1962

Advanced Income Taxation: Final Examination (June 6, 1962)

William & Mary Law School

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1. Corporation M was formed in 1910 by
   A (an individual) who contributed $5000 for 50 shs.
   B (a corporation) which contributed $5000 for 50 shs.

   M invested the $30,000 in timber land in 1910
   On March 1, 1913, the value of the land was $30000
   On Dec. 30, 1961, B sold its stock to Corp. X for $25000
   On Dec. 31, 1961, M sold the land to General Motors for $60000 cash
   On Jan. 1, 1962, M bought in the market 1050 shs. of General Motors for $50 a share.

   Assume (1) no other transactions than specified above; and, (2) for the purpose of
   this problem, no questions of personal holding company status or accumulated earnings --
   please answer the following questions:

   Tax effect (kind and amount) in respect to all parties--

   (a) B's sale of stock to X?
   (b) M's sale of land to GM for $60000 cash?
   (c) If M had distributed $20000 in cash received from GM to each stockholder on Dec. 31, 1961?
   (d) If, in lieu of question (c), M had distributed 400 shs. of GM stock (value $50) to each stockholder on Jan. 1, 1962?
   (e) If GM had bought the land from M by giving M 1200 shs. of its stock worth $60000 rather than cash of $60000?
   (f) If GM had acquired the use of the land on Dec. 31, 1961, by exchanging during 1961 600 shs. of its stock worth $50 a share, to each of M's stockholders for the 50 shares of M held by cash, without liquidating M?
   (g) If GM had acquired the land by its transfer to GM by M in exchange for 1200 shs. of GM stock worth $50 a share with M immediately distributing the GM stock to its shareholders in exchange for M stock and then liquidating?

2. The Y Corp. had outstanding $500000 principal amount of 4% bonds which matured on 10/1/61. The corporation was not in a position to pay the bond holders off in cash. It, therefore, discharged the bonds by issuing 5 shares of 5% preferred stock for each $100 face amount of the bonds. Individual A had bought a $500 bond in 1958 for $250. On 10/1/61, he received 25 shares of preferred stock in exchange for his bond. On that date the stock had a fair market value of $25 a share. What was the amount of his recognized gain, if any, on this transaction?

3. In 1956, Ind. A purchased 60 shares of 4% pfd. stock of the N Corp. at $105 per share. On 11/1/61, the N Corp. was absorbed by the O Co. under a statutory merger. In accordance with plans of reorganization, all holders of M Co. 4% pfd. stock were required to surrender their stock and receive in exchange one share of O Co. stock plus $4 cash for each share of 4% pfd. stock surrendered. On 12/31/61, Ind. A surrendered his 4% pfd. stock and received 60 shares of O Co. 6% pfd. stock and $210 cash. On that date, the O Co. stock had a fair market value of $100 per share. (a) What was Ind. A's recognized loss, if any, on the exchange? (b) What was the basis of the O Co. stock?

4. (a) In connection with a recapitalization, a shareholder exchange 100 shares of stock which cost him $10000 for 100 shares of new stock worth $105000, and a security in the principal amount of $1000 with a fair market value of $990. What is the amount, if any, of the recognized gain?
   (b) What would be the results if the facts were the same except that the shareholder also surrendered a security in the same company, of a principal amount of $1000 which had cost him $700?
5. The Y Corp, closely held by five individuals, relatives of one another, had in 1960 outstanding capital stock of $500000 in voting common stock, par value $100. For the year 1960 its business operations netted $150000 after all expenses and taxes. Its surplus account balance on January 1, 1960 stood at $250000. Before the end of the year a stock dividend at 40% of the total par value of the outstanding common stock was declared and paid in 5% non-voting and non-cumulative pfds. stock with a par value of $100 and a redemption value of $110. The fair market value of the preferred stock at the date of issuance was $105 and that of the common, $110. In 1961 net profit amounted to $150000. A nominal cash dividend of 1% on the common stock was declared and paid and the board of directors made a decision to redeem out of surplus all the outstanding preferred stock at the stipulated redemption value. A, one of the five stockholders, paid in $200000 as capital contribution for 2000 shares of the common stock at the date of organization. How would the above transactions of the corporation affect his taxable income in 1960 and 1961?

6. (a) The A Co. in exchange for certain property, acquired all the stock of the B Co. in 1950. On 9/17/61, as a result of a decision that the B Co. could be run more efficiently as a separate unit, A Co. gave its stock holders one share of the subsidiary's stock for each share owned of its own stock. The stockholders were not required to give up any of their stock and both corporations continued to engage in the publishing business. While not all of the subsidiary's stock was distributed, the amount given was sufficient to constitute control. Did the receipt of the subsidiary's stock result in any tax liability for the shareholders of A Co.?

(b) Individual C purchased 100 shares of the A Co. in 1952 at $10 a share. On 9/17/61 he received 100 shares of the B Co. with a market value of $3 per share as a result of the transaction described in (a) above. Does any tax liability result from the receipt of the B Co. stock; and, if so, how much?

7. The A Co. owned 87% of all classes of voting and non-voting stock of its subsidiary the B Co. Business expediency demands the merging of the subsidiary into the parent company, but the Parent, the A Corp. does not wish to incur any taxable gain on the transaction. Legal difficulties make a reorganization impossible. Can the corporation absorb its subsidiary with no gain or loss recognized under a method other than reorganization, and, if so, please explain how?

8. Taxpayer owned at the time of his death the entire 10000 outstanding shares of B Corp., which he had purchased in June 1936, for $100000. He died on February 1, 1961, on which date the B stock had a fair market value of $200 a share. Mr. A's gross estate had a value of $2500000. The corporation redeemed 2500 shares on December 22, 1961, at a price of $200 per share, the then fair market value of the stock. The executors used $400000 of the amount received from the redemption to pay the estate taxes and the funeral and administrative expenses, and the balance of $100000 was used to pay off a personal note of the decedent. On Dec. 22, 1961, the corporation had earnings and profits of $950000. How would the distribution in redemption affect the taxable income of the estate?

9. Please indicate very briefly in summary manner how you would explain to a layman type board of directors of an average size manufacturing corporation the salient purposes and objectives of Subchapter C.