**Corporate Tax I & II Outline**

**Fall 2020 – Malman**

**I. Introduction:**

* Why Tax Corporate Income:
	+ Classical System:
		- This means there is a double tax – 2 levels
			* Taxed at the corporate level;
			* Taxed again at shareholder level when distributed.
		- Corporations are taxable entities; individuals are taxable entities; partnerships, etc. are not.
		- Rates found in § 11(b).
			* 21% flat rate now.
		- The highest individual rate is 37%.
* Distortions:
	+ Does it incentivize people to do things they wouldn’t do without the tax?
		- Affects behavior: it is not efficient if it affects/influences behavior.
			* Efficiency according to economists does not affect/influence behavior.
* Who bears the burden of the tax:

**II. Distributions:**

* Process:
	1. Start with § 301;
	2. Go to § 316;
	3. Then § 312.
* Cash Distributions:
	+ § 301: covers distributions of property.
		- § 317: defines property:  money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock).
		- The amount of the distribution is the value of the property distributed.
		- Amount Taxable:
			* § 301(c)(1) – Amount Taxable as Dividend
			* § 301(c)(2) – Basis Recovery
			* § 301(c)(3) – Amount in excess of basis taxed as gain.
	+ § 301(c)(1) – Amount Taxed as a Dividend:
		- § 316 Defines Dividends:
			* A dividend in a distribution to shareholders in their capacity as such made out the earnings and profits.
			* Earnings & Profits:
				+ This is the corporation’s self-generated wealth.
				+ If there is sufficient EP, can make a dist. without dipping into capital.
				+ Presumption: every distribution is treated as coming out of EP to the extent there are EP;
				+ Presumption: every distribution is treated as first coming out of the current year EP and then out of accumulated EP.
				+ Computation:

Start with Taxable Income

Add in:

Municipal bonds - § 1.312-6(b);

LTCG - § 312(f);

Less:

Deductible Business Expenses

Loan expense for muni bonds;

LTCL -  §312(f);

Taxes owed

Note: a 1031 gain is not taken into account for EP calculation – 312(f)(1) & 1.312-7(b)(1).

* + - * + 4 Categories for Adjustments to EP

1) deductions that do not reduce EP;

2) Deductions that are not allowed for tax but reduce EP;

Items excluded from TI that are included in EP

E.g., muni bond interest

4) Items included in TI but not EP

Installment sales

* + - * + When do we look at EP:

§ 316(a)(2): current EP is determined at the end of the year and without regard to distributions made during the year.

* + - * + Ordering Rules:

§ 1.31602: if distribution is greater than EP, a proportion of each distribution of which the total EP bears to the total distribution is regarded as made out the EP for that year. The portion of each distribution

Fraction: EP/total amt. of dist. X Dist. to each SH = amt. from EP treated as dividend.

* + - * + Timing Issues:

RR 62-131: the date when the transfer occurs, not declaration, governs the date of distribution of a dividend.

* + - * + Accumulated Deficit & Positive Current Year EP:

§ 316 tells us there is no change to our analysis ­– we use current EP to measure dividend without regard to anything else.

Nimble Dividend Rule:

Even though there is a deficit accumulated, there will be a dividend currently because there is current EP.

RR 74-164, Sit. 2; Reg. 1.316-1(a)(1)

* + - * + Positive Accumulated EP & Current Year Deficit EP:

Pro rata for deficit. Take current year deficit and pro rata it to the distribution and take that deficit into account.

So count the number of days, divide by 365 and multiply by the amount of the current E&P deficit

Then we use accumulated E&P to offset that equation amount and the remainder can be used for dividend

RR 74-164, Sit. 4; Reg. 1.316-2(b)

* + - * + Charter Rules:

If there is a preference to a certain class of stock, the dividend is applied to that class first, to the extent there are EP.

Then, to the extent there are EP remaining, applied to the distribution to common shareholders.

RR 69-440

* + § 301(c)(2) – Basis Recovery:
	+ § 301(c)(3) – Gain to extent distribution exceeds basis:
		- Rules for taxing capital gain - § 1221 – is it a capital asset?
			* If capital asset – ask how long
				+ Held more than 1 year – then treated as LTCG and 20%
				+ Held less than a year – STCG and ordinary income rates
	+ Tax Consequences to Corporation:
		- § 312 tells us that we reduce E&P by amount of distribution to the point it exists, but not below zero.
* Non-Cash Distributions:
	+ Look to § 317 to determine whether the distribution is of property.
	+ Effect to Corporation:
		- § 311 provides that No g/l will be recognized to a corp. on the distribution, not in a complete liquidation, with respect to its stock of (1) its stock (or rights to acquire stock) or (2) property
			* Still need E&P for it to be treated as a dividend
		- **Exception** – Appreciated Property § 311(b)(1):
			* If FMV of property exceeds adjusted basis in the hands of the distributing corporation, then gain will be recognized to the distributing corporation as if it was sold to the distributee at its FMV.
				+ Gives us an interim E&P (see below)
				+ General Utilities and Operating Co. v. Helvering says this too
				+ Character on gain 🡪 as if actual sale, so look to the property & holding period.
			* Loss is not recognized.
				+ Better to sell built-in loss property, recognize the loss, and dist. the cash rather than distributing built-in loss property to the shareholder.
		- Debt Relief/Assumption of Debt by Distributee - § 311(b)(2)
			* Amount realized for the corporation and treatment of liability - §311(b)(2) 🡪 § 336(b)
				+ AR includes any debt assumed (recourse and non-recourse) and the greater of:

The FMV of the property or the amount of the liability

* + - * The debt reduces the distribution amount by the amount of the debt.
			* Shareholder’s Basis = FMV
				+ Basis in property where debt is attached (recourse and non-recourse) is FMV, not reduced by any debt attached to the property – Crane v. Commissioner
		- Corp. Distribution of its own obligation (bonds)
			* No pretend sales under § 311(b)(1)(A) 🡪 excludes obligation of such corporation
				+ So no gain or loss under § 311(a)

Sec. 311(b) doesn’t apply, so 311(a) applies

* + - * It is not taxable if it is an obligation of the corporation.
			* Shareholders would have a distribution in for the FMV of the property.
	+ Effect to Earnings & Profits:
		- Interim EP:
			* When FMV exceeds AB of property
				+ This means that the E&P will be increased by the profit from distributing the property and then reduced by the amount of taxes paid on the gain – this gives us the interim E&P, which we use in determining the distribution as dividend v. not dividend for TP
				+ If there’s liability attached to the appreciated property, reduce the FMV of property distributed by liabilities the property distributed was subject to - § 312(c) 🡪 § 312(b)
			* No interim adjustment when AB exceeds FMV
				+ No adjustment for distribution of corp.’s own obligation
		- Final E&P
			* Step 1:
				+ FMV exceeds AB of property - § 312(b)(2) go to § 312(a)(3)

Reduce E&P by the FMV of the property

* + - * + AB exceeds the FMV of the property - § 312(a)(3)

Reduce E&P by the AB of the loss/depreciated property distributed

* + - * + Distribution of Corp.’s own obligation - § 312(a)(2)

Reduce E&P by the face/principal value

* + - * Step 2:
				+ Assumption of liability - § 312(c)

Adjust E&P upward for the amount of liability distributed

* + Effect to Shareholders:
		- Under § 301(a), property distributions are treated as § 301 distributions
		- Amount distributed to SH - § 301(b)(1) & (2)
			* Amount distributed = $ money received + FMV of other property received – [liabilities assumed by SH] – [liabilities attached to the property]
				+ FMV determined as of the date of the distribution - § 301(b)(3)
* Constructive Dividends:
	+ Overview:
		- Constructive Dividends: the IRS can recharacterize distributions/payments not characterized as a dividend by the corporation.
			* This is an attempt to avoid 1 level of the corporate tax.
		- 3 Categories:
			* 1) corporation maintains that money coming into it does not give rise to income;
				+ Corp. rents out building and directs tenant to pay shareholders directly.
			* 2) corporation maintains that outflows do not give rise to SH income – i.e., not a dividend;
			* 3) While there is an outflow, it is a deductible outflow.
	+ Analysis:
		- Is it a constructive dividend?
			* The IRS will look at substance over form.
			* In what capacity was the distribution made?
				+ Was the shareholder receiving the distribution in his shareholder capacity or employee capacity?

If as shareholder, then it would be a distribution.

If as an employee, would be compensation (deductible to corp.)

