Journal of Business Administration Online

ARKANSAS TECH UNIVERSITY College of Business HTTPS://JBAO.ATU.EDU

Spring 2025, Vol. 19 No. 1

Two Sisters Enterprises, Inc.

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ABSTRACT

This case is prepared to be a teaching case for business taxation courses. The primary purpose of this case is to engage students in their fundamental knowledge of corporation taxation issues and more specifically challenge students in tax planning issues. The case presents the dilemma of majority owners of a corporation who seek professional tax advice on most effective and least costly approaches to disposing of their ownership in the business, discontinuing the current form of the business or completely dissolving the business.

KEYWORDS: Corporate Formation; Buy-Sell Agreement; Stock Redemption; Complete Liquidation; Corporation Taxation

INTRODUCTION

Forrow Jones and Nena Taylor are twin sisters living in Houston, Texas. Both sisters have always had an entrepreneurial spirt. Having recently come into significant resources following the death of a dear relative, Forrow and Nena decided to pool their resources and form a business together. Although being very loving sisters, they have had many contentious moments over the years.

In April 2021, Forrow and Nena formed a corporation named Two Sisters Enterprises, Inc. to operate a Flower Pot Store doing business under the assumed name of F&N Flower Pots Emporium. Forrow and Nena established the business with cash contributions ($300,000 each) making them equal owners of the corporation acquiring 1,000 shares of common stock each. F&N Flower Pots Emporium manufactures unique multi-colored flower pots. F&N Flower Pots Emporium has been profitable over its initial years of operation and Forrow and Nena have both been actively involved in managing the business. They have developed exceptionally good personal relationships with several customers (both wholesale and retail) that they believe keep the customers returning for more purchases as well as referring their experiences to others.

Wanting to quickly begin the business, Forrow and Nena formed the corporation to operate the business (without any advice from tax professionals). Forrow Jones assumed the role of president of the corporation and Nena Taylor became Vice-President of Finance. These titles were primary for corporate necessities and formalities and both were deeply involved in the day-to-day operations of the business. This was of particular interest to both of them to be very actively involved in the activities of the company at a personal level.

The corporation was organized with the express purpose of being a closely-held business with no outside owners. A buy-sell agreement was prepared and executed immediately upon formation of the corporation stating that the only owners of the corporation were to be the two initial owners and their children. If for any reason an owner wanted to discontinue their ownership in the business, their stock in the corporation may be transferred only to the corporation, the other shareholders or their children. As such, no outside ownership could occur.

EARLY STAGES OF BUSINESS

The initial stages of the business were very promising. The sizeable initial capital investments allowed for the business to get off to a great start as there was sufficient capital to locate a very desirable location for the business, hire sufficient and experienced personnel, acquire significant initial inventory and equipment and other items for the successful operation of the business. The profits of the business in its first three years of operations enabled the rapid development and growth of the business and no distribution of the earnings of the business to the owners occurred during this period.

Nena desired to get her two adult children deeply involved in the business. In early 2024, Nena gifted 250 shares each of her initial 1,000 shares of common stock in Two Sisters Enterprises, Inc. to her son, Daniel Taylor, and her daughter, Eileen Taylor. Daniel and Eileen both had been regularly active in the business since its inception and welcomed the opportunity to be owners as well.

The business has done very well and continues to thrive. The owners enjoyed running the business and the business has developed a solid positive reputation in the community. Despite this, there have been times where the contentious relationship between Forrow and Nena has surfaced. Initially there were minor disagreements on inventory purchases and facility layout and the like. However, now the disagreements have become more serious and contentious dealing with important financial management issues of the company.

DETERIORATION OF RELATIONSHIP OF PRINCIPAL OWNERS

Throughout the year of 2025, the declining relationship between Forrow Jones and Nena Taylor has reached the point where the effectiveness of the operation of F&N Flower Pots Emporium has suffered. The maintenance of sufficient and the appropriateness of inventory, employee morale, hours of operations and beyond were significantly impaired by the inability of the principal owners to effectively manage the business in a professional manner. It has become apparent that the business cannot continue its successful rise in the present management environment. As such, Forrow Jones and Nena Taylor have decided that for the sake of the business the two of them should no longer co-exist as owners of Two Sisters Enterprises, Inc.

