

Name _____

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Corporate Taxation (ACNT 1347)

Test 01: Chapters 1-10

True/False

___ 01. Many states have balanced budgets because laws or constitutional amendments preclude deficit spending.

___ 02. The U.S. Federal government has a provision in the Constitution which precludes deficit spending.

___ 03. Revenue-neutral tax laws reduce deficits.

___ 04. Olga's proprietorship earned a net profit of \$95,000 during the year and she withdrew \$70,000 of this profit. Olga must report \$70,000 net income from the proprietorship on her individual income tax return (Form 1040).

___ 05. Double taxation of corporate income results because dividend distributions are included in a shareholder's gross income but are not deductible by the corporation.

___ 06. The corporate marginal tax rates range from 10% to 39%, while the individual marginal tax rates range from 15% to 35%.

___ 07. The domestic production activities deduction is limited to manufacturers.

___ 08. The domestic production activities deduction is intended to preserve U.S. manufacturing jobs and discourage their outsourcing.

___ 09. The DPAD is limited by 50% of the total W-2 wages paid by a taxpayer.

___ 10. Similar to like-kind exchanges, the receipt of "boot" under § 351 can cause loss to be recognized.

___ 11. A secret process and patentable invention both constitute "property" for purposes of § 351.

___ 12. The receipt of securities (i.e., long-term debt) in exchange for the transfer of appreciated property to a controlled corporation results in recognition of realized gain to the transferor.

___ 13. Distributions by a corporation to its shareholders are presumed to be a return of capital unless the parties can prove otherwise.

___ 14. A distribution from a corporation will be taxable to the recipient shareholders only to the extent of the corporation's E & P.

___ 15. A distribution in excess of E & P is treated as capital gain by shareholders.

- ___ 16. The Code treats corporate distributions that are a return *from* a shareholder's investment as sales or exchanges and corporate distributions that are a return *of* a shareholder's investment as dividends.
- ___ 17. For tax purposes, all stock redemptions are treated as dividend distributions.
- ___ 18. A shareholder's basis in property received in a stock redemption is the property's fair market value.
- ___ 19. The Federal income tax treatment of a corporate restructuring is an extension of allowing entities to form without taxation.
- ___ 20. For corporate reorganizations, the tax laws should be considered while planning the structure of the reorganization.
- ___ 21. For a corporate restructuring to qualify as a tax-free reorganization, the transaction must have a sound business purpose.
- ___ 22. Tax incentives constitute the primary motivation for most corporations to form a conglomerate and file tax and financial accounting reports on a consolidated basis.
- ___ 23. A consolidated Federal income tax return may be the product of a merger of the affiliates, or of some other tax-favored reorganization.
- ___ 24. Most of the Federal consolidated income tax return rules are found in detailed sections of the Internal Revenue Code.
- ___ 25. The United States has income tax treaties with only members of the European Union.
- ___ 26. Income tax treaties may provide for either higher or lower withholding tax rates on interest income than the rate provided under U.S. statutory law.
- ___ 27. Unused foreign tax credits are carried back one year and then forward 10 years.
- ___ 28. In a limited partnership, all partners are protected from debts of the partnership.
- ___ 29. A limited liability company offers all "members" protection from claims by the LLC's creditors.
- ___ 30. A limited liability limited partnership (LLLP) is a limited partnership (LP) in which all partners, including the general partners, are protected from debts of the partnership.

Multiple Choice:

___ 01. Which provision could best be justified as a means of controlling the economy?

- a. Write-off of research and development expenditures.
- b. Accelerated depreciation method for depreciable capital expenditures.
- c. Amortization of pollution control facilities.
- d. The rehabilitation tax credit.
- e. None of the above.

___ 02. Which provision could best be justified as encouraging small business?

- a. S corporation election.
- b. Percentage depletion.
- c. Domestic production activities deduction.
- d. Interest deduction on home mortgage.
- e. None of the above.

___ 03. Which provision is not justified by social considerations?

- a. Refundable earned income credit.
- b. Adoption tax credit.
- c. Like-kind exchange treatment.
- d. Disallowance of illegal kickbacks.
- e. None of the above.

___ 04. Juanita owns 45% of the stock in a C corporation that had a profit of \$120,000 in 2011. Carlos owns a 45% interest in a partnership that had a profit of \$120,000 during the year. The corporation distributed \$20,000 to Juanita, and the partnership distributed \$20,000 to Carlos. Which of the following statements relating to 2011 is *incorrect*?

- a. Juanita must report \$20,000 of income from the corporation.
- b. The corporation must pay corporate tax on \$120,000 of income.
- c. Carlos must report \$20,000 of income from the partnership.
- d. The partnership is not subject to a Federal entity-level income tax.
- e. None of the above.

