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 <u>incorrect</u>? 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 <u>incorrect</u>? 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 <u>not</u> 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 b 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 in 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 claimec 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 ε 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 Corpor 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 o 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.

Exam

Name________________________________

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

1) The term "gross income" means the total of all income from any source, but after reduction for exclusions.

Answer: ✔ True False

2) Although exclusions are usually not reported on an individual's income tax return, interest income on state and local government bonds must be reported on the tax return.

Answer: ✔ True False

3) Generally, deductions <u>for</u> (not from) adjusted gross income are personal expenses specifically allowed by tax law.

Answer: True ✔ False

4) Generally, itemized deductions are personal expenses specifically allowed by the tax law.

Answer: ✔ True False

5) Taxpayers have the choice of claiming either deductions <u>for</u> AGI or the standard deduction.

Answer: True ✔ False

6) Refundable tax credits are allowed to reduce or totally eliminate a taxpayer's tax liability but any credits in excess of the tax liability are lost.

Answer: True ✔ False

7) Nonrefundable tax credits are allowed to reduce or totally eliminate a taxpayer's tax liability but any credits in excess of the tax liability are lost.

Answer: ✔ True False

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

8) Taxable income for an individual is defined as
A) AGI reduced by itemized deductions and tax credits.
B) AGI reduced by tax credits.
C) AGI reduced by the greater of the standard deduction or itemized deductions.
D) gross income reduced by itemized deductions.

Answer: C

9) All of the following items are generally excluded from income <u>except</u>
A) child support payments.
B) interest on state and local government bonds.
C) interest on corporate bonds.
D) life insurance proceeds paid by reason of death.

Answer: C

10) All of the following items are included in gross income <u>except</u>
A) interest earned on a bank account.
B) pension benefits received.
C) child support payments received.
D) rent income.

Answer: C

11) All of the following items are deductions <u>for</u> adjusted gross income <u>except</u>

A) state and local income taxes.
B) trade or business expenses.
C) charitable contributions made.
D) rent and royalty expenses.

Answer: A

12) All of the following items are deductions <u>for</u> adjusted gross income <u>except</u>

A) unreimbursed employee business expenses.
B) one-half of self-employment taxes on year's earnings.
C) qualifying contributions to individual retirement accounts.
D) interest on student loans.

Answer: A

13) Which of the following credits is considered a refundable credit?

A) adoption expense credit
B) credit for elderly and disabled
C) earned income credit
D) lifetime learning credit

Answer: C

14) A single taxpayer provided the following information for 2018:

Salary	$80,000
Interest on local government bonds (qualifies as a tax exclusion)	4,000
Allowable itemized deductions	13,000

What is taxable income?

A) $71,000
B) $62,950
C) $67,000
D) $80,000

Answer: C

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

15) Hannah is single with no dependents and has a salary of $102,000 for 2018, along with tax exempt interest incom $3,000 from a municipality. Her itemized deductions total $12,600.

Required: Compute her taxable income.

Answer:

Salary	$102,000
(Interest income is excluded)	
Less:	
Itemized deductions	(12,600)
Taxable income	$ 89,400

16) Kadeisha is single with no dependents and has a salary of $102,000 for 2018, along with tax exempt interest incor $3,000 from a municipality. Her itemized deductions total $11,600.

Required: Compute her taxable income.

Answer:

Salary	$102,000
(Interest income is excluded)	
Less:	
Standard deduction	(12,000)
Taxable income	$ 90,000

17) The following information is available for Bob and Brenda Horton, a married couple filing a joint return, for 2018. Bob and Brenda are age 32 and have no dependents.

Salaries	$200,000
Interest income	12,000
Deductible IRA contributions	11,000
Itemized deductions	25,600
Withholding	31,000

a. What is the amount of their gross income?
b. What is the amount of their adjusted gross income?
c. What is the amount of their taxable income?
d. What is the amount of their tax liability (gross tax), rounded to the nearest dollar?
e. What is the amount of their tax due or (refund due)?

Answer:

	Hortons	
Salary	$200,000	
Interest	12,000	
Gross Income	$212,000	a.
Minus: IRA Contributions	11,000	
Adjusted gross income	$201,000	b.
Minus: Itemized deductions	(25,600)	
Taxable Income	$175,400	c.
Tax liability (using Rate Schedule) *	$30,675	d.
Minus: Withholding	- 31,000	
Tax due (refund)	($ 325)	e.

*$28,179 + [.24 (175,400 - 165,000)]

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

18) The standard deduction is the maximum amount of itemized deductions which may be claimed by a taxpayer and is based on an individual's filing status, age, and vision.

Answer: True ✓ False

19) Nonresident aliens are allowed a full standard deduction.

Answer: True ✓ False

20) The standard deduction may not be claimed by one married taxpayer filing a separate return if the other spouse itemizes deductions.

Answer: ✓ True False

21) A qualifying child of the taxpayer must meet the gross income test.

Answer: True ✓ False

22) For purposes of the dependency exemption, a qualifying child must be under age 19, a full-time student under age 24, or a permanently and totally disabled child.

Answer: ✓ True False

23) For purposes of the dependency criteria, a qualifying child may not provide more than one-half of his or her own support during the year.