Forrow and Nena are now seeking professional tax advice on how to address their dilemma. They are interested in learning how they can best salvage the business with either one of them or neither of them still involved in the business. In addition to seeking advice on different approaches that can address the present dilemma, the minimization of the income tax consequences to both the business and each of them (as well as Daniel and Eileen) in their individual capacities are of paramount interest to them.

In anticipation of the major decision that the owners must soon make, Two Sisters Enterprises, Inc. had all its assets appraised. The Balance Sheet at the date of the very recent appraisal with the corresponding appraisals of the market value of all its assets is as follows:

Assets	**Adjusted Tax Basis**		**Fair Market Value**
Cash	$350,000		$350,000
Accounts Receivable	70,000		60,000
Inventory (LIFO Basis) *	180,000		360,000
Equipment	190,000		150,000
Investments (Marketable Securities)	250,000		370,000
Land (Used in The Business)	90,000		80,000
Building	270,000		190,000
Total Assets	$1,400,000		$1,560,000 **
Liabilities And Stockholders' Equity			
Accounts Payable	70,000		
Note Payable	100,000		
Mortgage on Building	130,000		
Total Liabilities	300,000		
Total Stockholders' Equity	1,100,000		
Total Liabilities and Stockholder's Equity	1,400,000		
* - The FIFO Method Basis (Adjusted Tax Basis) of the Inventory would be $240,000.			
** - The appraisal of the entire business was $1,900,000 (which indicates the presence of Accounting Goodwill).			

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Internal Revenue Code of 1986.

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TEACHING NOTES: TWO SISTERS ENTERPRISES, INC.

ABSTRACT

This case is prepared to be a teaching case for business taxation courses. The primary purpose of this case is to engage students in their fundamental knowledge of corporation taxation issues and more specifically challenge students in tax planning issues. The case presents the dilemma of majority owners of a corporation who seek professional tax advice on most effective and least costly approaches to disposing of their ownership in the business, discontinuing the current form of the business or completely dissolving the business.

KEYWORDS: Corporate Formation; Buy-Sell Agreement; Stock Redemption; Complete Liquidation; Corporation Taxation

INTRODUCTION AND MOTIVATION OF TEACHING CASE

Students are often challenged in their understanding and application of tax laws for business entities. Students are able to remember rules and provide answers to specific questions but often have a limited understanding of how to apply tax provisions in a true business setting. This teaching case is designed to enable students to make direct application of the vast materials learned in taxation of business courses. The case allows for students to be exposed to a practical real-world situation that is encountered on a daily basis by tax professionals and make application of the materials learned in the course. The case requires students to not just think of rules that they have memorized but identify what business situations certain tax rules are more appropriate. Effective critical thinking skills must be used by students to properly identify which tax laws apply to different businesses and the tax impact of those tax laws on various business entities. Remembering the tax laws is one thing but properly making practical application of specific tax laws is altogether different. This teaching case helps students make proper application of complicated tax laws in a true business setting. Moreover, the teaching case challenges students in the areas of analytical problem solving and critical thinking that will enable them to be more forward thinking. These skills will enable students to not only think about taxation in its specifics but be more broadly prepared for greater skills of providing solutions and planning for business enterprises beyond their current situation but also be able to predict and measure the impact of decisions now and in the future. (*IMA's Management Accounting Competency Framework)*

INTENDED COURSES AND AUDIENCE

The intended courses for this teaching case are primarily Graduate Taxation courses (Corporation Taxation and Business Entities) but may also be used in upper-level undergraduate Taxation courses as well (with perhaps slight modification in the approach). The case requires students to provide professional tax advice to the majority owners of a corporation on most effective and least costly approaches to dispose of their ownership in the corporation or other approaches to discontinuing the current form of the business or completely dissolving the business.

