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The 3 shareholders: Under sec 331(a), a distribution to D,E,F, shareholders, in a complete liquidation will be treated as a full payment in exchange for their stock in T and sec. 301 will not apply. The shareholders will recognize a gain on the distribution of 400 cash and their basis in the cash will be 400. 400 distribution amount less 250, their basis in T's stock = 150,000 taxable capital gain to each shareholder as long as T's stock was an investment for each of them.

Under sec. 346(a), a complete liquidation is one of a series of distributions in redemption of all its stock and it is pursuant to a plan. There will be one distribution of 400 to the shareholders. Although there is no formal plan of liquidation that was adopted by T, a plan to liquidate can be inferred because after T sold all its assets, T does not have another business and it only has cash. Also, usually after an asset acquisition, the targeted corporation will be liquidated.

Under 336, a gain/loss will be recognized by T, the liquidating corp, as if the property was sold. T will not recognize any gain or loss because the FMV of cash 1.2 mil and its basis in the cash is 1.2mil = zero gain/loss.

Question 2:

Part A:

Under sec. 351, no gain or loss is recognized to shareholders when property is transferred to a corporation in sole exchange for stock and immediately after the exchange the persons who transferred the property are in control as defined by sec. 368(c).

Hallie, H: H transferred property, Blackacre, to NewCo, a corporation, in exchange for NewCo stock and immediately after the exchange H was a 100% shareholder owning all of the class A stock, the only stock issued at the time, 3/1. H has a realized gain of 350, but she probably will not have to recognize it because of 351. H transferred Blackacre with a mortgage of 750.

Under sec. 357(a), generally, when H, a shareholder, received stock that is permitted under sec. 351 and another party to the exchange, NewCo, assumed H's mortgage, the mortgage is not boot and the transaction is still sec. 351. Boot will not invalidate a sec. 351 transaction, although sec. 351 states "solely" in the exchange for stock because of sec. 351(b).

However, under sec. 357(b), if the nature of the liability is considered and the principal purpose was tax avoidance and not a bona fide business purpose, the liability will be boot. NewCo assuming H's mortgage might be boot to H if H did not use the mortgage to buy the property or improve it but used the mortgage money for her own personal use. Further, under sec. 357(c), the excess of the mortgage (the liability over the adj. basis of the prop) is treated as gain from the sale or exchange of a noncapital asset property. Blackacre is noncapital asset property because it was inventory to H. H is a real estate developer and she had been holding Blackacre to sell to her customers in her development business. The gain is determined by the aggregate of all the property H contributed, since H only contributed Blackacre the basis is 650 less mortgage 750 resulting in a 100 taxable gain to H. H could avoid this if she places an IOU of 100 into NewCo which will increase her basis to 750 (650 plus 100), thus it will allow her to avoid recognizing a gain, or put in higher basis prop. into NewCo.

H immediately after the exchange is in control of NewCo under sec. 368(c) because H possesses more than or equal to 80% of the total voting power of all classes of voting stock, assuming A is voting stock since there was no other stock issued at the time, and H possesses more than or equal to 80% of all other classes of stock because A stock was the only stock issued at the time and H owned 100% of A stock.

The character of the gain will be ordinary as explained above under noncapital asset prop. analysis.

Since this is not a capital asset and if this is not 1231 prop, H's holding period of the stock will

start on 3/1.

H's Basis: Generally, if sec. 351 applies, under sec. 358(a)(1), the stock basis is the carryover basis, 650, from the property transferred to the corporation, NewCo.

If sec. 357(b) applies, 650 less FMV of the boot (assumed liability) of 750 and increased by the recognized gain of 750 = basis in NewCo's stock of 650.