____ 05. Norma formed Hyacinth Enterprises, a proprietorship, in 2011. In its first year, Hyacinth had operating income of \$400,000 and operating expenses of \$240,000. In addition, Hyacinth had a long-term capital loss of \$10,000. Norma, the proprietor of Hyacinth Enterprises, withdrew \$75,000 from Hyacinth during the year.

Assuming Norma has no other capital gains or losses, how does this information affect her taxable income for 2011?

- a. Increases Norma's taxable income by \$75,000.
- b. Increases Norma's taxable income by \$160,000.
- c. Increases Norma's taxable income by \$150,000 (\$160,000 ordinary business income – \$10,000 long-term capital loss).
- d. Increases Norma's taxable income by \$157,000 (\$160,000 ordinary business income – \$3,000 long-term capital loss).
- e. None of the above.

____ 06. Elk, a C corporation, has \$370,000 operating income and \$290,000 operating expenses during the year. In addition, Elk has a \$10,000 long-term capital gain and a \$17,000 short-term capital loss. Elk's taxable income is:

- a. \$90,000.
- b. \$80,000.
- c. \$73,000.
- d. \$63,000.
- e. None of the above.

____ 07. Which statement is false?

- a. The AMT is not limited to C corporations.
- b. The DPAD is not limited to C corporations.
- c. The penalty tax on PHCs is not dependent on the existence of a tax avoidance motive.
- d. In the case of a sole proprietor, the DPAD is a deduction *from* adjusted gross income.
- e. All are true.

____ 08. In a sole proprietorship situation, a DPAD would be a:

- a. Deduction *from* AGI.
- b. Deduction *for* AGI.
- c. Possible deduction *from* and deduction *for*.
- d. 9% credit.
- e. All of the above.

____ 09. Which formula is correct for DPAD?

- a. Smaller of 9% of QPAI or 9% of modified AGI, not to exceed 50% of allocable wages.
- b. Larger of 9% of QPAI or 9% of taxable income, not to exceed 50% of allocable wages.
- c. Smaller of 9% of QPAI or 9% of taxable income, not to exceed 60% of allocable wages.
- d. Larger of 9% of QPAI or 9% of alternative minimum tax, not to exceed 60% of allocable wages.
- e. None of the above.

____ 10. Jane and Walt form Orange Corporation. Jane transfers equipment worth \$475,000 (basis of \$100,000) and cash of \$25,000 to Orange Corporation for 50% of its stock. Walt transfers a building and land worth \$525,000 (basis of \$200,000) for 50% of Orange's stock and \$25,000 cash.

- a. Jane recognizes a gain of \$375,000; Walt recognizes a gain of \$325,000.
- b. Jane recognizes a gain of \$25,000; Walt recognizes no gain.
- c. Neither Jane nor Walt recognizes gain.
- d. Jane recognizes no gain; Walt recognizes a gain of \$25,000.
- e. None of the above.

____ 11. Tim, a cash basis taxpayer, incorporates his sole proprietorship. He transfers the following items to newly created Wren Corporation.

	Adjusted Basis	Fair Market Value
Cash	\$ 20,000	\$ 20,000
Building	\$110,000	\$160,000
Mortgage payable (secured by the building and held for 15 years)	\$135,000	\$135,000

With respect to this transaction:

- a. Wren Corporation's basis in the building is \$110,000.
- b. Tim has no recognized gain.
- c. Tim has a recognized gain of \$25,000.
- d. Tim has a recognized gain of \$5,000.
- e. None of the above.

____ 12. Rick transferred the following assets and liabilities to Warbler Corporation.

In return, Rick received \$75,000 in cash plus 90% of Warbler Corporation's only class of stock outstanding (fair market value of \$225,000).

	Adjusted Basis	Fair Market Value
Building	\$210,000	\$225,000
Equipment	45,000	75,000
Trucks	15,000	30,000
Mortgage (held for four years) on building	30,000	30,000

- a. Rick has a recognized gain of \$60,000.
- b. Rick has a recognized gain of \$75,000.
- c. Rick's basis in the stock of Warbler Corporation is \$270,000.
- d. Warbler Corporation has the same basis in the assets received

as Rick does in the stock.

- e. None of the above.

____ 13. The tax treatment of corporate distributions at the shareholder level does not depend on:

- a. The character of the property being distributed.
- b. The earnings and profits of the corporation.
- c. The basis of stock in the hands of the shareholder.
- d. Whether the distributed property is received by an individual or a corporation.
- e. None of the above.

____ 14. Scarlet Corporation (a calendar year taxpayer) has taxable income of \$150,000, and its financial records reflect the following for the year.

