

Pace University  
Lubin School of Business  
New York City Campus, Pace Plaza, New York

**Syllabus**

**Tax 660 Fall 2001**

Instructor:

Dean L. Surkin, Esq., Adjunct Professor  
Rosen Seymour Shapss Martin & Co. LLP  
757 Third Avenue, New York, NY 10017-2049  
Phone (212) 303-1887 Fax (914) 206-3711  
Internet dsurkin@rssmcpa.com

Office hours:

By appointment, during regular business hours

Required and Recommended Materials

Required books: Dubroff, Blanchard, Broadbent & Duvall, *Federal Income Taxation of Corporations Filing Consolidated Returns*, Vols. 1 and 2, published by Matthew Bender

Recommended: Internal Revenue Code  
Internal Revenue Regulations

Course Description and Prerequisites

Consolidated Returns. Considerations in determining whether an affiliated group of corporations should elect to file a consolidated income tax return, eligibility, computation of consolidated taxable income, liability for tax, effect on earnings and profits, corporations entering or leaving an affiliated group, sale of subsidiary's stock, deconsolidating.

The prerequisite for this course is the successful completion of Tax 656 (Advanced Corporate Income Taxation I), Tax 657 (Advanced Corporate Income Taxation II) and Tax 658 (Corporate Reorganizations). Substantial professional experience may be accepted in lieu of the prerequisite subject to departmental and instructor written approval. *Warning:* pursuant to departmental policy, students without the prerequisites or a written waiver may be removed from class.

Course Objectives

To learn when taxpayers may elect consolidated returns, and the consequences of the election.

## Procedure for students with disabilities who wish to obtain accommodations or auxiliary aids for this course

Pace University has a procedure that must be followed to insure that any disabled student who is entitled to accommodations and auxiliary aids may obtain them.

If you have a disability for which you wish to obtain an accommodation or auxiliary aid for this course or any other course or program at the University, you must contact the University's Counseling/Personal Development Office. For New York, call extension 1526. For Pleasantville and White Plains, call extension 3710. Trained professional counselors will:

- Evaluate your medical documentation;
- Conduct or refer you for appropriate tests
- Make recommendation for your plan of accommodation; and
- Contact your professors and pertinent administrators (with your permission) to arrange for the recommended accommodations.

Your professors are not authorized to provide accommodations or aids prior to your arranging for accommodations or aids through the Counseling/Personal Development Center. Neither are your professors authorized to contact the Counseling/Personal Development Center on your behalf. You must contact the Counseling/Personal Development Center directly in order for the University to be placed on notice of your request for accommodation. In order to insure that the Counseling/Personal Development Center has sufficient time to process your request, you should contact the Center at the earliest possible time, in advance of your need for the accommodation, preferably before the semester begins.

Following this procedure will ensure timely and efficient handling of your request for accommodation or auxiliary aids.

## Course requirements and grading

**Exams:** There will be a take home final exam. The final will be open book, and will likely comprise essay/computational problems. Your answers must be typed, or you must have a handwriting so beautiful that seeing it will make me want to frame your exam. All students will be on the honor system.

**Components of the final grade:** The exam will be 80% of the final grade, and class participation will be 20% of the grade. See below for a discussion of class participation.  
**Penalties for late work:** Not applicable.

**Attendance policy:** Class attendance is vital to understand the course work. If you must miss a class, have a classmate tape the lecture, or loan you notes (make sure you have a friend who takes good notes).

