Exercise #1

Mike and Nancy are equal shareholders in MN Corporation, an S corporation. The corporation, Mike, and Nancy are calendar year taxpayers. The corporation has been an S corporation during its entire existence and thus has no accumulated E&P. The shareholders have no loans to the corporation. The corporation incurred the following items in the current year:

Sales	$300,000
Cost of goods sold	140,000
Dividends on corporate investments	10,000
Tax-exempt interest income	3,000
Sec. 1245 gain (recapture) on equipment sale	22,000
Sec. 1231 gain on equipment sale	12,000
Long-term capital gain on stock sale	8,000
Long-term capital loss on stock sale	7,000
Short-term capital loss on stock sale	6,000
Depreciation	18,000
Salary to Nancy	20,000
Meals and entertainment expenses	7,800
Interest expense on loans allocable to:	
Business debt	32,000
Stock investments	6,400
Tax-exempt bonds	1,800
Principal payment on business loan	9,000
Charitable contributions	2,000
Distributions to shareholders ($15,000 each)	30,000

a. Compute the S corporation's ordinary income and separately stated items.

b. Show Mike's and Nancy's shares of the items in Part a.

c. Compute Mike's and Nancy's ending stock bases assuming their beginning balances are $100,000 each. When making basis adjustments, apply the adjustments in the order outlined on pages C:11-24 and C:11-25 of the text.

Exercise #2

Redfern Corporation, a calendar year taxpayer, has been an S corporation for several years. Rod and Kurt each own 50% of Redfern's stock. On July 1 of the current year (assume a non-leap year), Redfern issues additional common stock to Blackfoot Corporation for cash. Rod, Kurt, and Blackfoot each end up owning one-third of Redfern's stock. Redfern reports ordinary income of $125,000 and a short-term capital loss of $15,000 in the current year. Eighty percent of the ordinary income and all the capital loss accrue after Blackfoot purchases its stock. Redfern makes no distributions to its shareholders in the current year. What income and losses do Redfern, Blackfoot, Rod, and Kurt report as a result of the current year's activities?

Exercise #3

Bottle-Up, Inc., was organized on January 8, 2005, and made its S election on January 24, 2005.

The necessary consents to the election were filed in a timely manner. Its address is 1234 Hill Street, City, ST 33333. Bottle-Up uses the calendar year as its tax year, the accrual method of accounting, and the first-in, first-out (FIFO) inventory method. Bottle-Up manufactures ornamental glass bottles. It made no changes to its inventory costing methods this year. It uses the specific identification method for bad debts for book and tax purposes. Herman Hiebert and Melvin Jones own 500 shares each. Both individuals materially participate in Bottle-Up's single activity. Herman Hiebert is the tax matters person. Financial statements for Bottle-Up for the current year are shown in Tables C - 2 through C - 4. Assume that Bottle-Up's business qualifies as a U.S. production activity and that its qualified production activities income is $90,000. The S corporation uses the small business simplified overall method for reporting these activities (see discussion for Line 12d of Schedules K and K-1 in the Form 1120S instructions). Prepare a 2014 S corporation tax return for Bottle-Up, showing yourself as the paid preparer.

You will need to complete the return using Forms 1120 S, Schedule K-1 for Form 1120 S and 1125A for 2014 that you can access from the IRS web site (IRS.Gov). The forms are in a PDF format and should be completed by filling in the appropriate line items.

TABLE C:11-2 Bottle-Up, Inc. Income Statement for the Year Ended December 31 of the Current Year (Problem C:11-63)

Sales		$2,500,000
Returns and allowances		(15,000)
Net sales		$2,485,000
Beginning inventory	$ 102,000	
Purchases	900,000	
Labor	200,000	
Supplies	80,000	
Utilities	100,000	
Other manufacturing costs	188,000 [a]	
Goods available for sale	$1,570,000	
Ending inventory	(96,000)	1,474,000 [b]
Gross profit		$1,011,000
Salaries[c]	$ 451,020	
Utilities expense	54,000	
Depreciation (MACRS depreciation is $36,311)	11,782	
Automobile and truck expense	26,000	
Office supplies expense	9,602	
Advertising expense	105,000	
Bad debts expense	620	
Rent expense	30,000	
Interest expense[d]	1,500	
Meals and entertainment expense	21,000	

Selling expenses	100,000	
Repairs and maintenance expense	38,000	
Accounting and legal expense	4,500	
Charitable contributions[e]	9,000	
Insurance expense[f]	24,500	
Hourly employees' fringe benefits	11,000	
Payroll taxes	36,980	
Other taxes	2,500	
Penalties (fines for overweight trucks)	1,000	(938,004)
Operating profit		$ 72,996
Other income and losses:		
Long-term gain on sale of capital assets	$ 48,666[g]	
Sec. 1231 loss	(1,100)[h]	
Interest on U.S. Treasury bills	1,200	
Interest on State of Florida bonds	600	
Dividends from domestic corporations	11,600	
Investment expenses	(600)	60,366
Net income		$ 133,362

[a] Total MACRS depreciation is $74,311. Assume that $38,000 of depreciation has been allocated to cost of sales for both book and tax purposes so that the book and tax inventory and cost of sales amounts are the same. The AMT depreciation adjustment on personal property is $9,000.

[b] The cost of goods sold amount reflects the Uniform Capitalization Rules of Sec. 263A. The appropriate restatements have been made in prior years.

[c] Officer salaries of $120,000 are included in the total. All are employer's W-2 wages.

[d] Investment interest expense is $500. All other interest expense is trade- or business-related. None of the interest expense relates to the production of tax-exempt income.

[e] The corporation made all contributions in cash to qualifying charities.

[f] Includes $3,000 of premiums paid for policies on lives of corporate officers. Bottle-Up is the beneficiary for both policies.

[g] The corporation acquired the capital assets on March 3, 2012 for $100,000 and sold them on September 15, 2014, for $148,666.

[h] The corporation acquired the Sec. 1231 property on June 5, 2013 for $10,000 and sold it on December 21, 2014, for $8,900.

TABLE C:11-3 Bottle-Up, Inc. Balance Sheet for January 1 and December 31 of the Current Year (Problem C:11-63)

	January 1	December 31
Assets:		
Cash	$ 15,000	$116,948
Accounts receivable	41,500	45,180
Inventories	102,000	96,000
Stocks	103,000	74,000
Treasury bills	15,000	16,000
State of Florida bonds	10,000	10,000
Building and equipment	374,600	375,000
Minus: Accumulated depreciation	(160,484)	(173,100)
Land	160,000	190,000
Total	$660,616	$750,028
Liabilities and equities:		
Accounts payable	$ 36,000	$ 10,000
Accrued salaries payable	12,000	6,000
Payroll taxes payable	3,416	7,106
Sales taxes payable	5,200	6,560
Due to Mr. Hiebert	10,000	5,000
Mortgage and notes payable (current maturities)	44,000	52,000
Long-term debt	210,000	260,000
Capital stock	10,000	10,000
Retained earnings	330,000	393,362
Total	$660,616	$750,028

TABLE C:11-4 Bottle-Up, Inc. Statement of Change in Retained Earnings, for the Current Year Ended December 31 (Problem C:11-63)

Balance, January 1		$330,000[a]
Plus: Net income	$133,362	
Minus: Dividends	(70,000)	63,362
Balance, December 31		$393,362

[a] The January 1 accumulated adjustments account balance is $274,300.