TEACHING OBJECTIVES

The teaching objectives of the case are to:

(1) Enhance students' understanding of the tax impact on stockholders and a corporation in dissolving of a corporation,
(2) Challenge students' critical thinking skills in advising on the tax consequences to owners of changing the form of business to other acceptable forms of businesses and
(3) Enable students to compare the tax impact on owners of various forms of businesses.

Students are often overwhelmed in business entities taxation courses. The uniqueness of the tax laws for various business entities adds to the difficulty for students to fully grasp an understanding of business entities taxation. The goals of the teaching objectives of the case are to assist the students in not only understanding the specific tax laws for different business entities but also be able to know how to properly apply the correct tax laws to the correct business entity and be able to determine the income tax consequences to the business entities and their owners. Moreover, in evaluating the tax impact on different business entities, students will be able to determine which course of action in proposed situations is more effective for the specific business entity that is under consideration and its owners.

READING MATERIALS

Before beginning the teaching case, students should have been exposed to the taxation for the most common business entities of C (Regular) Corporations, Partnerships and S Corporations. This is an in-depth understanding of these business entities from the standpoint of formation, operation and discontinuation of these type of businesses. The tax consequences to both the business entities and the owners of the business entities should be comprehended by the students for successfully addressing the issues of the teaching case.

Most advanced taxation business entities textbooks are meaningful reading sources for instructors to resort to for assistance in this subject matter. (A specific recommended textbook source is: Nellen, Annette, William A., Young, James C., Cripe, Bradrick M., Lassar, Sharon S., Persellin, Mark B., Cuccia, Andrew D. (2026). *South-Western Federal Taxation 2026: Corporations, Partnerships, Estates and Trusts*. Cengage Learning, Inc.). A comprehensive comparison of the tax implications of different business entities may be found in this reading resource at the following link:

https://ebooks.cenreader.com/#!/reader/b3a4ab7d-44b2-4d2b-946a-4283dd18249b/page/3510becd08b4d8af859073f879f89757

ASSIGNMENT QUESTIONS

Specific Assignment Questions for the case are as follow:

(1) Write a memorandum to Forrow Jones and Nena Taylor explaining the federal income tax consequences to each of them and the corporation if the corporation is dissolved.
(2) Write a memorandum to Forrow Jones and Nena Taylor describing other forms of businesses that can be pursued that will allow them to separate their ownerships. Briefly emphasize the potential federal income tax impact to each of them (and the business entities where appropriate) of the other forms of businesses.
(3) Write a memorandum contrasting the federal income (and other) taxation consequences of C (Regular) Corporations, S Corporations, Partnerships, Limited Liability Companies (LLC's) and Sole Proprietorships.

The first two Assignment Questions are the likely reactions in addressing the dilemma presently facing the principal owners of the corporation. The last Assignment Question is to ensure the students have a clear understanding of the tax implications of different business entities. Suggested solutions to these Assignment Questions are shown at the end of these Teaching Notes.

TEACHING PLAN

As with most business entities taxation courses, the course progresses through the semester with in-depth discussion of the primary business entities: C (Regular) Corporations, Partnerships (and Limited Liability Companies (LLC's) and S Corporations. (This order may vary but this is the typical approach, and the approach used for my courses although my courses also include additional topics beyond business entities). As such, the most appropriate time to introduce the case is towards the end of the course after the business entities have been fully discussed and assignments and testing of the business entities have been completed. For my courses, the case is presented to the class in the Learning Management System with the Assignment Questions included at the end of the case after the final testing on business entities in the courses. One hour of the first class after final testing on business entities can be devoted to discussion of the case although I found in my most recent classes thirty minutes of discussion at the beginning of the next two classes after testing of business entities was very effective. The second discussion allowed students to digest the first discussion and think about other ways to address the Assignment Questions. The second-class discussion produced ideas far beyond the first discussion and some ideas that I found to be quite novel and innovative. The class discussion(s) began with the instructor asking basic questions on business entities to get students involved such as the following:

1. Which business entities are subject to double taxation?
2. Which business entities are subject to single taxation?
3. Which business entities create self-employment taxes for its owners?