**Class participation:** The burden of learning is yours. If you have ever tried to teach something, you will understand this little gem of philosophy. I use the Socratic method, combined with some lecturing. The Socratic method means that I ask you questions, and you answer them. Based upon your answers, I ask different questions. Ideally, my questions will guide you to an understanding of the topic. For this to work, you *must* do all assigned reading *before* the class session, and work out all the assigned problems (if any). Do not hand in the

homework, but use your answers as a guide to the class dialogues. I will call on each of you in turn. You will learn best if you are prepared. *Your answer does not have to be right.* I recognize effort. I do not expect you to know the correct answers, and in fact, we will have the best dialogues if your answer is a well thought-out wrong answer. You have to pay close attention to my dialogues with other students, and not doze off when I have not called on you: you will also learn well if you can follow another student's mistakes and determine what he or she did wrong, and why. You will get a good grade for class participation if you try. You will get a bad grade if you are unprepared.

## Course Schedule

Because the Socratic method takes varying amounts of time depending upon class size or student enthusiasm, I cannot tell you exactly when we will cover each of the units below. My goal is to do all the chapters cited below by the end of the term.

## Reading Assignments

- 1 Introduction  
General overview  
DBBD Chapter 1,2,3  
Code §1502; Reg. -0, -1(a), (b), (c)
- 2 Corporate groups eligible to make election  
DBBD Chapter 11, 12  
Code §1504(a), (b); Reg. -1(a), (b), (c)  
Problem I
- 3 Election to file consolidated returns and termination  
DBBD Chapter 13, 14.01–14.05  
Code §1501  
Reg. -34, -75(a), (b), (d), (e), (f), (h), (j), -77, -80  
Problem II
- 4 Accounting Considerations—Periods and Methods  
DBBD Chapter 21  
Reg. -17(a), -76(a),(b),(d)  
Problem III
- 5 Consolidated Taxable Income and Intercompany Transactions  
DBBD Chapter 22, 23.04, 23.05, 23,10  
Reg. -11(a), -12, -21(0)  
Code §§267, 1239; Reg. -13, -31(a)  
Problem IV
- 6 Intercompany Distributions  
DBBD 32.01[1]  
Reg. -14(a).(c),(e), -31(b)(1)

- 7 Consolidated NOL Deduction and NOL Carryback/over  
DBBD Chapter 41.01- 41.05, 42  
Reg. -21(a), (b)(1), (b)(3)  
Reg. -1(d), (e), (f) (1), (f)(2), (f)(3), (g), -21 (c), (d), -79(a)  
Problem V, VI and VII
- 8 Earnings & Profits  
DBBD Chapters 53, 54, 61.01  
Code §1552  
Reg. -2, -6, -33, 1.1552-1  
Problem VIII
- 9 Annual investment adjustments in subsidiary stock  
DBBD Chapter 51  
Reg. -31, -32  
Problem IX
- 10 Excess Loss Accounts  
DBBD Chapter 52  
Reg. -19
- 11 Dispositions of Stock in Subsidiaries  
DBBD Chapter 71.01, 71.02, 72  
Reg. -11(b), -14(d), -20

Problems

Problem I—Affiliated Groups

1. X owns 100% of class A, 75% of class B in Y Corp.

Class A has 100% of vote, 50% of value

Class B has 0% of vote, 50% of value

Do these companies form an affiliated group in 2000?

2. X Corp owns 85% class A, 70% class E; A and B outstanding in equal numbers

Class A has 10 votes per share

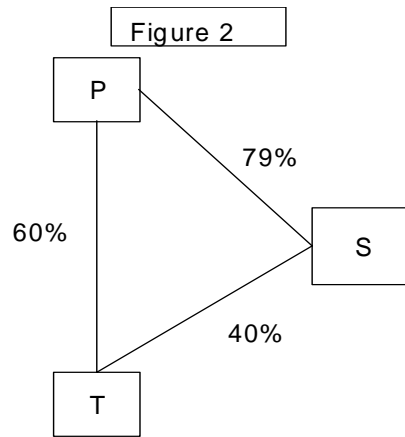
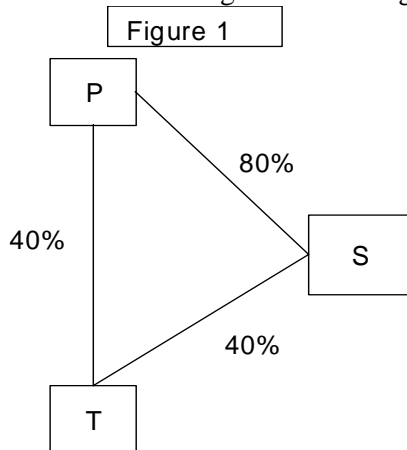
Class B has 1 vote per share

(a) Do X and Y form an affiliated group?

