The first unit is an attempt to level the playing field. Before we begin our march through Subchapter C of the Code (the subchapter that applies to corporations), we will spend a class reviewing certain fundamental topics that you should have under your belt before you begin this course. None of them specifically relates to corporate taxation, but they play out in their own way in the corporate context. Most of you should be familiar with these concepts, but there will be some variations in your classes and some subjects that you may not have covered (e.g. installment sales). We will just do a quick overview so we all start with a minimum level of understanding. You will be expected to have an understanding of these subjects for the remainder of the semester.

Realization, Gains, Losses and Basis

Review Code §§ 61(a)(3), 1001(a)-(c), 1011, 1012, 165(a)-(c)

Problem:

1. In Year 1 X Co. purchases Blackacre, unimproved land, for $100,000 in cash. At the end of Year 1, Blackacre is worth $110,000. In Year 3 X Co. transfers Blackacre to B in exchange for $200,000 in cash. When and in what amount does X Co. recognize the appreciation with respect to Blackacre?

Tax Cost Basis, Cash Method, Accrual Method

Review Code §§ 446(a); Reg. §§ 1.451-1(a), 1.61-2(d)(1), (2)(i), (4), (6)(i)

Problem:

2. In November of Year 1, X Co. contracts with T Co. to paint T’s factory and subsequently it is painted. In December of Year 1, X Co. sends T Co. a bill for $10,000. In January Year 2 T Co. tells X Co. that it is short on cash and asks whether X Co. would accept two computers worth $10,000 in payment of the bill. X Co. agrees and takes delivery of the computers in January Year 2.

(a) Does the fact that X Co. accepts the computers in payment of the bill change the fact of or the amount of income?

(b) What is the basis of the computers in X Co.’s hands?

(c) If X Co. is on the cash method of accounting, when does it realize gross income?
(d) If X Co. is on the accrual method of accounting, when does it realize gross income?

(e) If T Co. is on the cash method of accounting, when does it have a deduction for payment for the painting?

(f) If T Co. is on the accrual method of accounting, when does it have a deduction for payment for the painting?

Indebtedness; Effect of Liabilities on Basis and Amount Realized

Code: Review §§ 61(a)(12), 108, 166, 163

Problem:

3. 
(a) What are the tax consequences if Citibank loans X Co. $10,000 and X Co. subsequently repays Citibank? What if there is interest on the debt?

(b) What if X Co. fails to repay Citibank and the debt is discharged? How does the answer change if X Co. is insolvent?

(c) What is X Co.’s basis if it acquires Blackacre by paying $10,000 in cash and transferring $90,000 it borrows from Citibank? Does it matter if the debt is unsecured?

(d) What is X Co.’s basis if it acquires Blackacre by paying $10,000 in cash and by assuming an existing mortgage of $90,000 encumbering the property? Does it matter if the debt is unsecured?

(e) What is X Co.’s basis if it acquires Blackacre by transferring $10,000 in cash and by giving the seller a purchase money mortgage for $90,000? Does it make any difference if the mortgage is nonrecourse?

(f) In questions (c)-(e) what is the seller’s amount realized on the sale of Blackacre?

Characterization

Review Code §§ 1(a), (h) (recall the general idea of ordinary rates; capital gains rates), 165(a), 1211, 1212(b), 1221, 1222(1), (3), (11), 1223(1), (2).
Code §§ 11, 1211 (corporate rule), 1212 (corporate rule)

Problems

4.  
(a) What is the character of the gain on the disposition of Blackacre in problem 1 if X Co. holds it for investment? What is the maximum rate of tax to which the gain is subject?

(b) Would the answer be different if X Co. were an individual?

(c) How would the answer change if X Co. sold Blackacre for $40,000? What if X Co. were an individual?

Installment Sales

Code §§ 1001(c), 453(a)-(d), (f)(3)-(f)(5); Reg. § 15a.453-1(b)(2)

Problem

5.  
(a) How would the answer to problem 1 change if, instead of being paid $200,000 in cash X Co. received $50,000 in cash, plus B’s note in the face amount of $150,000, payable in three years? The note has adequate stated interest.

(b) How would the answer to (a) change if there was no interest stated on the note? Assume the applicable federal rate is 6%. The present value of $150,000 to be paid in three years at 6% is $126,000 (approximately).

Depreciation and Depreciation Recapture

Review Code §§ 167(a), 168, 197, 1016, 1245

Problem

6. In Year 1 X Co. buys a bulldozer for business use, paying $100,000 in cash. Absent a disposition of the bulldozer, X Co’s proper cost recovery (depreciation) deductions under 167 and 168 (ignoring conventions for the year the year of disposition) for the first three years would be approximately: Year 1, $20,000; Year 2, $32,000, Year 3, $19,200.

(a) If X Co. sells the bulldozer for $200,000 cash on April 1 of Year 3, what is the amount and character of what X Co. reports on the sale?

(b) How would the answer change if instead of a bulldozer X Co.
purchased an intangible subject to section 197?