Answer: ✔ True False

24) Parents must provide more than half the support of their child under the age of 19 in order for the child to be considered as a dependent *qualifying child*.

Answer: True ✔ False

25) A daughter or son may not satisfy the criteria to be considered a qualifying child but may still qualify as a dependent.

Answer: ✔ True False

26) One requirement for claiming a dependent as a qualifying relative is that the taxpayer provides more than 50 percent of the dependent's support (assuming it is not a multiple support agreement situation).

Answer: ✔ True False

27) When two or more people qualify to claim the same person as a dependent, a taxpayer who is entitled to the exemption through the qualified child rules has priority over a taxpayer who meets the requirements for other relatives.

Answer: ✔ True False

28) The person claiming a dependent under a multiple support declaration must provide more than 25% of the dependent's support.

Answer: True ✔ False

29) Generally, in the case of a divorced couple, the parent who has physical custody of a child for the greater part of the year is entitled to claim the child as a dependent.

Answer: ✔ True False

30) A child credit is a partially refundable credit.

Answer: ✔ True False

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

31) In 2018, the standard deduction for a married taxpayer filing a joint return and who is 67 years old with a spouse who is 65 years old is

A) $24,000. B) $25,300. C) $26,600. D) $27,200.

Answer: C

32) In 2018, Brett and Lashana (both 50 years old) file a joint tax return claiming as a dependent their son who is blind. Their standard deduction is

A) $25,600. B) $13,600. C) $24,000. D) $25,300.

Answer: C

33) Annisa, who is 28 and single, has adjusted gross income of $55,000, itemized deductions of $5,000 and a lifetime learning credit of $1,000. In 2018, Annisa will have taxable income of

A) $42,000. B) $43,000. C) $50,000. D) $55,000.

Answer: B

34) On June 1, 2018, Ellen turned 65. Ellen has been a widow for five years and has no dependents. Her standard deduction is

A) $25,300. B) $13,600. C) $24,000. D) $12,000.

Answer: B

35) Taquin, age 67 and single, paid home mortgage interest of $5,000, charitable contributions of $5,000 and property taxes of $4,000 in 2018. He has no dependents. In addition to the personal exemption, Taquin will claim a deduction from AGI of

A) $14,000. B) $13,600. C) $15,300. D) $15,600.

Answer: A

36) The regular standard deduction is available to which one of the following taxpayers?

A) a nonresident alien
B) a married taxpayer filing a separate return where the other spouse itemizes
C) a person who has only unearned income and is a dependent of another
D) None of the above.

Answer: D

37) Husband and wife, who live in a common law state, are eligible to file a joint return for 2018, but elect to file separately. Wife has adjusted gross income of $25,000 and has $2,200 of expenditures which qualify as itemized deductions. Husband deducts itemized deductions of $14,200. What is the taxable income for the wife?

A) $25,000 B) $22,800 C) $13,000 D) None of the above.

Answer: B

38) Lewis, who is single, is claimed as a dependent by his parents. He received $2,000 during the year in dividends, which was his only income. What is his standard deduction for 2018?

A) $1,050 B) $2,000 C) $12,000 D) $2,350

Answer: A

39) Charlie is claimed as a dependent by his parents in 2018. He received $8,000 during the year from a part-time acting job, which was his only income. What is his standard deduction?

A) $8,000 B) $8,350 C) $12,000 D) $1,050

Answer: B

40) Deborah is claimed as a dependent by her parents. She had a part-time acting job during 2018 and earned $13,000 during the year, which was her only income. What is her standard deduction?

A) $1,050 B) $13,350 C) $13,000 D) $12,000

Answer: D

41) Cheryl is claimed as a dependent by her parents. She had a part-time job during 2018 and earned $4,900 during the year, in addition to $600 of interest income. What is her standard deduction?

A) $1,050 B) $12,000 C) $4,900 D) $5,250

Answer: D

42) Ben, age 67, and Karla, age 58, have two children who live with them and for whom they provide total support. Their daughter is 21 years old, blind, is not a full-time student and has no income. Her twin brother is 21 years old, has good sight, is a full-time student and has income of $4,800. Which of the following statements is correct regarding Ben and Karla's ability to claim the twins as dependents?

A) The couple can only claim the son as a dependent.
B) The couple can only claim the daughter as a dependent.
C) The couple can claim both twins as dependents.
D) The couple cannot claim either twin as a dependent.

Answer: C

43) Sarah, who is single, maintains a home in which she, her 15-year-old brother, and her 21-year-old niece live. Sarah provides the majority of the support for her brother, her niece, and her cousin, age 18, who is enrolled full-time at the university and lives in an apartment. While the niece and cousin have no income, her brother has a part-time job and earns $4,500 per year. How many dependents may Sarah claim?

A) 1 B) 2 C) 3 D) None

Answer: B

44) Anita, who is divorced, maintains a home in which she and her 16-year-old daughter live. Anita provides the majority of the support for her daughter and for a son, age 23, who is enrolled part-time at the university and lives in the dorm. The son also works in the campus bookstore and earns spending money of $4,500. Which of the following statements is correct regarding the number of dependents Anita can claim?

