Professor: Keith Medleau, Chief Counsel, IRS
Ph. 206.220.5553 (office)
E-mail: kmedleau@u.washington.edu
Office: none at the law school
Office Hours: room 117, 6:30 - 7:00 and after 8:45 each day of class
Other times by appointment
Make up class: either Friday, January 17th from 4:15 – 6:00 or Saturday, January 18th from 1:00 – 2:45, depending on which day the class votes for. It will be put to a class vote on January 6th, the first day of class. It will most likely be in room 117.

TAXATION OF S CORPORATIONS
SYLLABUS

Class meets Monday/7:00-8:45, Room 117

Textbook:
There are three sets of course materials for this course that will be posted on the course website: the Assignments & Course Materials; the Course PowerPoint slides and the Overview Materials to the Problems Sets. The Assignments & Course Materials and the PowerPoint Slides will each be available in print for purchase at the bookstore. The Overview materials will only be available on the course website.

The Nutshell (Kahn, Kahn & Perris, Taxation of S Corporations in a Nutshell), is optional. While it does not address every topic we will be covering in class, you may find it helpful with many of the basic topics we will be covering.

Class Description:
There will be a thorough consideration of the entire range of technical and planning issues relating to the adoption and maintenance of S corporation status. This will include a detailed analysis of situations in which the S corporation form is, or is not, useful, issues relating to qualification and eligibility (including utility of shareholder agreements), election mechanics, the manner in which S corporation income is passed-through to shareholders, the effect of S corporation distributions, reorganizations, divisions or liquidations, and the effect of an S corporation having previously been a C corporation (including the effect of the tax on built-in gains). There also will be comparisons of the S corporation form with that of partnerships, limited liability companies and C corporations.

Students will be expected to be prepared to answer problem set questions in class. I will ask for volunteers in this class, but may change to designating students that will be called on to answer most of the problems covered in class.

Disability-Related Needs:
To request academic accommodations due to a disability, please contact Disability Resources for Students (DRS), 448 Schmitz, (206) 543-8924 (V), (206) 543-8925 (TTY). If you have a letter from DRS, please present the letter to [your
name here] so you and he/she can discuss the accommodations you might need in this class.

**Grades:**
The grades for the course are based primarily on the final exam. I may increase a student or student’s grade by 1/10th of a point for any outstanding class participation.

The final exam will be 3 hours. You will be allowed to bring all materials to the exam (i.e., the Code, regulations, notes, student outlines and any class handouts), with the exception that you cannot bring the S Corporations nutshell or any treatise or commercial outline to the final exam. The exam will likely be 2 or 3 essay questions and you will be allowed to use your computers (if the final exam is multiple choice, you will not be allowed to use computers other than for calculation purposes).

My understanding is that the final examination will be on Wednesday, March 19th from 6pm to 9pm. The final examination schedule is available at [http://www.law.washington.edu/Students/Exams/Default.aspx](http://www.law.washington.edu/Students/Exams/Default.aspx) and it is your (the student’s) responsibility to know when your exam is schedule.

**Law School Attendance Policy:**
Under changes to ABA Accreditation Standard 304, adopted in August 2004, a law school shall require regular and punctual class attendance.

At any time after the fifth week of a course, a student who has been determined by the instructor to have attended fewer than 80 percent of the class sessions in any course will be required to drop the course from his or her registration upon the instructor’s so indicating to the Academic Services Office.

I plan to follow this attendance policy. Also, any student wanting CLE credit should let me know before or during the first class he/she attends.

**Podcasts:**
All classes and make up classes will be podcasted.

**Cell Phones (Computers):**
Computers will be allowed in class and for the final examination. Cell phones should be turned off or on vibrate.

**Course Evaluation:**
Your course evaluation will most likely be administered on Monday, March 3rd from 7:00 - 7:10. Please bring your laptop or mobile device to class on this date to participate in the evaluation. Your evaluation/feedback is important both to the school and to me so participation in the evaluation process is encouraged.

**Guests and Visitors:**
Guests and visitors are welcome to attend any class(es).

**Review Session:**
Students will be given the option of having a review session during the last class.
Classes 1 & 2

Problem 1 - Eligibility

Assignment:


Regs: Review Reg. § 1.1361-1(a)-(b)(2), (c), (e)-(g), (h)(1)(v). Skim Reg. § 1.1361-1(m)(1), (4)(i), (ii), (vi) & (vii), -2(a), (b) & (d) (Ex. 1-4), -4(a)(1)-(2)(ii) (Ex. 1 & 2) & (a)(5)(i).