* + - * Reg. 1.301-1(j) and RR 58-1 – applies to below market sales
				+ The excess of fair rental value or FMV over the amount of rent or amt. paid by each shareholder is treated as a distribution by the corporation under § 301.
				+ Rest of transaction is treated as a sale – so take basis of what they paid under § 1012

If a Corporate SH, get DRD still

* + - * *Weigle* Factors:
				+ 1 – The taxpayer's degree of control over the corporation;
				+ 2 – The existence of restrictions on the amount of disbursements;
				+ 3 – The corporate earnings and dividends history;
				+ 4 – The use of customary loan documentation, such as promissory notes, security agreements or mortgages;
				+ 5 – The ability of the shareholder to repay;
				+ 6 – The treatment of the disbursements on the corporate records and financial statements;
				+ 7 – The creation of legal obligations, such as payment of interest, repayment schedules, and maturity dates;
				+ 8 – The corporation's attempts to enforce repayment; and
				+ 9 – The shareholder's intention or attempts to repay the loan.
		- If it is a constructive dividend 🡪 Effect on Shareholders:
			* It is treated and taxed as if it was a § 301 distribution.
			* If multiple SHs receive distribution, spread the deemed distribution among the SHs
			* Transfer/use of property to SH for less than FMV – Reg. 1.301-1(j) and RR 58-1
				+ Discount price is treated as § 301 distribution

Pretend property (discounted portion) is the § 301 portion

SH basis in the land = FMV - §§ 301(d) and 1012

Excess value is treated as “pretend property” and added to the property purchased, so SH ultimately takes a FMV basis in that portion of the property

Get credit for the taxed portion of the property

* + - If it is a constructive dividend 🡪 Effect on Corporation:
			* Two things going on
				+ Realized and recognized gain from the sale - § 1001
				+ Distribution of “Pretend (Appreciated) Property” - § 311(b)
			* Steps in process
				+ Step 1: determine basis proportions

Bifurcate basis – Reg. 1.61-6(a)

Allocate basis in the property b/t the actual property and pretend property distributed, in proportion to the FMV of the property

AR of actual property/fmv = % of basis

AR of pretend property/fmv = % of basis

* + - * + Step 2: allocate basis

Multiple percentage obtained in proportions by the AB of the property in order to obtain the AB for each property

* + - * + Step 3: Determine Gain

AR – basis = § 1001 gain for actual property (taxable)

FMV – basis = § 311(b) taxable gain for pretend property (disguised dividend)

* + - * + Step 4: E&P Adjustments

Interim E&P § 312(b) = Current E&P + Step 3 § 1001 gain on sale + Step 3 § 311(b) gain on deemed distribution of appreciated property – tax paid on both

Final E&P § 312(a) = interim (above) – FMV of pretend property distributed (the discount or excess amount)

* Dividend Received Deduction (DRD) – § 243:
	+ § 243: Allows a corporation to take a 50% deduction for dividends received.
		- Increased to 65% if the corporation owns between 20% and 80% of the corporation making the dividend.
		- Increased to 100% if the corporation making the dividend is part of the same affiliated group.
			* This means owns 80% of vote or value.
	+ Limitations on the DRD:
		- § 246(c): Holding Period Requirement:
			* Designed to prevent tax arbitrage – conforms the tax results with the economic results by denying the DRD.
			* Don’t get DRD unless corporation holds the stock for 46 days out of a 91-day time period
				+ Take the ex-dividend date – the last day to buy the stock and get a dividend.

Count 45 days before

Count 45 days after

Have to hold for 46 days during the 91-day time span

* + - * + Specificities in days to count

Sec. 246(c)(3)(A) – don’t count the day of acquisition BUT can count disposition

* + - § 1059 – Extraordinary Dividends
			* If a corporate SH receives an extraordinary dividend and has not held its stock for more than 2 years before the dividend announcement date, corp. ***SH must reduce basis of its stock by the portion of the dividend that goes untaxed.***
				+ Cannot go below 0;
				+ If DRD > TP’s basis

The excess is treated as gain from the sale of the stock.

* + - * + Triggered by the existence of an ***extraordinary dividend***.

This is a dividend that exceeds certain thresholds:

Equals or Exceeds 5% of TP’s basis in the preferred stock;

Equals or Exceeds 10% of the TP’s in the common stock.

§ 1059(c)(4): TP can apply these percentages to the FMV of the stock on the day before the ex-dividend date.

Would make sense if the stock has appreciated in value in the TP’s hands, this would avoid extraordinary dividend treatment.

* + - * + Aggregation rules:

(c)(3): all dividends received by TP with ex-dividend dates within 85 days of each other are considered 1 dividend.

All dividends within 1 year shall be treated as extraordinary dividends if the aggregate of such dividends exceeds 20 percent of the taxpayer's adjusted basis in such stock

* + - * + Exceptions:

If TP held the stock for the entire life of the corp, §1059(a) does not apply. (look at 1059(d)(6).)

* + - * + Holding Period Requirement:

Must hold for more than 2 years before dividend announcement date to avoid 1059.

* + - Recharacterization of Sham Dividends:
			* Re-characterization Factors – RR 75-493
				+ Timing
				+ Plan or not
				+ Source of funds
				+ Business purpose of transaction
			* *Waterman Steamship* and *Litton Industries* Cases:
				+ *Waterman*:Dividend was a sham, so no DRD and treated as part of purchase price. Note/debt they issued to the target was clearly part of a tax avoidance plan – occurred nearly simultaneously with the sale. The money really came from the purchaser.
				+ *Litton*: the biggest difference between Litton and Waterman was that the dividend dist. of the note and the actual sale of business were substantially separated in time – more than 6 months.

And at the time of the dist. even though the corp wanted to sell the stock, it hadn’t yet come up with a plan to sell the stock.

And there were business purposes to make the dist.

b/c considering a sale, wanted to ensure they didn’t have to share the EP with a potential buyer.

* + - * + *TSN Liquidating*:

The buyer didn’t want certain investments. Those assets were dist. by dividend to parent. There was a real purpose of stripping out some of the assets in the sub and having the dist. treated as a dividend.

**III. Redemptions:**

* Not Essentially Equivalent to a Dividend & Substantially Disproportionate Redemptions
	+ § 317(b): For purposes of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired, or held as treasury stock.
	+ § 302(a): if you fit into a 302(b) category, it is an exchange. If not, § 302(d) states it is a §301 dividend.
	+ Analysis:
		- § 302(b)(3): Was there a complete redemption of the SH’s shares?
			* Look at complete termination section below.
		- § 302(b)(2): Was there a substantially disproportionate distribution?
			* Test:
				+ After redemption:

1) Redeemed SH must own less than 50% of the voting stock.

2) Disproportionality:

1 – figure out the proportion of voting stock owned after the redemption.

2 – Compare that to the proportion of voting stock owned before the redemption.

3 – Divided the percentage of shares **after** by the percentage of the shares **before**

If less than 80% - substantially disproportionate treatment

If equal to 80% or more – 301 treatment, unless satisfies another safe harbor

The redemption is dipropionate if the proportion of the voting stock held by the SH after the redemption is less than 80% of the proportion held before – i.e., must reduce by more than 20%.

* + - § 302(b)(1): Not Substantially Equivalent to a Dividend
			* In order to be a redemption there must be a meaningful reduction in the interest of the shareholder
			* So, if no meaningful reduction – is equivalent to a dividend
			* Rev. Rul. 75-502
				+ Went from 57% ownership to 50% ownership
				+ This is a meaningful reduction – goes from majority to deadlock
				+ This means it is a redemption
				+ Rev. Rul. said if not for reduction to deadlock position – 7% would not normally be meaningful
			* Rev. Rul. 76-364
				+ Shareholder previously had 27% of stock
				+ Other 3 shareholders had 24% each
				+ He had the powerful swing vote
				+ Losing this swing vote power was a meaningful reduction
			* Rev. Rul. 78-401
				+ Reduction from 90% to 60%
				+ Could not control some supermajority votes
				+ However, were no super majority problems imminent
				+ So, was not considered meaningful by the IRS
			* Rev. Rul. 76-385
				+ Teeny to Tiny Rule
				+ Any reduction, no matter how small is meaningful
				+ If minority holder in a publicly traded company
				+ THIS IS IMPORTANT
			* Rev. Rul 77-426:
				+ fit into (b)(1) so long as TP owned no other stock directly or indirectly.
				+ Redemption of any amount of . . . meaningful reduction of SH proportionate redemption under (b)(1).
		- Sale of preferred can be piggy backed onto the sale of the common 1.203-3(a): any sale of preferred at the time of the redemption of common which meets 302(b), will just tag along and get exchange treatment.
		- Aggregation Rules:
			* Rev. Rul. 85-14:
				+ If one redemption is casually related to the other redemption, you will take the aggregate of the 2 redemption.
				+ Measure whether there was a sufficient redemption after all of the transactions.
				+ Does not have to be a true plan – can plan by one’s self.

Essentially, the plan needs to be to have more than 50% of control after the transactions.

Just need a causal relationship – the person engaged in the transaction knowing that the other transaction was going to happen.

* + - * Step Transaction – Look at whether there was:
				+ 1) A binding commitment: you look at A’s redemption by taking into account B’s redemption only if there was a binding commitment to have that chain of events;
				+ 2) mutual interdependence test: one step is meaningless without the other step – A would not have done it without;
				+ 3) End Result: was the intention of the transaction to get a certain result, which result included the effects of B’s sale as well.
		- Sale/Exchange Treatment – if it satisfies § 302(a):
			* Tax consequences to Corporation:
				+ If it is treated as a § 301 distribution, § 312(n)(7): limits the amount of the reduction to EP.

Creates a lesser of rule:

Reduced by the lesser of:

Amount distributed; or

Pro rata amount of E&P attributable to these shares

* + - * + Recognizes gain on distribution of appreciated property in redemption of stock, but may not recognize loss on a distribution - §§ 311(a), (b)
			* SH will get a “cost basis” under 1012 of the property received – which will be FMV of the redeemed stock (generally the same as value of the distributed property)
		- § 301 Distribution Treatment -  §302(d):
			* Follow steps of 301 distribution above
			* Under 301(c)(2), reduce basis of stock by non-dividend portion
				+ BUT – TP essentially sold some of his stock back, so there’s missing basis

Reg. 1.301-2(c) – take some of the basis that TP would never otherwise get to recover and ‘tack’ it onto the remaining shares and reduce based off of this tacked amount

Basis: if the redemption is treated as a distribution, the shareholder’s basis is shifted to the shareholder’s remaining shares.

