.
B) $100,000 ordinary loss; $50,000 capital loss.
C) $150,000 ordinary loss.
D) $100,000 ordinary loss; $50,000 ordinary loss carryforward.

Answer: B

114) Yenhung, who is single, forms a corporation using a tax-free asset transfer, which qualifies under Sec. 351. She contributes property having an adjusted basis of $50,000 and an FMV of $40,000. The stock received from the corporation is Sec. 1244 stock. When Yenhung sells the stock for $30,000, her loss is 114) ______

A)

Ordinary loss	Capital loss
$10,000	$ 0

B)

Ordinary loss	Capital loss
$ 0	$20,000

C)

Ordinary loss	Capital loss
$10,000	$10,000

D)

Ordinary loss	Capital loss
$20,000	$ 0

Answer: C

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

115) Nikki exchanges property having a $20,000 adjusted basis and a $16,000 FMV for 100 shares of Niftik stock in a transaction qualifying under Sec. 351. The stock qualifies as Sec. 1244 stock. Nikki's basis in her Niftik stock is $20,000. If Nikki sells her stock for $5,000, what is the amount and character of her loss?

Answer: Nikki has a $15,000 ($5,000 - $20,000) recognized loss. Her ordinary loss under Sec. 1244 is $11,000 ($5000 - $16,000 Sec. 1244 basis). The remaining $4,000 loss is a capital loss.

116) Darnell, who is single, exchanges property having a $60,000 adjusted basis and a $50,000 FMV for 1,000 shares of Fox Corporation stock in a transaction qualifying under Sec. 351. The stock qualifies as Sec. 1244 stock. If Darnell sells his stock for $30,000, what is the amount and character of his recognized gain or loss?

Answer: Darnell has a $20,000 ordinary loss and a $10,000 capital loss.

Proceeds	$30,000
Adjusted basis in the stock	$60,000
Realized loss	$30,000

For Sec. 1244 purposes, his basis is $50,000. Therefore only $20,000 ($30,000 - $50,000) qualifies as an ordir loss. The remaining $10,000 is a capital loss.

117) Will, a shareholder in Wiley Corporation, lent money to the corporation. The corporation is unable to repay him. What tax issues should Will consider with respect to the loan?

Answer:
- Was the loan evidenced by a security?
- Was there a business purpose for making the loan?
- Is the shareholder an employee of the corporation?
- If so, was the loan made in his capacity as an employee or as a shareholder?
- What are the relative dollar amounts of his stock investment and his compensation?

The type of loss allowed if a shareholder lends money to a corporation that is not repaid depends on the n of the loan. If the unpaid loan was not evidenced by a security, it is either a business or nonbusiness bad debt. Nonbusiness bad debts are deductible only as short-term capital losses when the debt is determined to be totally worthless. Business bad debts are deductible as ordinary deductions without limit when they are either partially or totally worthless. The IRS generally treats a loan made by a shareholder to a corporation in connection with his stock investment as a nonbusiness activity. If the loan is made to protect the shareholder's employment with the corporation, it may be treated as an ordinary loss under the business bad debt rules.

118) Severs Corporation employs Susan as an Advertising Director. Her annual compensation from Severs Corporation is $100,000. Severs Corporation is experiencing financial problems, and Susan lends the corporation $50,000 in 2008 in an attempt to help it through its financial difficulties. Severs Corporation subsequently declares bankruptcy, and in 2010 Susan and the other creditors receive 10 cents on each dollar they are owed. What is the amount and character of Susan's loss?

Answer: Since Susan is not a shareholder in Severs Corporation, her loss of $45,000 ($50,000 × .90) is an ordinary loss and is fully deductible in the year she incurs the loss.

119) Gene purchased land five years ago as an investment. The land cost him $200,000 and is now worth $530,000. Gene plans to transfer the land to Dee Corporation, which will subdivide the land and sell individual parcels. Dee Corporation's profits on the land will be ordinary income. What are the tax consequences of the asset transfer and land sales if Gene contributes the land to Dee Corporation in exchange for all of its stock? What alternative methods can be used to structure the transaction to achieve better tax consequences?