Note: The regulations under subchapter S in most instances reflect legislative changes made by Congress. However, to the extent the regulations are inconsistent with Code sections, the Code controls.

1. Would S, a domestic corporation, qualify as an S corporation under the following alternative situations?

(a) S has 101 individual shareholders that are unrelated except for H and W who are husband and wife.

(b) Same as (a) except H dies and his shares are held by his estate.

(c) Same as (a) except shareholder A dies and his shares are held by his estate for four years and then distributed to the residuary beneficiary, B, a citizen of France temporarily residing in New York – i.e., a nonresident alien.

(d) Same as (c) except A’s estate winds up immediately and distributes the shares to a trust for the benefit of B, a U.S. citizen.

(e) Shareholder C transfers her S shares to a trust. Under the terms of the trust, C has the power to reinvest the entire corpus and income in herself and C’s daughter is the sole income and residuary beneficiary.
(f) Shareholder D transfers her S shares to a voting trust for 10 years. The trustee has the power to vote the shares, receive distributions and hold them until D requests receipt.

(g) Shareholder E transfers her S shares to a trust that provides for all income to be paid to E’s son for life. The trust will terminate at E’s death and the corpus will be distributed to E’s son.

(h) Shareholders F & G transfer their S shares to FG, a limited liability company.

(i) Shareholder H makes a charitable contribution of his S shares to the Red Cross (a section 501(a) and (c)(3) organization).

(j) S sets up a section 401(a) qualified retirement plan trust for its employees transferring some of its S stock to the plan.

(k) Shareholder K files a petition in bankruptcy.

2. What provisions would you want to include in shareholders’ agreement to insure eligibility as an S corporation?

3. What result if S, an S corporation, forms a wholly owned subsidiary, X, to carry on part of S’s operations? Is X eligible for S corporation treatment?

4. What result if Partnership AB transfers all its assets to S in exchange for stock of S, an existing S corporation? AB immediately liquidates and distributes the S stock to its individual partners, A and B.

**Classes 2 & 3**

**Problem 2 - Eligibility: One Class of Stock Requirement**

**Assignment:**

**Code:** Study § 1361(b)(1)(D), (c)(4) & (5). Review §§ 83(a), (b) & (h). Skim §§ 1366; 1377; 7872(a) & (c)(1)(C); 1368.

**Regs:** Review Reg. §§ 1.1361-1(b), (3)-(5), -1(l); 1.701-2(d) (Ex. 2). Skim Reg. §§ 1.83-3(b), (c)(1) & (d); 1.83-7(b)(1) & (2).

**Materials:** Review Class Discussion Handout; PowerPoint Handouts; Minton v. Comm’r, 562 F.3d 730 (5th Cir. 2009); Santa Clara Housing Group Inc. v. U.S. (N.D. Cal. 2011); Santa Clara Housing Group Inc. v. U.S. (N.D. Cal. 2012); Rev. Rul. 77-220; Rev. Rul. 94-43.

**Suggested:** Review Nutshell Chapter 2 (§ 5).
Assume S otherwise qualifies as an S corporation and has two equal shareholders A and B, each of whom own 100 shares of stock. All shares confer identical rights to distribution and liquidation proceeds unless otherwise stated.

1. S, in order to retain the services of C, a key employee, issues to her 100 shares of a new class of common stock on January 1, Year 1 which is identical in all respects to the shares held by A and B except it is nonvoting. C must transfer the stock back to S for $1 if she is not employed for a period of two years from the date of transfer. C makes a section 83(b) election with respect to the shares.

(a) Suppose instead that C did not make a section 83(b) election.

(b) Suppose instead C’s employment contract provides for “phantom stock” under a plan where C could receive an additional 5% of net profits.

(c) Suppose A’s employment contract provides for compensation equal to 10% of net profits and a year-end bonus to be determined. Such additional compensation and yearend bonus amount to $1,000 thereby reducing S’s income for Year 1 from $1,000 to zero.

(1) Assume A’s compensation is $400 and that S distributes $1,000 to A.

(d) Suppose S makes a $15,000 non-interest bearing loan to A and provides A with an automobile and home for his personal use?

(e) Suppose S, pursuant to a binding agreement with A, distributes additional cash to A to take into account A’s heavier state tax burden.