A) Anita can claim her daughter, but not her son, as a dependent.
B) Anita can claim her son, but not her daughter, as a dependent.
C) Both the son and daughter qualify as Anita's dependents.
D) Neither the daughter nor the son qualify as Anita's dependent.

Answer: A

45) John supports Kevin, his cousin, who lived with him throughout 2018. John also supports three other individuals not live with him:

Donna, who is John's mother
Melissa, who John's stepsister
Morris, who is Kevin's brother

Assume that Donna, Melissa, Morris, and Kevin each earn less than $4,150. How many dependents can John clai

A) 1 B) 2 C) 3 D) 4

Answer: C

46) Julia provides more than 50 percent of the support for three individuals: Theresa, an unrelated child who lives with Julia all year long; Margaret, Julia's cousin, who lives in another city; and Emma, Julia's daughter, who lives in her own home. Each of the potential dependents earned less than $4,150. How many dependents can Julia claim?

A) 0 B) 1 C) 2 D) 3

Answer: C

47) David's father is retired and receives $14,000 per year in Social Security benefits. David's father saves $4,000 of the benefits and spends the remaining $10,000 for his support. How much support must David provide for his father to meet the dependent support requirement?

A) $14,000 B) $14,001 C) $10,001 D) $10,000

Answer: C

48) Which of the following is not considered support for the dependent support test?
A) clothing
B) value of services rendered by the taxpayer for the dependent
C) rental value of lodging
D) food

Answer: B

49) Juanita's mother lives with her. Juanita purchased clothing for her mother costing $1,000 and provided her with a room that Juanita estimates she could have rented for $4,000. Juanita spent $5,000 on groceries she shared with her mother. Juanita also paid $700 for her mother's health insurance coverage. How much of these costs is considered support?
A) $10,000 B) $10,700 C) $8,200 D) $5,000

Answer: C

50) Anna is supported entirely by her three sons John, James, and Joseph who provide for her support in the followi percentages:

John: 10%, James: 40%, Joseph: 50%

Assuming a multiple support declaration exists, which of the brothers may claim his mother as a dependent?
A) James or Joseph B) any of the sons C) Joseph only D) None of them.

Answer: A

51) Blaine Greer lives alone. His support comes from the following sources:

Buddy (his son)	$2,600
Ken (his brother)	4,200
Martha (his daughter)	2,300
Natalie (a friend)	1,000
Total support	$10,100

Assuming a multiple support declaration exists, which of the individuals may claim Blaine as a dependent?
A) Ken or Martha B) Ken, Martha, or Natalie
C) Buddy, Ken, or Martha D) None of them.

Answer: C

52) The child credit is for taxpayers with dependent children under the age of
A) 24. B) 19. C) 14. D) 17.

Answer: D

53) Steven and Susie Tyler have three children ages 13, 15, and 19. The 19-year-old is in the military and not a dependent. Their modified AGI is $108,000. What is the amount of the child credit to which they are entitled?
A) $2,000 B) $0 C) $4,000 D) $6,000

Answer: C

54) Nate and Nikki have two dependent children ages 12 and 15. Their modified AGI is $410,000. What is the amount of the child credit to which they are entitled?
A) $500 B) $0 C) $3,500 D) $4,000

Answer: C

55) Ryan and Edith file a joint return showing $420,000 of AGI. They have three dependent children ages 7, 9, and 13. What is the amount of their child credit?

A) $2,000 B) $0 C) $5,000 D) $6,000

Answer: C

56) Amanda has two dependent children, ages 10 and 12. She earned $30,000 from her job, and her income tax before credits is $1,200. How much of her child credit is refundable?

A) $4,000 B) $1,200 C) $1,400 D) $2,800

Answer: C

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

57) Steve Greene, age 66, is divorced with no dependents. In 2018, Steve had income and expenses as follows:

Gross income from salary	$80,000
Total itemized deductions	5,500

Compute Steve's taxable income for 2018. Show all calculations.

Answer:

Adjusted gross income	$80,000
Less: Standard deduction ($12,000 + $1,600)	(16,600)
Taxable income	$63,400

The additional standard deduction is for Steve's age.

58) Sean and Martha are both over age 65 and Martha is considered blind by tax law standards. Their total income in 2018 from part-time jobs and interest income from a bank savings account is $80,000. Their itemized deductio $25,000.

Required: Compute their taxable income.

Answer:

Salary & interest	$60,000
Less:	
Standard deduction [$24,000 + (3 × 1,300)]	(27,900)
Taxable income	$32,100

The standard deduction is increased because of age for both and blindness for Martha.

59) Kate is single and a homeowner. In 2018, she has property taxes on her home of $4,000, pays state income taxes o $5,000, makes charitable contributions of $3,000, and pays home mortgage interest of $6,000. Kate's adjusted gros income for 2018 is $77,000.

Required: Compute her taxable income for 2018.

Answer:

Adjusted gross income			$77,000
Minus:	Itemized deductions:		
	Property taxes	$4,000	
	State income taxes	5,000	
	Home mortgage interest	6,000	
	Charitable contributions	3,000	(18,000)
Taxable income			$59,000

60) In 2018, Sam is single and rents an apartment for which he pays $800 per month, pays state income taxes of $2,00 makes charitable contributions of $1,000. Sam's adjusted gross income is $47,000.

