

Tax of Corps & Shareholders

Spring Semester, 2009 / Professor Ashley

Course Syllabus

Tue. Jan 13th: Introduction—Chap 1: Read pp. 2-20; 34-57. Chap 2: 60-83. Prepare Part I. Parts 1-6 of the attached problem set.

Tue. Jan 20th: Read pp. 103-112 and prepare Parts I-IV of the problem set handed out in The first class.

Tue. Jan 27th: Read pp 83-102 and pp 121-130. Prepare Part V. Begin Capital Structure—Chap 3. Read pp. 132-157. No problem set.

Tue. Feb 3rd: Non-Liquidating Distributions. Read pp. 159-193 and prep problems 1-3 of the problems that will be distributed in class..

Tue. Feb 10th: Prepare the problem entitled “The Concept of Earnings & Profits” and read the *Demmon* case.

Tue, Feb 17th: Begin Redemptions. Read pp. 208-249. Prepare problems 1-5.

Tue. Feb 24th: Finish Redemptions. Read pages 249-287. Finish problem set.

Tue. Mar 3rd: Stock Dividends & Section 306 Stock: Read pages 303-323. Omit *Fireoved v. U.S.* pp. 323-330. Prepare problems.

Tue. Mar 10th: Complete Liquidations. Read 332-361. Prepare problems.

Tue. Mar 17th: Acquisitive Reorganizations: Read pp 413- 471.

Tue. Mar 24th: **SPRING BREAK — NO CLASS**

Tue. Mar: 31st: Read pp. 472-492.

Tue. Apr 7th: Divisions, read pp 499-560.

Tue. Apr 14th: Non-Acquisitive Reorganizations: Read pp 562-590.

Tue. Apr 21st: S Corps. Read pp 686-736.

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General Comments

Welcome to corp tax. The syllabus is below. Federal Income Tax is a prerequisite for this course so if you haven't completed taken it, please see me. Corporate tax builds more or less logically so don't get behind. If you miss a class or fail to understand earlier topics you'll have a hard time understanding later topics, too. I am always available before and after class, via phone at (312) 362-8325, via e-mail at pashley@depaul.edu, during the office hours posted by my office, Room 827, or by appointment. Attendance is not required but, again, I strongly urge you not to get behind. I have no objection to students taping the class.

We will be using a Foundation Press text, *Fundamentals of Corporate Taxation* by Lind *et. al.* And you will need a copy of the IRS Code and Regulations. Many publishers print an edited and combined volume. I use Thompson West *Selected Federal Taxation Statutes and Regulations* but many others will do as well.

We will also be using the problem method of instruction which means that in addition to reading the assigned text material you must also prepare the problem set and be ready to analyze why the numbers turn out as they do. The arithmetic will be easy but knowing which numbers to use and how will be harder. The first problem set is attached.

Your entire grade will be based on a 3-hour final exam. Like every other law school exam, this one will ask you to identify relevant issues and to intelligently address them using the cases and materials we will have studied. Unlike most law school exams, however, this one will require you to quantify your answers. Tax lawyers must be adept at performing calculations that involve simple arithmetic. Do not be afraid of the numbers. You may use a calculator both in class and on the exam if you wish but that may only slow you down.

The final exam, which is at 6:00 p.m. on May 7th is open "everything" (open notes, code, regs, commercial outlines, etc.). In fact, I encourage you to annotate your code and regs. as we identify problems with the statutory and regulatory language.

Prof. Ashley

Problem 1: Transfers to

Controlled Corporations

Assume that individuals A-E organize new corporation, X, on January 2, 2006. Each transfers to X the assets or cash indicated in exchange for the stock of other property indicated. FMV = 'fair market value' and A/B = 'adjusted basis.'

	Assets Transferred to X		Stock & Assets Issued by X	
	A/B	FMV	Shares	Other Property
A – Cash	\$100	\$100	100	0
B – Land/Buildings	100	200	200	0
C – Inventory (from C's business)	20	40	40	0
D – Patent	20	60	40	20
E – Trucks	60	40	20	20
Totals:	\$300	\$440	400	\$40

Assignment

Read pp 60-83.

