**Homework for Chapter 11. S Corporations**

**[§1363, 1366]** Jan is married and files a joint return. The joint return does not have unusually   
large personal deductions. The joint return does not contain substantial amounts of income   
other than the income from the business described below. Jan operates an unincorporated   
office supply business that has the following income statement each year:

|  |  |
| --- | --- |
| **Sales** | **$1,000,000** |
| **Operating expenses** | **900,000** |
| **Net income** | **$ 100,000** |

Jan is considering incorporating the business. If the business is incorporated,   
she will receive a salary of $50,000, and the corporation will not pay dividends.   
Retained earnings will be reinvested in additional warehouse space and delivery equipment.   
The corporation is not expected to have surplus funds in the forseeable future.   
Which of these organizational forms is likely to result in the lowest total income tax burden?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | Proprietorship | **b.** | Corporation without S election | **c.** | Corporation with S election |  |

Which entity is likely to face an IRS challenge because of allegedly   
unreasonably low salaries?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | C corporation | **b.** | S corporation | **c.** | Proprietorship |  |

If the IRS audits an S corporation and questions the level of compensation to   
the CEO and owner of the corporation, the IRS is likely to consider the compensation to be

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| --- | --- | --- | --- | --- | --- | --- |
| **a.** | Unreasonably high | **b.** | Unreasonably Low | **c.** | Neither |  |

**[§1363]** A business operated as a C corporation from 1990 through 12-31-2017, and   
had accumulated earnings and profits of $100,000 at 12-31-2017. The corporation did not   
use LIFO. The corporation elected S status as of 1-1-2018. In 2018, the corporation had   
net ordinary business income from its pest control operations of $800,000. The company   
did not sell any assets in 2018. How much tax is owed by the corporation for 2018?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $35,000 | **c.** | $280,000 | **d.** | none of these |  |

|  |  |
| --- | --- |
| **1** | **Explain the requirements for being taxed under Subchapter S.** |

**[§1361]** A corporation may elect to be an S corporation if it meets the following tests:

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| --- | --- | --- | --- | --- |
| **a.** | It is a domestic corporation. | **b.** | It has no more than 100 shareholders. |  |
| **c.** | It has only one class of stock. | **d.** | All of these. |

|  |  |
| --- | --- |
| **2** | **Explain the procedures for electing to be taxed under Subchapter S.** |

**[§1362]** Acme Corporation wishes to be treated as an S Corporation for the year   
ending December 31, 2018. The corporation must file Form 2553 before what date?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 12-31-2017 | **b.** | 3-15-2017 | **c.** | 3-15-2018 | **d.** | 12-31-2018 |  |

|  |  |
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| **3** | **Identify the events that will terminate an S election.** |

**[§1362(d)(3), §1375] Bristol Corp**. was formed as a C corporation on January 1, 2013.

Bristol elected S corporation status on January 1, 2016.   
At the time of the election, Bristol had accumulated C corporation earnings and profits.   
Bristol has had the same 25 shareholders throughout its existence.   
The corporation’s passive net income was 30% of gross receipts in both 2016 and 2017.   
In 2018, Bristol will owe a penalty tax if it

|  |  |  |
| --- | --- | --- |
| **a.** | Increases the number of shareholders to 75. |  |
| **b.** | Adds a decedent's estate as a shareholder to the existing shareholders. |
| **c.** | Makes a charitable contribution. |
| **d.** | Has passive investment income exceeding 25% of gross receipts. CPA |

**[§1361]** Which of the following can disqualify a corpo­ration from S corporation status?

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| --- | --- | --- |
| **a.** | Having only one class of stock. |  |
| **b.** | Having over 25 shareholders |
| **c.** | Having an estate as a shareholder. |
| **d.** | Having a non-resident alien as a shareholder |

**[§1362(g)]** After a corporation's status as an S corporation is revoked or terminated,   
how many years is the corporation required to wait before making a new S election, in   
the absence of IRS consent to an earlier election?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | 1 | **b.** | 3 | **c.** | 5 | **d.** | 10 | CPA |  |

|  |  |
| --- | --- |
| **4** | **Determine the permitted tax years for an S corporation.** |

|  |  |
| --- | --- |
| **5** | **Calculate ordinary income and loss.** |

**[§1366]** **Foster’s RV Sales**, Inc. is an S corp. with the following activity during the year:

|  |  |
| --- | --- |
| Gross sales of RV’s and campers | $600,000 |
| Cost of sales | 300,000 |
| Operating expenses | 100,000 |
| Interest income | 1,000 |
| Charitable contributions | 3,000 |
| Section 179 expense (not included above) | 10,000 |

How much ordinary income from trade or business activities will be reported on   
Schedule K, Shareholders’ Shares of Income, Credits, Deductions, etc.?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $188,000 | **b.** | $190,000 | **c.** | $198,000 | **d.** | $200,000 | IRS |  |

**[§1366]** **The Mooresville Corporation,** an accrual basis, calendar year S corpo­ration,   
reported the following items? What is the nonseparately stated net income amount?