Required: Compute his taxable income. Show all calculations.

Answer:	Adjusted gross income	$47,000
	Minus: Standard deduction	(12,000)
	Taxable income	$35,000

61) Eliza Smith's father, Victor, lives with Eliza who is a single taxpayer. During the year, Eliza purchased clothing f father costing $1,200 and provided him with a room that could have been rented for $6,000. In addition, Eliza spe $4,000 for groceries she shared with her father. Eliza purchased a new computer for $900 which she placed in the room for both her father and her use.

What is the amount of support provided by Eliza to her father?

Answer:	Clothing	$1,200
	Rental value of room	6,000
	Groceries (1/2 × $4,000)	2,000
	Total support	$9,200

62) Paul and Hannah, who are married and file a joint return, are in the process of adopting a child who is born in December 2018. The child, a son, comes to live with them a week after his birth on December 12. The adoption is not finalized until February of 2019. What tax issues are present in this situation?

Answer: Are Paul and Hannah able to claim the baby as a dependent in 2018, allowing them to claim a child tax credit?

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

63) A married couple need not live together to file a joint return.

Answer: ✓ True False

64) A widow or widower whose spouse passed away in the current year may file a joint tax return as long as the surviving spouse does not remarry before the end of the year.

Answer: ✓ True False

65) An unmarried taxpayer may file as head of household if he maintains a home for his qualifying child.

Answer: ✓ True False

66) Theo's wife moved overseas in April, and they have not been in touch, although they are still legally married. Theo pays all the costs of the household which includes his 12-year-old son. Because Theo is still married, his only option is to file his tax return as married filing separately.

Answer: True ✓ False

67) Kelly is age 23 and a full-time student with interest and dividend income of $2,600 in the current year. The total cost of her support for the year is $19,000. She is not subject to the kiddie tax.

Answer: True ✓ False

68) Divya is age 22 and a full-time student with $8,000 of income from part-time and summer jobs and $2,600 of interest and dividend income. The total cost of her support for the year is $15,000. Divya is not subject to the kiddie tax.

Answer: ✓ True False

69) If a 13-year-old has earned income of $500 and interest and dividends of $2,500, all of the income can be reported on the parent's return.

Answer: True ✓ False

70) Suri, age 8, is a dependent of her parents and has unearned income of $6,000. She must file her own tax return.

Answer: True ✓ False

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

71) You may choose married filing jointly as your filing status if you are married and both you and your spouse agree to file a joint return. Which of the following facts would prevent you from being considered married for filing purposes?

A) You are married but living apart until some problems can be solved.
B) Your spouse died during the year.
C) You were married for several years, but your divorce became final in December.
D) None of the above.

Answer: C

72) Tom and Alice were married on December 31 of last year. What is their filing status for last year?

A) They file as single for 364 days and married filing jointly for one day.
B) They file as single.
C) They file as single for half the year and married filing jointly for the other half.
D) They file as married filing jointly or married filing separately.

Answer: D

73) When a spouse dies, the surviving spouse for the year of death

A) must file a tax return using the single filing status.
B) may file a married filing jointly return only if the death occurred in the last half of the year.
C) may file a married filing jointly return.
D) must file a tax return using the head of household filing status.

Answer: C

74) In 2015, Leo's wife died. Leo has two small children, ages 2 and 4, living at home whom he supports entirely. Leo does not remarry and is not claimed as a dependent on another's return during any of this period. In 2016, 2017, and 2018, Leo's most advantageous filing status is, respectively

A) surviving spouse, surviving spouse, head of household.
B) single for all three years.
C) head of household for all three years.
D) surviving spouse, surviving spouse, single.

Answer: A

75) Edward, a widower whose wife died in 2015, maintains a household for himself and his 10-year-old daughter. Edward's most favorable filing status for 2018 is

A) single.
B) surviving spouse.
C) married filing jointly.
D) head of household.

Answer: D

76) In order to qualify to file as surviving spouse, all of the following criteria must be met by the widow or widower except

A) he or she must be a U.S. citizen or resident.
B) he or she must have at least one dependent child living at home the entire year and pay over half of the expenses of the home.
C) he or she must be qualified to file a joint return in the year of death.
D) he or she and the decedent must have shared the same household as of date of death.

Answer: D

77) Which of the following dependent relatives does not have to live in the same household as the taxpayer who is claiming head of household filing status?

A) brother B) nephew C) uncle D) father

Answer: D

78) Sally divorced her husband three years ago and has not remarried. Since the divorce she has maintained her home in which she and her now sixteen-year-old daughter reside. The daughter is a qualified child. Sally signed the daughter's dependent status over to her ex-spouse by filing the appropriate IRS form. What is Sally's filing status for the current year?

A) surviving spouse
B) single
C) married filing separately
D) head of household

Answer: D

79) Dave, age 59 and divorced, is the sole support of his mother age 83, who is a resident of a local nursing home for the entire year. Dave's mother had no income for the year. Dave's filing status is

A) married filing separately.
B) married filing jointly.
C) head of household.
D) single.