Sec 357(c) applies. The basis 650 less liability assumed 750 increased by gain recognized of 100 = zero basis in stock

Isacc, I: I transferred property, a future promise to perform services for NewCo, and 7,000 cash. Under sec. 351(d), services are not property, but if services and property, 7,000 cash, are exchanged for stock sec. 351 can still apply. For this future promise and 7,000 cash, I received 100 worth of class B stock . However, immediately after the exchange H is not in control of NewCo, if I and H's transaction are viewed as two separate transactions, I might possess more than or equal to 80% of the total voting power of all classes of voting stock, if only B stock is voting, but I does not possess more than or equal to 80% of all other classes of stock because he does not own A stock, under sec. 368(c).

No matter if I ends up with a sec. 351 or not, I will have to recognize a 93,000 ordinary gain because he is a cash basis taxpayer for his services. I will not have any gain or loss on the cash he contributed.

I Basis: His stock basis will be 7,000(7,000 for cash and zero basis for services) under sec. 358(a)(1) if sec. 351 applies.

If sec. 351 does not apply, his basis will be the amount of his contribution of 100 (93 for services and 7 for cash)

The IRS might argue that the property, 7,000 cash, transferred with the services was of a relatively small value in compared with the stock value of 100,000. The cash is less than 10%

of the stock's value; and the primary purpose was for I and H to qualify for sec. 351. if I and H's transactions are view as one. Then H would not be able to meet the control test and H would not get to use sec. 351 and would have to recognize a ord. gain of 350. The basis in the stock will be 1 mil.

NewCo. Under sec. 1032, no gain or loss is recognized on the receipt of property for stock although this is a realization event for NewCo.

Basis in Blackacre - under sec. 362(a), NewCo gets a carryover basis from the shareholder = 650. It will assume the laibility for 750. The holding period will be the same as for H meaning 3/1 under sec. 1223(2). Since H has to recognize at least a 100 gain on the property, the basis will be increased to 750 (650 plus 100). NewCo will be able to depreciate this prop.

Basis in cash = 7,000

Basis in service contract = 93,000 because this is NewCo's cost basis. NewCo will be able to exp this as I does work because NewCo is on accural basis.

Part B:

Question 1: Under sec. 1361, a S corporation is a "small business corporation" that makes an election under sec 1362(a). If NewCo meets the following requirements under sec. 1361(b), it will qualify as a "small business corporation:

1. NewCo does ot have more than 100 shareholders. This is met because H, Hallie and I, Isaac are the only shareholders (2 shareholders).
2. NewCo does not have a partnership or a corporation or an S corporation as a shareholder. All its shareholders are individuals.
3. As long as, H and I are not "nonresident aliens," H and I are fine to be shareholders.
4. NewCo does not have more than 1 class of stock. This is a problem! NewCo has two

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classes of stock A and B which have both been distributed.

Therefore, NewCo will not qualify as a small business corporation, thus not eligible for S corp status.

Question 2: Under sec. 1362, the S corp election would take effect at the beginning of the NewCo's next taxable year 1/1/X2 or if the election is made 2 1/5 months from when the tax year begins meaning when the business was formed, 3/1 (the date H, Hallie, contributed blackacre) meaning May 15, X1, the S corp election will start this taxable year, 3/1/X1.

Question 3:

sec. 318 attribution rules do not apply because Randy, R, and Sam, S, are brother and sister which are not relatives under 318.

Part A:

Stock distribution to S: Under sec 305(a), Generally, S gross income will not include a distribution of stock of C, Cresco, made by C to S with respect to its stock. However, if the distribution meets sec 305(b), (a) will not apply, and the whole distribution will be treated as a distribution of property to which sec. 301 applies. This distribution falls under sec. 305(b)(2) where there is a disproportionate distribution where some of the shareholders have an increase in the assets and E&P of the corporation. Here, S is receiving more stock which allows her to participate in 50% of the E&P and assets while R's % decreased because he received 100 cash. (S got stock while R got property - not allowed). Thus, S's stock will be treated as property for sec. 301.

Under sec. 301, a distribution of property made to C's shareholders with respect to its stock is taxable to the portion of the distribution that is a dividend as defined in sec. 316. a dividend will be taxed to the shareholder at capital gain rates under sec. 1(h)(1) if shareholder meets the