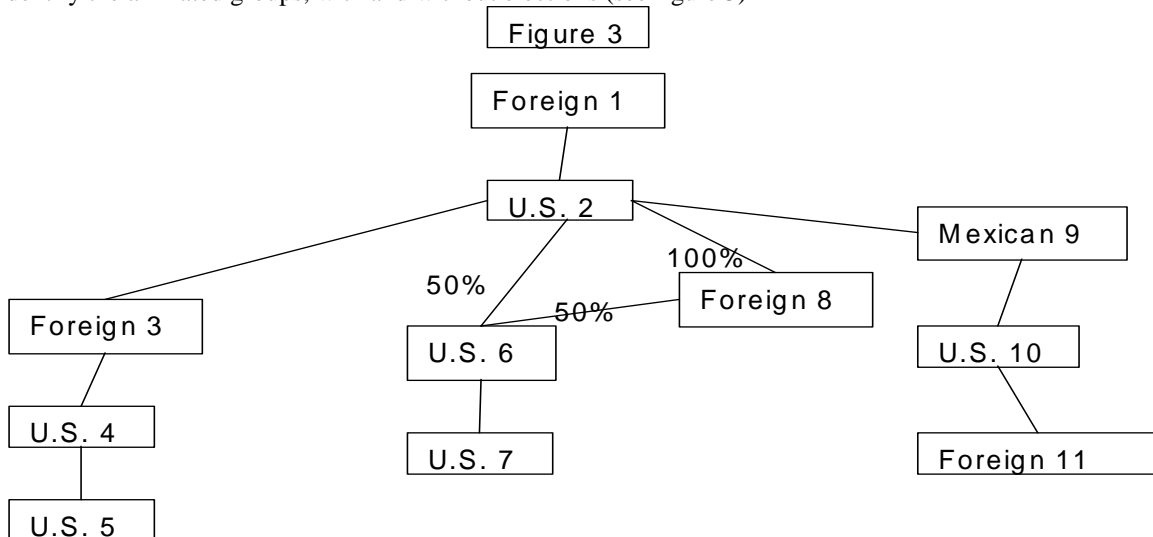
(b) However, assume that because of voting rights and controlling interest X's class A worth \$12.50/share, minority worth \$10/share. All class B worth \$9/share

(c) would your answer be different if Class B rose to \$9.5/share?

3. (a) Which of the following are affiliated groups? (see figures 1 and 2)



(b) identify the affiliated groups, with and without elections (see figure 3)



