Exam Questions and Answers
Final Exam 2011

5) (20 pts. total) Provide short answers to each of the following questions.
Mable and Patrick own a farm, with all assets owned as marital property with a right of survivorship under Wisconsin’s marital property law. Among their assets are 50 raised beef cows currently worth $25,000 with a zero income tax basis because they deducted all the costs of raising them.

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

a) (2 pts.) If Ma and Pa gave the cows to George, what is George’s income tax basis in the cows?

George gets a carryover basis from Mable and Patrick, which is zero.

b) (2 pts.) If George put the cows in his breeding herd for 24 months and then sold them for $20,000, how much gain or loss must he report on his income tax return?

George must report the entire $20,000 as gain because he has a zero basis.

c) (3 pts.) Would George’s gain or loss from the sale of the cows be ordinary income or capital gain and would it be subject to self-employment tax?

George’s gain would be capital gain and is not subject to self-employment tax.

d) (3 pts.) If Patrick died and Mable gave the cows to George, how much income would George have to report if he sold them the next day for $25,000?

George would not have to report any income because his basis would be the $25,000 date of death value.
e) (3 pts.) If Mable and Patrick contributed the cows to a C-Corporation in exchange for an ownership interest in the C-Corporation and the C-Corporation sold the cows the next day for $25,000, how much gain would the C-Corporation realize?

The C-Corporation would realize $25,000 of gain because it would have a carryover basis from Mable and Patrick, which is zero.

i) (2 pts.) If the C-Corporation realizes gain from the sale, does it pay income tax on that gain?

Yes, the C-Corporation must pay income tax on its income.

ii) (2 pts.) If instead the C-Corporation returned the cows back to Mable and Patrick before the cows were sold, would the C-Corporation and/or Mable and Patrick have to pay income tax as a result of this transfer?

Yes, the C-Corporation would have to pay income tax as if it sold the cows for $25,000. Mable and Patrick would have to pay income tax on their $25,000 dividend.

6) Mable and Patrick own a bull that they purchased 4 years ago for $2,000. They claimed $1,500 of depreciation and sold the bull this year for $900.

i) (3 pts.) How much gain or loss must Mable and Patrick report on their income tax return?

Mable and Patrick’s income tax basis in the bull is $500 ($2,000 cost minus $1,500 depreciation). Their gain is $400 ($900 sale price minus $500 basis).

ii) (3 pts.) Is the gain or loss ordinary income or capital gain and is it subject to self-employment tax?

Under the depreciation recapture rules, their $400 gain is ordinary income that is not subject to self-employment tax.

7) (2 pts.) Which of the business entities discussed in class provide some limited liability to the owners of the entity?

C-Corporations, S-Corporations, Limited Liability Companies, and Limited Partnerships.