

LESSON 1

Introductory/ Definition of "Corporation"

SUBJECT: Identifying the corporation as a taxable entity for federal tax purposes—Determining when the corporation will be treated as the earner of income—Overview of the income taxing regimes—The current world of "status electivity" for noncorporate business entities (check-the-box regime)

ASSIGNMENT

B&E: ¶ 1.01, 1.05, 2.01, 2.02, 2.03, 2.04, 2.05, 2.06, 2.07, 2.10

Code: §§ 11(a), 7701(a)(1), 7701(a)(2), 7701(a)(3), 7701(a)(14), 7704(a), 7704(b)

Regs: §§ 301.7701-1, 301.7701-2(a)–301.7701-2(c), 301.7701-3(a)–301.7701-3(b)(1), 301.7701-4(a)–301.7701-4(c)(1)

PROBLEMS

- (1) Two individuals, *A* and *B*, want to form a new business venture, invest \$5,000 each in it, and raise additional capital of \$10 million from either a handful or thousands of investors. What are the three principal alternative regimes in the Code for taxing the business income that might be earned by such venture (identify by subchapter name)? Which of these regimes requires the business entity to pay tax on the income earned by the business? Which of these regimes requires the entity's owners to pay tax on the income earned by the entity?
- (2) *A* and *B* may organize one of the following entities to operate their business venture. Which of the the following entities will the Code necessarily treat as

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a corporation? Which can the Code treat as a corporation, if the entity so elects? Assume for these questions that the investors number either 10 or 10,000 (in which case the equity units are publicly traded).

- (a) A corporation chartered under the Delaware corporate laws.
 - (b) A general partnership.
 - (c) A limited partnership.
 - (d) A limited liability company organized under the Delaware LLC statute.
 - (e) A trust of which *A* and *B* are the trustees and the investors are "beneficiaries."
- (3) *X* owns 100 percent of an LLC. How will the income of the LLC be taxed if the LLC makes no election?

ADD TO ASSIGNMENT

Cases: CIR v. Bollinger, 485 US 340 (1988); Charles Johnson, 78 TC 882 (1982)

- (4) *A* and *B* organize a Delaware corporation for the business (having obtained no investors) but continue to operate the business under its pre-incorporation name, "A&B Enterprises," continue to use the pre-incorporation bank account, make contracts for the incorporated business in their own names as individuals, and generally ignore the incorporation except for depositing receipts in a corporate bank account and paying themselves "salary" (but with no employment contract or board resolution) and filing a corporate income tax return as a C corporation. Could the Service assess *A* and *B* for tax on the "corporate income"? Should it do so?
- (5) *A* and *B* are surgeons who form a professional corporation under the laws of their state, which laws require that licensed professionals own all of the stock

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of the corporation. The corporation's income consists entirely of charges for operations *A* and *B* perform. All activities are carried out in the name of the corporation. Who owns the income from operations; what other facts may be relevant to answer this question?

- (6) *A-B* partnership was formed to own and operate an apartment project. Because of local usury laws, it was necessary that corporation *X* (owned by unrelated persons) be utilized to hold legal title to the property as a "nominee" (or straw person) for the benefit of *A-B*. Does *A-B* want *X* to be treated as the owner of the project for federal income tax purposes, and, if not, will *A-B* get the result it wants?

Alternative: The partners of *A-B* own all the stock of *X*.