I:6-41 *Business Investigation Expenditures.* Assume the same facts as in Problem I:6-40, except that Big Bang LLC incurs $41,000 in expenses, it does *not* already own the other entertainment galleries and it does not own anything similar.

a. What is the proper tax treatment of these expenses if Big Bang does not open the new gallery?
b. What is the proper tax treatment of these expenses if Big Bang decides to open the new gallery on May 1 of the current year and makes the appropriate election under Sec. 195?

I:6-42 *Timing of Expense Recognition.* Solutions Corporation, a computer vendor and consulting company, uses the accrual method of accounting. Its tax year is the calendar year. The following are three of the corporation's transactions during the current year:

1. Solutions Corporation hired a contractor to remodel its sales floor. The contractor completed the remodeling on November 30. On December 15, Solutions received a $21,000 bill from the contractor. Solutions immediately contacted the contractor to contest the $8,000 labor charge included in the total bill, which Solutions claims should only be $7,000. Solutions made no payment on the bill.
2. Solutions offers a 2-year warranty on all of its computer systems. For sales of computers in the current year, it paid $11,500 to service warranties during the current tax year, and it expects to pay $12,000 to fulfill the remaining warranty obligations next year.
3. Every year, Solutions offers a series of six trade seminars from November 1 through April 30. It receives all registration fees from participants by October 1, before the seminars begin. As of December 31, two of the six seminars are completed, and the next seminar is scheduled for January 14–15. The expenses incurred in performing the seminars are routine each year. On the first of each month from November through April, Solutions pays the $625 monthly rent for the seminar location. On September 16, Solutions signs a contract with the seminar teacher, a computers expert and excellent public speaker. The contract requires Solutions to pay the teacher $900 after each seminar, a total of $5,400. On October 3, Solutions signs a contract with a local printing company, which will provide text materials for the seminars. Solutions pays the printer $350 after each seminar's materials are delivered the day before the seminar.

Required:

a. How should Solutions Corporation treat these transactions? What rules apply?
b. How would your answers change for each of the transactions if Solutions Corporation were a cash-method taxpayer?

I:6-43 *Prepaid Expenses.* Pamello, Inc., an engineering consulting firm, uses the cash method of accounting and is a calendar year taxpayer. Compute the amount of Pamello's current year deductions for the following transactions:

a. On November 1 of the current year, it entered into a lease to rent some office space for five years. The lease agreement states that the lease payments are $12,000 per year, payable in advance each November 1 for the following 12-month period. Under the terms of the lease, Pamello is required to pay a $5,000 deposit, refundable upon the termination of the lease.
b. On December 1 of the current year, Pamello also renewed its malpractice insurance, paying $18,000 for the three-year contract.
c. On December 31 of the current year, Pamello mailed out a check for $5,000 for drafting services performed for it during the current year by an individual who lives in another city.
d. On December 31, the firm received a shipment of $700 worth of stationery and other office supplies. Pamello has an open charge account with the office supply company, which bills the firm monthly for charges made during the year.
e. On December 31, Pamello picked up some work that a local printing company had done for it, which amounted to $1,000. The firm charged the $1,000 with its corporate credit card.

I:6-44 *Prepaid Interest.* During the current year, Richard and Alisha, a married couple who use the cash method of accounting, purchased a principal residence for $320,000. They paid $40,000 down and financed the remaining $280,000 of the purchase price with a 30-year mortgage. At the closing, they also paid $500 for an appraisal, $500 for a title search, and 1.5 points representing additional interest over the term of the loan. At the end of the year, Richard and Alisha received a statement from the mortgage company indicating that $12,000 of their total monthly payments made during the year represents interest and $1,000 is a reduction of the principal balance.

a. What is the total amount Richard and Alisha may deduct in the current year arising from the purchase and ownership of their home?
b. What is the treatment of the other items that are not deductible?

