

Chapter C4

Corporate Nonliquidating Distributions

Problems

C4-28 a.	Gross profit from operations		\$250,000
	Dividends		20,000
	Interest		10,000
	Net capital gain (\$8,000 - \$1,200)		<u>6,800</u>
	Gross income		\$286,800
	Minus: Administrative expenses	\$110,000	
	Bad debt expense	5,000	
	Depreciation	<u>86,000</u>	(201,000)
			\$ 85,800
	Charitable contribution [lesser of \$8,000 or 0.10 x (\$85,800 - \$40,000)]		(4,580)
			\$ 81,220
	Dividends-received deduction (0.80 x \$20,000)		(16,000)
	NOL deduction (carryover)		(40,000)
	Taxable income		<u>\$ 25,220</u>
b.	Earnings and profits:		
	Taxable income		\$ 25,220
	Plus: Municipal bond interest	\$ 12,000	
	Life insurance proceeds	100,000	
	Excess depreciation (\$86,000 - \$42,000)	44,000	
	NOL deduction (carryover)	40,000	
	Dividends-received deduction	<u>16,000</u>	212,000
	Minus: Excess charitable contribution (\$8,000 - \$4,580)	\$ 3,420	
	Penalties	450	
	Taxes (\$25,220 x 0.15)	<u>3,783</u>	(7,653)
	Current earnings and profits		<u>\$229,567</u>

pp. C4-3 through C4-6.

C4-29 Taxable income		\$500,000	
Plus: Dividends received deduction			
(0.70 x \$80,000)	\$ 56,000		
NOL deduction (carryover)	30,000		
Excess depreciation	<u>40,000</u>	126,000	
Minus: Long-term capital loss	\$ 80,000		
Fines and penalties	6,000		
Federal income taxes			
(\$500,000 x 0.34)	<u>170,000</u>	<u>(256,000)</u>	
Current earnings and profits		<u>\$370,000</u>	

pp. C4-3 through C4-6.

C4-30 Beginning of 1998: (\$10,000) (The \$2,000 distribution is a return of capital and does not affect E&P.)

Beginning of 1999: (\$6,000) [(\$10,000) + (\$8,000 - \$4,000)]

Beginning of 2000: (\$11,000) [(\$6,000) + (\$5,000)]

Beginning of 2001: \$2,000 [(\$11,000) + (\$18,000 - \$5,000)]

p. C4-3.

C4-31 a. \$60,000 dividend to Edna; \$15,000 out of current E&P and \$45,000 out of accumulated E&P.

b. \$25,000 is a dividend to Edna; \$25,000 is a return of capital that reduces Edna's basis to zero; the excess \$10,000 is taxable as a capital gain.

c. Yellow's accumulated E&P as of March 1 (of a non-leap year) is \$65,000 - [(\$36,500 ÷ 365) x 59] = \$59,100. Therefore, \$59,100 is taxable as a dividend. \$900 is a return of capital that reduces Edna's stock basis to \$24,100.

d. \$25,000 is a return of capital that reduces Edna's basis to zero; the excess \$35,000 is taxable as a capital gain. pp. C4-6 through C4-8.

C4-33 a.

Individual	Date	Amount	Current E&P	Accumulated E&P	Dividend	Return of Capital
Charles	3/1	\$ 60,000	\$16,000	\$30,000	\$46,000	\$14,000
Donald	9/1	<u>90,000</u>	<u>24,000</u>	<u>-0-</u>	<u>24,000</u>	<u>66,000</u>
Total		<u>\$150,000</u>	<u>\$40,000</u>	<u>\$30,000</u>	<u>\$70,000</u>	<u>\$80,000</u>

Thus, Charles has \$46,000 of dividend income and a \$14,000 return of capital, which reduces his

basis for the Pearl stock from \$80,000 to \$66,000. The basis reduction increases Charles's capital gain on the sale to \$59,000 [\$125,000 - (\$80,000 - \$14,000)]. Donald has a \$24,000 dividend and a \$66,000 return of capital, which reduces his stock basis at year-end from \$125,000 to \$59,000.

b.

Individual	Date	Amount	Current E&P	Accumulated E&P	Dividend	Return of Capital
Charles	3/1	\$ 60,000	\$ 40,000	\$ -0-	\$ 40,000	\$20,000
Donald	9/1	<u>90,000</u>	<u>60,000</u>	<u>-0-</u>	<u>60,000</u>	<u>30,000</u>
Total		<u>\$150,000</u>	<u>\$100,000</u>	<u>\$ -0-</u>	<u>\$100,000</u>	<u>\$50,000</u>

The return of capital distributions reduce Charles' basis in his Pearl stock from \$80,000 to \$60,000 and Donald's basis from \$125,000 to \$95,000. This basis reduction increases Charles's capital gain on the sale to \$65,000 [\$125,000 - (\$80,000 - \$20,000)].

c.