Answer: C

80) The filing status in which the rates increase most rapidly is

A) surviving spouse.
B) married filing separately.
C) married filing jointly.
D) head of household.

Answer: B

81) A married taxpayer may file as head of household under the abandoned spouse provisions if all of the following are met except

A) the taxpayer pays over half of the cost of maintaining a household in which the taxpayer and a dependent son or daughter live for over half of the year.
B) the taxpayer lived apart from his or her spouse for the last six months of the year.
C) the taxpayer must have been married for at least two years.
D) the taxpayer is a U.S. citizen or resident.

Answer: C

82) To qualify as an abandoned spouse, the taxpayer is not required to

A) be a U.S. citizen or resident.
B) have a son or daughter in the home for the entire year.
C) live apart from the spouse for the last six months of the year.
D) pay more than half the cost of maintaining the home.

Answer: B

83) In October 2018, Joy and Paul separated and have not lived with each other since, but they are still legally married. They do not file a joint return. Joy supports their children after the separation and pays the cost of maintaining their home. Joy's filing status in 2018 and 2019 is, respectively

A) married filing separately and head of household.
B) married filing separately for both years.
C) head of household and single.
D) single for both years.

Answer: A

84) The oldest age at which the "Kiddie Tax" could apply to a dependent child is

A) 20.
B) 23.
C) 17.
D) 18.

Answer: B

85) Tobe is a 22-year-old college student with $5,000 of interest income and $6,000 of earned income. Kiddie tax will apply to him if

A) he is a part-time student and the cost of his support exceeds $12,000.
B) he is a full-time student and the cost of his support exceeds $12,000.
C) he is a part-time student and the cost of his support is $12,000 or less.
D) he is a full-time student and the cost of his support is $12,000 or less.

Answer: B

86) Elise, age 20, is a full-time college student with earned income from wages of $4,400 and interest income of $500. Elise's parents provide more than half of her support. Elise's 2018 taxable income is

A) $150.
B) $3,850.
C) $0.
D) $500.

Answer: A

87) Michelle, age 20, is a full-time college student with earned income from wages of $5,200 and interest income of $700. Michelle's parents provide more than half of Michelle's support. Michelle's 2018 taxable income is

A) $350.
B) $4,850.
C) $700.
D) $0.

Answer: A

88) Satish, age 11, is a dependent of his parents. His only source of income in 2018 is $8,000 of interest income on bonds given him by his grandparents, resulting in taxable income of $6,950. Under kiddie tax rules, calculation of tax requires dividing taxable income between net unearned income and earned taxable income. Satish's taxable income will be divided as follows:

A) net unearned income -$6,950 and earned taxable income -$0.
B) net unearned income -$0 and earned taxable income -$6,950.
C) net unearned income -$8,000 and earned taxable income -$1,050.
D) net unearned income -$5,900 and earned taxable income -$1,050.

Answer: D

89) Yusef, age 15, is a dependent of his parents. In 2018 he earned $5,000 from a part-time job and $8,000 of interest income on bonds given him by his grandparents, resulting in taxable income of $7,650. Under kiddie tax rules, calculation of tax requires dividing taxable income between net unearned income and earned taxable income. Yusef's taxable income will be divided as follows:

A) net unearned income -$7,650 and earned taxable income -$0.
B) net unearned income -$1,750 and earned taxable income -$5,900.
C) net unearned income -$0 and earned taxable income -$7,650.
D) net unearned income -$5,900 and earned taxable income -$1,750.

Answer: D

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

90) The following information for 2018 relates to Emma Grace, a single taxpayer, age 18:

Salary	$6,500
Interest income	1,200
Itemized deductions	500

a. Compute Emma Grace's taxable income assuming she is self-supporting.
b. Compute Emma Grace's taxable income assuming she is a dependent of her parents.

Answer: a.

Salary	$ 6,500
Interest	1,200
Adjusted gross income	$7,700
Minus: Standard deduction	(12,000)
Taxable income	0

b.

Salary	$ 6,500
Interest	1,200
Adjusted gross income	$ 7,700
Minus: Standard deduction ($6,500 + 350)	(6,850)
Taxable income	$ 850

91) Indicate for each of the following the most favorable filing status for the 2018 tax year.
a. Kenny died on March 2, 2017. Marge, his wife, and Bart, their son, survive. Marge filed a joint return in 2017. age 18 in 2018, is a full-time college student and continues to live at home with his mother. He works part-time, earning $3,200. What is Marge's filing status in 2018?
b. Alan Spaulding is single and provides over 50% support of his niece Alicia who lives with him all year long. maintains the household and claims Alicia as a dependent. Alicia makes $3,600 at a part-time job. She is a full-ti student, age 18. What is Alan's filing status?
c. Lily, who was divorced on July 27, 2018, provides 100% of the support for her parents who live in a nursing l Kansas and have no income. What is Lily's filing status?
d. Holly was abandoned by her husband Fletcher in September of the current year. She has not seen or commu with him since then. What is Holly's filing status?
e. Rick, whose wife died in December 2015, filed a joint tax return for 2015. He did not remarry, but has continued to maintain his home in which his two dependent children live. What is Rick's filing status for 2018?

