

UNIVERSITY OF NEW HAMPSHIRE
SCHOOL OF LAW
FINAL EXAMINATION
BUSINESS ENTITIES TAXATION

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This exam will represent fifteen percent (15%) of your final grade. The test has five (5) questions and you are required to select and answer **four (4)** of the five (5) questions, please note you are free to choose any **four (4)** of the five (5) questions to answer.

The exam is worth a total of 100 points (25 points per answer). No text material or notes are permitted. You may use a copy of the federal Tax Code that has been lightly annotated. You may bring and use a calculator. Kindly utilize either the School's Electronic Blue Book or the hardcopy Blue Books to work up your answers.

The test is to be completed by students on an individual basis (no collaboration is permitted). You have 3 hours in which to complete the test. **Please be sure to cite the applicable provision of the Internal Revenue Code, Treasury Regulation or other authority to back the position you are taking for answers and reasoning for the exam.**

Please remember, you should only answer *four* of the five questions.

Good Luck!

QUESTION #1 – 25 Points, estimated time, 45 minutes

Hogwarts Enterprises, Inc. (“Inc.”) is a closely-held C corporation formed 20 years ago by Harry Potter and Ginny Weasley, who are husband and wife, to develop and manufacture multimedia entertainment products for personal computers.

Five years ago, Harry and Ginny began making gifts of some of their Inc. common stock to their son, Albus, and to a trust for the benefit of Albus’ two children. Albus’ wife, Hermione, serves as Trustee of the trust. Albus Potter has been active in the family business for several years and is currently serving as vice-president. Harry and Ginny are the two members of the Board of Directors of the corporation.

As of the beginning of the current year, Inc.’s common and preferred shares were held as follows:

Shareholders	Shares	Adjusted Basis	Fair Market Value
Harry Potter	800	\$ 80,000	\$ 800,000
Ginny Weasley	800	80,000	800,000
Albus Potter	300	30,000	300,000
Childrens’ Trust	<u>100</u>	<u>10,000</u>	<u>100,000</u>
	2,000	\$ 200,000	\$ 2,000,000

Evaluate the tax consequences of the following alternative transactions:

- (a) Inc. redeems Ginny’s 800 shares for cash. Ginny resigns as an employee, officer and director.
- (b) Same as (a), above, except that Ginny neglects to file the agreement required by § 302(c)(2)(A)(iii). What is the purpose of this agreement?
- (c) Same as (a), above, except Ginny remains as a director of Inc.

QUESTION #2 - 25 Points, estimated time, 45 minutes

Jo owns all of the common stock (the only class outstanding) of Little Women Corporation. Prior to the transactions below and as a result of a § 351 transfer, Jo has a \$10,000 basis in her Little Women stock. What results to Jo and Little Women in each of the following alternative situations?

- (a) In year one Little Women has \$5,000 of current and no accumulated earnings and profits and it distributes \$17,500 to Jo?

- (b) Little Women has a \$15,000 accumulated deficit in its earnings and profits at the beginning of year two. In year two Little Women has \$10,000 of current earnings and profits and it distributes \$10,000 to Jo.

QUESTION #3 - 25 Points, estimated time, 45 minutes

Smile Corporation is organized with two classes of voting common stock: Class A and Class B. Shares in each class of stock have an equal right to Smile's assets and earnings and profits. Stevie owns 100 shares of Class A stock, and Amy and Leah each own 50 shares of Class B stock.

Assuming that Smile Corporation has ample earnings and profits, determine whether the following distributions are taxable under § 301 or excludable under § 305(a):

- (a) A pro rata distribution of nonconvertible preferred stock to both classes of shareholders.
- (b) A pro rata distribution of Class A stock on Class A and Class B on Class B. The Class B shareholders also are given the option to take cash in lieu of additional Class B shares. Amy exercises this option.

QUESTION #4 - 25 Points, estimated time, 45 minutes

Arnold owns 100 shares of Terminator Corporation which he purchased several years ago for \$10,000. Terminator has \$12,000 of accumulated earnings and profits. What are the tax consequences to Arnold on the liquidation of Terminator Corporation in the following alternative situations:

- (a) Terminator distributes \$20,000 to Arnold in exchange for his stock?
- (b) What result in (a), above, if Arnold receives \$10,000 in the current year (year one) and \$10,000 in year two? Would there be any problem if Terminator does not adopt a formal plan of complete liquidation in year one?

QUESTION #5 - 25 Points, estimated time, 45 minutes

Stark Corporation (“Stark”) is a publicly traded C corporation engaged in the publication of professional textbooks. Stark has 5 million shares of voting common stock outstanding. The stock is currently trading at \$10 per share.

Stark wishes to acquire control of Captain America, Inc. (“Captain”), a closely held corporation that is the leading publisher of student study aids for law students. Captain has 4,000 shares of common stock (its only class) outstanding, held by 10 shareholders each of whom own 400 shares. Captain’s assets and liabilities are as follows:

Asset	Adjusted Basis	Fair Market Value
Cash	\$ 600,000	\$ 600,000
Inventory	200,000	1,000,000
Equipment	800,000	1,400,000
Goodwill	0	2,000,000
	<u>\$ 1,600,000</u>	<u>\$ 5,000,000</u>

Liabilities

Bank Loan	\$ 1,000,000
	<u>\$ 1,000,000</u>

Both Stark and Captain have substantial accumulated earnings and profits.

Captain’s board of directors has agreed to sell the business for \$4 million. Four of Captain’s shareholders have a very low adjusted basis in their stock and wish to minimize their taxable gain on a sale.

Stark does not wish to dilute the interests of its current shareholders by issuing too much voting common stock to acquire Captain, but Stark is willing to use a mix of consideration (including newly issued preferred stock) and to assume Captain’s \$1,000,000 bank loan. For business reasons, Stark ultimately wishes to operate Captain’s business through a wholly-owned subsidiary and would prefer to avoid exposure to any unknown Captain’s liabilities. Assume that any preferred stock used by Stark to make the acquisition is not “nonqualified preferred stock” within the meaning of Section 351(g).

Consider generally the tax consequences of the plan described below, focusing on whether the acquisition will qualify as a tax-free reorganization.

Captain merges directly into Stark, and each Captain shareholder receives \$300,000 of Stark non-voting preferred stock and \$100,000 of Stark five-year notes.