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Gross receipts | | | | | $200,000 | | |
| Interest income | | | | | 12,000 | | |
| Rental income | | | | | 25,000 | | |
| Cost of goods sold and commissions | | | | | 127,000 | | |
| Net long-term capital gain | | | | | 17,000 | | |
| Compensation paid to shareholder | | | | | 10,000 | | |
| **a.** | $63,000 | **b.** | $73,000 | **c.** | $117,000 | | **d.** | $127,000 | |  |  |  |

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| **6** | **Calculate the amount of any special S corporation taxes.** |

An S corporation is not subject to the following tax:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | Built-in gains tax | **b.** | Excess net passive income tax | **c.** | Accumulated Earnings tax |  |

**[§1374]** When a corporation incurs the built-in gains tax, the tax is actually paid by:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **a.** | The corporation | **b.** | The stockholders | **c.** | Both |  |

**[§1374]** Cal Corp. had the following balance sheet on 1-1-2016 when it elected S status:

|  |  |
| --- | --- |
| Cash | $ 5,000 |
| Land |  |
| Adjusted basis | 300,000 |
| Fair market value | 500,000 |

In 2018, Cal sells the land for $560,000. What is the Built-in Gains tax from this sale?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $ 15,000 | **c.** | $ 35,000 | **d.** | $70,000 |  |  |

**[§1363]** **Tarheel Corporatio**n was organized on 1-1-2017, and immediately elected S status.   
In 2017, Tarheel had gross receipts of $1,000,000, consisting of service revenue of $700,000   
and interest revenue of $300,000. Its only expenses were $200,000 incurred in earning the   
service revenue. Taxable income was $800,000. How much tax is owed by Tarheel for 2017?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $17,500 | **b.** | $35,000 | **c.** | $280,000 | **d.** | none |  |

**[§1375] MeanGreen Corp.** operated as a C corporation from 1990 through 12-31-2017.

It had accumulated earnings and profits of $100,000 at 12-31-2017. The corporation elected   
S status as of 1-1-2018. In 2018, the corporation had gross receipts of $1,000,000, consisting   
of service revenue of $700,000 and interest revenue of $300,000.   
Its only expenses were $200,000 incurred in earning the service revenue. Net ordinary   
business income was $800,000. How much tax is owed by the corporation for 2018?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $17,500 | **b.** | $35,000 | **c.** | $280,000 | **d.** | none of these |  |

|  |  |
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| **7** | **Shareholder’s share of ordinary income or loss & separately stated items.** |

**[§1366, 1368(a)]** **Bow Corporation**, an S corporation, has three equal stockholders.   
During 2017, Bow had net ordinary business income of $300,000, and municipal   
interest of $20,000. Bow made cash distributions totaling $120,000 during 2017.   
What amount from Bow should be included in each stock­holder's gross income for 2017?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $60,000 | **c.** | $ 100,000 | **d.** | $ 140,000 | CPA |  |

**[§1366(d)(3)]** **Bern Corp., an S corporation**, had an ordinary loss of $36,500 for the   
year ended December 31, 2017. At January 1, 2017, Meyer owned 50% of Bern's stock.   
Meyer held the stock for 40 days (including date of sale) in 2017 before selling the entire   
50% interest to an unrelated third party. Meyer's basis for the stock was $10,000.   
Meyer was a full‑time employee of Bern until the stock was sold.   
Meyer's share of Bern's 2017 loss was

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $ 2,000 | **c.** | $10,000 | **d.** | $18,250 | CPA |  |

**[§1366(c)]** On January 1, **Kane** owned all the 100 issued shares of Mart Corp., a   
calendar­ year S corporation. On the 20th day of 2017, Kane sold 25 of the Mart   
shares to Rodgers. For the year (a 365-day calendar year), Mart had $73,000 in   
nonseparately stated income and made no distributions to its share­holders.   
What amount of nonseparately stated income from Mart should be reported on Kane's   
tax return for 2017? (The seller is treated as owning the stock on the date of sale.)