4. What are the federal income tax consequences of the operations of business entities (including debt) to the owners of various business entities?
5. What are the federal income tax consequences of distributions to the owners of various business entities?
6. Which business entities may be converted to other forms of business? What are the federal income tax consequences, if any, of converting to other forms of businesses?

All of these questions do not necessarily need to be asked but these questions engage the students on discussing business entities and allow them to clearly think about the federal income tax consequences of different business entities on both the entity and owners of the entity. Students should be able to clearly determine from the financial information (Balance Sheet) provided in the case the components of the Stockholders' Equity and the values of the assets and their basis (for purposes of identifying possible built-in-gains and built-in-losses) but the instructor should ensure that this information is clearly identified in the discussion session(s). The discussion session(s) prepare the students to complete the Assignment Questions of the case. The instructor should facilitate the discussion to get the students actively involved and then allow the students to carry the discussion and debate. References to specific relevant problems and assignments covered earlier in the course can be made as a basis to assist students in relating the case materials to materials previously covered in the course.

Students generally work on the case assignment individually although I give them permission to work with classmates for discussion of the case if they choose to do so but each student submit separate assignment responses. After the initial class discussion, students have two weeks to complete the Assignment Questions and submit their responses for grading. (Due to the large size of my classes for the most recent semester, I allowed students to answer either of the three Assignment Questions. This can be a regular approach for future classes as well and especially for upper-level undergraduate taxation courses).

(As stated above, the recommendation is for the teaching case to be discussed after all of the business entities have been thoroughly discussed and tested in the course. However, some may find it effective to introduce and briefly discuss aspects of the case as each business entity has been covered in class. This approach allows for students to develop ideas as the course progresses through discussion of all of the business entities. This approach may be very ideal for upper-level undergraduate business entities taxation courses)

STRATEGIES FOR USING THE TEACHING CASE

The teaching plan outlined above can be modified for different modalities for the course. A traditional face-to-face or hybrid course is ideal for the class discussion(s) noted above (the time allowed for discussion may need to be adjusted depending on available in class time). However, for fully online courses, creativity may be necessary to assist students in getting focused and prepared for the case. This creativity may include providing the basic discussion questions listed in the Teaching Plan as a Discussion Board post for students' participation. A live synchronous meeting can also be an option for discussion of the case for fully online courses.

The case is more meaningful for students when they are allowed to carry the discussion and make many comments and suggestions. In addition, real-world situations inspire students to be even more engaged in the discussion. Taxation is an area where real-world atmospheres can be achieved as most college level students in some way have been exposed to taxation even if at only a very basic level.

EVIDENCE OF EFFICACY

A survey of the students completing the Assignment Questions was taken after completion of the teaching case. A total of eighty-eight surveys were completed. The survey consisted of eight questions regarding the usefulness of the teaching case in enhancing the understanding of the subject matter of the courses, critical thinking skills applied and the like. The responses to the eight questions were measured on a Likert Scale of 1 to 5 with 1 being "Strongly Disagree" and 5 being "Strongly Agree". A final ninth open ended question was included in the survey to elicit any comments, suggestions or ideas the students wished to offer regarding the teaching case.

The results of the responses to the survey are shown below. The results indicate a very positive rating for the teaching case. The vast majority of the responses to the eight Likert Scale questions shows that the teaching case was well received by the students and the students benefited from the teaching case in the areas of enhancing their understanding and application of the subject matter of the courses, the effective use of critical thinking skills in addressing the Assignment Questions of the teaching case and by recommending that the teaching case be used in future semesters for the courses.

