EXAMPLIFY PASSWORD:

Advanced Corporate Tax **Spring 2024**
Bogdanski

WRITE YOUR EXAM NUMBER HERE: ________

FINAL EXAMINATION
(Three hours)

INSTRUCTIONS

This examination consists of three essay questions, each of which will be given equal weight in determining grades. Three hours will be permitted for this examination.

The suggested time limit for each question is one hour. Experience has shown that failure to budget one's time according to this limit can result in a drastic lowering of one's overall grade on this examination.

At the end of the three hours, you must turn in this set of questions in the original envelope in which this set came. You must submit your answers using Examplify. No credit will be given for anything written on this set of questions. Only your electronic answer file will be graded.

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. 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 instructed, assume that:

- all shareholders described in the question are individuals and U.S. citizens;
- all entities described in the questions are organized and operated exclusively in the United States;
- all parties described in the questions use the calendar year as their taxable year for federal income tax purposes; and
- all parties described in the questions report their income using the cash method of accounting for such purposes.

Any references to "the Code" are to the Internal Revenue Code of 1986, as amended.

QUESTION 1
(One hour)

Corp is a C corporation with two long-time shareholders, Ana and Barry. At the start of 2024, Ana and Barry each own 100 shares of Corp's only class of stock, voting common stock. The 200 shares are the only Corp stock outstanding. Ana's adjusted basis in all of Ana's Corp stock is $1,000, and Barry's adjusted basis in all of Barry's Corp stock is $3,000, at the start of 2024. Corp's accumulated earnings and profits at the start of 2024 are $10,000. The stock owned by each shareholder has a fair market value of $20,000, or $200 per share, as 2024 begins.

On March 31, 2024, Corp's board of directors declares a dividend under state law. In the dividend transaction, each shareholder is given the option to receive additional shares of Corp's stock, with a fair market value of $2,000, or $2,000 cash. Ana elects to take the additional Corp stock; Barry elects to take the $2,000 cash. Corp makes no other distributions to shareholders in 2024. After these distributions, Ana owns 111 shares of Corp stock, and Barry continues to own 100 shares. Each share of the Corp stock has a fair market value of $180 immediately after the distributions.

In 2024, Corp has a net operating loss for federal income tax purposes of $28,000.

On January 1, 2025, Ana and Barry sell all of their Corp stock to an unrelated buyer, Sharco. Ana receives $19,000 cash from Sharco in payment for all of Ana's stock, including the shares previously received as a dividend. Barry receives $15,000 cash from Sharco in payment for all of Barry's stock. At the time of the sale, Corp owns several assets that have appreciated substantially in value.

Assuming Corp never becomes an S corporation, what are the federal income tax consequences to Ana, Barry, Corp, and Sharco of each of the transactions just described, with and without all available elections? Be sure to discuss the amount, timing, and character (capital or ordinary) of any income, gain, loss, or deduction realized or recognized by each party; and each party's basis in the stock or assets that party holds at each stage of the transactions.

Discuss.

(End of Question 1)

QUESTION 2
(One hour)

On January 2, 2024. Ernie and Finn enter into the following exchanges with their new corporation, ABC: Ernie transfers to ABC $50,000 cash in exchange for 100 shares of ABC's common stock. Finn transfers to ABC a parcel of real estate, Blackacre, in exchange for the other 100 shares of ABC's common stock. Blackacre has a fair market value of $130,000, but it is encumbered by a mortgage of $80,000, so that Finn's "equity" in Blackacre is $50,000. ABC assumes the mortgage liability. Immediately before the exchange, Finn's adjusted basis in Blackacre is $60,000. Each share of stock received by Ernie and Finn has a fair market value of $500.

Two weeks later, Gordon transfers to ABC a truck that he has been using for personal purposes, with a fair market value of $40,000, in exchange for 30 shares of ABC's preferred stock and ABC's promissory note for $10,000. The note calls for payments of $2,000 a year for five years beginning in 2025, plus interest at a market rate on the unpaid balance. According to the terms of the preferred stock, ABC has the right to redeem the preferred stock at any time beginning in 2025 for $33,000 cash. Immediately before the exchange, Gordon's adjusted basis in the truck, which Gordon owns free and clear of any liens or encumbrances, is zero. Each share of preferred stock received by Gordon has a fair market value of $1,000. The ABC promissory note has a fair market value equal to its face amount, $10,000.

Under the articles of incorporation of ABC, each share of common stock and each share of preferred stock has one vote in the election of ABC's board of directors. The preferred stock does not participate in corporate growth to any significant extent.

What are the federal income tax consequences to Ernie, Finn, Gordon, and ABC of each of the transactions just described, with and without all available elections? Be sure to discuss the amount, timing, and character (capital or ordinary) of any income, gain, loss, or deduction realized or recognized by each party; and each party's basis in the stock or assets that party holds at each stage of the transactions.

Explain.

(End of Question 2)

QUESTION 3
(One hour)

Demco is a C corporation with substantial accumulated earnings and profits. Demco has one class of stock outstanding, voting common stock. There are 80 shares of Demco stock outstanding. Of the 80 shares, 40 are owned by Malia, and the other 40 are owned by Firm.

Malia's basis in Malia's Demco stock is $10,000 a share, or $400,000 in the aggregate.

Firm's basis in Firm's Demco stock is $20,000 a share, or $800,000 in the aggregate.

Firm is a limited liability company classified as a partnership for federal tax purposes. The ownership interests in Firm are held by three individuals, Malia, Seth, and Udo. Malia is the same individual who owns Demco stock directly. Seth is Malia's spouse. Udo is unrelated to Seth and Malia. The ownership interests in Firm are held in the following percentages of the capital and profits of Firm:

Member of Firm	Percentage Interest of Firm
Malia	25
Seth	25
Udo	50
Total	*100*

In a single transaction, Demco redeems 8 shares of its stock from Firm and 32 shares of its stock from Malia. For each share redeemed, the shareholder receives from Demco $20,000 cash, and a three-year promissory note of Demco for $30,000, payable $10,000 a year along with interest at a market rate. Each promissory note has a fair market value equal to its face amount. Accordingly, in the redemption, Firm receives $160,000 cash and a promissory note for $240,000, for total consideration of $400,000; Malia receives $640,000 cash and a promissory note for $960,000, for total consideration of $1,600,000.

Assuming Demco never becomes an S corporation, what are the federal income tax consequences to Malia, Firm, and Demco of each of the transactions just described, with and without all available elections? Be sure to discuss the amount, timing, and character (capital or ordinary) of any income, gain, loss, or deduction realized or recognized by each party; and each party's basis in the stock or assets that party holds at each stage of the transactions.

Discuss.

(End of examination)