Federal income taxes paid	\$55,000
Net operating loss carryforward deducted currently	35,000
Gain recognized this year on an installment sale from a prior year	22,000
Depreciation deducted on tax return (ADS depreciation would have been \$5,000)	20,000
Interest income on Iowa state bonds	4,000

Scarlet Corporation's current E & P is:

- a. \$127,000.
- b. \$107,000.
- c. \$97,000.
- d. \$57,000.
- e. None of the above.

____ 15. Platinum Corporation, a calendar year taxpayer, has taxable income of \$500,000. Among its transactions for the year are the following:

Collection of proceeds from insurance policy on life of corporate	\$75,000
Realized gain (not recognized) on an involuntary conversion	10,000
Nondeductible fines and penalties	40,000

Disregarding any provision for Federal income taxes, Platinum Corporation's current E & P is:

- a. \$455,000.
- b. \$535,000.
- c. \$545,000.
- d. \$625,000.
- e. None of the above.

____ 16. Five years ago, Eleanor transferred property she had used in her sole proprietorship to Blue Corporation for 1,000 shares of Blue Corporation in a transaction that qualified under § 351. The assets had a tax basis to her of \$100,000 and a fair market value of \$270,000 on the date of the transfer. In the current year, Blue Corporation (E & P of \$800,000) redeems 250 shares from Eleanor for \$220,000 in a transaction that does not qualify for sale or exchange treatment. With respect to the redemption, Eleanor will have a:

- a. \$195,000 capital gain.
- b. \$220,000 capital gain.
- c. \$195,000 dividend.
- d. \$220,000 dividend.
- e. None of the above.

____ 17. Finch Corporation distributes property (basis of \$140,000, fair market value of \$200,000) to a shareholder in a distribution that is a qualifying stock redemption. The property is subject to a liability of \$90,000, which the shareholder assumes. The basis of the property to the shareholder is:

- a. \$0.
- b. \$50,000.
- c. \$110,000.
- d. \$140,000.
- e. None of the above.

____ 18. Kite Corporation has 1,000 shares of stock outstanding. Kent owns 250 shares, Kent's father owns 150 shares, Kent's brother owns 250 shares, and Kent's son owns 50 shares. Plover Corporation owns the other 300 shares in Kite Corporation. Kent owns 60% of the stock in Plover Corporation. Applying the § 318 stock attribution rules, how many shares does Kent own in Kite Corporation?

- a. 250.
- b. 400.
- c. 450.
- d. 630.
- e. None of the above.

____ 19. All of the following statements are true about corporate reorganization *except*:

- a. Taxable amounts for shareholders are classified as a dividend or capital gain.
- b. Reorganizations receive treatment similar to corporate formations under § 351.
- c. The transfers of stock to and from shareholders qualify for like-kind exchange treatment.
- d. The value of the stock received by the shareholder less the gain not recognized (postponed) will equal the shareholder's basis in the stock received.
- e. All of the above statements are true.

____ 20. Which of the following statements is true concerning *all* types of tax-free corporate reorganizations?

- a. Assets are transferred from one corporation to another.
- b. Stock is exchanged with shareholders.
- c. Liabilities that are assumed when cash is also used as consideration will be treated as boot.
- d. Corporations and shareholders involved in the reorganization may recognize gains but not losses.
- e. None of the above statements is true.

____ 21. A shareholder bought 2,000 shares of Zee Corporation for \$90,000 several years ago. When the stock is valued at \$200,000, Zee redeems these shares in exchange for 6,000 shares of Yea Corporation stock. This transaction meets the requirements of § 368. Which of the following statements is true with regard to this transaction?

- a. The shareholder has a recognized gain of \$110,000.
- b. The shareholder has a postponed gain of \$110,000.
- c. The shareholder has a basis in the Yea stock of \$200,000.
- d. Gain or loss cannot be determined because the value of the Yea stock is not given.
- e. None of the above statements is true.

____ 22. Which of the following potentially is a disadvantage of electing to file a Federal consolidated corporate income tax return?

- a. Recognition of losses from certain intercompany transactions is deferred.
- b. The taxation of intercompany dividends is not eliminated.
- c. The tax basis of investments in the stock of subsidiaries is unaffected by members contributing to consolidated taxable income.
- d. The § 1231 loss of one member is not offset against the § 1231 gain of another member of the group.

____ 23. Which of the following is *not* generally a disadvantage of filing Federal corporate income tax returns on a consolidated basis?

- a. Compliance costs usually are higher when a consolidation election is in effect.
- b. Realized losses from transactions between affiliates are not recognized immediately.
- c. Capital gains from one affiliate can be offset by the capital losses from another. This can reduce the tax liabilities of the group as a whole.
- d. The election generally is binding for future tax years.