ASSIGNMENT QUESTIONS	N	MEDIAN	MEAN	STANDARD DEVIATION
1. The Teaching Case increased my knowledge and understanding of the taxation of various business entities covered in the course.	88	4.00	4.01	1.01
2. The Teaching Case increased my ability to apply the knowledge gained in the course to practical real-world situations.	88	4.00	3.93	1.01
3. The Teaching Case increased my ability to distinguish the federal tax applications to different business entities.	88	4.00	3.88	.99
4. The Teaching Case was appropriate and useful for the course and effective in increasing my understanding of federal income (and other) taxation matters.	88	4.00	3.99	.97
5. The Teaching Case and the related Assignment Questions caused me to apply critical thinking skills in responding to the assignments of the case.	88	4.00	4.03	.92

6. The Teaching Case added value to the course.	87	4.00	3.92	.95
7. I enjoyed and benefited from reading the Teaching Case and responding to the Assignment Questions of the case.	88	4.00	3.74	1.05
8. I recommend that this Teaching Case be used in future semesters for this course.	88	4.00	3.97	.98
9. Please provide any comments/suggestions/observations that you wish to make regarding the Teaching Case and its use in this course.				

The following comments were provided for question 9:

"Between completing extra credit, tax projects, studying for the last exam, and completing this assignment i felt i could have benefitted better from getting the assignment sooner. It would have allowed me more time to write on the different federal income tax consequences between corporations, parternerships, etc. I felt rushed and like I could have done better on the memorandum assignment if I was given a week's more time. ”Should be for extra credit"
"Nothing more to add"
"IT DOES MAKE US THINK ABOUT THE MATERIAL WE LEARN AND TRY TO APPLIE IT BUT I FELT LIKE IF I DIDN’TFULLY UNDERSTAND THE COURSE WE HAD DIFFICULTIES."
"I learned a lot from this teaching case."
"I really enjoyed the case, but I think if you extended the original case throughout the semester then that'll allow us to apply everything we learn to the case and maybe different the cases different throughout the semester or different stats but applying and researching options and solutions to problems within the tax helped understand the course form"
"I think the case should be available to read in the beginning of the semester so that we can add/subtract to our initial thoughts as our knowledge grows through out the course."
"The teaching case was a really good way to apply what we learned in the course."
"It is worth extra credit"
"Great assignment"
"N/A"
"thank you for all things you thought us this semester it was a pleasure like always. Yeraldin Pineda"
"Practical cases like this teaching case can be beneficial to any tax course to help students apply the principleslearned. I strongly recommend."
"Assign second case right after second examination or first."
"I have no comment about the case. I believe this helps average students a lot by pulling multiple chapters into1 case. It would force them to review those chapters in order to have a good solution."
"Too fast paced, but professor very knowledgeable"
"Good example of how memorandum are supposed to be written"

The responses of the students to the survey indicate that the Teaching Objectives of the teaching case have been met.

SOLUTIONS TO ASSIGNMENT QUESTIONS

ASSIGNMENT QUESTION

(1) Write a memorandum to Forrow Jones and Nena Taylor explaining the federal income tax consequences to each of them and the corporation if the corporation is dissolved.

MODEL RESPONSE

DISSOLVE Two Sisters Enterprises, Inc. through a Complete Liquidation of the Corporation

A drastic action to address this matter is to dissolve (terminate) the corporation. The termination of a corporation is achieved through what is referred to as a "Complete Liquidation". A Complete Liquidation treats a corporation as if it sold all its Assets for their fair market value and after satisfying all debts of the corporation distribute the remaining Assets of the corporation proportionately to the owners (shareholders) of the corporation. For a successful and profitable corporation as Two Sisters Enterprises, Inc., the tax implications for both the corporation and the owners (shareholders) can be significant as illustrated below:

EFFECT ON CORPORATION

$1,900,000 Fair Market Value (Appraised Value)

- 1,400,000 Basis

= **$ 500,000 Recognized Gain**

Income Tax Liability - **$105,000 ($500,000 x 21%)**

EFFECT ON SHAREHOLDERS

$1,900,000 Fair Market Value (Appraised Value)

- 300,000 Liabilities (If not paid by the Corporation) *

- 105,000 Income Tax Liability (If not paid by the Corporation) *

- 600,000 Basis In Stock

= **$ 895,000 Capital Gain**

The allocation of this Capital Gain is allocated one-half ($447,500) to Forrow Jones, one-fourth to Nena Taylor ($223,750) and one-eight ($111,875) **each** to Daniel Taylor and Eileen Taylor.