Answer: a. surviving spouse
b. head of household
c. head of household
d. married filing separately
e. head of household

92) Gina Lewis, age 16, is claimed as a dependent on her parent's return. She is their only child. She earned $4,300 fr summer job. She also earned interest of $3,750. Her parents' marginal tax rate is 37 percent.

Required:

a. Compute the amount of Gina's tax liability for 2018. The following schedule of tax brackets will be helpful.

Marginal Rate	Portion of TI over ETI Plus	But Not Over ETI Plus
10%		$2,550
24%	$2,550	$9,150
35%	$9,150	$12,500
37%	$12,500	

b. Can Gina's parents take a child tax credit for her?

Answer:

Adjusted gross income ($4,300 + $3,750)	$8,050
Less: Standard deduction [greater of $1,050 or ($4,300 + 350)]	(4,650)
Allowable exemption (None-dependent of another)	0
Taxable income	$3,400

Gina's net unearned income:

Unearned income: Interest	$ 3,750
Less: Statutory deduction of $1,050	(1,050)
Less: Standard deduction	(1,050)
Net unearned income	$ 1,650

Gina's earned taxable income (ETI):

Taxable income	$3,400
Less net unearned income	-1,650
Earned taxable income	$1,750

Tax calculation:

Gina's relevant tax bracket- 10% = $1,750 ETI + $2,550 per table = $4,300 for top of 10% bracket

$3,400 taxable income × 10% = $340 tax liability

b. She is under age 17 and their qualifying child so she qualifies for the child credit. The credit will be ph because the parents' marginal tax rate is 37% so their AGI will be beyond the phaseout range.

93) For each of the following taxpayers, indicate the applicable filing status and the number of children who qualify child credit.

a. Jeffrey is a widower, age 71, who receives a pension of $10,000, nontaxable social security benefits of $12,000 interest of $2,000. He has no dependents.

b. Selma is a single, full-time college student, age 20, who earned $6,800 working part-time. She has $1,700 of interest income and received $1,000 support from her parents.

c. Olivia is married, but her husband left her three years ago and she has not seen or heard from him since. She supports herself and her six-year-old daughter. She paid all the household expenses. Her income consists of sala $18,500 and interest of $800.

d. Ruben is a single, full-time college student, age 20, who earned $6,800 working part-time. He has $250 of interest income and received $10,000 support from his parents.

e. Cathy is divorced and received $12,000 alimony from her former husband and earned $35,000 working as an administrative assistant. She also received $2,500 of child support for her daughter who lives with her. Cathy file appropriate IRS form and gave up the dependency exemption to her former husband.

Answer:

	Filing Status	Child Credit
a.	Single	0
b.	Single	0
c.	Head-of-Household	1
d.	Single	0
e.	Head-of-Household	0

94) Mary Ann pays the costs for her Aunt Hazel to live in a nursing home. Aunt Hazel receives Social Security benefits of $7,000 a year which are turned over to the nursing home. Mary Ann pays the remaining cost of $33,000. Hazel has no other income. Mary Ann visits Hazel twice a week and meets with doctors and nurses regarding Hazel's medical care. What tax issues should Mary Ann consider?

Answer: Can Mary Ann file as head of household? Would Mary Ann be able to claim Hazel as a dependent?

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

95) The only business entity that pays federal income taxes is the C corporation.

Answer: ● True False

96) The annual tax reporting form filed with the IRS by C corporations is the Schedule C.

Answer: True ● False

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

97) A corporation has revenue of $350,000 and deductible business expenses of $240,000. What is the federal income tax, before credits?

A) $26,400 B) $38,500 C) $23,100 D) $22,000

Answer: C

98) Ray is starting a new business and trying to decide between a C corporation, S corporation, and partnership. Which of the following statements regarding his decision is correct?

A) S corporations pay taxes on their current year income.
B) A partner in a partnership is taxed on his or her share of partnership income.
C) A shareholder in a C corporation is taxed on his or her share of corporate income.
D) An S corporation owner must pay income taxes only on the salary received.

Answer: B

99) Artco Inc. is a C corporation. This year it earned $50,000 of taxable income and paid a $10,000 distribution (dividend) to Lily, its sole shareholder. Lily has a marginal tax rate of 24%. Due to the corporation's results and the distribution paid, the IRS will receive total taxes of

A) $10,500. B) $12,000. C) $13,500. D) $12,900.

Answer: B

100) Silver Inc. is an S corporation. This year it earned $60,000 of taxable income and paid a $10,000 distribution to Daisy, its sole shareholder. Daisy has a marginal tax rate of 24%. Due to the corporation's results and the distribution paid, the IRS will receive total taxes of

A) $9,000. B) $14,100. C) $14,400. D) $27,000.

Answer: C

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

101) Paige is starting Paige's Poodle Parlor and is considering alternative organizational forms. She anticipates the business will earn $100,000 from operating before compensating her for her services and before charitable contributions. Page, who is single, has $6,000 of income from other sources and other itemized deductions of $12,000. Her compensation for services will be $50,000. Charitable contributions to be made by the business are expected to be $5,000. Other distributions (dividends) to her from the business are expected to be $14,000.