____ 24. Which of the following potentially is a *disadvantage* of electing to file a Federal corporate income tax consolidated return?

- a. Additional administrative costs in complying with the election.
- b. Deferral of gains realized in transactions between group members.
- c. Increased basis in the stock of a subsidiary that generates annual taxable income.
- d. Dividends received deduction for payments from a subsidiary to the group's parent.

____ 25. GreenCo, a domestic corporation, earns \$25 million of taxable income from U.S. sources and \$5 million of taxable income from foreign sources. What amount of taxable income does GreenCo report on its U.S. tax return?

- a. \$30 million.
- b. \$25 million.
- c. \$30 million less any tax paid on U.S. income.
- d. \$25 million less any tax paid on the foreign income.

____ 26. Without the foreign tax credit, double taxation would result when:

- a. The United States taxes the U.S.-source income of a U.S. resident.
- b. The United States and a foreign country both tax the foreign-source income of a U.S. resident.
- c. A foreign country taxes the foreign-source income of a nonresident alien.
- d. Only the United States taxes the foreign-source income of a U.S. resident (e.g., a treaty prevents foreign taxation).

____ 27. U.S. income tax treaties:

- a. Provide rules by which multinational taxpayers avoid double taxation.
- b. Provide for taxation exclusively by the source country.
- c. Provide that the country with the highest tax rate will be allowed exclusive tax collection.
- d. Provide for taxation exclusively by the country of residence.

____ 28. Which of the following partnership owners *is* personally liable for the entity's debts to general creditors?

- a. A partner in a limited liability partnership.
- b. A member of a limited liability company.
- c. A limited partner in a limited partnership.
- d. A general partner in a limited partnership.
- e. None of these owners are personally liable for entity debts.

____ 29. Which one of the following statements regarding partnership taxation is *incorrect*?

- a. A partnership is not a taxable entity for Federal income tax purposes.
- b. Partnership income is comprised of ordinary partnership income or loss and separately stated items.
- c. A partnership is required to file a return with the IRS.
- d. A partner's profit-sharing ratio equals the partner's loss-sharing ratio.
- e. All of these statements are correct.

____ 30. On a partnership's Form 1065, which of the following statements is *not* true?

- a. The partnership reconciles its net income (including separately stated items) to book income on Schedule M-1 or M-3.
- b. The partnership balance sheet on Schedule L is generally presented on a financial (book) basis.
- c. All partnership income and expense items are reported on Form 1065, page 1.
- d. The partnership's equivalent of taxable income is reported in the "Analysis of Income (Loss)."
- e. All of the above statements are true.

Essay:

1. What is the wherewithal to pay concept? Give an example.
2. Compare the basic tax and nontax factors of doing business as a partnership, an S corporation, and a C corporation. Circle the correct answers.

Tax Questions	Column A Partnership	Column B S Corporation	Column C C Corporation
Who pays tax on the entity's income?	Partners Partnership	Shareholders S corporation	Shareholders C Corporation
Are operating losses passed through to owners?	Yes No	Yes No	Yes No
Are capital gains (losses) reported on owners' tax returns as such?	Yes No	Yes No	Yes No
Are distributions of profits taxable to owners?	Yes No	Yes No	Yes No
Nontax Factors	Partnership	S Corporation	C Corporation
Is the liability of owners limited?	Yes No	Yes No	Yes No
Is there free transferability of ownership interests?	Yes No	Yes No	Yes No

3. Why is the DPAD benefit somewhat unique?
4. When forming a corporation, a transferor-shareholder may choose to receive some corporate debt along with stock. Identify some of the issues the transferor must consider when deciding whether debt should be a part of the transaction.
5. Briefly describe the reason a corporation might distribute a property dividend to a shareholder in lieu of a cash distribution. Describe the tax effects of the property distribution on the shareholder and on the corporation.
6. Explain the stock attribution rules that apply in the case of stock redemptions.
7. There are several different types of corporate reorganizations allowed by the Internal Revenue Code. Provide a brief description of each type.
8. Outline the major advantages and disadvantages of filing Federal corporate income tax returns on a consolidated basis. Limit your comments to the income tax effects of the election.
9. Discuss the primary purposes of income tax treaties.
10. Harry and Sally are considering forming a partnership. Both taxpayers use the calendar year and are cash basis taxpayers. The partnership will not be a tax shelter. The partners are uncertain as to whether the partnership should use the cash or accrual method of accounting. Also, the idea of a tax deferral in the first year of operations has led them to consider using a June 30 fiscal year-end for the partnership.

As their tax adviser, identify the issues that must be considered in selecting an accounting method and tax year for the partnership.