(f) Suppose instead that C received her shares outright but that under the shareholders agreement she could only transfer the shares upon termination of employment to S or to A and B for one-half book value.

(1) Suppose instead the shareholders’ agreement allowed B to only transfer the shares with the consent of A and if consent is not obtained could only transfer the shares to S or to A for book value.

(g) Assume C is not a shareholder. On July 1, Year 1, A sells 50 of his 100 shares to B. S generates $1,000 taxable income in Year 1 of which $375 is allocable to A and $625 to B. On December 31, Year 1, S distributes cash to A and B in the respective amounts of $375 and $625.

2. A and B each lend $15,000 to S, and the respective notes have the same terms.
(a) What result if A’s note provides for interest at prime + 2% and is subordinated to B’s note which provides for interest at prime?

(b) Suppose the loans were not evidenced by notes but were unwritten advances.

(c) Suppose Citibank also lends funds to S and receives a note providing for interest at prime + 20% of S’s net profits.

3. On January 1, Year 2, S issues to A an option to acquire an additional 100 shares at 50% of the then fair market value.

(a) Suppose the option could only be exercised if S generated $X gross income for two consecutive years.

(b) Suppose instead A acquired the option under the terms of his employment agreement.

(c) Would the result in (2) be different if the option were granted to Citibank in connection with a loan to S?

4. D, an unrelated individual, will advance $2,000 to S under the following terms. S and D will form a 50/50 partnership. S will contribute all its assets and D will contribute $2,000. The partnership agreement will provide that D will be allocated the first $2,000 of losses and will also receive the first $2,000 of distributions.

Classes 3 & 4

Problem 3- Election; Termination; Taxable Year; Statute of Limitations

Assignment:

Code: Study §§ 1362; 1377(c); 1375; 1378. Review §§ 6501(a); 6037(a) & (c). Skim §§ 1366(a)(1); 1377(a)(1); 1368(e)(3); 444; 1374; 1363(d).


Suggested: Review Nutshell Chapters 2 (§ 6); 3 (§ 2); 8 (page 188 and carryover sentence on page 189); 7.
1. On January 1, Year 1, individuals A and B, both of whom are U.S. citizens, and Corporation C form Corporation S. On February 15, Year 1, C’s stock in S is redeemed. After the redemption A owns 60% and B owns 40% of S. On March 1, Year 1, S elects to be an S corporation and both A and B consent to the election.

(a) Is the election effective for Year 1?

(b) Same as (a) except C is an individual.

(c) Same as (b) except C also consents to the election.

(d) Assuming a valid S election was made for Year 1, suppose S revokes the election (and A and B consent to the revocation) on March 15, Year 1; on April 15, Year 1.

(e) Suppose B wants to revoke the election but A does not. On April 15, Year 1, B transfers his shares to X, his wholly owned corporation.

(f) On June 30, Year 1, B transfers his shares to D, a non-resident alien. A, upon learning of the transfer, acquired such shares from D on July 15, Year 1. What additional action would you recommend?

(g) Suppose instead B sold all his stock to Corporation X on July 1, Year 1. What result if S generated $1,000 income for Year 1, all of which was attributable to the period after June 30, Year 1? What action would you recommend?

(h) Same as (g) except A and not B sold all his stock to X.

2. Assume Corporation S, an S corporation, is in the hotel business that “breaks even” and has a small amount of accumulated earnings and profits from years prior to making the S election. S purchases a shopping center on January 2, Year 1, and immediately enters into a net lease with Corporation A. Also, on January 2, Year 1, S purchases a trademark and immediately enters into a licensing agreement with Corporation X. In Year 1 and Year 2, gross receipts from the hotel, shopping center, and the licensing agreement amounted to $100,000, $25,000 and $25,000, respectively. What would you recommend in Year 3?

3. On January 1, Year 5, A, an individual, purchased all the stock of S, a subsidiary of Corporation P. S owns and operates a department store and has had a January 31 fiscal year end since its inception in Year 1. A filed an S election on March 15, Year 5. Can S retain its January 31 fiscal year end?

4. On May 1, Year 5, the Internal Revenue Service mails a Statutory Notice of Deficiency to individual A for A’s Year 1 tax year in which the only adjustment to income was the disallowance of a deduction attributable to
the S corporation in which A was a shareholder. The notice of deficiency was sent within 3 years from the date A filed his individual return for Year 1, but not within 3 years from the date S filed its return for Year 1. What result?