* - If the Liabilities (including the Income Tax Liability) of the corporation are paid by the corporation, this simply reduces the Net Assets distributed to the shareholders. As such, the net results to the shareholders are the same as shown in this illustration.

The tax rate for the capital gain to each shareholder is likely to be 15% (but this depends on the total overall taxable income for each shareholder). Therefore, the income tax due for each shareholder will likely be as follows:

All Shareholders

$895,000 x 15% = **$134,250**.

(One-half ($67,125) to Forrow Jones; One-fourth ($33,562.50); One-eight ($16,781.25) **each** to Daniel Taylor and Eileen Taylor.

The combined corporation level tax and the tax to the shareholders is a total of **$239,250** ($105,000 + $134,250).

As pointed out before, the income tax consequences of this course of action can be significant.

ASSIGNMENT QUESTION

(2) Write a memorandum to Forrow Jones and Nena Taylor describing other forms of businesses

that can be pursued that will allow them to separate their ownerships. Briefly emphasize the

potential federal income tax impact to each of them (and the business entities where appropriate)

of the other forms of business.

MODEL RESPONSE

Have either Forrow Jones or Nena Taylor or both of them dispose of their ownership in the corporation

To more directly address the issue of the co-existence of the both of you in the operations and ownership of Two Sisters Enterprises, Inc., another approach is for either or both of you dispose of your ownership in Two Sisters Enterprises, Inc.

From strictly a federal income tax standpoint, income tax consequences will materialize for either of you if you dispose of your stock in Two Sisters Enterprises, Inc. through a sell of your stock to the corporation pursuant to a Section 302(b)(3) Stock Redemption (or to the remaining shareholders, Daniel Taylor and/or Eileen Taylor if they are interested and able to do so (or one principal shareholder sell to the other principal shareholder)). By selling all of your shares of stock to the corporation (or the other shareholders (or to each other)) results in a Capital Gain to the selling shareholder(s) but avoids a Complete Liquidation of the corporation (and the related income tax consequences) as illustrated in Assignment Question 1 above.

The income tax consequences of the sale of all your stock in Two Sisters Corporation for each of you is shown as follow:

Forrow Jones (1,000 Shares Of Common Stock)

Sales Price $800,000 ($800 Per Share X 1,000 Shares Of Common Stock)

- Basis In Stock - 300,000 ($300 Per Share X 1,000 Shares Of Common Stock)

Capital Gain $500,000

Nena Taylor (500 Shares Of Common Stock)

Sales Price $400,000 ($800 Per Share X 500 Shares Of Common Stock)

- Basis In Stock - 150,000 ($300 Per Share X 500 Shares Of Common Stock)

Capital Gain $250,000

($800 Per Share is the Value of the Net Assets ($1,900,000 (Appraised Value of Assets) - $300,000 (Total Liabilities) of the corporation per share of common stock outstanding)

($300 Per Share is the amount paid (Cost Basis) by each of you for each share of stock in April 2021)

The tax rate for the capital gain to Forrow Jones is likely to be 20% (but this depends on the total overall taxable income for Forrow Jones) and the tax rate for the capital gain for Nena Taylor is likely to be 15%. Therefore, the income tax due for the sale of stock for either of you will likely be as follows:

Forrow Jones

$500,000 x 20% = **$100,000**.

Nena Taylor

$250,000 x 15% = **$37,500**.

In either case or both cases, Two Sisters Enterprises, Inc. does not have sufficient cash to purchase the stock of either or both Forrow Jones and Nena Taylor. As such, Two Sisters Enterprises, Inc. may either (1) Need to borrow additional cash or (2) Sell assets or distribute assets (to the selling shareholder(s)) which may result in Recognize Gain to Two Sisters Enterprises, Inc. and, thereby, creating income tax consequences to the corporation.

This analysis illustrates that disposing of your stock in Two Sisters Enterprises, Inc. will result in significant federal income tax for the selling shareholder(s) and/or the corporation.

