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and they will be taxed on the gains realized. 331. Here each shareholder will receive 400k for 250K basis stock= 150k realized gain. This will be capital; stock which is a capital asset. On a liquidation the E&P of T will disappear.

Q2.

A.

Hallie can qualify for a tax free 351 exchange. She will receive 100 shares of equity stock in exchange for property; she will be in control immediately after the exchange because she will own all of the stock in the company on 3/1/06. The fact that she exchanges property with a mortgage does not effect the applicability of 351. If the purpose of the liability was not tax avoidance then the assumption of the liability by N will not be boot to H. However, for the computation of H's basis in her stock, we consider her basis and count the liability assumed as cash received (if the liability is not something that would be deductible when paid). 357. Here, there would be a negative basis in her stock, so to the extent that the basis is negative, H will be taxed. Here she will be taxed on 100k gain ( $650 - 750 = -100$ ); this gain will be ordinary because she is a real estate dealer and the gain is realized on the sale of real estate. 358. H's basis in her stock is zero. N will obtain a basis carryover basis increased by the amount realized by H here  $650 + 100$  (H's realization) = 750 basis.

I is transferring his services and cash for stock. Because services are not property for 351 purposes, he must contribute a substantial amount of money compared to the value of his services, so that his property contribution is not "di minimis." Di minimis contributions are those of 10% of the value of the stock received or less. Here I contributed 7k in property for stock worth 100k -- this is di minimis, so this transaction does not get 351 treatment. I does not really need 351 treatment because he just put in money... spending money will not be taxable to him.

He will be taxed on his income 93k worth of stock; this is ordinary income. I will get 100k basis in his stock.

Furthermore, there are multiple classes of stock in this corporation, and since the terms of the stock are not given, there is some question as to whether the stock received would be considered common or non-qualified preferred. Common stock grows has unlimited growth opportunity, while preferred may be limited in some way. If there are call or put options between the shareholder and N with regards to his stock, this may also be determinative (such bells and whistles will make the stock non-qualified).

The problem arises for H if the IRS tries to treat these transactions as having occurred in a common plan. If this were the case, then including I in the control group would screw up H's non-taxable transfer of property. I did not qualify for 351 treatment b/c he received stock not solely for property, and possibly not common stock. If they were in the same transaction, then H would not be an 80% owner by value--(250k/350k). However, given the time separating the two transactions, it looks as though the transaction was not coordinated.

N will get the property with a 750k basis (see above). Its holding period in the property will carryover from H. 1223. N will be able to deduct the costs of starting a business 248 allows limited deductions for the costs of incorporation. 195/248. 5k is deductible for start up costs, but as the cost of startup increases beyond 50k, then the 5k is reduced by that amount and the remainder is amortizable for 180 mos. The costs of I's employment contract is deductible as a business expense. N is not taxed on the 7k received.

B.

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N may be eligible to elect S. It must qualify as a small business corp. (not more than 100 SH, individual or eligible entity SHs, and citizens or residents). Its 2 shareholders are individuals, and they probably live in the US or are citizens of the US. However, there are two classes of stock. the eligibility for small business corp will depend upon the differences in the stock terms. differences in voting rights are ignored for purposes of classes of stock however, if the stock rights differ as to their rights to the earnings and profits and rights in liquidation, then the stocks are treated as different classes. this will wreck eligibility.

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If we assume eligibility, then the election will be applicable at the beginning of the next taxable year--jan 1. However, if the election was made in the first 2.5 mos of this taxable year then the election would be retroactive. It is not clear when that would be--but probably on may 15th (2.5 months from 3/1/06 when the corp had shareholders) if the election were made in this timeframe, the consent of H only would be needed because she would be the only shareholder. If this happened then I's receipt of shares may wreck or "terminate" the S election if the shares were a second class of shares. This will lead to a bifurcated year for tax purposes.

Q3.

A.

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The planned distribution of 100k to R and 10 shares to S will be a 301 distribution to both shareholders. Normally distributions of stock are not taxable--305 allows proportionate distributions to be excluded from gross income. However, here R is receiving cash while S is receiving stock: the distribution has the effect of changing the proportionate share of ownership of C. 305(b2). Therefore the distribution is a 301 distribution and taxable as a dividend to the extent of E&P. The distribution amounts are 100k to R and about 82k in stock to S for a total of 182k in distribution.

Here there is E&P of 175k current and 50k deficit. Therefore, the 182k reduces the current

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