Classes 4 & 5

Problem 4- Operations and Distributions

Assignment:

Code: Study §§ 1363(a)-(c); 1366(a)-(c) & (e); 1367(a)-(b)(1); 1368; 1377(a)(1); 1371(a)-(c). Review §§ 267(a)(2) & (e)(1)(B)(ii); 163(d); 702(a); 703(a). Skim §§ 1223(1) & (2); 311(b); 351(a) & (b); 358(a) & (d); 469(a), (b), (c)(1), (2) & (4), (d)(1), (e)(1)(A)(i)(l), (j)(1), (2) & (3)(A), & (j)(7); 704(c); 721(a); 724(a)-(c); 1001(a)-(c); 1012; 1014(a)(1); 1401(a); 1402(a).

Regs: Review Reg. §§ 1.1366-1 (except skim –1(c) & (e)); 1.1367-1(a)-(h) (Ex. 1-3); 1.1368-1(a)-(d)(1), -1(e)-(f)(1)(ii), (f)(2)(i) & -(f)(3), -2(a) & (b), -3 (Ex. 2, 4, 5, 7 & 8). Skim Reg. §§ 1.1366-3, -4; 1.1368-1(g), -2(c)-(e); 1.163-8T(a)(1), (3), (4)(i) & (c)(1); Prop. Reg. § 1.469-7(a)(1), (c)(1) & (2), (d)(1) & (2), (e) & (f)(1).


Suggested: Review Nutshell Chapters 3 (§§ 1 - 8, 11); 6 (§§ 1 - 3, 5); 4 (§§ 1, 2); 5 (§ 3); 6 (§§ 1, 2 (stop at § 2(a) on page 156), 3, 5 (examples optional).

1. S, an accrual basis S corporation, has two equal shareholders A and B. A is a full time employee of S and B is retired and lives in Florida. Compute the taxable income of S that passed through to A and B assuming the following events occurred in Year 1.

   (a) S generated $100,000 of gross receipts and incurred $80,000 of expenses including $60,000 salary to A. Suppose instead A received no salary.

   (b) Suppose in (a) $10,000 of A’s salary was paid on January 10, Year 2.

   (c) In Year 1, S also received $5,000 of dividends, $5,000 tax-exempt interest on New York notes (i.e., tax-exempt bonds), contributed $1,000 to the American Red Cross, and recognized $1,000 gain on
the sale of vacant land which would have been inventory in A’s hands.

(d) In Year 1, S also determined that it would never pay $10,000 of accrued, unpaid interest on a debt it owed to a third party creditor. S had accrued and taken a deduction for the $10,000 interest amount in Year -3 when S was a C corporation (assume the S election for S was effective January 1, Year 1). How is the $10,000 amount treated in Year 1?

(1) When S converted from a C corporation to an S corporation in Year 1, S had an NOL carryforward of $20,000 from its operation as a C corporation. Can S claim the $20,000 NOL as a deduction in Year 1?

(e) B dies and S receives $100,000 life insurance proceeds upon his death.

(f) Suppose on January 1, Year 1, A transferred one half of his shares to his 1-year-old grandchild. Would the grandchild be recognized as a shareholder? Suppose A reduced his compensation after the transfer.

(g) Suppose in (a) that on July 1, Year 1, A and B each loaned $20,000 to S to finance current operations and each received $1,000 interest from S (annual interest rate 10%) on December 31, Year 1.

1. Assume A and B borrowed the funds from the bank to lend to S and each paid interest to the bank.

2. Suppose S used the proceeds of the loans to purchase shares of IBM and not for working capital?

(h) What result if S sold land for $25,000 in Year 1, and the land was received from B as a capital contribution upon formation? At the time B transferred the property it had a fair market value of $20,000 and a zero basis. A contributed $20,000 cash on formation.

2. S generated $20,000 of taxable income for Year 1 (ordinary business income less business deductions), its first year as an S corporation. As of January 1, Year 1, A had a $10,000 basis in his stock and B had a zero basis. Assuming no distributions in Year 1, what are the consequences to A and B?

(a) Suppose S distributed $15,000 to each on July 31, Year 1.

(b) Suppose in (a) instead A had acquired his shares in two separate transactions and the bases of his stock as of January 1, Year 1, was zero for block 1 and $10,000 for block 2, respectively. [Assume further that each block has the same number of S shares]
(c) Suppose in (a) instead S distributed property with a fair market value of $15,000 and zero basis to A and $15,000 cash to B.