Required: Compare her 2018 income tax assuming she operates the business as a proprietorship, an S corporation, and a C corporation. Ignore payroll and other taxes.

Answer:

	Proprietorship	*S Corporation*	*C Corporation*
Business income:			
Operating income	$100,000	$100,000	$100,000
Compensation paid to Paige		(50,000)	(50,000)
Charitable contributions			(5,000)
Net business income	$100,000	$ 50,000	$ 45,000
Corporate income tax			$ 9,450
Paige's income:			
Business income (above)	$100,000	$ 50,000	
Compensation (above)		50,000	$ 50,000
Dividends			14,000
Other income	6,000	6,000	6,000
Adjusted gross income	$106,000	$106,000	$ 70,000
Charitable contributions	5,000	5,000	
Other itemized deductions	12,000	12,000	12,000
Taxable income	$ 89,000	$ 89,000	$ 58,000
Individual income tax	$ 15,650*	$ 15,650*	$ 7,826**
Total tax	$ 15,650	$ 15,650	$ 14,576

*$14,089.50 + [.24 × ($89,000 - 82,500) rounded

**Tax on dividends: $14,000 × .15 = $2,100 plus

Tax on taxable income of $58,000 - 14,000 or $44,000: $4,453.50 + [.22 × ($44,000 - 38,700)] = $5,620 (rounded). The total is $7,720.

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

102) A $10,000 gain earned on stock held 13 months is taxed in a more favorable manner than a $10,000 gain earned on stock held 11 months.

Answer: ✓ True False

103) A building used in a business is sold after five years of use for a gain. The gain will be treated as a long-term capital gain.

Answer: True ✓ False

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

104) If an individual with a taxable income of $15,000 has a long-term capital gain, it is taxed at

A) 10%. B) 15%. C) 0%. D) 20%.

Answer: C

105) If a single taxpayer with a marginal tax rate of 37% has a long-term capital gain, it is taxed at

A) 10%. B) 20%. C) 15%. D) 0%.

Answer: B

106) If a single taxpayer with a marginal tax rate of 24% has a long-term capital gain, it is taxed at

A) 20%. B) 25%. C) 0%. D) 15%.

Answer: D

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

107) Steve and Jennifer are in the 32% tax bracket for ordinary income and the 15% bracket for capital gains. They have owned several blocks of stock for many years. They are considering the sale of two blocks of stock. The sale of one would produce a gain of $12,000 while the sale of the other would produce a loss of $18,000. For purposes of this problem, ignore itemized deductions, phase-outs and additional investment taxes. They have n

other gains and losses this year.

a. How much tax will they save if they sell the block of stock that produces a loss?
b. How much additional tax will they pay if they sell the block of stock that produces a gain?
c. What will be the impact on their taxes if they sell both blocks of stock?

Answer: a. $990. A net capital loss is limited to $3,000 per year × .32 = $960. They can carryover the remaining $1

loss to next year.

b. $12,000 × .15 (maximum rate on long-term capital gains) = $1,800.

c. $12,000 gain - $18,000 loss = Net capital loss of $6,000 of which $3,000 is currently deductible to save taxes of $3,000 × .32 = $960. They should sell both so that they totally escape taxation of the gain this year. They can carryover the remaining $3,000 loss to next year.

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

108) Mr. and Mrs. Kusra are in the top tax bracket. They have just had a baby. The Kusras plan to gift a corporate bond they currently own to the baby. The bond pays $2,100 of interest income per year. The Kusra family overall will save taxes if the bond is transferred to the child.

Answer: ✓ True False

109) Ivan Trent, age five, receive $2,900 of dividends per year from a mutual fund he owns; it is his only source of taxable income. Ivan's parents plan to gift a corporate bond they currently own to him. The bond pays $4,100 of interest income per year. Ivan's parents are in the 37% tax bracket. The individual income tax rate schedule that generally applies to a single taxpayer indicates a 10% tax rate until taxable income of $9,525. Ivan's family will save tax at the rate of 27% (37% - 10% tax rates) on the bond interest income if the parents transfer the bond to Ivan.

Answer: True ✔ False

110) Generally, when a married couple files a joint return, each spouse is liable for one-half of the entire tax and any penalties incurred.

Answer: True ✔ False

111) A taxpayer is able to change his filing status from married filing jointly to married filing separately by filing an amended return.

Answer: True ✔ False

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

112) In order to shift the taxation of dividend income from a parent to a child

A) the parent must direct the corporation to pay the dividend to the child.
B) the parent can deposit the dividend in the child's bank account.
C) the parent must transfer ownership of the stock to the child.
D) all of the above will result in shifting the taxation to the child.

Answer: C

113) Married couples will normally file jointly. Identify a situation where a married couple may prefer to file separately.

A) A couple is separated and contemplating divorce.
B) One spouse can be held responsible for the entire tax liability.
C) The spouse with lower income has substantial medical expenses.
D) All of the above.

Answer: D

114) A taxpayer can receive innocent spouse relief if

A) under the circumstances, it would be inequitable to hold the innocent spouse liable for the understated tax.
B) the understated tax is attributable to erroneous items of the other spouse.
C) the innocent spouse did not know and had no reason to know that there was an understatement of tax.
D) All of the above conditions apply.