* + - * SHs basis of property will be the FMV of the property - § 301(d)
		- Extraordinary Dividends – may apply is shareholder is a corporation:
			* § 1059(e): this is an extraordinary divided because it is not a pro rate redemption; as a result, only the basis in the stock redeemed shall be taken into consideration under § 1059(a), without regard to the holding period.
				+ Any distribution which is:

Part of a partial liquidation

Not pro-rata to all shareholders

Which would not be treated as a dividend under 318(a)(4) or 304(a)

Any amounts treated as a dividend with respect to such redemption shall be treated as an extraordinary dividend

* Attribution Rules – 318 – & Complete Termination:
	+ Attribution Rules:
		- § 302(c) provides that the attribution rules of § 318 are applicable.
* Attribution rules are in § 318
	+ Sec. 318(a)(1) 🡪 members of the family
		- Spouse, children, grandchildren, parents

No attribution from sibling to sibling –  §318(a)(1)(A).

* + - Sec. 318(a)(5)(B) 🡪 no double attribution between family members
			* Stock attribution from one family member to another – can’t be attributed to third family member

Can’t go from brother to dad to A.

* + - * Family hostility is not taken into account.
	+ Sec. 318(a)(2) 🡪 attribution from entities to beneficiaries
		- Sec. 318(a)(2)(A)
			* Stock owned by a partnership or trusts will be considered as owned proportionately by its partners or beneficiaries
				+ THIS STOCK CAN THEN BE ATTRIBUTED TO FAMILY MEMBERS

318(a)(5)(C) prevents 318(a)(2)(C) and then 318(a)(2)(A).

* + - Sec. 318(a)(2)(C)
			* Stock owned by a corporation is deemed owned by SHs in proportion to the value of their interests in the corporations, but only if they own 50% or more of the corporation’s stock, either actually or constructively
	+ Sec. 318(a)(3) 🡪 Beneficiary to entity attribution
		- Attribution rules to partnerships, estates, trusts, and corps.
		- All of a beneficiary’s shares are going to be attributed to the entity
		- Sec. 318(a)(5)(C) 🡪 no sideways attribution or double attribution through an entity
			* Can’t attribute from Bob to X Co to Sue via X Co
	+ Sec. 318(a)(4) 🡪 option to acquire stock will be considered owned by that person
		- Sec. 318(a)(5)(D) – stock considered owned by an individual under (a)(4) can be attributed to another person
		- Treated as if own the stock 🡪 then we also increase the number of “outstanding” shares
	+ Complete Termination – § 302(b)(3):
		- Redemption that completely terminates a SH’s actual and constructive stock interest in the corporation is treated as an exchange
			* If corp. distributes its debt obligations in exchange for stock, Service may contend that the SH has not terminated equity interest
			* Attribution rules will be taken into consideration for determining if there is a complete termination of the shareholder’s interest
		- If fails attribution rules and no complete termination, end up with § 301 treatment
			* So what happens when there is a complete termination, not enough E&P for it all to be a dividend, and supposed to reduce basis – when there is no basis to reduce?
				+ Current rule – Reg. 1.302-2(c)

If attribution prevents sale/exchange treatment and SH’s interest is completely terminated, then the basis of the property owned by the terminated SH is ‘flipped’ to the other family member(s) attributed

* + - * + Prop. Reg. 1.302-5(b)

TP holds onto the amount as a deferred loss waiting to recognize until the inclusion date

The inclusion date is the day on which the attributed stock is sold enough for TP to meet Sec. 301(b)(1), (2) or (3)

**Blank won’t make us apply this on the exam, but I’m too pissed to take it out**

* + - Family attribution rules can be waived in a complete termination – § 302(c)(2):
			* Requirements:
				+ 1) No Prohibited Interest:

distributee (redeeming shareholder) can have no interest in the corporation immediately after the redemption other than as a creditor.

Including as officer, director, or employee.

Regs say distributee cannot have greater rights after the redemption than those necessary to enforce his claim as a creditor and cannot be proprietary in any sense.

There are often fines lines between debt and equity – rules say it must be real debt and not equity.

Payments cannot depend on corporate earnings.

Interest cannot be tied to earnings.

* + - * + 2) Shareholder cannot acquire a prohibited interest in corporation within 10 years

Other than stock acquired by bequest or inheritance.

* + - * + 3) Shareholder must file an agreement to notify the IRS of an acquisition of a prohibited interest and to maintain records of the transaction.

If a prohibited interest is acquired within 10 years, the statute of limitations stays open for a year after the shareholder notifies the IRS; if the shareholder fails to notify the IRS, the SOL stays open permanently.

* + - * Family hostility is not taken into account.
		- *Zenz* & RR 77-447:
			* It does not matter whether a sale or redemption occurred first – looks at end result – was the substance a complete redemption?
				+ If so, it is a complete redemption.
			* Fair to say and logical to say the longer the timeframe between the exchanges and sales the less it looks like an integrated transaction.
				+ Could be counter-balanced by facts to support an integrated transaction.

Compare to step-transaction doctrine

Binding commitment to engage in such transaction.

* + - * A combination of redemption and sale to 3rd party makes it easier for our selling T to have the redemption treated as a sale/exchange.
	+ What happens when the remaining shareholders’ interest is increased:
		- Generally, this is not taxable.
		- However, if the shareholder is under a primary and unconditional obligation to purchase the other shareholder’s shares and the corporation satisfies that obligation, it is treated as a constructive dividend.
			* RR 69-608: the fact that the corporation in purchasing the shares satisfies the continuing shareholder’s executory contractual obligation to purchase the redeemed shares does not result in the distribution to the continuing shareholder provided that the continuing shareholder is not subject to an existing primary and unconditional obligation to perform the contract and that the corporation pays no more than FMV for the stock redeemed.
			* If the corporation purchases the shares before the obligation ripens into an unconditional obligation, or if the shareholder is only secondarily liable, the purchase by the corporation would not result in a constructive dividend.
			* Common for death, retirement, disability or divorce.
		- Drafting tip: language along the lines of: “buy or cause to be redeemed. . .”
			* This does not cause an unconditional obligation and provides an out.
* Redemptions by Related Corporations – § 304:
	+ § 304 General overview:
		- Rules covering scenario where a related corporation purchases stock and will be treated as a redemption. The concern is that shareholder controls the corporation from which he is receiving sales proceeds. Once recharacterized as a § 304 Redemption, it is governed by the rules of § 302.
			* Two Categories: (i) acquisitions by related corporations other than subs; and (ii) acquisitions by subs.
	+ Acquisitions by Related Corporations (Brother/Sister Transaction) – § 304(a):
		- 
		- Terms:
			* Acquiring Corp. – the corp. acquiring the shares in exchange for property
			* Issuing Corp. – the corporation who originally issued the shares that are being exchanged
			* Transferor – SH who controls both the acquiring corp. and issuing corp.
		- Requirements:
			* 1) 1 or more persons need to control both corporations;
			* 2) one corporation needs to acquire stock from a person or persons in control of the other corporation in return for property.
		- § 304 creates a fictional redemption and as a result it is analyzed under § 302.
			* 1) Need stock for property:
				+ Property does not include stock of the acquiring corporation;
				+ Cash is included in § 317(a).
			* 2) Control Requirement:
				+ § 304(a)(1)(A): one or more persons are in control of each of two corporations,

§ 1.304-5: only the persons who control the corporation both before and after

* + - * + What is control:

§ 304(c): 50% vote or value.

Proposed Reg. § 1.304-2(a)(1): need control before; need a sale for property; and need control after.

§ 318 Attributions rules apply, with modification:

Attribution to Shareholder:

Sec. 304(c)(2)(C) changes the 50% to 5% for up- and down-stream attribution but ONLY for purposes of control

Attribution to Corporation –  § 318(a)(3)(C)

So from corporation – SH owns at least 5% there is full downstream attribution to the corporation

Stock Acquired in the Transaction:

§ 304(c)(2)(A): Where 1 or more persons in control of the issuing corporation transfer stock of such corporation in exchange for stock of the acquiring corporation, the stock of the acquiring corporation received shall be taken into account in determining whether such person or persons are in control of the acquiring corporation.

The consideration of 10 shares of stock is not part of 304 because not property for this purpose.

* + - * 3) § 302(b) Analysis:
				+ The deemed redemption is of the ***acquiring*** corporation’s stock.
				+ Test whether the pretend redemption reduced the transferor’s proportional interest in the ***Issuing*** Corporation was sufficiently reduced.

If none of the § 302(b) exceptions are met, no sale/exchange treatment. Move to § 301 Analysis below.

* + - * + Watch out for attribution.
				+ Look at X’s ownership of X before then after the sale.
			* 3) Fictional Redemption is analyzed under § 301:
				+ SH:

1) Pretend that transferor transferred Issuing Corp. shares to the acquiring corporation in exchange for acquiring corp. shares in a § 351 transaction – no g/l recognized here.

SH Basis in acquiring corp. shares: same as in the issuing corp. stock – 358; Corp. takes SH basis - § 362.

2) Now Acquiring Corporation is treated as redeeming the Acquiring corp. shares from the transferor - § 301(c) analysis here:

§ 301(c)(1): Look at the EP of Acquiring Corp. first then to EP of Issuing Corp. This is the dividend amount.

§ 302(c)(2): basis recovery:

Prop. Regs says to allocate the basis recovery pro rata between pretend shares.

# Real Shares / total shares X Amt.

# Pretend Shares / total shares X Amt.

* + - Basis
			* Shareholder/Transferor:
				+ If § 302 sale/exchange treatment

Basis in stock sold – for determining gain

Take AB in the Issuing Corp. stock – Prop. Reg. 1.304-2(a)(5)

Take SH’s basis in Issuing stock and treat that as Basis in pretend Acquiring stock – Prop. Reg. 1.305-2(a)(5)

AR – AB (in Issuing Corp. stock) = gain recognized to SH

Basis in Acquiring Corp. Stock the SH still holds

Basis in Acquiring Corp. stock – stays the same for the real stock

Treat as sale. SH is deemed to own two things

Pretend Acquiring Corp. stock

Real Acquiring Corp. stock

SH sells pretend stock

SH retains real stock

* + - * + If § 301 distribution treatment 🡪 see above
			* Acquiring Corp. POV – if § 304 turned on
				+ Basis in “Issuing Corp.” stock

If gets § 302 sale/exchange treatment 🡪 § 1012 🡪 just gets normal “cost basis” in the stock

Prop. Reg. § 1.304-1(a)(5): confirms this. Gets what it paid for the stock.