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $56,750 | **b.** | $55,750 | **c.** | $54,750 | **d.** | $16,250 | **e.** | $0 | CPA |  |

**[§1366(c)]** At the beginning of year 1, **Lisa and Marie** were equal shareholders in LM Inc.,   
an S corporation. On April 30, year 1, Lisa sold half of her interest to Shelley.   
On August 8, year 1, Marie sold her entire interest to George.   
On December 31, year 1, the corporation reported net income of $50,000.   
How is this income allocated to Lisa assuming year 1 is not a leap year, and   
the date of sale is allocated to the seller?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $9,932 | **b.** | $15,070 | **c.** | $8,391 | **d.** | $16,610 |  |  |

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| **8** | **Determine the limits on a shareholder's deduction of S corporation losses.** |

**[§1366(d)]** On January 1, **Mr. Karl** purchased 50% of **Olive Inc**., an S corporation,   
for $75,000. Olive Inc. incurred an ordinary loss of $160,000 for the year.   
How much of the loss can Mr. Karl deduct on his personal income tax return for the year?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $160,000 | **b.** | $80,000 | **c.** | $75,000 | **d.** | $37,500 |  |  |

**[§1366(d)]** Bob invested $25,000 for all of the stock of a new Corporation on January 1.   
The corporation immediately elected S Status. He also loaned the S Corporation $10,000   
during the year which has not been repaid. At year-end the corporation owed $100,000   
to the local bank.   
The S Corporation has an operating loss of $50,000 for the year. What maximum amount   
of loss (before passive & at-risk limitations) can Bob deduct on his current tax return?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $35,000 | **b.** | $10,000 | **c.** | $50,000 | **d.** | $25,000 |  |

**[§1366(d)]** Sunnie purchased 50% of the shares of Corporation H, a calendar   
year S corporation, for $7,000 on January 1, 25017. She also guaranteed a   
corporate loan of $6,000. H had an operating loss of $22,000 for 2017.   
How much of H's loss that Sunnie can deduct on her individual in­come tax return for 2017?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $11,000 | **b.** | $10,000 | **c.** | $7,000 | **d.** | $-0- |  |  |

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| **9** | **Calculate a shareholder’s basis in his or her S corporation’s stock and debt.** |

**[§1367]** The **Haas Corp**., a calendar year S corpora­tion, has two equal shareholders.   
For the year ended December 31, Haas had taxable income of $60,000, which included   
$50,000 from operations and $10,000 from corporate bond interest income.   
Hass also had municipal bond interest income of $8,000.   
There were no other transactions that year.   
Each shareholder's basis in the stock of Haas will increase by

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $50,000 | **b.** | $34,000 | **c.** | $30,000 | **d.** | $25,000 | **e.** | $0 | CPA |  |

**[§1367]** The **Bass Corp.**, a calendar year S corpora­tion, has two equal shareholders.   
For the year, Bass had taxable income of $60,000, which included $50,000 from operations   
and $10,000 from investment interest income. Bass spent $20,000 on entertainment   
expenses, and claimed a deduction of $10,000 in arriving at taxable income of $60,000.   
Bass also had municipal bond interest income of $8,000. There were no other   
transactions that year. Each shareholder's basis in the stock of Bass will increase by:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $50,000 | **b.** | $34,000 | **c.** | $30,000 | **d.** | $29,000 | **e.** | $0 | CPA |  |

**[§1367]** **Rich Corp,** an S corporation since its organization, is owned entirely by Mr. Rich.   
The corporation uses a calendar year as its tax­able year. Mr. Rich paid $200,000 for his Rich   
stock when the corp. was formed on January 1, 2017.   
Rich Corporation reported the following results in its first year:

|  |  |
| --- | --- |
| Ordinary Income | $40,000 |
| Tax‑exempt bond interest income | 6,000 |
| Short‑term capital loss | (3,000) |

No distributions were made in 2017. What is the basis of Mr. Rich’s stock on December 31?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $240,000 | **b.** | $243,000 | **c.** | $246,000 | **d.** | $249,000 | IRS |  |

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| --- | --- |
| **10** | **Determine taxability of an S corporation's distributions to its shareholders.** |

**[§1368]** Mr. Oliver received a distribution from an S corporation that was in excess of   
the basis of his stock in the corporation. The S corporation had NO earnings and profits.   
Mr. Oliver should treat the distribution in excess of his basis as

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | a capital gain. | **b.** | previously taxed income. |  |
| **c.** | a return of capital. | **d.** | a reduction in the basis of his stock. |

**[§1368]** Beth invested $25,000 in a new Corporation on January 1, 2017. Beth does not   
borrow from the Corporation or make loans to the Corporation. The Corporation elected S   
Status on January 1. The Corporation had net income of $50,000 in 2017.   
On December 31, 2017, the Corporation distributed $60,000 to Beth.   
How much income does Beth recognize as a result of the cash distribution?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $10,000 | **c.** | $25,000 | **d.** | $60,000 |  |

**[§1368]** Repeat preceding question. What is Beth’s basis in the stock on   
January 1 of the corporation’s second year?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $10,000 | **c.** | $15,000 | **d.** | $25,000 |  |

**[§1368]** The books and records of Wizard, a calendar year S corporation   
since 2005, reflect the following information.

|  |  |  |
| --- | --- | --- |
| Accumulated adjustments account | 1/1/2017 | $ 30,000 |
| Accumulated earnings & profits | 1/1/2017 | 75,000 |
| Net ordinary income for the year | 2017 | 100,000 |

Wizard has only one shareholder, Ms. Heil, whose basis in Wizard's stock was $60,000   
on January 1, 2017. During 2017, Wizard distributed $150,000 to Ms. Heil.   
What is the amount of this distribution that should be treated as a capital gain by Ms. Heil?