ALTERNATE RESPONSE

Liquidate the corporation and distribute all of the Net Assets to the shareholders to form Separate business entities

The distribution of the Net Assets of Two Sisters Enterprises, Inc. to the four shareholders of the corporation will require a Complete Liquidation of the corporation as described in Assignment Question 1 above. Thus, the significant income tax consequences (including the capital gains tax) to both the corporation and the owners of the corporation will be the same **$239,250** as shown in the Solution to Assignment Question 1 above.

It should be noted that if the shareholders decide to form separate business entities after the Complete Liquidation of Two Sisters Enterprises, Inc., the annual income tax treatment will be much different for the shareholders than before the Complete Liquidation of Two Sisters Enterprises, Inc. If a separate business is formed by any of the shareholders other than a C (Regular Corporation) that Two Sisters Enterprises, Inc. is presently, the shareholders will have direct federal income tax consequences on an annual basis. All of the other types of business entities of S Corporations, Partnerships, Limited Liability Companies (LLC's) and Sole Proprietorships require for the business activities (income (gains) and losses (deductions)) of the businesses to flow-through (or pass-through) directly to the owners of these business entities in proportion to their ownership of these entities. This result occurs regardless of whether the business entities made a distribution to the owners during the tax year. As such, the owners of these business entities will have federal income tax consequences annually for the activities of the business entities. (The business entities, for the most part, will have no federal income tax consequences each year).

OTHER POSSIBLE RESPONSE

Another possible response to this Assignment Question may include the following:

Have the corporation create two separate subsidiary corporations and allocate assets appropriately to each subsidiary corporation. The corporation can then perform a Section 355 Type D (Divisive) Reorganization (as a Split-Up) by distributing each subsidiary (the stock of each subsidiary) to the shareholders (one subsidiary to Forrow Jones and the other to Nena Taylor and her two children) in exchange for the stock of the corporation (Two Sisters Enterprises, Inc.) and the corporation (Two Sisters Enterprises, Inc.) goes out of existence. There are no federal income tax consequences to either party and the corporation (Two Sisters Enterprises, Inc.) if no "Boot" was involved. The income tax consequences of a Complete Liquidation as described in Assignment Question 1 above is avoided. However, there is a five year ownership of the subsidiary requirement by the corporation (Two Sisters Enterprises, Inc.) which will delay this approach for the present owners of Two Sisters Enterprises, Inc. (This may prove to be a challenging and perhaps expensive alternative and will also be delayed by the five year ownership requirement but nevertheless is a viable alternative).

ASSIGNMENT QUESTION

(3) Write a memorandum briefly contrasting the federal income (and other) taxation consequences

of C (Regular) Corporations, S Corporations, Partnerships and Limited Liability Companies

(LLC's) and Sole Proprietorships.

MODEL RESPONSE

comparison of c (regular) corporations, s corporations, partnerships, limited liability companies (LLC's) and sole proprietorships

The memorandum should include many of the following attributes.

ATTRIBUTES	C (REGULAR) CORPORATIONS	S CORPORATIONS	PARTNERSHIPS	LIMITED LIABILITY COMPANIES (LLC'S)	SOLE PROPRIETOR-SHIPS
DOUBLE TAXATION	X	(1)			
SINGLE TAXATION		X (1)	X	X	X
LIMITED LIABILITY	X	X		X (2)	
UNLIMITED LIABILITY			X (3)	(2)	X
CAPITAL FORMATION ADVANTAGE	X	X	X	X	
OWNERS LIMITATIONS	NONE	100	NONE (4)	NONE	1
MAXIMUM TAX RATE	21%	37%	37%	37%	37%
SELF-EMPLOYMENT TAX			X (5)	X (6)	X
QBI DEDUCTION (SECTION 199A)		X	X	X	X
TAX YEAR	FISCAL OR CALENDAR	CALENDAR	FISCAL OR CALENDAR	FISCAL OR CALENDAR	CALENDAR
ALTERNATIVE MINIMUM TAX	X (7)	X (Indirectly)	X (Indirectly)	X (Indirectly)	X (Directly)
AT-RISK RULES	X (8)	X	X	X	X
PASSIVE LOSS RULES	X (9)	X	X	X	X
EXCESS BUSINESS LOSSES		X	X	X	X
SALARY TO OWNER(S)	X	X	X (10)	X (10)	
FRINGE BENEFITS FOR OWNER(S)	X	X (11)	X (10)	X (10)	X (12)

(1) S Corporations may be subject to (1) Built-In-Gains Tax (Section 1374), Excessive Passive Investment Income Tax (Section 1375, (3) LIFO Recapture Tax and (4) Section 291 Depreciation Recapture Tax.