If gets § 301 distribution treatment 🡪 Sec. 351 treatment under § 304(a)(1)

Under § 362 🡪 basis in Issuing Corp. SHs – same as in hands of SH

Do not increase basis based on any gain recognized under § 304 because under § 362(a), the gain will not be recognized/occur “on such 351 transfer”

* + - * Issuing Corp. POV – if § 304 turned on
				+ § 302 sale/exchange treatment

Nothing really happens. There is just a new owner of its stock.

* + - * + § 301 distribution treatment

Nothing really happens, except E&P may be reduced (if Acquiring Corp. E&P depleted)

* + Acquisitions by Subsidiaries – § 304(a)(2):
		-  
		- If in return for property, one corporation acquires from a shareholder of another corporation stock in such other corporation, and the issuing corporation controls the acquiring corporation, then such property shall be treated as a distribution in redemption of the stock of the issuing corporation.
			* There is another pretend § 304 transaction.
		- Analysis:
			* 1) Stock for Property?
			* 2) Control:
				+ 50% of vote or value.
				+ § 318 Attributions rules apply, with modification:

Sec. 304(c)(3)(B) changes the 50% to 5% for up- and down-stream attribution but ONLY for purposes of control

So from corporation – SH owns at least 5% and less than 50% - attribute proportionally

If SH owns 50% or more – full downstream attribution to the corporation

Ex: picture above – D would be treated as owning 16% of S through attribution: 45% X 35% (P shares owned by S).

* + - * 3) § 302 Analysis – same as above.
			* 4) If no § 302 exchange treatment, look to § 301.
				+ § 301(c)(1): dividend.

Look to EP of Acquiring Corp. first then to EP of Issuing Corp.

* + - * This is the end of the analysis for our purposes.

**IV. Stock Dividends – § 305:**

a. 305(a) general rule: stock dividends are not included in gross income/taxable

* Eisner v. Macomber – this very proposition
* Koshland – preferred holders got shares of common stock
	+ This is taxable because it changes their interest
	+ Now have common stock
	+ Also decreases common stockholders’ interest/increases the preferred stockholders’ proportionate interest.
* Distinguishing between classes of stock:
	+ We don’t distinguish based on the vote. Instead, look at the taxpayer’s interest in the EP and assets at liquidation.
		- Priority leans toward preferred stock.
* Exceptions (i.e., taxable):
	+ § 305(b)(1) – Distributions in Lieu of Money:
		- If distribution is electable as stock or property by SH
			* Can affect proportion of ownership of stock
			* *Doesn’t matter if nobody actually elects for the cash or not*
			* A debt instrument is property.
		- SH who receives cash will be taxed under § 301
		- SH who receives stock will be taxed under §§ 305(b)(1) and 301 as if SH had received cash and used it to purchase additional shares
			* Amount of § 301 distribution to SHs receiving stock is the FMV of the stock 🡪 Reg. 1.305-1(b)
		- § 311 – no income to the corporation.
	+ § 305(b)(2) – Disproportionate Distributions:
		- Requirements:
			* 1) receipt of property by some shareholders; and
			* 2) an increase in proportionate interest of other shareholders.
		- Companion distribution of property and shares
			* Affects proportion because one increases ownership while other doesn’t
		- Those who increase their proportionate interest via stock are taxed on the value of the increased interest
			* Not concerned with increased voting rights or control; only concerned with increase in share of current earnings or percentage of assets at liquidation.
		- Cash and stock distributions can have a disproportionate effect, even if not pursuant to a plan and unrelated
			* If separated by more than 36 months 🡪 presumed to be beyond reach of § 305(b)(2) unless made pursuant to a plan – 1.305-3(b)(2), (4)
		- Cash for fractional shares:
			* Reg. § 1.305-3(c): if a corp. declares a dividend payable in stock and dist. cash in lieu of fractional shares, then 302(b)(2) does not apply if the purpose of the purpose of giving cash in lieu of fractional shares is to save the corp. the trouble, expense, and inconvenience of the fractional shares and is not for the purpose of increasing the proportional interest of shareholders.
				+ If the total cash distribution made in lieu of fractional shares is 5% or less of the FMV of the stock distribution, it is a qualified purpose.
			* The fractional shares are treated as redeemed and analyzed under § 302.
				+ This typically only arises in a widely held/public company.

So it is likely it will be a 302 redemption because of the teeny to tiny rule.

So likely sale treatment.

* + - Preferred on Common:
			* Not concerned with increased voting rights or control; only concerned with increase in share of current earnings or percentage of assets at liquidation.
			* The common shareholders now have a greater interest in the assets and earnings of the corp. because of the new preferred shares dist. to them.
			* Reg. § 1.305-3(b)(2) tells us that preferred dividends paid can be property for this purpose.
			* This would be a distribution and analyzed under § 301.
	+ Sec. 305(b)(3) – Distributions of Common and Preferred Stock
		- Receipt of preferred stock by some common SHs and receipt of common stock by other common SHs
		- Taxable because not proportionate interest distribution
		- **BUT** if there is only common outstanding at the time of distribution of preferred stock, it is not a distribution because it does not change their proportional interests.
			* Reg. § 1.305-7(a): proportion old basis based on FMV to new shares.
	+ Sec. 305(b)(4) – Distributions on Preferred Stock
		- Distribution on preferred stock is going to be taxable
			* Preferred stock is any stock which does not participate in corporate growth to any significant extent and has limited rights and privileges – Reg. 1.30-5(a)
		- Not taxable if it’s an increase in conversion ratio of convertible preferred stock
		- If it can be reasonably anticipated the preferred will participate beyond the limited nature, it is not preferred.
	+ Sec. 305(b)(5) – Distributions of Convertible Preferred Stock
		- Can affect proportionate interest because can choose what kind of stock to have.
* Sec. 305(c) – certain transactions treated as distributions – deemed distributions
	+ If a redemption increases the proportional interest of one class of shares of another class, you could have a deemed distribution.
	+ The redemption is treated as if there had been a stock distribution.
	+ Reg. 1.305-7(a) 🡪 taxable under 305(c) if have a result described in § 305(b)(2) – (5)
		- Deemed stock dividend if …
			* Specified act occurs and
				+ I) Change in Conversion ratio

Conversion ratio is the rate at which a security may be converted into a security of another class

But changes to conversion ratio to prevent dilution are not deemed stock distributions under § 305(c)

Where there is a dist. of common on common and no change to the preferred conversion ratio, there is a change to the proportional interests the different classes of stock.

An anti-dilution feature would stop this from happening.

i.e., increase the conversion ratio so that it stays the same.

Conversion ratio can also be increased when there is a dist. of cash – can change conversion ratio to take the new FMV into account.

* + - * + II) Change in redemption price
				+ III) Difference between redemption price and issue price
				+ IV) A redemption which is treated as a distribution to which 301 applies

Corporation is deemed to have made a stock distribution to the SHs whose interests have been increased – Reg. 1.305-7(a)

* + - * + V) Any transaction having a similar effect on the interest of any SH
		- Increase in proportionate interest in assets OR earnings of at least one SH
			* Reg. 1.305-3(b)(6) 🡪 two classes of stock and stock is redeemed from one class and 301 distribution is the result – in cases where there’s more than one stock outstanding, each is to be considered separately for determining increase. S/hs will be deemed to have an increased interest if the stock as a whole has an increase of interest in the corporation
		- BUT – RR 78-60; Reg. 1.305-3(e), Ex. 10
			* Don’t apply § 305(c) as long as the redemption that caused the trouble is not part of a regular series of redemptions
				+ If singular event – don’t apply § 305(c)
	+ If transaction falls under § 305(c), then go to § 302 to see if fall within a safe harbor. If don’t fall within a safe harbor, get § 301 treatment.
* Sec. 305(d) – definitions
	+ Stock includes the rights to acquire such stock
		- So if preferred shares can change for common, going to be deemed to own the common for purposes of determining if we fall inside an exception for § 305.
* Effect to E&P - § 312(d)
	+ If § 305(a) non-taxable distribution 🡪 no change to E&P
	+ If § 305(b) or (c) taxable 301 distribution 🡪 reduce E&P by the FMV of the stock dividend distributed – Reg. 1.312-1(d)
* Basis to SHs –
	+ If non-taxable, § 305(a) new stock dividends
		- Allocate AB of the original stock between the old and new stock, based on FMV of old and new stock - 307(a) and Reg. 1.307-1(a)
	+ If taxable as § 301 distribution 🡪 FMV of the stock - § 301(d)
* Holding period for SHs - § 1223(4)
	+ Holding period in new stock is the same as the holding period of the old, underlying stock

b. Dispositions of Tainted Stock – § 306:

* Sec. 306 purpose = prevent ‘stock bailouts’ through sale or redemption of preferred shares, where SH has same share/interest in the corp. before and after but uses E&P of the company.
* Sec. 306(a) – if SH sells or otherwise disposes of 306 stock, then set rules
	+ Sec. 306 stock is defined in § 306(c)
		- Essentially, § 306 stock is preferred stock which was distributed to SHs via a § 305(a) stock distribution, upon which no GI was recognized to the SH
			* Also includes stock having a basis determined by reference to basis of 306 stock 🡪 306(c)(1)(C)
		- Requirements for § 306 stock
			* Stock dividend
			* Sec. 305(a) applies
			* Has to be preferred stock
		- Right to acquire stock - § 306(d)
			* Will be considered stock
		- Holding period - § 1223(5) – holding period the same
	+ What is NOT § 306 stock
		- Common stock – 306(c)(1)(A) – common stock’s main attribute is unlimited share in upside/growth of company.
		- RR 76-386
			* Fact that there is a right of first refusal does not cause stock to become preferred stock
		- RR 76-387
			* Common stock requires both (1) voting control and (2) unlimited interest in company growth/profitability
				+ If both are not present, MAY be preferred stock
		- RR 79-163
			* If there’s a limitation on participation in dividends and liquidation proceeds, then going to be preferred stock, even if that stock is substantial in the control of the corporation
		- If the company had no E&P at time of the distribution, then not § 306 stock - § 306(c)(2)
			* Will be treated as a § 302 redemption
	+ Disposition of § 306 stock
		- § 306(a)(1) – Sale
			* Step 1: Dividend Treatment – § 306(a)(1)(A):
				+ AR will be ordinary income to the extent of pro rata portion of issuing corporation’s EP at time SH received the § 306 stock.