Answer: D

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

115) Kelsey is a cash-basis, calendar-year taxpayer. Her salary is $60,000, and she is single. She plans to purchase a residence in 2019. She anticipates her property taxes and interest will total $11,000 in 2019. Each year, Kelsey con approximately $1,500 to charity. Her other itemized deductions total $2,000. For purposes of this problem, assum 2018 standard deduction amount remains in effect for 2019.

a. What will be her deductions from AGI in 2018 and 2019 if she contributes $1,500 to charity in each year?

b. What will be her deductions from AGI in 2018 and 2019 if she contributes $3,000 to charity in 2018 but makes contribution in 2019?

c. What will be her deductions from AGI in 2018 and 2019 if she makes no contribution in 2018 but contributes to charity in 2019?

d. Why does option C yield the largest deductions over time?

Answer:

		2018	2019
a.	Potential itemized deduction	$ 3,500	$14,500
	Standard deduction	12,000	12,000
	Deduction from AGI (larger of above)	$12,000	$ 14,500
	Deductions across two years		$ 26,500
b.	Potential itemized deduction	$ 5,000	$13,000
	Standard deduction	12,000	13,000
	Deduction from AGI (larger of above)	$12,000	$ 13,000
	Deductions across two years		$ 25,000
c.	Potential itemized deduction	$ 2,000	$16,000
	Standard deduction	12,000	12,000
	Deduction from AGI (larger of above)	$12,000	$ 16,000
	Deductions across two years		$ 28,000

d. The contributions have no tax benefit in 2018 because the standard deduction is taken and charitable contributions are itemized deductions.

116) Discuss reasons why a married couple may choose not to file a joint return.

Answer:
1. One spouse incurs most of medical expenses and itemized deductions can be maximized.
2. They may not want joint tax liability.
3. Casualty losses may be deductible on a separate return but not on a joint return because of the 10% flc

117) Discuss why Congress passed the innocent spouse provision and detail the requirements to be met in order to qualify as an innocent spouse and be relieved of liability for tax on unreported income.

Answer: The provision was passed because each spouse is liable for the entire tax on a joint return as well as penalt imposed. This would not be fair if one spouse concealed information regarding income or deductions fron other spouse.

An innocent spouse is relieved of liability when

1. The amount is attributable to grossly erroneous items of the other spouse.
2. The innocent spouse did not know of and had no reason to know that there was such an understateme tax.
3. To hold the innocent spouse liable for the understatement would be inequitable.
4. The innocent spouse elects relief within two years after the IRS begins collection activities.

118) Oscar and Diane separated in June of this year although they continue to live in the same town. They have twin sons, Blake and Cliff, who remain in the family home with Diane. Oscar's income this year was $45,000 while Diane worked only part-time and made $15,000. Oscar also gambles heavily but told Diane that he had no winnings this year. What tax issues should they consider?

Answer: Oscar and Diane have several choices for filing status. Since they are still married on December 31, the last day of the tax year, they could file jointly. That will probably result in the lowest overall tax liability. However, they should consider joint and several liabilities, especially if Diane fears that Oscar may be hiding income. If Diane is maintaining the home in which at least one dependent child lives, she may be able to file as head of household. Of course, they could file separately which would result in the highest overall tax liability.

119) Alexis and Terry have been married five years and file joint tax returns. Alexis began embezzling funds from her employer during the third year of their marriage. Last year, Alexis suddenly left the country and Terry does not know where she is. In the current year, Terry learned that the IRS had assessed him $27,000 in unpaid taxes due to Alexis's embezzlement. What tax issue(s) are present in Terry's situation? What questions would you ask Terry to determine his appropriate response to the IRS?

Answer: Is Terry eligible for innocent spouse relief? Did Terry benefit financially from Alexis's embezzlement? Did Terry have reason to know of the embezzlement?

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

120) The requirement to file a tax return is based on the individual's adjusted gross income.

Answer: True False

121) Tax returns from individual and C corporate taxpayers are due on the 15th day of the third month following the close of the tax year.

Answer: True False

122) Tax returns from individual taxpayers and partnerships are due on the 15th day of the fourth month following the close of the tax year.

Answer: True False

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

123) Assuming a calendar tax year and the conventional 15th of the month due date, all of the following business entities must file their 2018 tax returns by the March 15, 2019 except

A) the partnership.
B) the C corporation.
C) the S corporation.
D) All of the above entities must file their 2018 tax returns by March 15, 2019.

Answer: B

124) Form 4868, a six-month extension of time to file, allows a taxpayer to

A) avoid interest on underpayment of taxes due.
B) extend the filing date of the return but the estimated amount of tax due must still be paid by the original due date of the return.
C) extend the filing date only at the discretion of the IRS.
D) extend the filing date of the return as well as payment of the tax due.

Answer: B

125) Lester, a widower qualifying as a surviving spouse, has $209,000 of salary, five personal and dependency exemptions and itemizes deductions. Lester must use which form to report his taxable income?

A) Form 1040A B) Form 1040 C) Form 1040ES D) Form 1040EZ

Answer: B