I:6-45 *Wash Sales.* Broward Corp. owns 1,500 shares of Silver Fox Corporation common stock. Broward Corp. purchased the 1,500 shares on April 17, 2008, for $20,000. On December 8, 2012, Broward sells 750 shares for $5,000. On January 2, 2013, Broward Corp. buys 250 shares of Silver Fox Corporation common stock for $1,750 and 50 shares of Silver Fox Corporation preferred stock for $1,000. The preferred stock is nonvoting, nonconvertible.

a. What is Broward's realized and recognized loss on the December 8 sale of stock?
b. What is Broward's basis and the holding periods of the stock?

I:6-46 *Wash Sales.* Cougar Corporation owns 1,000 shares of Western Corporation common stock, which it purchased on March 8, 2007, for $12,000. On October 3, 2013, Cougar purchases an additional 300 shares for $3,000. On October 12, 2013, it sells the original 1,000 shares for $8,500. On November 1, 2013, it purchases an additional 500 shares for $4,000.

a. What is Cougar's recognized gain or loss as a result of the sale on October 12, 2013?
b. What are the basis and the holding period of the stock Cougar continues to hold?
c. How would your answers to Parts a and b change if the stock Cougar purchases during 2013 is Western nonvoting, nonconvertible, preferred stock instead of Western common stock?

I:6-47 *Constructive Ownership.* During the current year, Troy sells land to Berry Corporation for $165,000. Troy purchased the land for investment in 2000 for $170,000. Berry Corporation is owned as follows:

Owner	*Percentage Ownership*
Tom (Troy's son)	20%
Jimmy (Troy's cousin)	15%
Jimmy's father (Troy's uncle)	30%
Angie (Troy's wife)	10%
Nicole (Angie's Sister)	25%

Troy and Jimmy are equal partners in a separate entity, TJ Partnership.

a. What is Troy's constructive ownership in Berry Corporation?
b. What is the amount of loss Troy may recognize?
c. How would your answers to Parts a and b change if TJ Partnership owned 25%, instead of Nicole?

I:6-48 *Constructive Ownership.* PIB Partnership is owned 20% by Sara, 40% by Steve, and 40% by Thann. Burnham, Inc. is owned 70% by PIB Partnership, 10% by Ralph, 10% by Thann, and 10% by Sara. Ralph and Thann are brothers. All other individuals are unrelated. During the current year, Ralph sold a piece of land to Burnham, Inc., for $90,000. Ralph originally purchased the land as an investment a few years ago for $100,000.

a. How much of the loss may Ralph recognize?
b. Now assume all the same facts except that the sale occurred between Thann and Burnham, Inc. How much of the loss may Thann recognize?
c. Now assume the same facts as in b except that Burnham, Inc., is owned 60% by Sara and 40% by Ralph. Thann sells the land to Burnham, Inc. How much of the loss may Thann recognize?

I:6-49 *Related Party Transactions.* Sally is an attorney who computes her taxable income using the cash method of accounting. Sage Corporation, owned 40% by Sally's brother, 40% by her cousin, and 20% by her grandmother, uses the accrual method of accounting. Sally is a calendar-year taxpayer, whereas Sage Corporation's fiscal year ends on January 31. During 2012, Sally does some consulting work for Sage Corporation for a fee of $10,000. The work is completed on December 15 and Sage receives Sally's invoice on that date. For each of the following assumptions, answer the following questions: During which tax year must Sally report the income? During which tax year must Sage Corporation deduct the expense?

a. The payment to Sally is made on December 27, 2012.
b. The payment to Sally is made on January 12, 2013.
c. The payment to Sally is made on February 3, 2013.

I:6-50 *Related Party Transactions.* During the current year, CVI Corporation sells a tract of land for $75,000. The sale is made to Sandi, CVI Corporation's sole shareholder. CVI Corporation originally purchased the land five years earlier for $98,000.

a. What is the amount of gain or loss that CVI Corporation will recognize on the sale during the current year?