Calculate pro rata portion of EP at time of distribution by taking inot account other SHs receiving § 306 stock.

Ordinary income treated as a dividend under § 1(h)(11) - § *see* § 306(a)(1)(D).

The greater of the amount that is pro rata or the worth of the distribution at the time of the distribution will be treated as ordinary income.

* + - * Step 2: Amount in excess – § 306(a)(1)(B):
				+ Take the AR and subtract out the portion treated as OI in Step 1 and subtract out SH’s adjusted basis in the § 306 stock.
				+ Formula:

AR – amt. treated as OI – SH’s AB from § 306 stock = gain.

* + - * Step 3: No loss Recognized – § 306(a)(1)(C):
				+ If there is a loss, there will be no recognition.

Tack it onto the basis for the non-306 stock – Reg § 1.306-1(b)(2).

* + Redemption of § 306 Stock – § 306(a)(2):
		- Step 1: § 301 Treatment of distribution
			* Don’t even go through the § 302 redemption analysis.
			* EP: take the EP from the current year for determining dividend amount under § 301(c)(1);
				+ No pro rata limit.
			* If no EP: don’t need to give § 306 treatment because this qualifies for an exception under § 306(b).
		- Step 2: Basis:
			* Reg. § 1.302-2(c): add the old basis back to the old/original stock.
* Exceptions to § 306 Treatment:
	+ If you fall under one of the exceptions, it is treated as a sale under § 1001.
	+ § 306(b)(1) – Disposition totally terminates SH’s interest:
		- Requirements:
			* It is not a redemption;
			* It is not a sale to someone who directly or indirectly the ownership of the shares would be attributable to the shareholder; and
			* It terminates the entire interest of the shareholder – including § 318 attribution.
		- When you think about the preferred stock bail out problem, it makes sense that these particular facts get different treatment. The bailout is when the shareholder sells and has continuing participation; but if you sell everything, there is no continuing participation.
	+ § 306(b)(2) – Complete Liquidation of the Corporation
	+ § 306(b)(3) – Disposition in a Non-Recognition Transaction:
		- It is a non-recognition transaction, but the taint continues in the hands of the transferor.
			* E.g., in a 351 transaction, the corporation will hold the shares with the taint.
		- The shares received by the shareholder from the new corporation will be considered to be § 306 stock as well – Reg. § 1.306-3(e).
	+ § 306(b)(4) – Tax avoidance is not a principal purpose:
	+ Charitable Distributions:
		- Can give to a charity – they take substituted basis
		- It is still 306 tainted stock
			* They don’t care – won’t recognize any income on sale
		- Plus, donor gets a charitable deduction
		- Congress wanted to limit the charitable deduction
		- Deduction is usually FMV of property
			* BUT 170(e) – charitable deduction reduced by the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its FMV

**V. Liquidations:**

a. Liquidations in General:

* Code:
	+ § 331(a): amounts received by a shareholder in a distribution in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.
	+ § 331(b): § 301 does not apply to distributions in complete liquidation.
	+ § 331(c): look to § 1001 to determine amount of gain recognized.
	+ § 336(a): corporation recognizes g/l on liquidations of property as if the property had been sold for FMV.
	+ § 336(b): if property distributed is subject to a liability or the shareholder assumes the liability in connection with the distribution, the FMV
* Complete Liquidation - § 346(a) – distribution is treated as complete liquidation if it is:
	+ Part of a series of distributions,
	+ In redemption of all of the stock of the corporation,
	+ Pursuant to a plan
* 3 Scenarios:
	+ 1) Asset sale then liquidation;
	+ 2) Liquidation in kind then asset sale by shareholders;
	+ 3) Stock sale by shareholders.
* *Asset Sale the Liquidation*:
	+ Corporation tax consequences:
		- Sale of Property:
			* 1) Do normal § 1001 to determine g/l on that sale to the 3rd party.
			* 2) determine the tax consequences from that sale (21%. Corporate rate).
			* 3) determine net proceeds from the sale (Cash rec’d – Tax liability).
		- Distribution to Shareholder
			* § 336(a): G/L is recognized to the liquidating corporation on distribution of property in complete liquidation as if sold at FMV.
				+ In this scenario cash is dist. there won’t be g/l recognized on the dist. b/c basis = FMV.
	+ Shareholder tax consequences:
		- § 331(a): treats the amounts received in distribution in complete liquidation as in exchange for full payment of the shareholder’s stock.
		- 1) AR = net proceeds from corporation’s sale of the property dist. to SH.
		- 2) AB = SH’s basis in the corporation’s stock.
		- 3) Gain/loss = difference between AR – AB.
* *Liquidation in Kind then asset sale by shareholders*:
	+ Corporation tax consequences:
		- § 336: treats a distribution in kind as a sale/exchange for FMV of the property.
			* Do a normal § 1001 with the AR as the FMV of the property.
		- Liabilities taken subject to/assumed by the Shareholder:
			* § 336(b): includes the liabilities shed in the AR of the corporation.
	+ Shareholder tax consequences:
		- § 331: treats the distribution of property as in exchange for the shareholder’s stock.
			* § 1001 transaction.
				+ The amount received is the FMV of the property reduced by the liabilities taken subject to/assumed by the shareholder – and will likely include the tax liability of the corporation from the pretend sale to the shareholder.
		- Basis:
			* Basis in Prop = FMV – § 334(a)
			* Exchange Treatment - just a normal § 1001 sale/exchange
				+ All tax liability was recognized at Corp Level (makes sense b/c SH has lower basis in stock, so more gain recognized above.
* *Stock Sale by Shareholders*:
	+ Corporation tax consequences:
		- The corporation does not have any tax consequences in this scenario. It only has a different shareholder after the transaction.
	+ Shareholder tax consequences:
		- It will be a § 1001 transaction for the sale of the shareholder’s stock.
			* The amount received for the stock will take into account the built-in gain on the corporation’s property.
	+ Pay attention to § 338 application.
* Loss Limitations:
	+ *Corporate level*:
		- § 336(d)(1): the liquidating corp’s loss on a distribution of property to a related party under §267 will be disallowed if either:
			* *i) the distribution is not pro rata; or*
			* *ii) the property distributed is disqualified property.*
			* § 267 is limited because if it applied, any loss would be disallowed on a liquidating dist.
			* *Disqualified Property*: " means any property which is acquired by the liquidating corporation in a transaction to which section [**351**](https://www.bloomberglaw.com/product/tax/bc/W1siRG9jdW1lbnQiLCIvcHJvZHVjdC90YXgvZG9jdW1lbnQvWE9GSUhQMTg_amNzZWFyY2g9SVJDJTI1MjAzMzYiXV0--73865d13fbbfde8f1072fa3a7a75141d6b43a911/document/1?citation=26%20USC%20351&amp;summary=yes#jcite) applied, or as a contribution to capital, during the 5-year period ending on the date of the distribution.
		- § 362(d)(2): The AB of disqualified property is adjusted for the purposes of determining loss recognized by a liquidating corp.
			* (d)(2) only disallows the built-in loss – it basically bumps up the basis
			* in the asset to FMV at contribution.
			* Essentially, requires in general that the corp. take a FMV basis in the property where the property has a built-in loss, so that the potential for this problem is eliminated at the outset.
				+ The AB is reduced (but not below 0) by the excess of

The AB of the property immediately before its acquisition by the corp. over

The FMV of the property at such time.

* + - * What happens if the property’s value declines even further?
				+ Ex: 15 FMV declines to 12 FMV
				+ On its dist. to a related property in a liquidation, the entire loss (20 – 12) will be covered by § 336(d)(1).

So the entire loss will be disallowed, not just the built-in loss.

