

Exam Questions on Harris Material

Exam #2 2010

5) (20 pts. total) Provide short answers to each of the following questions.

Ma and Pa own a farm, with all assets owned as marital property under Wisconsin's marital property law. Among their assets is stored corn currently worth \$100,000 with a zero income tax basis because they raised the corn and deducted all the costs of raising it.

Use this information to answer each question below. Give a brief explanation for each answer.

a) (3 pts.) If Ma and Pa gave the corn to Girl and she sold it the next day, how much income would Girl have to report as a result of the sale?

Basis transfers with gift, so Gain = Sale Price – Basis = 100,000 – 0 = \$100,000

b) (3 pts.) If Ma died and Pa gave the corn to Girl, how much income would Girl have to report if she sold it the next day for the same value?

Basis updates to date of death fair market value, so basis becomes \$100,000, so Gain = Sale Price – Basis = 100,000 – 100,000 = \$0

c) (3 pts.) If Ma and Pa contributed the corn to an LLC in exchange for an ownership interest in the LLC and the LLC sold the corn the next day, how much income would the LLC realize?

Income realized would be \$100,000, since Gain is \$100,000 sale price minus the \$0 basis.

i) (2 pts.) If the LLC has income from the sale, does it pay income tax on that income?

No, like a partnership, income is passed through to owners of LLC who then pay taxes.

ii) (2 pts.) If instead the LLC returned the corn back to Ma and Pa before the corn was sold, would the LLC and/or Ma and Pa have to pay income tax as a result of this transfer?

No, assets can be passed into and of an LLC without triggering recognition of gains.

d) (3 pts.) If Ma and Pa contributed the corn to an S-Corporation in exchange for shares in the S-Corporation and the S-Corporation sold the corn the next day, how much income would the S-Corporation realize?

Income realized would be \$100,000, since Gain is \$100,000 sale price minus the \$0 basis.

i) (2 pts.) If the S-Corporation has income from the sale does it pay income tax on that income?

No, like a partnership, income is passed through to owners of S-Corporation who then pay taxes.

ii) (2 pts.) If instead the S-Corporation returned the corn back to Ma and Pa before the corn was sold, would the S-Corporation and/or Ma and Pa have to pay income tax as a result of this transfer?

Yes, moving assets out of S-corporation triggers recognition of gain. Since the asset moved out is corn grain in this case, this would trigger income tax.

6) (3 pts.) This problem continues the ongoing saga of Ma, Pa, and Girl. Ma and Pa own all assets as marital property under Wisconsin's marital property law. Ma and Pa bought land years ago for \$50,000. Ma dies and the next day Pa sells the land to Girl at its fair market value of \$400,000. How much taxable gain does Pa realize from this land sale?

Basis updates to date of death fair market value, so basis becomes \$400,000, so Gain = Sale Price - Basis = 400,000 - 400,000 = \$0

7) (3 pts.) Which of the business entities discussed in class provide some limited liability to the owners of the entity?

Limited liability company, limited liability partnership, S and C corporations