1973

Advanced Corporate Tax (1973)

William & Mary Law School

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Question 1 - 90 minutes

The X Corporation organized in 1965 has the following assets and no liabilities:

<table>
<thead>
<tr>
<th>ASSET</th>
<th>BASIS</th>
<th>FMV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Apartment Building</td>
<td>400,000</td>
<td>500,000</td>
</tr>
<tr>
<td>Developed Lots (a subdivision)</td>
<td>100,000</td>
<td>200,000</td>
</tr>
<tr>
<td></td>
<td>800,000</td>
<td>1,000,000</td>
</tr>
</tbody>
</table>

The Corporation has earnings and profits of $40,000.

The Corporation at its inception in 1965 purchased the apartment building and has been operating the apartment building since that time. The stockholders, A (50%), a lawyer; B (35%), a dealer in real estate; and C (15%), a dentist; in 1970 contributed 300,000 additional capital to the Corporation. The Corporation invested the money in two separate tracts of land. One hundred and fifty thousand was used for the purchase and development of tract 1, which was sold as 30 separate building lots for a total realization of $250,000. (No taxes were paid because the excess deductions generated from the apartment building offset that income). The 250,000 realized on the sale was invested in short term treasury bills. The remainder of the contributed $300,000 (150,000) was invested in tract 2. Thirty building lots have been developed, each having a basis of $5,000. Ten lots have been sold at basis. The $50,000 realized on the sales was also invested in short term treasury bills. The remaining 20 lots, on advice of former tax counsel, have been taken off the market in order to permit appreciation and also, as tax counsel put it, "to age". These lots have now appreciated to a value of $200,000.

The shareholders, none of whom are related, (in fact they have no relatives) have no interest in any other corporation. Their basis in the stock is.

- A - $400,000
- B - $275,000
- C - $100,000

The shareholders would like to dispose of their interests in the Corporation. They are willing to sell on the installment basis, but in no event do they want the payments to extend beyond four years. There is no buyer in view for all of the property in the corporation but there is a buyer who is presently willing to purchase all of the 20 lots in tract 2. The buyer, Corporation X, is willing to sign a contract immediately with closing fixed for 6 months from now, at which time it will pay $100,000—the balance of $100,000 to be paid in two equal annual installments of $50,000 each with interest of 7%. With an intensive search, there is a good chance that a buyer for the apartment building could be found in the next year.

Discuss completely the tax problems involved in the sale of the Corporate holdings or Corporate stock. Formulate a plan which, from a tax standpoint, is the most advantageous way to carry out the disposition, but discuss other plans and indicate why those may cause tax problems.

Question 2 - 20 minutes

Your client A, a superstar in the National Basketball Association, would like to use a corporation to shelter some investment earnings from inclusion in his own income, at least for the next 5 years. It is contemplated that the corporation will have gross rental income in the amount of $60,000. The deductions attributable to the rent will not exceed $20,000. The corporation will have additional interest and dividend income totaling $40,000. It is not contemplated that any deductions will result from these investments. What kind of a distribution policy would you suggest for the corporation? Will later changes in this policy be necessary if the retained earnings are reinvested in rental and non rental property in such a way that the income from each will be in the same proportions as set forth above? If a change in the policy will be necessary, when should it be made? What change would you suggest, if any, at that time?
Question 3 - 70 minutes

For purposes of this question, L Co. has the following characteristics: operating assets (§ 1231) with adjusted bases of $500 and an FMV of $200; a deficit in its earnings account of $200; and unused net operating loss carryovers of $10 from 1968, $30 from 1969, $30 from 1970, $20 from 1971, and $10 from 1972. L Co. is engaged in the manufacture and sale of electronics products. All of L's stock is owned by A whose basis therefore is $300. It may be assumed that L will continue to lose $10 per year for the next five years. L's business will be continued unless otherwise stated.

G Co. is a profitable corporation with the following tax attributes: G's operating assets have adjusted bases of $400 and an FMV of $800. G has been earning $100 per year before taxes and has accumulated earnings of $300. All of G's stock is owned by B and such stock has an FMV of $1,000 (B's basis therefore is $200). G is engaged in the publishing business.

All transactions herein will occur on 12/31/72 and will take place at arm's length. Both G and L corporations are on the accrual basis method of accounting and both use a calendar year.

In the following questions determine the extent to which the tax attributes of L and G will survive the particular transaction in question.

(A) 1. L purchases all of G's operating assets for cash and notes and conducts the G business as a separate division.

2. L purchases all of G's stock for cash and notes and alternatively:
   (a) L and G file consolidated returns;
   (b) L liquidates G under § 332;
   (c) L merges downstream into G.

3. What effect on your above answers if:
   (a) shortly before the transactions in questions (1) and (2), all of L's stock was acquired by C?

(B) 1. L acquires all of G's stock in a Type B reorganization and alternatively:
   (a) L and G file consolidated returns;
   (b) L liquidates G under § 332;
   (c) L merges downstream into G.

2. G acquires all of L's operating assets in exchange for 15% of its voting stock.
   (a) Suppose instead that S, a wholly owned subsidiary of G, acquired the L assets for the stock of G after being organized by G for this purpose?