## Problem II—The Election and Termination of Election

1. P acquires S on 1/1/98. P sold S on 7/15/98. P had no other subsidiaries during the year. Can P and S file a consolidated return during 1998?
2. P and S are an affiliated group which thus far has not filed on a consolidated basis.
  - (a) P has filed a valid extension to 9/15/98. S has already filed a separate tax return. Can P and S file a consolidated tax return on 8/17/98?
  - (b) Suppose instead that both companies have filed separate tax returns after having filed extensions to 9/15/98. May P and S now file a consolidated return on 8/15/98?
  - (c) Would your answer be different if it was now 9/20/98?
3.
  - (a) P, S1 and S2 form an affiliated group. S1 files form 1122 to file a consolidated tax return. S2 does not file a form 1122. The consolidated return reflects operations of P and S1 only. Is the P, S1 consolidated tax return valid?
  - (b) Suppose instead that the consolidated return reflects the operations of S2 and form 851 includes S2. Is the consolidated return now valid?
  - (c) Suppose instead that S1 and S2 file forms 1122 but the return, while presenting the consolidated results of operations, does not break out income, deductions, balance sheet or surplus on a company by company basis. Is the consolidated return valid?
4. S2 was a member of the P group in 1994. S2 was sold to unrelated persons in 1998. In 2001, the IRS sent a 90 day letter to P claiming a deficiency of \$1,000,000 due to the 1998 operations of S1. The deficiency was not challenged by P and S2 had no knowledge of the notice or proceeding. P and S1 are now bankrupt and the IRS wishes to proceed against S2 for the deficiency. May the IRS proceed against S2 for collection?
5.
  - (a) On 1/1/98 P owns S1. On 4/1/98 P buys S2. On 5/1/98 P sells S1. For what portions of the year does an affiliated group exist?
  - (b) Would your answer be different if P sold S1 on 3/1/98?
6. Prior to the transaction below, A, an individual, owns all 10 shares of P Corp. which in turn owns all 100 shares of S Corp. B, an individual, owns all 100 shares of X Corp. which in turn owns all 100 shares of Y Corp. B exchanges all 100 of his X shares with P and receives back 90 newly issued P shares. Which company acquired which, and which affiliated group continues to exist?

### Problem III—Accounting Period and Methods

Assume that all corporations have calendar year-ends unless otherwise indicated.  
Assume that sales of all corporations are as of the close of the day indicated unless otherwise specified.

1. P Corp. owns 100% of S Corp. S Corp. owned 100% of T Corp. until 6/2/98. P, S and T have been filing consolidated returns. At 12:00 Noon on 6/2/98, S sold T to a third party. T had \$100,000 of income in 1998:

45,000 prior to 6/2/98

10,000 on 6/2/98

45,000 after 6/2/98

How much of T's income is included in P Group's consolidated tax return?

2. (a) Suppose instead that T was sold at the close of 6/2/98. Suppose further that T's books and records indicate that 50% of T's 100,000 of earnings was earned through 6/2/98 and 50% after 6/2/98 and no election to ratably allocate is made. How much of T's income is included in P's return?

(b) Suppose instead that in (a) an election to ratably allocate is made. How much of T's income would be included in P's return?

3. Same group as above

(a) Suppose that P sells S (which owns T) to A, an individual, on 5/31/98. A wants the S-T group to file a consolidated return. What period would be included in the S-T consolidated tax return?

(b) Suppose instead that P, S and T had not previously filed consolidated returns. What period is included in the S-T consolidated return?

4. On 1/1/98, P owns 100% of S. On 5/31/98, P sells S. On 6/30/98, P buys S1. P has been filing a consolidated return with S. What periods of the various companies are included in the tax returns filed by P?

5. Assume The same P-S-T group. P and S use the FIFO method of valuing inventory. T uses The LIFO method of valuing inventory. T reports to its creditors and 5, its sole shareholder, on LIFO. But T's operations are converted to FIFO on P's books. Is T's LIFO election valid?

## Problem IV—Consolidated Income and Intercompany Transactions

Assume calendar tax years for all parties.

1. P, Sand T form an affiliated group filing a consolidated tax return. On a separate basis their items of operations are as follows:

P, operating income of 100, charitable contribution of 20

S, operating income of 50, Sec. 1231 loss of 100

T, operating income of 60, s.1231 gain of 100

What is the consolidated taxable income?

2. P, Sand T form an affiliated group filing a consolidated tax return. P owns 5, S owns T. P is T's landlord. P is a cash basis taxpayer, T uses the accrual method. T pays 300 rent (100/mo.) for 1/1/99–3/31/99 on 12/28/98. P's depreciation for the three months is 175. When do T and P report their respective items of expense and income?