(d) Suppose instead S distributed $25,000 to each and it has accumulated earnings and profits of $50,000 from when S was a C corporation.

(1) Assume S’s S election was effective January 1, Year 0, and it had taxable income of $10,000 for Year 0. A was the sole shareholder of S during Year 0, with A and B 50/50 shareholders of S as of January 1, Year 1. S distributed $25,000 to each during Year 1.

(e) Would the result in (d) (ignoring (d)(1)) be different if all of S’s income for Year 1 was from tax-exempt interest?

Class 6

Problem 5- Losses

Assignment:

Code: Study §§ 1366(d); 1367(b)(2) & (3). Review §§ 1368; 465(a)(1) & (2), (b)(1), (2), (4) & (5); 469(a), (b), (c)(1), (2) & (4), (d)(1) & (i)(1), (2) & (3)A; 1271(a)(1); 1275(a)(1); 165(b) & (g)(1) & (2); 166(d); 108(a)(1) & (d)(A)(7); 1244(a). Skim §§ 1001(a)-(c); 1012.

Regs: Review Reg. §§ 1.1366-2(a); 1.1367-1(a)-(h) (Ex. 1-3), -2; 1.1368-1(a)-(d)(1), -1(e)-(f)(1)(ii), (f)(2)(i) & -(f)(3), -2(a) & (b), -3 (Ex. 2, 4, 5 & 8); 1.469-2T(d)(6). Skim § 1.1366-2(b) & (c).


Suggested: Review Nutshell Chapters 4 (§ 3); 5 (§§ 1, 4).

1. S Corporation has one shareholder, A. A valid subchapter S election is in effect at all times. In Year 1, S has a net loss of $10,000. A’s basis at the beginning of Year 1 was $5,000. A materially participates in the business operated by S.

(a) In Year 1, how much of the S loss may A deduct?

(b) Suppose S also distributes $2,000 on May 15, Year 1? Ignore this question (b) for the remainder of the problem.
(c) Assuming S has net income of $4,000 in Year 2, what income or loss of S would A report?

(d) How would the answers in (a) and (c) change if A loaned S $5,000 on December 31, Year 1?

(e) Suppose in (d) S repaid the $5,000 loan on August 1, Year 2?

(f) Suppose in (e) S did not repay the $5,000 loan but instead made a $5,000 distribution to A in Year 2? What if the distribution was made to A in Year 3 and S had no income or loss during that year?

(g) Suppose at January 1, Year 2, A’s stock and debt basis is $10,000 each. S incurs a $5,000 loss in Year 2 and is worthless at year-end.

2. How would the answer in 1(d) differ under the following alternative situations?

(a) A borrows, on a recourse basis, $5,000 from Citibank which is immediately re-loaned to S in exchange for notes which qualify as straight debt. A pledges his S stock as security for the Citibank loan.

(b) Suppose on January 2, Year 2, S repays the loan to A and A repays Citibank.

(c) Same as (a) except the loan to A from Citibank was nonrecourse.

(d) Suppose Citibank lends $5,000 directly to S instead of to A. Suppose A co-signs the note.

(e) Same as (a) except Citibank takes a direct pledge of S’s assets to secure the loan to A.

(f) Suppose in (d) A also guarantees the S debt.

(g) Same as (f) except A is required to make good on the guarantee and makes a $5,000 payment to Citibank.

3. How would the answer in 1(d) differ under the following alternative situations?

(a) A does not loan $5,000 to S, but causes his wholly owned S corporation (S1) to loan S $5,000?

(b) Suppose A does not loan $5,000 to S but instead gives S his personal note for $5,000 in exchange for additional S shares.

(c) Suppose A does not loan $5,000 to S but instead sells S a piece of
equipment on December 31, Year 1, in exchange for an S note for $5,000 payable in Year 2.

Classes 7 & 8

Problem 6- Dispositions and Conversions

Assignment:

Code: Study §§ 1377; 1362(e); 1374; 1363(d); 1366(f)(2). Review §§ 1366; 1367; 1363(b); 1368; 338(a), (d), (g), (h)(3)(A) & (h)(10); 453B(h); 453(h)(1)(A) 382(a), (b)(1) & (2), (e)(1), (f), (g), (h)(1)-(3). Skim §§ 61; 1001(a)-(d); 1012; 1014(a)(1); 453(a)-(d); 302; 331; 311(b); 336(a); 1244(a).