* + - * + If there were no further loss, § 362(e)(2) would cover the loss.
			* If (d)(2) and (d)(1) both applied to a dist., (d)(1) is the applicable rule because it disallows potentially more of a loss.
	+ *Shareholder Level*:
		- Loss - § 331(a)
			* May be recognized by SH, not subject to limitations at SH level
			* § 267 would not apply in this case because § 267(a) states “The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.”

b. Liquidations of Controlled Subsidiaries – §§ 332 *et seq*.:

* § 332 Basic Rule: not taxable to the parent or the subsidiary.
	+ The parent corporation will not recognize gain/loss on the receipt of property in complete liquidation of a subsidiary.
		- The assets are received by the parent – the form of the holdings has changed, but not the substance.
	+ § 1504: control requires 80% of voting power and 80% of total value of shares from date of plan of liquidation continuously until parent receives final distribution.
		- No reference to § 318, so actual ownership.
	+ In order to qualify – distribution must be in complete cancellation or redemption of all the liquidating corporation’s stock
	+ Must either be distributed in the same taxable year or within 3 years pursuant to a plan
		- Have to waive the SOL signed by parent; possibly requirement of posting bond.
			* Similar to waiver of family attribution under  §302(c).
	+ When there is a Majority SH (with at least 80%) and a minority shareholder, the transaction must be bifurcated.
		- § 332 & § 337 will only apply between the sub and controlling parent.
		- Between the minority and sub it is taxable at both sub and SH level.
	+ 332 does not apply to minority holders
		- They will be subject to regular 331 recognition
		- Recognize gain or loss; take FMV basis under 334(a)
	+ § 337 provides for nonrecognition to liquidating subsidiary if distributing to 80% controlling parent shareholder.
		- Distributions to minority SHs
			* Governed by general liquidation rules in 336
			* Gains on property distributed to minority holders will be recognized
			* However, not losses
			* 336(d)(3) says that if there is a liquidation in which 332 applies, no loss recognized on liquidation.

c. Stock Sales treated as asset sales – § 338 elections:

* Purpose of § 338
	+ Allows Corp. TPs to treat a stock purchase as an asset purchase, so they can get the built-in gain out of the assets purchased by recognizing gain immediately upon the stock purchase.
		- The statute tries to ensure that the target and its SH bear the same tax on the stock sale as if there had been an asset sale.
		- Also, gives the buyer a cost basis in the target’s assets and to terminate the tax attributes of the target.
* Two types
	+ § 338(g) 🡪 purchasing corp. recognizes and bears tax liability; unilateral election
	+ § 338(h)(10) 🡪 selling corp. recognizes and bears tax liability; joint election
* *§ 338(g) Unilateral Election*:
	+ § 338(g) Election Requirements – there must be:
		- A qualified stock purchase (QSP);
			* Must purchase 80% of the vote **and** value within a 12-month period – § 338(d)(3).
				+ 12-month period begins on the first date of purchase of stock to be included in a QSP - § 338(h)(2).
			* The purchase isn’t valid if § 1014 basis, stock acquired in organization (351) or reorganization (354, 355, 356), or stock acquired by a person who would be attributed to owning the stock under § 318(a) 🡪 § 338(h)(3).
		- By a purchasing corporation;
		- Of a target corporation; and
		- Unilateral election made by purchasing corp. within 8.5 months after the acquisition date – 338(a) & (g)(1).
			* The acquisition first day the purchaser acquired the 80% ownership of QSP – i.e., the first day there is a QSP.
			* § 338(a) tells us the purchaser makes the election.
				+ § 338(g)(3) provides that the election is irrevocable.
	+ Mechanics of the § 338 Election:
		- 1) The purchaser buys stock of the target.
			* Treated as an exchange under § 1001.
		- 2) Pretend sale of Assets:
			* + Old target is treated as selling all of its assets to an unrelated 3rd party on the close of the acquisition date for FMV. The purchaser owns target at this point.

There is deemed to be a § 1001 gain

* + - * + The target is not part of an affiliated group; losses cannot be offset by the buyer or its affiliates –§ 338(h)(9).
		- 3) Pretend purchase of Assets:
			* New Target purchases assets from the unrelated 3rd party at FMV on the day after the acquisition date (still owned by the purchaser).
				+ This is deemed to have occurred the day after the acquisition date.
			* Tax Consequences:
				+ Target’s basis in the assets is going to equal the FMV of the assets.
		- 4) end Consequences:
			* Gain recognized: the gain is recognized to the old target on the deemed asset sale to the new target.
			* The purchaser is ultimately liable for the taxes on these gains.
* *§ 338(h)(1) Joint Election*:
	+ If elected, the parent will not recognize g/l on the sale of T’s stock and T will recognize g/l as if it sold its assets for FMV.
	+ Requirements:
		- Have to have a QSP – Reg. § 1.338(h)(10)-1(c)(1)
		- By a corporate purchaser – Reg. § 1.338(h)(10)-1(c)(1).
		- Target Corporation was a member of a selling consolidated group – § 338(h)(10)(C).
			* Has to be part of a corporate structure where treated as one entity.
				+ § 1504(a)(2) – affiliated corporation
				+ File one tax return – consolidated return
			* Reg. § 1.338(h)(10)-1(c)(1), -1(b)(3)
				+ Target and Seller have to be part of the same affiliated group.

Look for § 1504(a)(2) control – 80% of vote and value.

* + - Election is made by both Target and Purchaser – § 338(h)(10(A).
			* Target corp. and purchaser corp. may make the election:
				+ Gain/loss to be recognized to target corp. (while a part of selling consolidated group); and
				+ No gain/loss to be recognized on stock sold or exchanged by selling consolidated group if:

Target corp., before transaction, was part of selling consolidated group, and

Target corp. recognizes gain/loss in the transaction as if it sold all of its assets in a single transaction.

* + § 338(h)(10) election steps:
		- Step 1:
			* Consolidated group sells target corp. stock to purchaser corp.
				+ P corp. takes cost basis in stock.

Because consolidated group bears the tax of deemed asset sale, there is no reason to discount the price for tax.

* + - * + No gain recognized to selling group 🡪 ignore the sale of stock.
		- Step 2:
			* While still a part of consolidated group, old T is deemed to sell its assets for FMV to an unrelated 3rd party, which triggers gain and tax liability to old T while owned by consolidated group. Old T (i.e., the consolidated group) is responsible for paying the tax on the gain.
			* Next, Old T is deemed to have liquidated to consolidated group as if § 332 parent/sub liquidation, so no recognized gain consolidated group on the liquidation.
				+ Reg. § 1.338(h)(10)-1(d).
			* Tax Consequences:
				+ Seller has no gain/loss when old T is treated as liquidating up its assets – becomes a  §332 liquidation for seller and § 337 treatment for old target.
				+ In terms of sale to unrelated 3rd party:

§ 338(a) deemed sale – gain/loss recognized on the sale of assets;

Seller group retains the tax consequences of this sale though.

If seller has unrelated losses, can use to offset the gain.

* + - Step 3:
			* New T, now owned by P, buys back Assets for FMV.
				+ Stepping up the basis to FMV and allocates FMV basis among New T assets.
			* Tax consequences:
				+ P corp. takes § 1012 basis in the stock – cost basis.
				+ As a result of the § 338(h)(10) election, the buyer will hold the stock with a cost basis and the then the target holds its assets with a FMV basis.
		- Step 4:
			* P corp. owns new T with stepped up FMV basis allocated among assets.
		- Tax consequences summed up:
			* P corp: treated as buying stock and taking cost basis.
			* Seller corp. no gain/loss on stock sale – it is essentially ignored.
				+ Old T: recognized gain/loss on deemed sale (while owned by seller)
				+ New T: no gain/loss recognized on repurchase of assets. Takes stepped-up FMV basis in assets. Allocates basis among assets.

**VI. Non-Recognition Transactions – Transfers to Controlled Corporations § 351:**

a. General Overview of § 351:

* Theory: You only changing the form of ownership, but not the substance of what is owned.
	+ Similar to like-kind exchanges.
	+ There is a continuity of investment.
	+ The difference between realized and recognized is important here.
	+ If § 351 does not apply, the gain/loss will be realized and recognized and the basis in the stock received will a cost basis with a new holding period.
	+ This is a deferral of gain through the basis.
		- The basis reflects the potential to realize and recognize the gain/loss.
* Regardless of whether § 351 is satisfied, § 1032 will provide the corporation with nonrecognition.

b. § 351 Requirements:

* 1) A transfer of property from one or more transferors;
	+ One or more person:
		- Reg. 1.351-1(a)(2), Ex. 1:
			* Look to all persons that are transferring in the same transaction
				+ But can’t include those who only give services in the ultimate control for this or control
	+ What is property:
		- § 317 is not the applicable definition of property.
		- Examples:
			* A/R, cash, equipment, building, etc.
		- Services are not property
		- Contribution of services results in ordinary income
		- Also does not count towards control group
* 2) For solely stock of the corporation; and
	+ Sec. 351(a) says solely for stock – not non-qualified preferred stock.
		- But - § 351(b) - Tells us that if subsection (a) would apply but there’s other property or money received in addition to the stock, then gain to the recipient shall be recognized
			* Gain will not be recognized in excess of boot received or the FMV of the property received
				+ Character 🡪 by reference to the underlying property.

Can have 1245 depreciable personal property and 1250 recapture of realty

* + - * + If multiple properties transferred in, the gain will be recognized in proportion to the FMV of each

This is important for purposes of character (because the character is that of the property that had realized gain that isn’t recognized) and because it won’t be allowed for the proportion that is to a loss property.

Transfer of multiple assets – built-in gain & built-in loss properties:

Compute gain/loss on an asset-by-asset basis.

Allocate the boot based on FMV of the properties contributed.

Take % of total FMV for each property and multiple by the boot to determine how much boot rec’d for each property and the shares for how many of each shares for each property to determine how much AR for each property.