3. P and S form an affiliated group filing a consolidated tax return. During 1998, S sells inventory to P:

Sales price 100.

S's direct costs are 30.

S's indirect costs are 30.

An allocable (but unrelated) portion of S's G&A expenses would be 10. P sells the goods to an outside party in 1999 for a sales price of 110. What consequences do these transactions have?

4. P and S form an affiliated group filing a consolidated tax return. In 1998 P produces and then sells a piece of equipment to S for 100. P's cost was 60. P did not depreciate the asset. S fully depreciates under ACRS, treating the asset as 5 year recovery property. What results to P and S in years 1998 through 2003?

5. P has 2 subsidiaries, 5, a domestic corporation and F, a British company.

(a) P sells property with a cost of 60 to F for 100. What consequences to P from these transactions?

(b) Suppose instead that P's cost was 160. Would this change your answer?

6. Going back to question 4, what if P sells S to an unrelated party during the middle of 2000 (assume group depreciation in 2000 is 50% of a full years depreciation). P continues to file a consolidated return with its other subsidiaries. What consequences?

### Problem V—Consolidated NOL Deduction

1. P, S and T form an affiliated group. This group first elects to file a consolidated return in 1998. Assume that none of the companies had operating histories prior to 1996. P formed S on 1/1/96. T was formed by third parties on 1/1/96. S bought T on 12/31/97. The companies had the following losses in 1996 and 1997:

P	(6)	(4)
S	(3)	(5)
T	(7)	(7)

The companies had the following items of tax significance for 1998 (assume that operating income does not already reflect the items indicated)

P had operating income of 17. P also has deferred gains of 5 at year-end from sales to T.

P also had restoration of deferred gains of 3 from the prior year.

S has operating income of 4. S also has a long term capital loss of 5.

T has operating income of 6, long term capital gains of 5 and deferred gains of 3 on sales to S at yearend.

What is the 1998 consolidated taxable income (after NOL deduction)?

2. P and S form an affiliated group filing a consolidated return starting in 1998. S had no operating results prior to 1997. Assume that P had no operating results prior to 1996. S was acquired by P on 12/31/97. The companies had the following results for 1996, 1997 & 1998:

P	(2)	(7)	8
S		(6)	3

What will be the NOL carryovers to 1999?

3. A owned all 100 shares of P Co. which has always owned 100% of S Co. B owned all 100 shares of T Co. which has always owned 100% of U Co. Both the P-S and T-U groups file consolidated returns. On 12/31/97, T acquired 100% of A's P stock in exchange for 102 shares of T Co. P and S have traditionally been profitable, each earning profits of 150/yr. T and U have had histories of losses, and each has a NOL carryover into 1998 of 500. P, S, T, and U have the following results in 1998 and 1999:

	P	S	T	U
1998	150	150	(60)	30
1999	150	150	400	200

What are the results of the above transaction?

### Problem VI—Consolidated NOL Carryover/back & CRCO

Assume unless otherwise indicated that P Corp. owns 100% of S Corp. which owns 100% of T Corp. Assume that the group files a consolidated return.

1. P, S and T have the following results for 1996 and 1998: 1996 P had profits of 50; S had profits of 40; T had 30 loss. 1998 P had 30 loss; S had 60 loss; T had profits of 20. In 1997 none of the companies had profit or loss. How do you apportion to the various members the NOL deduction created in 1998 and carried back to 1996?

2. P has the following items of tax significance:

Current operating loss of 30. Current capital loss of 20. NOL carryover of 10.

S has the following items of tax significance:

Current operating income (exclusive of items below): 10. Charitable contributions of 10.

Capital loss carryover of 30. Deferred gain from sale of inventory to T of 20.

T has the following items of tax significance:

Operating loss of 20. General Motors dividends of 100. Current capital gain of 40.

Determine the amount of consolidated taxable income, the amount of consolidated NOL, if any, and the allocation of any such NOL.