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $-0­- | **b.** | $20,000 | **c.** | $105,000 | **d.** | $150,000 | IRS |  |

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| **11** | **Procedures for filing an S corporation tax return. Estimated tax payments.** |

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| --- | --- |
| **12** | **Fringe Benefit Rules** |

**[§1372]** The fringe benefit rules for major shareholders of S corps have the effect of:

|  |  |  |  |
| --- | --- | --- | --- |
| **a.** | Making the S corporation preferable to the partnership form of organization. | |  |
| **b.** | Limiting tax advantages associated with fringe benefits provided to shareholders. |
| **c.** | Increases the limit from $50,000 to $100,000 for group-term life insurance |
|  | provided to an employee who is also a major shareholder. |
| **d.** | Increasing the taxes paid by an S corporation on its net income. |

###### Use the following information for the next four questions – See worksheet provided below.

|  |  |  |
| --- | --- | --- |
| 1-1-2016 | Ms. White invested $100,000 cash for 100% of stock of New Corporation. | $ 100,000 |
| 2016 | New Corporation paid Ms. White a salary of $60,000. | $ 60,000 |
| 2016 | New corporation had after-tax income of $20,000. | $ 20,000 |
| 2016 | New Corporation paid a dividend of $5,000. | $ 5,000 |
| 1-1-2017 | Ms. White elected S status for New Corporation. |  |
| 2017 | New Corporation paid Ms. White a salary of $60,000. | $ 60,000 |
| 2017 | Net income per books (after all salaries) was $70,000 | $ 70,000 |
| 2017 | Net income per books included municipal interest income of $4,000. | $ 4,000 |
| 7-1-2017 | New Corporation paid a dividend of $10,000. | $ 10,000 |
| 2018 | New Corporation paid Ms. White a salary of $60,000. | $ 60,000 |
| 2018 | Net income per books (after all salaries) was $50,000. | $ 50,000 |
|  | Net income per books did not include any separately stated item. |  |
| 7-1-2018 | The corporation paid a dividend of $10,000. | $ 10,000 |

|  |  |  |
| --- | --- | --- |
|  | What is the total amount of income reported by Ms. White on her Federal 1040 in 2016? |  |
|  | a. $40,000 b. $45,000 c. $60,000 d. $65,000 e. none of these |
|  | What is the balance in AAA at the end of 2018? |  |
|  | a. $88,000 b. $96,000 c. $100,000 d. $116,000 e. none of these |
|  | What is the basis of the stock to Ms. White on 12-31-2018? |  |
|  | a. $220,000 b. $210,000 c. $200,000 d. $196,000 e. none of these |
|  | What is total income reported by Ms. White on her Federal 1040 in 2017 and 2018? |  |
|  | a. $240,000 b. $220,000 c. $236,000 d. 196,000 e. none of these |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **NewCorp Corporate Accounts** | | | **Ms. White** | |
|  | **Amount** | **AAA** | **E & P** | **OA** | **Form 1040** | **Basis** |
| Begin. Bal. 1-1-2016 | N/A | **0** | **0** | **0** | N/A | **$100,000** |
| **Operates as C corp.** |  |  |  |  |  |  |
| 2016 salary | $ 60,000 |  |  |  | $ 60,000 |  |
| 2016 after tax income | $ 20,000 |  | $ 20,000 |  |  |  |
| 2016 Dividend | $ 5,000 |  | ($ 5,000) |  | $ 5,000 |  |
| **1-1-2017 - Elect S** |  |  |  |  |  |  |
| **Starting balances** |  |  | $15,000 |  |  | **$100,000** |
| 2017 salary | $ 60,000 |  |  |  | $ 60,000 |  |
| 2017 net income | $ 70,000 | $ 66,000 |  | $ 4,000 | $ 66,000 | $ 70,000 |
| 2017 Dividend (7-1) | $ 10,000 | ($ 10,000) |  |  |  | ($ 10,000) |
|  |  |  |  |  |  |  |
| 2018 salary | $ 60,000 |  |  |  | $ 60,000 |  |
| 2018 net income | $ 50,000 | $ 50,000 |  |  | $ 50,000 | $ 50,000 |
| 2018 Dividend (7-1) | $ 10,000 | ($ 10,000) |  |  |  | ($ 10,000) |
| Subtotal | N/A | $ 96,000 | $15,000 | $ 4,000 | $236,000 | $ 200,000 |