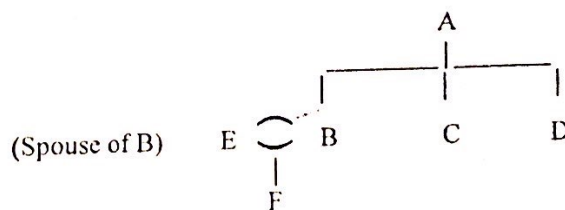


PROBLEM 44C

Square One, Inc. is a Florida corporation with capital stock consisting of 100 shares of voting stock, ten shares of which are owned by each of the following ten persons or entities:

1. Alvin Kelly;
2. Bruce Kelly, the son of Alvin;
3. Clarissa Kelly, the daughter of Alvin;
4. Denise Kelly, the daughter of Alvin;
5. Eunice Kelly, the wife of Bruce;
6. Frederick Kelly, the son of Bruce and Eunice;
7. Golden Harbor, Inc., a holding company, the stock of which is owned 30% by Alvin and 70% by Bruce;
8. Hargrove Enterprises, a partnership in which Frederick has a 30% interest and Ignatius Summers has a 70% interest;
9. Ignatius Summers, whose connection with the Kelly family rests entirely on his ownership interests in Square One and Hargrove Enterprises; and
10. Jill Summers, the wife of Ignatius, whose connection with the Kelly family rests entirely on her ownership interest in Square One.

The following lineal chart of the Kelly family accurately conveys the nature of their relationships with the first initial of each member being substituted for his or her name.



Square One's principal business activity is the leasing and management of a moderate size shopping center on the outskirts of Tampa, Florida.

Each party who owns stock in Square One acquired that stock five years ago for \$250,000 from Burger Construction, Inc., a large developer of shopping centers. Square One has prospered, and each share of its stock is now worth approximately \$50,000. Clarissa and Denise Kelly both have complained of the heavy-handed control of Square One by the Kelly men (Alvin, Bruce and Frederick) and have suggested that part of the corporation's \$2,000,000 in retained earnings and profits be used to redeem some of the shares of the Kelly men. Since the Summers have long been pushing for a diminution in Kelly family control, it has been proposed that a corporate restructuring suitable to the Summers, Clarissa and Denise could be produced by redeeming, for \$50,000 per share, (1) 5 shares held by Alvin; (2) 5 shares held by Bruce; and (3) all 10 shares held by Frederick.

Alvin, Bruce and Frederick Kelly are anxious to avoid having any funds that they receive treated as a dividend and would like to have the benefit of your analysis of the proposal.

PROBLEM 66C

As you may remember, in Problem 44C you advised Alvin, Bruce and Frederick Kelly and Square One, Inc. with respect to the redemption by Square One of certain shares of its voting stock then held by Alvin, Bruce and Frederick. After the redemption planned in Problem 44C took place, you asked Clarissa Kelly, who had been elected president of Square One, to keep in touch with the firm. Square One, Inc. had invested a substantial portion of its earnings from the shopping center in various marketable securities, and you were concerned that any significant reduction in its rental income might present personal holding company problems. Today your firm received the following letter, which was referred to you for reply.

Please let us know at your earliest convenience whether, in your opinion, Square One will have any personal holding company problems this year, and if so, what steps we can take to avoid or minimize such problems. For your information, none of the present shareholders of Square One expect to be subject to high marginal rates of income tax this year. In addition, both Golden Harbor, Inc. and Hargrove Enterprises have indicated a willingness to lease some of the presently vacant space in the shopping plaza and this year to prepay two or three years' rent, which could amount to \$400,000 to \$600,000, if you felt that this course of action was advisable.

Very truly yours,

Clarissa Kelly

Clarissa Kelly

Toward the end of last year and at the beginning of this year, there were two events which significantly affected our rental income. First, at the end of last year the state highway department condemned a substantial portion of the land and improvements located on the western side of the plaza. The highway department took title to the property early this year and offered us \$1,400,000 for the property taken. We contested this, and about a week ago the matter was settled for \$1,600,000 plus approximately one year's interest at 9% per annum. This settlement produced interest income of \$144,000, capital gain of \$300,000 and depreciation recapture of \$100,000. Second, at the beginning of this year there was a serious fire in the part of the plaza leased to Montgomery Ward Department Stores, Inc. This caused a substantial diminution in our rental income since we lost the rent from Montgomery Ward as well as that from some nearby tenants who suffered smoke and water damage. We have settled with the fire insurance company and will use the proceeds to repair the part of the plaza damaged by the fire. We have also collected about \$600,000 under our valued use and occupancy policy with respect to the loss of the use of the premises involved in the fire, but that does not come close to replacing the rental income lost. Our projected income statement for this year is as follows:

Square One, Inc.
 Projected Income Statement
 for the Period Ending Dec. 31, Year

Income	
Rental Income	\$1,400,000
Investment Interest Income	240,000
Dividend Income	180,000
Interest on Condemnation Award	144,000
Depreciation Recapture on Condemned Improvements	100,000
Capital Gain on Condemned Improvements and Land	300,000
Proceeds of Valued Use and Occupancy Policy	<u>600,000</u>
Total Income	\$2,964,000
Expenses	
Operating Expenses	\$ 800,000
Mortgage Interest	480,000
Depreciation	180,000
Real Estate Taxes	<u>240,000</u>
Total Expenses	<u>1,700,000</u>
Net Income	\$1,264,000