Part I: The Basics

- 1) Determine the amount of the gain or loss realized to each transferor as defined in sec 1001.
- 2) Determine the amount and character of any gain or loss recognized to each transferor. This will require you to determine if 351 applies. For the moment you may assume that the shares that X has issued are common voting stock and also assume that the 'control' test has been met. See 7701(a)(1), and also review 1239 and 1245 from the basic tax course as they will help you determine character.
- 3) For each transferor, determine the basis and holding period of the

stock received from X in so far as the facts allow you to do so. See 358(a) and 1223 (1).

4) Determine X's basis and holding period for each asset transferred to X by the transferors. See 362 and 1223(2).

5) Is X's issuance of stock a taxable event? See 1032. See also 118.

6) Sec 351 transactions are supposed to be 'tax neutral' but are they? What possible advantage could the transferors achieve by using 351 to change potential ordinary income into long-term capital gain?

Part II: More on "Control"

1) What would be the tax result is transferor A had transferred \$100 worth of services to X in exchange for 100 common shares instead of the cash? What if A had transferred \$95 worth of services and \$5 in cash? What if A had transferred \$90 in services and \$10 in cash? See 368(c), 351(d)(1), 1.351-1(a)(1)(i), (ii), and -1(a)(2); *Intermountain Lumber*, and Rev. Proc. 77-37 (attached).

2) The 368(c) control test is based in part on ownership of "stock entitled to vote." What does this mean. See 1.302-3(a).

3) Departing from the given facts, determine if the control test has been met under each of the alternatives below. See Rev. Rul. 59-259 (attached).

	Class of Stock	Total Stock Outstanding	Stock Owned By Control Group
Alternative A:	Voting common	100	100
	Non-voting common	100	90
	Non-voting preferred	100	70
Alternative B:	Voting Common	100	100
	Non-voting common	100	80
	Non-Voting preferred	100	80

Part III: Multiple Assets Received

Earlier we saw that transferor D received 40 worth of X stock and 20 in 'other property.' This time assume that the \$40 worth of stock is composed of \$30 worth of voting common shares and \$10 worth of non-voting common shares. Also assume that the \$20 non-stock received is composed of \$5 in cash and \$15 worth of some non-cash asset. (It doesn't matter what it is as long as it's not X stock.) What is D's basis in the common voting stock, the non-voting common stock, the cash and the other property? See 358(b)(1) and 358(a)(2).

Part IV: Multiple Assets Transferred

This is a more challenging transaction. To illustrate the problems encountered here assume that X is incorporated by a single individual, G. Assume that G transferred into X everything that B-E transferred earlier and at the same FMV's and A/B's. Ignore the \$100 cash that A put in. Thus, G transferred in a total of \$340 worth of assets with a combined basis of \$200. Further assume that, in exchange for the land/buildings, inventory, patent and trucks, X transferred \$260 worth of common voting stock to G plus \$80 worth of other property.

Now answer again the questions from Part I. To help guide you see Rev. Rul. 68-55 on page 75. You may round-off your answers to the nearest whole dollar if you wish.

Part V: Transfers of Indebtedness. Read pp 103-112.

As you may recall from studying the case of *Crane v. Comm.*, the presence of debt always complicates things. Study 357 and 358 (d) and then prepare this problem.

a) Assume that the following assets are transferred to Y in a 351 exchange by transferor J. Assume that the \$60 mortgage is a recourse liability and that Y will assume it and issue \$40 in stock to equalize values. What are the tax consequences of these transfers? In other words, what is the gain/loss realized, gain/loss recognized, basis of X stock in J's hands and basis of assets in Y's hands. Pay attention to 357(c)(1) and 358(d)(1).

Asset 1: FMV \$60	Asset 2: FMV \$40
A/B 20	A/B 10
Mtg 60	Mtg 0

b) This time we will change the nature of the debt from non-deductible mortgage to a debt (the account payable) that would be deductible if paid. Assume that K transfers the two assets below to Z corp. Z will pay the payable and will issue \$40 in stock to equalize values.

Asset 1: FMV \$60	Asset 2: FMV \$40
A/B 20	A/B 10
Mtg 0	Mtg 0

Deductible account payable: \$60

Again run the numbers assuming these assets are transferred to Z under 351. Pay attention to 357(c)(3) and 358(d)(2). Even though both J and K transfer exactly the same total FMV, Total A/B and total debt they have different results. Why?