* + - * No loss allowed – 351(b)(2)
		- Nonqualified Preferred Stock
			* 351(g)
			* Treated as boot
			* Nonqualified preferred stock: stock which is limited and preferred as to dividends and does not participate in corporate growth to any significant extent
			* Four specific instances when stock is NQPS:
				+ If the SH has right to have shares redeemed within 20 years of issue
				+ Redemption is mandatory within 20 years of issuance
				+ The corporation has the right to redeem within 20 years and it is more likely than not that they will
				+ When dividend rate varies, in whole or in part, with reference to interest rates, commodity prices or other indices
			* *However, still treated as stock for control test purposes under 351(a)*
* 3) exchanged in a transaction where, immediately after, there is control by the transferors of the corporation.
	+ § 368(c): defines control. Must have 80% of vote and 80% of the total number of shares of all classes of stock.
	+ If person only gives services, then can’t be counted for purposes of control either
		- But – Reg. 1.351-1(a)(1)(ii) – property and services given in exchange for stock
			* If mix of property and services, and property is of “relatively small value” in proportion to the services (so to try to get non-recognition), then the mixed transfer doesn’t qualify.
				+ Rev. Proc. 77-37 § 3.07

Property won’t be considered nominal or token if it equals at least 10% of the value of stock already owned by the transferor AND of the amount to be received in exchange for services by the transferor.

* + When is control tested for:
		- Simultaneous transfers of property is not required.
		- The Step Doctrine is used to analyze the transaction.
			* 1) Binding Commitment:
				+ Look to whether there was a binding commitment for A to sell the shares that A got in the would-be § 351 transaction at the time of the exchange.
			* 2) End Results Test:
				+ Looks at the end result of the steps and asks whether there was a preconceived plan to get to that result.
			* 3) Mutual Interdependence:
				+ Asks whether the steps were so interdependent that the legal relations created by one step would have been fruitless without the series.

c. Shareholder Tax Consequences:

* § 351(a) provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control.
	+ If boot received:
		- Lesser of boot or gain realized will be recognized as gain.
		- No loss will be recognized.
* Shareholder Basis:
	+ § 358: the shareholder’s basis in the shares received is the same as the basis in the property transferred.
		- Decreased by:
			* the FMV of any property received;
			* any cash received;
			* Liabilities shed; or
			* any loss recognized on the exchange.
		- Increased by:
			* The amount treated as a dividend;
			* The amount of gain recognized on the exchange.
* The taxpayer’s holding period is “tacked.”
* Shares in exchange for services:
	+ This is not property for § 351 purposes.
	+ Shareholder will treat the FMV of the shares received for services as compensation – i.e., ordinary income. (corporation has a deductible expense).
	+ If the shareholder meets the exception for property & services contributed, will have 351 treatment for the shares in exchange for property and ordinary income treatment for the shares received as compensation.
		- § 1.351-1 says property will not qualify if it is relatively small in value in comparison to the stock received for services – if the primary purpose of the transaction is to fall under 351.
		- However, RR 77-37 states that if the FMV of the property transferred is ≥ 10% of the FMV of the stock to be received for services, it will not be considered “relatively small in value.”
	+ The shares exchanged for services are not counted in the control group.
		- § 1.351-1(a)(2), ex. 3; unless the exception above is met, then all shares are counted.
	+ Shareholder’s basis will be the amount of services contributed plus any property contributed -  §1012.
* Related parties & losses:
	+ If the transaction doesn’t qualify for 351 treatment and there is a loss, look out for related parties.
		- § 351(g)(3)(B) points us to § 267 to determine related persons. § 267(c)(2) says an individual is considered to own stock that is owned by his family.
			* Lineal descendants are considered family. Grandchildren are lineal descendants, so this is a related party transaction under 267.
			* 267(b)(2) says that if an individual and a 50% owned corporation engage in a transaction, then a loss will be disallowed.
		- This means the loss will be disallowed.
* Shedding of Liabilities:
	+ § 357(a): the assumption of a liability is not treated as boot.
		- § 357(d):
			* Recourse liability: the amount treated as assumed is the amount of the liability.
			* Nonrecourse liability: an amount an owner of other assests has agreed to pay or the FMV of the other assets.
	+ § 358(d): shareholder’s basis in the shares received is reduced by the amount of liabilities shed
	+ Sec. 357(c) – liabilities in excess of basis
		- If the liabilities assumed exceeds the basis of the contributed property, then the excess liability is going to be taxed as gain
			* If multiple properties – looking at aggregate liabilities in excess of basis to adjust 🡪 but each transferor is looked at separately.
			* The character will be dependent on the type of property the liability is attached to
				+ If multiple properties transferred, then character determined in proportion to respective FMV – Reg. 1.357-2(a)
			* Whenever § 357(c) applies, we have a basis of 0 in the stock held by that SH
				+ Reduce basis by the full amount of debt; add back any gain. Basis can’t be negative.
		- Exceptions
			* Sec. 357(c)(3)
				+ Requirements

If corp. assumes SHs liability in § 351, AND

Payment of liability would be deductible, THEN

Assumed liability not treated as a liability for § 357(c) and § 358 purposes

Not taken into consideration for adjusting basis and not treated as a liability for purposes of §§ 357(c) or 358

RR 95-74 says this too

* + - * + Talking about liabilities for salary
				+ *Black and Decker* case → where the corp transferred contingent health care liability obligations as part of tax shelter.
				+ Tax Shelter badges

Resulted in a huge tax loss

Confidentiality agreement

Money back guarantee from accounting firm if IRS challenges and TP loses

Third party facilitator

No real economic loss = lacks economic substance

Sec. 7701(o) – TP needs to have a business purposes, other than tax avoidance purpose, to have economic substance

Notice 2001-17 – reportable transactions

Listed transactions, or any transactions ‘substantially similar’

Transactions of interest

Confidential transactions

Contractual protection

Significant tax losses

* + - * RR 95-74
				+ Says that if payment of a liability would be deductible, then liability not treated as a deduction as well (i.e., salaries)
* Under this RR, this specifically excluded assumed environmental liabilities that gave rise to deduction or capital expenditure

d. Corporation Tax Consequences:

* § 1032: No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation.
	+ Sec. 351 requirements do not need to be met; this is always the case
* Holding period
	+ Sec. 1223(2) – Corp. can tack regardless of character
* Corporation’s Basis:
	+ § 362(a): Corp. takes same basis as SH + amount of gain recognized to the SH
		- Liabilities Assumed
			* Do NOT increase basis by liabilities assumed, unless debt relief was recognized as gain to the SH (increase by the amount of gain).
			* If § 357(b) applies (assumption to avoid tax consequences), that means there is boot recognized, so it’ll increase the basis
				+ But see § 357(c) exception above – if liability allows for a deduction.
	+ But - § 362(e)(2) – anti-loss duplication rule
		- If **aggregate** AB of property transferred by SH to corporation exceeds aggregate FMV, corp. must reduce its basis in those assets by the amount of the net built in loss
			* Basis of property first has to be increased by any gain the SH received – before determining net loss – Reg. 1.362-4(a)(4)
			* But– under § 362(e)(2)(C) – corp. and SH can make a joint election so that the SH reduces his basis in the stock by the amount of the net built in loss rather than the corporation reducing its basis in the property
		- Sec. 362(e)(2)(B) tells us what to do when there’s multiple properties and **aggregate** AB exceeds aggregate FMV
			* Reduce each property by its proportional amount of basis
				+ Figure out the portion of each asset with built in loss to the total built in loss and then multiply by difference between aggregate basis and aggregate FMV

BIL/Total BIL \* (Aggregate basis – aggregate FMV) = for each property with a BIL

Then take this number and reduce the asset basis for the corporation

**VII. Acquisitive Reorganizations:**

a. Tax Consequences if it does not qualify as a tax free reorg:

* Target:
	+ Sale and gain/loss recognized under § 1001
	+ Gain/loss passed onto T’s SHs on Liquidation
	+ Sec. 336 treatment on liquidation
* Shareholders:
	+ Gain recognized under § 331
* Corporation:
	+ § 1032 won’t recognize g/l when it issues its own stock.

 b. Judicial Requirements:

* Continuity of Proprietary Interest (COPI):
	+ Requires that a substantial part of the proprietary interest in T be preserved through an equity interest in the Acquirer – Reg. § 1.368-1(e)(1).
		- Means that stock must be a substantial part of the “bucket” of consideration used in the reorg – Reg. 1.368-1(e)(1)(i).
			* *MN Tea*: the target SH must acquire a definite and material interest in the acquiring corporation. It must be a substantial part of the thing transferred.
			* Debt instruments do not convey equity interest – even if convertible.
			* *John A. Nelson* case: SCOTUS held preferred stock qualitatively satisfied the COPI requirement – even if redeemable and non-voting.
	+ Statutory language overrides this for B Reorgs.
* Continuity of Business Enterprise:
	+ Acquirer must either continue T’s historic business or continue to use a “significant portion” of T’s “historic business assets” in a business – Reg. § 1.368-1(d)(1).
		- If T had more than 1 line of business, just to continue a significant line of the business – Reg. § 1.368-1(d)(2)(ii).
		- In general, the portion of those assets that are considered “significant” is based on their relative importance to the operation of the business.
* Business Purpose:
	+ It will not qualify for a reorg unless it is motivated by a business or corporate purpose apart from tax avoidance – Reg. § 1.368-1(c).

c. “A” Reorganizations:

* A Reorg Defined – § 368(a)(1)(A):
	+ Statutory Merger or consolidation.
		- Determined under state law.
	+ Steps:
		- 1) Exchange Purchaser’s stock for Target’s assets;
		- 2) Liquidation of Target
* Need:
	+ 1) a Plan of Reorg;
	+ 2) Parties to the Reorg.
		- Party to Reorganization defined:
			* § 368(b): a party to a reorg includes:
				+ A corporation resulting from a reorganization, and
				+ both corporations, in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.
* Judicial Requirements:
	+ COPI:
		- T’s SHs must have a continued equity interest in P.
			* How much of the consideration must be equity:
				+ Reg. § 1.368-1(e)(2)(v), ex. 1: 40% equity is enough for an A Reorg.
			* 66-224: 4 shareholders; 2 got stock and 2 got nonequity interest. The point is COPI applies to the reorg as a whole, not the SH individually. If the reorg is good as a whole, it is good. It doesn’t matter if one shareholder got only short-term note and the other got the stock.
			* *MN Tea*: SHs must have a definite and material interest in the acquiring corporation.
				+ However, this does not require that the target shareholders have a certain percentage ownership of P; it requires equity ownership.
			* Receipt of nonvoting preferred is enough.
		- Reg. 1.368-1(e)(2) we test for continuity on the last business day before the first date there is a binding contract.
			* A binding contract: a contract with terms that are enforceable. Certain terms that are left open – reg changes or requirements – are ok.
			* Fixed Contract:
				+ # of shares and amount of money set forth, it is fixed
				+ 1.368-1(e)(2)(v).
		- Disinters’ Rights:
			* Reg. § 1.368-1(e)(1): payments to dissenters that occur in connection with the reorg. Are included in the analysis of COPI.
		- Pre-Reorg Redemptions:
			* 1.368-1(e)(8), ex. 9: cash received in a prereorg redemption does not affect COPI.
				+ This ex. Is a B reorg.