Answer: Gene recognizes no gain when he transfers the land to Dee Corporation. Dee Corporation's basis in the land will be $200,000. All gain on the subsequent sale will be ordinary income to Dee Corporation. This alternative results in the precontribution gain that accrued prior to Gene's transfer and the postcontribution profit originating from subdividing the land being taxed at Dee Corporation's marginal tax rate. Gene could transfer the land to Dee Corporation in exchange for stock and $330,000 of debt instruments. In this case, Gene would recognize $330,000 of long-term capital gain and Dee Corporation's basis in the land would be $530,000. The $330,000 of precontribution capital gain (net of any capital losses that Gene has recognized) is taxed at a 15% capital gains tax rate.

120) Why would a transferor want to avoid the nonrecognition of gain under Sec. 351? How can the nonrecognition provision of Sec. 351 be avoided?

Answer: A transferor may want the corporation to have a higher basis in the property transferred. A higher basis would allow greater depreciation deductions and reduce the gain recognized if the corporation sells the property. The increased depreciation and/or reduced gain may be an advantage because the corporation may be in a higher tax bracket than the transferor. A transferor's gain also may be a capital gain that is reduced by a capital loss so as to be tax-free.
Nonrecognition can be avoided by selling the property to the corporation for cash or cash and debt. The 8(control test may be intentionally avoided by issuing property for services. Also, by using debt in an amou exceeds the transferor's basis or by having debt assumed or acquired without a business purpose, the tran can be required to recognize gain.

121) Discuss the tax planning opportunities that are available in forming a corporation when one of the parties owns property that has a high basis and a low FMV.

Answer: The plan should be formulated to allow the contributor to avoid Sec. 351 and be able to recognize the loss. This can be done by having the transferor sell the property to an unrelated party and then have the transferor contribute cash. The transferor must be careful to avoid the related party rules of Sec. 267, which could prevent the loss from being recognized if the property is sold directly to the corporation. Several other suggestions are explored on pages C:2-34 and C:2-35.

122) Several years ago, John acquired 200 shares of Jersey Corporation stock directly from the corporation for $150,000 in cash. This year, he sold the stock to Bill for $85,000. What tax issues should John consider with respect to the stock sale?

Answer:
- Was the stock sold to a related party (Bill) as defined by Sec. 267(b)? If so, John cannot recognize the lo the remaining issues do not have to be examined.
- Is the stock a capital asset?
- Is Jersey Corporation a qualifying small business corporation?
- If a qualifying small business corporation, does the stock qualify for Sec. 1244 stock treatment?
- If Sec. 1244 stock, what is John's marital and filing status?
- Has John's basis for the stock changed from its initial acquisition cost?
- What is the amount and character of John's recognized loss?

John's stock sale results in a $65,000 ($150,000 - $85,000) long-term capital loss, provided the purchaser w not a related party. If the purchaser is a related party, Sec. 267(a) prevents John from recognizing any loss. Since John is the original holder of the stock, the loss may be characterized as ordinary under Sec. 1244 if the various requirements of Sec. 1244 are satisfied.

123) Discuss the IRS reporting requirements under Sec. 351.

Answer: Both the transferor-shareholders and the transferee corporation must attach a statement to their tax returr the period that includes all the facts pertinent to the exchange and discloses the date of the exchange.

The transferor-shareholder statement would include:

- a description of the property transferred and its adjusted basis to the transferor.
- a description of the stock received in the exchange, including its kind, number of shares, and FMV.
- a description of the securities received in the exchange, including the principal amount, terms, and FM
- the amount of money received.
- a description of any other property received, including its FMV.
- a statement of the liabilities transferred to the corporation, including the nature of the liabilities, when why they were created, and the corporate business reason for their transfer.

The transferee corporation statement would include:

- a complete description of all property received from the transferors.
- the adjusted basis of the property to the transferors.
- a description of the stock issued to the transferors.
- a description of the securities issued to the transferors.
- the amount of money distributed to the transferors.
- a description of any other property distributed to the transferors.
- information regarding the transferor's liabilities that are assumed by the corporation.