Individual	Date	Amount	Current E&P	Accumulated E&P	Dividend	Return of Capital
Charles	3/1	\$ 60,000	\$ -0-	\$60,000 ^a	\$60,000	\$ -0-
Donald	9/1	<u>90,000</u>	<u>-0-</u>	<u>35,700^b</u>	<u>35,700</u>	<u>54,300</u>
Total		<u>\$150,000</u>	<u>\$ -0-</u>	<u>\$95,700</u>	<u>\$95,700</u>	<u>\$ 54,300</u>

a

$$\frac{59}{365} \times (\$36,500) = (\$5,900) \text{ E\&P deficit for 1/1-2/28.}$$

$$\text{Acc. E\&P on 3/1} = \$120,000 - \$5,900 = \$114,100 \text{ available.}$$

b

$$\frac{243}{365} \times (\$36,500) = (\$24,300) \text{ E\&P deficit for 1/1-8/31.}$$

$$\text{Acc. E\&P on 9/1} = \$120,000 - \$24,300 - \$60,000 = \$35,700$$

Charles reports a \$45,000 capital gain (\$125,000 - \$80,000) on the stock sale since the distribution does not affect the basis for his stock. The return of capital distribution reduces Donald's stock basis from \$125,000 to \$70,700 (\$125,000 - \$54,300). pp. C4-6 through C4-8.

- C4-34** a. Barbara receives a taxable dividend of \$52,000 (\$60,000 - \$8,000).
 b. Barbara's basis for the land is \$60,000, its FMV.
 c. Ruby Corporation recognizes a \$30,000 [(\$52,000 net FMV + \$8,000 release from liability) - \$30,000] capital gain on the distribution.

d. Ruby Corporation's E&P is increased by the \$30,000 E&P gain, which is the excess of the land's FMV over its E&P adjusted basis. (Note that the E&P gain and the tax gain are the same in this problem.) E&P is decreased by the \$52,000 (\$60,000 FMV - \$8,000 mortgage) net amount of the distribution and by the \$10,200 ($0.34 \times \$30,000$) of federal income taxes imposed on the gain, or a net reduction of \$32,200. pp. C4-8 through C4-11.

C4-35 a. The \$20,000 cash received by Arlene is taxable as a dividend. The amount of the property (land) distribution is zero because the liability reduces the FMV, but not below zero. This results holds under either interpretation of FMV, i.e., whether actual FMV or the greater liability is used (see Part b).

b. Two alternatives exist for the basis amount. One approach is that the basis of the land is \$50,000, or the property's actual FMV. Proponents of this approach argue that Sec. 311(b)(1) applies only for gain recognition purposes. The other approach is that the land's basis is \$60,000 or the FMV determined under Sec. 311(b)(1). See footnote in text.

c. Stowe Corporation must recognize a \$45,000 (\$60,000 FMV - \$15,000 tax basis) capital gain on the distribution. pp. C4-8 through C4-11.

C4-38 a. \$220,000 (\$500,000 paid - \$280,000 reasonable compensation) would be nondeductible to the corporation and be a constructive dividend to Wilma.

b. \$400,000 would likely be a constructive dividend to Harry.

c. The net FMV of the property sold is \$290,000 (\$350,000 - \$60,000). Since Wilma paid only \$150,000, she has a constructive dividend of \$140,000 (\$290,000 - \$150,000). King Corporation must recognize a total gain of \$260,000 (\$350,000 FMV - \$90,000 basis) on the sale of a portion of the building and the distribution of the remainder of the building.

d. Harry has a constructive dividend of \$15,000 per year. King's rent expense is reduced by \$15,000.

e. Wilma has a constructive dividend of \$65,000 (\$250,000 - \$185,000). King's basis in the land is reduced from \$250,000 to \$185,000.

f. Harry and Wilma have a constructive dividend of \$8,000. King's deductions for its airplane use are reduced by \$8,000. pp. C4-11 through C4-13.

C4-39 a. The \$200,000 in disallowed salary and bonuses will be nondeductible by Forward Corporation and taxable as a dividend to Alvin.

b. The repayment will be deductible by Alvin. The dividend income and deduction items would represent offsetting amounts reported in the year in which the initial "salary" payment was made and the year of repayment, respectively. pp. C4-12, C4-13, C4-33 and C4-34.

C4-40 a. The stock dividend is nontaxable under Sec. 305(a).

b. Robert's basis in each share is \$909.09 ($\$100,000 \div 110$ shares). His gain on the sale is computed as follows:

Amount received on sale	\$7,000.00
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Minus: Basis of five shares (5 x \$909.09)	<u>(4,545.45)</u>
Recognized gain	<u>\$2,454.55</u>

c. Total basis for the 105 remaining shares is \$95,454.55 (\$100,000 - \$4,545.45), or \$909.09 per share. Robert's holding period for all shares begins in 1994 when he acquired the original 100 shares. pp. C4-13 through C4-15.