Regs: Review Reg. §§ 1.1374-1 (ignore -1A), -2, -3, -4(a)(1), (b)(1), (2) & (h), -5, -8, -9, -10(b)(3) & (4); 1.1363-2. Skim Reg. §§ 1.1374-6, -7; 1.1377-1(b); 1.1367-1(j); 1.338(h)(10)-1(a), (d) & (e).

Materials: Review Class Discussion Handout; PowerPoint Handouts. Skim Rondy, Inc. v. Comm’r, 97-2 USTC par 50,546 (6th Cir. 1997).


1. A and B form S (a calendar year S corporation) on January 2, Year 1, with each contributing $1,000 cash in exchange for 100 shares of S common stock. S breaks even in Year 1. In Year 2, S generates no income and makes no distributions except as otherwise stated. What result under the following alternative situations?

(a) A sells all of his shares to individual C for $2,000 cash on June 30, Year 2. S’s income for Year 2 is $1,000, all of which is generated after June 30.

(b) Suppose in (a) S has a $1,000 loss for Year 2, all of which is generated after June 30.

(c) What result in (a) if S generated a $4,000 loss in Year 0 (assume S formed on January 2, Year 0) and breaks even in Year 1 and Year 2.

(1) Would the result differ if A contributed an additional $1,000 to S’s capital prior to the sale?

(d) Suppose in (a) A instead sells all his shares to C on January 1, Year 3, for $1,000 cash and a $1,000 note.

(e) Suppose in (d) S distributes $500 each to A and B on December 31, Year 2, and A sold all of his shares to C for $500 cash and a $1,000 note.
(f) Suppose in (d) S distributes $500 to C on January 3, Year 3, which C uses to reduce the bank loan she obtained to purchase A’s shares.

(g) Suppose A died on December 31, Year 1, when the fair market value of his stock is $8,000 (i.e., the value of S at that time is $16,000). S receives (as owner and beneficiary) $10,000 life insurance proceeds all of which are used to redeem A’s stock as required by the shareholders’ agreement. Assume S is on the accrual method of accounting.

(h) Suppose in (g) instead B receives the $10,000 life insurance proceeds from S (the owner and beneficiary) all of which are used by B to purchase A’s stock as required by the shareholders’ agreement.

(1) Alternatively, B directly receives (as owner and beneficiary) the $10,000 life insurance proceeds all of which he uses to purchase A’s stock as required by the shareholders’ agreement.

(i) Suppose in (a) S sold all of its assets to Corporation Z, a C corporation, on July 1, Year 1, for $4,000. S’s assets consisted of inventory with a basis of $2,000.

(j) Suppose in (i) A and B each sell all of their S shares to Z for $2,000. Suppose Z also makes an election under section 338(g).

(k) Suppose in (j) Z and A and B make a joint section 338(h)(10) election.

(l) Suppose in (i) S instead had a zero basis in its assets.

(1) Would the result be different if S’s assets were non-inventory assets, S made an installment sale of the assets and S immediately distributed the installment obligation to A and B meeting the requirements of section 453B(h)?

2. Corporation CS was formed in Year -15 by A, an individual, and Corporation B. At the end of its fiscal year ended June 30, Year 1, A purchased all of B’s CS stock, representing 60% of the outstanding stock. CS elected under section 1362(a) on September 15, Year 1, to be taxed as an S corporation and A consents to the election. As of June 30, Year 1, CS’ assets (assume there are no liabilities) were as follows:
<table>
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<th>Assets</th>
<th>Basis</th>
<th>FMV</th>
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<td>$ 10</td>
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<td>(LIFO; FIFO basis would be $50)</td>
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<td></td>
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<tr>
<td>Inventory for Division 2</td>
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<td>(FIFO)</td>
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<td>Stocks &amp; Securities</td>
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<td>(Acquired by contribution</td>
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<td>from A on June 1, Year 0)</td>
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<tr>
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<td>$100</td>
<td>$190</td>
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(a) What must CS report on its final C return for its fiscal year ending June 30, Year 1, as a result of the S election?

(b) For its first year ending December 31, Year 1, CS generated $200 from operations apart from events below. What result assuming all the following events occurred during such period?

