### **Problem Set 2: C Corporation Taxation**

1. What is the US corporate tax rate on business income and capital gains?
   1. **Answer: 21%, sec. 11a & b**
2. What is the effective corporate tax rate on $100 of dividends received by a C corp from a:
   1. 5% owned US company?
      1. **50% DRD; 50%\*21% = 10.5; 243a1**
   2. 25% owned US company?
      1. **65% DRD; taxed on 35%\*21% = 7.35%**
   3. 100% owned US company? §243(a)-(c)
      1. **Qualifying div; 243a3; 100%; 0%**
3. C corp has operating revenues of $1,000, operating expenses (not including depreciation and amortization) of $600, depreciation of $100, $200 of interest expense, and $50 of interest income (all amounts in $MM). What’s C corp’s allowable interest deduction? §163(j)
   1. **Limit is 30% of ATI plus BII: ATI = TI plus Depreciation w/out regard to BII and BIE: TI= 1k – 600 -100(dep) -200(BIE) + 50 BII = 150; ATI = 150 + 100 (dep) + 200 (BIE) – 50 BII = 400; 30% \* [400 ATI] + 50 = 120 + 50 = 170**

1. Find the final §163(j) regs as published in the Federal Register. How long are they? How small is the font? How many words are in the regs? If you started on p. 56686 and read every word until the end, would you go blind or consider suicide before you finished?
   1. **See Program (1/3 length of Odyssey); 1/10 length of Bible**
   2. **Brief overview of 163j**
2. In 2021, Barbie and Ken, two friends who are law firm associates, have an idea to develop a series of apps that are aimed at the corporate legal compliance market. They form a Delaware corporation (DC) and initially fund it with $200,000 of seed capital ($100,000 each) in exchange for all the common stock of DC. The first apps are a success and generate some significant revenue, around $3MM, but Barbie and Ken realize that they need additional funds to expand the business, e.g., hire additional programmers, rent office space both in NY and Austin. Later that year, they are approached by VC fund and agree to accept additional funding from VC fund in exchange for equity in DC. VC fund invests $40MM into DC in exchange for shares of DC. Immediately after VC fund’s investment, DC has a cash balance of $42MM on its balance sheet—all of DC’s assets, such as Aeron chairs and Apple laptops have been expensed and do not appear on the balance sheet.
   1. Is DC a QSB? §1202(d)
      1. **Answer: Yes, Aggregate Gas don’t exceed 50MM either before or immediately after issuance; AGA = Cash and AB of other property**
   2. Assume that VC invested $55M so that DC’s cash balance was $57MM immediately after the contribution. Is DC a QSB? §1202(d) Suggest a planning alternative to avoid or mitigate this result.
      1. **Answer: Not a QSB b/c net assets > 50MM;** 
         1. **put in up to 48MM and wait to put in additional 5MM until assets (cash is used up) or**
         2. **two financings, one of which is good and the other bad, but “immediately after” issue**
         3. **risk step-transaction doctrine;**
         4. **Q whether firm commitment to contribute additional cash is treated as asset of the corporation**
   3. How long must Barbie, Ken, and VC hold the DC stock to potentially benefit from 1202? §1202(a)
      1. **Answer: 5 years; holding period generally begins on acquisition date**
   4. Original facts. It’s 2027, and DC has been incredibly successful: each year, its cash balance has increased by roughly $25MM, so that by 2027, it has around $200MM. Barbie, Ken, and VC receive and accept an offer to sell the company for $400MM--$50MM to each Ken and Barbie, and $300MM to VC.
      1. How much can each exclude under 1202? §1202(b)
         1. **Answer: Greater of 10MM or 10X basis**
            1. **Ken: AR: 50MM – 100K = 49,900,000; can exclude greater of 10M or 10x AB (1M), so 10m**
            2. **VC: greater of 10MM or 10x40 or 400M**
   5. If Barbie, Ken, or VC cannot exclude all the gain under 1202 on a sale to VC, suggest a planning alternative to increase the excludable gain. §§1202(b) and 1045
      1. **Answer: Roll over w/in 60 days into another QSBS stock; gain realized only to the extent that AR (50MM) exceeds the costs of the replacement QSBS**
         1. **Basis of acquired shares need to be reduced (b)(3)**
      2. **Maybe a way to multiple 10MM/10X: If 20MM of BIG, could invest in two or more small businesses to achieve new 10MM exclusion for each new issuer.**
   6. It’s 2027. Assume that Barbie and Ken each own two blocks of stock, one block with a basis of $0 and the other with a basis of $1MM. They have a received an offer of $20MM each for their shares.
      1. Assume that they sell all their shares in 2027. How much can they exclude under section 1202?
         1. **Greater of 10x AB (10MM) or 10MM; taxed on 10MM**
      2. Suggest an alternative to maximize their excludable gain.
         1. **Sell low basis shares first for 10MM and exclude 10MM under 1202(b)(1)(A); sell high basis shares next year for 10MM and exclude 10MM under 1202b1B.**
         2. **Don’t sell high basis shares first b/c you could exclude 10MM (10X basis); but couldn’t exclude any other the next year b/c no basis and the 10MM under 1202b would be**
3. Describe two ways a shareholder can conduct business through a corporation and reduce or eliminate the double tax burden?
   1. **Answer: capitalizing company with debt and receiving interest or paying out profits as compensation**