

### Introductory Questions

After you have read Chap. 1, please try to answer the following questions and be prepared to discuss the questions and the chapter at our first class meeting. We will try to get through Chap. 1 and these questions during the first class, with time left to make a start on Chap. 2.

1. As a general rule, a corporation is a business organization that must have two or more founders or incorporators.

- A) TRUE. Otherwise the business organization will be formed as a sole proprietorship.
- B) TRUE. The only exception is for a corporation formed as a subchapter S corporation under the Federal tax law.
- C) FALSE. Under state corporation law a corporation must have a sole incorporator.
- D) FALSE. Under state corporation law a corporation may be formed by one or more incorporators.

2. A sole proprietorship may be formed without making a filing with the state in which it conducts business AND there should never be a need for a sole proprietorship to make a state filing related to its existence or operation.

- A) FALSE. A sole proprietorship is formed by making a notice filing in the state in which it conducts business.
- B) FALSE. Although a sole proprietorship may be formed without making any state filing, if the sole proprietorship conducts business under an assumed name it must file to conduct business under the assumed name in most states.
- C) TRUE. Because the sole proprietorship is an unincorporated business organization, it need not file a certificate with the state to form and it may conduct business under a name selected by the sole proprietor without a state filing.
- D) TRUE. Although some unincorporated business organizations must file a certificate of formation with the state, this requirement does not apply to sole proprietorships and a name for the sole proprietorship may be freely chosen without the need for a filing.

3. Choose the business organization type listed below (if any) that does not require a filing with the state in order to initiate its formation.

- A) A limited liability company.
- B) A limited partnership.
- C) A general partnership.
- D) None of the entities listed may be formed unless a formation document is filed with the state.

4. Assume that the corporate tax rate is a flat 35% and that all relevant shareholders are taxed at a 15% rate. If a subchapter C corporation earns an additional \$10,000 which it would like to use to pay dividends to its shareholders, how much will its shareholders have to spend after all taxes are paid if the corporation properly reserves for taxes and the shareholders pay their taxes?

- A) \$5,525
- B) \$8,500
- C) \$6,500
- D) \$5,000

5. Assume that the corporate tax rate is a flat 35% and that all relevant individual shareholders are taxed at a 15% rate. If a subchapter S corporation earns an additional \$10,000 which it would like to use to pay dividends to its shareholders, how much will its shareholders have left to spend after all taxes are paid if the corporation properly reserves for taxes and the individual shareholders pay their taxes?

- A) \$6,500
- B) \$8,500
- C) \$5,525
- D) \$5,000

6. Which of the following types of business organization must pay Federal income tax at the entity level?

- A) A corporation.
- B) A limited liability company.
- C) A limited partnership.
- D) None of the listed business organizations must pay an entity level income tax.

7. Acme Corp. has two shareholders--Mutt and Jeff. Acme Corporation borrowed money from Big Bank, which it is unable to repay. Big Bank thereafter sued Acme Corp., as well as Mutt and Jeff, for repayment. On these simple facts, what is the likely recovery by Big Bank.

- A) Big Bank can recover from Acme Corp. AND from either Mutt or Jeff (depending on which of them is the manager of Acme.
- B) Big Bank can recover from all of Acme Corp., Mutt and Jeff because Acme is a closely held corporation.
- C) Big Bank can recover from Acme Corp. BUT NOT from either Mutt or Jeff.
- D) Big Bank can choose to recover from either Acme Corp. OR Mutt and Jeff, but not both.

8. A separatist political group consisting of 125 adult persons has purchased a strawberry farm in Homestead, Florida. The group has an egalitarian philosophy and has formed a corporation to hold the farm, with each person holding one share in the corporation. The leader of the group recently learned about the "horrors of double taxation" and tells all the shareholders that they must elect subchapter S status. Can they do it?

A) YES

B) NO

9. Jack and Jill want to form a business organization to run a bakery business. Jack wants to use a general partnership because they will be free to draft whatever sort of contract they want to govern their business relationship. Jill is skeptical that they will have complete contractual freedom to specify the terms of a general partnership. Who is correct?

A) Jack

B) Jill

10. Doctor Clumsy has incorporated his practice as a professional corporation. During a recent surgery, Doctor Clumsy arrived to the operating room late and in a fluster. He negligently left a sponge inside the patient, which became infected. The patient has sued both the professional corporation and Doctor Clumsy in his individual capacity for malpractice. Does the incorporation of the practice insulate Doctor Clumsy from any personal liability for a tort that he may have committed?

A) YES by incorporating his practice Doctor Clumsey has protected himself from personal tort liability.

B) NO the incorporation protects against actions taken by the corporation but does not relieve Doctor Clumsey from personal torts committed by him.

11. Stingy LLC is treated as a partnership or flow-through entity for tax purposes. Assume a corporate tax rate of 35% and a personal income tax rate of 15%. Stingy earned income of \$20,000. Stingy distributed \$10,000 to its "members" (i.e. the owners of the LLC). Pick the best calculation of the aggregate taxes payable on this earned income.

A) \$5,000

B) \$1,500

C) \$3,000

D) \$8,500

12. Boss formed Cab Inc. to which he transferred three yellow cabs as a capital contribution. Cab Inc. hired three drivers: Curly, Moe and Larry. Curly picked up a passenger at University of Miami who said, "Please drive me to Coconut Grove." On the way, Curly tried to answer a text message and got into an accident due to negligence. Passenger asks you who she can sue in tort for damages she suffered in the crash. Pick the best answer.

A) Passenger can sue Boss as the owner of Cab Inc. and Cab Inc. as a distinct legal entity recognized by law.

B) Passenger can sue Cab Inc. only because the corporate form protects all the other individuals from liability.

C) Passenger can sue Cab Inc. and Curly in his individual capacity who was acting as the agent or employee of Cab Inc.

D) Passenger can sue Boss as the owner of Cab Inc. because the corporate form insulates Cab Inc. and the three drivers from liability.

13. Identify the type of business organization that currently is most popular for investors seeking pass-through tax treatment for a closely held business.

A) A limited partnership.

B) A subchapter S corporation.

C) A limited liability company.

D) A subchapter C corporation.

14. Macho L.P. is a limited partnership that has a booming business. The president and majority owner of Macho wants to take Macho public by issuing limited partnership interests listed on a stock exchange. He thinks Macho will have a big advantage because it is taxed as a pass-through entity. Is he correct?

A) YES. A limited partnership is, by default, taxed as a pass-through entity under the "check the box" regulations of the IRS.

B) NO. Macho, as a publicly traded partnership, will be taxed as a corporation.

15. In addition to the payment of income taxes on earnings, a sole proprietorship must pay these additional Federal taxes. Pick the most complete answer.

A) 12.4% additional tax (under the Self Employment Contributions Act or SECA).

B) 12.4% additional tax under SECA plus an additional 2.9% tax for Medicare.

C) Only the 2.9% Medicare tax because a sole proprietor is not an employee as he works for himself.

D) None of the above--the taxes would apply only if the sole proprietor incorporated or formed an unincorporated association to hold his business.