1. CS sold all of its FIFO inventory on hand as of June 30, Year 1, for $20.

2. CS sold one-half of its stock and securities for $5.

3. On September 1, Year 1, CS acquired assets with a basis of $100 and FMV of $200 from Z, a C corporation, in a statutory merger qualifying under section 368(a)(1)(A). These assets were sold in December Year 1, for $250.

4. CS sold fixed assets with a basis of $0 for $20 cash and also received an interest bearing note providing for two principal payments of $5, the first due on July 1, Year 4, and the second due on January 1, Year 15.

5. CS leased fixed assets with a basis of $2 and a FMV of $12 to X for $2/year for a period of 10 years whereby X had an option to acquire the property at the end of the lease term for the then FMV.

6. CS had a NOL from the year ending June 30, Year 1, of $10 and Z had a NOL carryover of $50.
(c) Assume CS granted a large year-end bonus to A and, thus, had a loss from operations of $200 apart from the events in (2)(b)(1) through (6) for the year ending December 31, Year 1.

Class 9

Problem 7 - Subchapter C Transactions; Debt Workouts

Assignment:

Code: Study §§ 1371(a), (b) & (e). Review §§ 1361; 1362(d)-(f); 1363(d); 1366; 1367; 1368; 1374; 1375; 331; 332(a); 334(a) & (b)(1); 337(a) & (c); 338(a), (d), (g), (h)(3)(A) & (h)(10); 368(a)(1) & (2)(G), (b) & (c); 453(h)(1)(A); 453B(h); 108(a)(1), (b)(1) & (2), (c)(1), (d)(7), & (e)(2) & (6). Skim §§ 1001(a)-(d); 1012; 1014(a)(1); 1060(a) & (c); 197(a) & (d); 354(a); 358(a); 361(a) & (c); 362(b); 381(a), (b)(1) & (c)(1), (2) & (3); 1032; 1212(b).


A. C, a C corporation, has assets with a basis of $200 and FMV of $500, liabilities of $100, and earnings and profits of $100. The shareholders of C have a zero basis in their stock. S, which has always had an S election in effect, also has assets with a basis of $200 and a FMV of $500, liabilities of $100 and its shareholders have a $100 basis in their stock. S acquires C or C acquires S in the following alternative transactions. What result to C and S?

1. Acquisition by S

(a) S acquires all of C’s assets for a cash payment of $400 and assumes its liabilities. C immediately liquidates or, alternatively, C continues in existence.

(b) S acquires all of C’s outstanding stock for $400 cash and promptly liquidates C.

(c) Same as (b) except S makes a section 338(g) election prior to the liquidation of C.

(d) S acquires C’s assets in a transaction qualifying under section 368(a)(1)(C).

(e) Same as (d) except C is also an S corporation.
(f) S acquires all of C's outstanding stock in a transaction qualifying under section 368(a)(1)(B).

2. Acquisition by C

(a) C acquires all of S's assets and assumes its liabilities for $400 cash. S immediately liquidates.

(1) Suppose instead the S shareholders have $400 basis in their S stock and S immediately liquidates. Suppose S waits until the following year to liquidate?

(2) Suppose in (1) instead the S shareholders' basis was $500 but C gave S a $400 5-year note in consideration for S’s assets.

(b) C acquires all of the shareholders’ S stock for $400. C liquidates S without making a section 338 election.

(c) Same as (b) but C makes a section 338(g) election and then liquidates S.

(d) Same as (b) but C and S shareholders make a joint section 338(h)(10) election.

(e) C acquires S’s assets in a transaction qualifying under section 368(a)(1)(C).

(f) C acquires all of S’s outstanding stock in a transaction qualifying under section 368(a)(1)(B).

B. A and B each own 50% of S, a historic S corporation. S has assets with a basis and FMV of $50 and liabilities of $150. The liabilities are owed $25 to each of A and B and $100 to Citibank. Each shareholder has suspended losses of $20 from Year 0 and S incurs an additional $10 loss in Year 1. What result in the following alternative situations?

(1) A and B each exchange their $25 note, the basis of which had been reduced to zero under section 1367 by losses passed-through under section 1366, as a capital contribution.

(2) A exchanges his note for additional shares of S.

(3) On December 31, Year 1, Citibank agrees to reduce the principal amount of its debt from $100 to $50.

(4) Suppose in (3) that S is solvent, the debt was “qualified real property indebtedness” under section 108(c)(3) and the basis and FMV of S’s real property was $40 and $50, respectively.