(2) Limited Liability Companies (LLC's) have limited liability in only certain areas.

(3) Only General Partners have unlimited liability. Limited Partners have limited liability.

(4) Partnerships must have at least two (2) owners (partners).

(5) For General Partners, the share of Ordinary Income (Nonseparately Stated Income) of the Partnership and Guaranteed Payments received for Services Rendered are subject to Self-Employment Tax. For Limited Partners, Guaranteed Payments received for Services Rendered only are subject to Self-Employment Tax. Guaranteed Payment for Use Of Capital are not subject to Self-Employment Tax for neither General Partners or Limited Partners.

(6) Members treated as limited partners are not subject to Self-Employment Tax. Members not treated as limited partners are subject to Self-Employment Tax.

(7) A new Corporate Minimum Tax was enacted effective August 16, 2022 for certain corporations with average Financial Accounting Net Income in excess of $1 billion. As such, the new Corporate Minimum Tax will have very limited application for C (Regular) Corporations.

(8) Closely held corporations only.

(9) Closely held corporations and Personal Service Corporations (PSC's) only.

(10) Called "Guaranteed Payments". (This is Taxable Income (Ordinary Income) to the recipient).

(11) Taxable Income to more than 2% shareholders. Not Taxable Income to a 2% or less shareholders.

(12) Health Insurance for taxpayer, spouse and dependents are deductible "For" Adjusted Gross Income (AGI).

TAX RATES

Please note that the tax rates (15%, 20%, 21% and 37%) used throughout the Solutions are the tax rates that are currently in effect as of the date of this publication. These tax rates are certainly subject to change in the future.

RECOMMENDED COURSE ACTION FOR THE PRINCIPAL OWNERS OF TWO SISTERS ENTERPRISES, INC.

In light of the dilemma of the principal owners unable to co-exist as owners of Two Sisters Enterprises, Inc., the recommended course of action is that either or both principal shareholders sell all of their stock to either the corporation (Section 302(b)(3) Stock Redemption or to the remaining shareholders (Daniel Taylor and/or Eileen Taylor)) if they are interested and able to do so. The principal shareholders may also consider one selling all their stock in the corporation to the other. This course of action will result in the federal income tax consequences to the selling shareholder(s) as illustrated in the Model Response for Assignment Question 2 shown above.

Ideally the best outcome is for the principal owners to attempt to reconcile their personal conflicts and continue to operate the business successfully as they have done. Perhaps seeking professional management advice and services may be pursued if interim management is needed while the principal owners seek a solution to their dilemma. However, if a resolution of personal conflicts cannot be achieved, the Model Response for Assignment Question 2 above is the recommended course of action.

(The Type D (Divisive) Reorganization is a possibility, but this course of action will cause a significant delay in its execution due to the five-year ownership requirement and the potential costs of structuring such an arrangement)

CONCLUSION

Two Sisters Enterprises, Inc. is a fictional corporation, but it presents a very practical real-world atmosphere for students. The issues posed in this case are issues addressed on a daily basis by tax professionals. This teaching case was well received in my courses as evidenced by the positive responses of the students in the survey conducted at the end of the courses. The teaching case is effective in terms of engaging students in their fundamental knowledge of corporation taxation issues and enabling students in applying critical thinking skills. This teaching case adds value to taxation of business entities courses by providing a real-world atmosphere for the students. I plan to use this teaching case in my future courses for some time to come.

REFERENCES

IMA's Management Accounting Competency Framework

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