3. (a) P, S and T have been members of the same group for decades. In 1996 and 1998 they had the following results:

P 20 (10)

S 0 0

T 20 (30)

Determine the utilization of the NOL.

(b) Suppose instead that T was acquired by S on 12/31/96 from an individual. Would this change your answer?

(c) Same as (b) except that T was bought from another consolidated group of which X Co. is the common parent. X formed T on 1/1/96. The X group had consolidated taxable income of 1000 in 1996. Determine the utilization of the 1998 NOL.

(d) Same as (b) except that T was formed on 1/1/97 and purchased by S on 12/31/97. How would this change your answer?

(e) Suppose instead that T was formed on 1/1/97 by S. How would this change your answer?

(f) Same as (a) except that T was formed by A, an individual, on 1/1/97. S bought T from A on 12/31/97. S sells T to B, an individual, on 12/31/98. The results of operations are as follows:

	1996	1997	1998	1999
P	20	20	(10)	50
S	0	0	0	0
T	—	(10)	(30)	40

Determine the amount and utilization of any NOLs.

4. P has NOL carryovers to 1998. P is owned by 4 individuals — A, B, C and D. A owns 10% B owns 20%, C owns 40% and D owns 30%. These ownership percentages have remained constant for many years. On 1/3/96, D buys all of C's interest in P and on 4/4/97, D buys B's entire interest. What impact do these facts have on consolidated income?

### Problem VII—Built-in Deductions

1. P buys S on 12/31/97. In 1997 and prior years, S had no income or loss. The P group (P has a wholly owned subsidiary T) files consolidated tax returns. P and T together have and will continue to earn 100/yr. At the time of P's acquisition, S had assets consisting of equipment with a FMV of 50 and an adjusted basis of 100. S takes depreciation (ACRS) of 20 on the asset in 1998. S sells the asset for 10 in 1999. S has income exclusive of the above items of 15 in 1998 and 50 in 1999.

How much of the deductions generated by the equipment can be used to offset consolidated income in 1998 and 1999?

Problem VIII—Earnings & Profits, Investment Adjustments and Excess Loss Accounts

1. P, S and T form an affiliated group filing a consolidated return. Their items of income and credit are as follows:

	Income		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
P	15	15	9
S	(9)	6	6
T	3	3	3
	Credits		
	<u>1996</u>	<u>1997</u>	<u>1998</u>
P	0	0	0
S	0	2	0
T	3	0	2

Assume that all credits can be used to the extent of 100% of tax liability. Assume a 33-1/3 % tax rate.

(a) Determine the allocation of tax pursuant to §1552(a)(1) and §1552(a)(2).

(b) Instead, allocate the liability according to -33(d)(3) assuming that §1552(a)(2) was also chosen

2. A, an individual, owns 100% of P Co. A's basis in P is 50. P bought 100% of S on 12/31/97 for 50. S owns 90% of T and has a basis in the T stock of 100. P, S and T have accumulated earnings and profits, operating income and distributions as indicated in the following table:

	E&P	Income	Distributions
P	0	50	10
S	50	(100)	50
T	50	30	50

The E&P figure is as of 12/31/97. The income is for all of 1998. The distributions are on 12/31/98. Assume that the group files a consolidated return and elects §1552(a)(1). Assume S and T had no profits or losses in 1995–1997. Determine the basis, income and E&P for each of the parties for and at the end of 1998.

3. P Co. purchases 100% of S on 1/1/97 for 10. P has a net negative adjustment in S for 1997 of 50. P has a net positive adjustment in S for 1998 of 80. P sells 80% of S on 1/1/99 for 32. Assume no distributions or other transactions between S and P. What consequences to P?

4. P Co. formed S Co. which formed T Co. Several years later, S has an excess loss account in T of 40.

(a) S sells 50% of T for 5. What is S's gain?

(b) Suppose instead that S sells 10% of T for 1. What would be S's gain?