Pre-transaction with P; redemption by T; maybe this tells us that the redemption is not treated as other property or money under 356 and would not adversely affect the reorg.

* + - * There is not a clear answer; to be safe analyze the transaction taking the pre-reorg redemption & after. If good both ways, then there isn’t a problem.
		- Pre-Reorg Sales of Stock:
			* Doesn’t matter if the shareholders sell before the reorg – it is not a historic shareholder requirement.
		- Sales of Stock after Merger:
			* Reg. § 1.368-1(e)(i): money received as a result of a sale to an unrelated party, it is not taken into account. If T SH are paid all stock and sell some of that stock, that doesn’t matter.
				+ Sales to a related party are not ok.

Related parties of the issuing corporation

Not related to the seller

Affiliated corporations or under 304

§ 1.368-1(e)(4): For purposes of this paragraph (e), two corporations are related persons if either--

The corporations are members of the same affiliated group as defined in section [**1504**](https://www.bloomberglaw.com/product/tax/bc/W1siRG9jdW1lbnQiLCIvcHJvZHVjdC90YXgvZG9jdW1lbnQvWE5PT1NEMTg_amNzZWFyY2g9MjYlMjUyMGNmciUyNTIwMSUyNTIwMzY4LTElMjUyOGUlMjUyOSUyNTI4MSUyNTI5Il1d--23eb35f6631be9e29b5c2135847a299fdff978a1/document/1?citation=26%20USC%201504&amp;summary=yes#jcite) (determined without regard to section [**1504(b)**](https://www.bloomberglaw.com/product/tax/bc/W1siRG9jdW1lbnQiLCIvcHJvZHVjdC90YXgvZG9jdW1lbnQvWE5PT1NEMTg_amNzZWFyY2g9MjYlMjUyMGNmciUyNTIwMSUyNTIwMzY4LTElMjUyOGUlMjUyOSUyNTI4MSUyNTI5Il1d--23eb35f6631be9e29b5c2135847a299fdff978a1/document/1?citation=26%20USC%201504(b)&amp;summary=yes#jcite)); or

A purchase of the stock of one corporation by another corporation would be treated as a distribution in redemption of the stock of the first corporation under section 304(a)(2) (determined without regard to Section 1.1502-80(b)).

Sales to related parties are taken into account – would count against the equity.

* + - * + Subsequent sales to related parties do not affect COPI – even pursuant to a pre-existing agreement and if P is a facilitator.

1.368-1(e)(8), exs. 1,3,4.

* + - * Subsequent redemption by P:
				+ RR 99-58It was not in connection with the merger; given market mechanics it did not favor old T shareholders over P shareholders; cannot be established who the shares were purchased from; merger and sale would not resemble a sale of T to P.

But if buy-back was announced after the negotiations, this would not satisfy COPI.

* + COBE:
		- Purchaser must continue the target’s business in some way OR must use a significant portion of the target’s assets in a business. Reg. § 1.369-1(d).
			* The reg § 1.368-1(d)(3): you can have asset continuity through the target’s intangibles.
				+ It will depend on whether the intangibles were a significant part of T’s business.
				+ Consider the relative importance of the assets to T’s operations; facts and circumstances are considered – including net FMV.
				+ Exploiting a patent or goodwill/brand name for example.
			* Reg. § 1.368-1(d)(5), exs. 4 & 5:
				+ If there are no assets because T liquidated prior to the merger, there is not a continuation of business or use of business assets. No COBE.
				+ If the purchaser turns around and sells all of the assets, there is no COBE.
			* RR 81-25:
				+ Purchaser doesn’t have to continue its business; the analysis is concerned with the target’s business.
	+ Business Purpose:
		- Must have a business purpose other than tax avoidance – Reg. § 1.368-2(g).
* Tax Consequences:
	+ Target Corporation:
		- On exchange of Assets & Liabilities:
			* § 361(a): no g/l on transfer if:
				+ The corporation is a party to a reorg; and
				+ Exchanges solely for property;
				+ In pursuance of the plan of reorg;
				+ Solely for stock or securities in another corporation, a party to the reorg

Security is generally viewed as long-term debt:

Maturity 10 + years = security

5 or less is not security

In between = gray area

20 year is definitely a security.

What if there is boot? § 361(b)(1):

If (a) would apply but for the boot, so long as it is distributed in liquidation, no g/l recognized.

* + - On liquidation:
			* § 361(c): no g/l will be recognized to a corp. a party to a reorg on the distribution to its SHs of property in pursuance of the plan of reorg.
				+ § 361(c)(2): if the distribution is other than qualified property and the FMV exceeds the adjusted basis, the gain will be recognized as if such property were sold to the distributee for FMV.

(c)(2)(B): *qualified property*: any stock in (or right to acquire stock in) the distributing corporation or obligation of the distributing corporation, or any stock in (or right to acquire stock in) another corporation which is a party to the reorganization or obligation of another corporation which is such a party if such stock (or right) or obligation is received by the distributing corporation in the exchange.

Obligation can mean debt – short-term or long-term.

Broader than security.

Real Estate is not qualified property – if appreciated there will be gain recognized.

But target would take the basis as FMV and it would be deemed sold for FMV, so likely no actual gain recognized.

* + - * Liability assumption:
				+ Not treated as boot – 357(a) since T is receiving P stock, the liability assumption is not treated as money or other property.
				+ What if it exceeded the basis in the assets transferred:

Still not treated as boot; does not apply outside of a 351 or D reorg.

* + - * Transfers to Creditors:
				+ § 361(c)(3): treated as a transfer to shareholders. No g/l recognized.
		- Basis:
			* § 358: Substituted basis in the property transferred.
			* But doesn’t matter because T is dissolved.
	+ Target Shareholders:
		- § 354(a)(1): no g/l shall be recognized if stock or securities in a corporation a party to the reorg are, in pursuance of the plan of reorg, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorg.
			* Reg. § 1.354-1(a):
				+ Stock for stock = good
				+ Securities for securities = good if:

Securities are the same principal amount or

RR 2004-78

Lesser than principal without recognition of g/l to holder

* + - * + Stock for securities = not good
				+ Securities for stock = ok
		- Basis in P shares received:
			* Basis in stock received = basis in stock transferred.
				+ This preserves the gain/loss to be recognized at a later date.
		- Boot – § 356:
			* SH recognizes gain realized to the lesser of boot received or gain realized.
				+ § 356(a)(1)(A): recognize lesser of boot or gain realized.
			* No loss recognized – § 356(c).
			* Character:
				+ § 356(a)(2): there is a boot dividend rule: if the transaction has the effect of dividend, the gain is recognized as a dividend to the extent of the target’s EP.
				+ To test for Dividend equivalency – *Clark* case:

An exchange has the effect of a dividend if:

Pretend SH only got P stock;

Pretend there is a redemption of stock in exchange for the boot;

Test the redemption under § 302.

* + - SH Basis in P Shares – § 358:
			* § 358(a)(1): take SH’s original basis in target stock;
			* Reduce by the FMV of boot received;
			* Increase by the amount of gain recognized;
			* Reduced by Liabilities assumed by P:
				+ The assumption is not counted for boot, but is counted for basis

§ 358(d)(2): liabilities excluded under § 357(c)(3) do not need to be subtracted.

Liabilities that would give rise to a deduction.

* + - * = SH new basis in P shares.
			* Holding period: § 1223(1) tacks the holding period of the target stock to the P stock.
		- SH basis in property received – § 258)a)(2): FMV
	+ Purchaser:
		- § 1032: no g/l on the exchange when it uses its own stock.
			* But g/l will be recognized on the boot paid.
		- Basis in T’s assets:
			* § 362(b): basis in the assets is the same as the basis was in the hands of the target + gain recognized by the transferor (target).
		- Target’s EP: P inherits T’s accumulated EP & other tax attributes – e.g., NOLs.

d. “C” Reorganizations:

* C Reorganization defined – § 368(a)(1)(C):
	+ The acquisition by one corporation, in exchange solely for all or a part of its *voting stock* (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), *of substantially all of the properties* of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other shall be disregarded
* C Reorg. Requirements:
	+ *1) Exchange: Purchaser gives Target stock in exchange for substantially of Target’s assets.*
		- Substantially all of Target’s assets:
			* Rev. Proc. 77-37: purchaser must acquire:
				+ 70% of the FMV of target’s gross assets AND

Debt relief is included like cash received for these purposes in amount received of assets

* + - * + 90% of the FMV of target’s net assets

Assets less liabilities = net assets.

Compare net assets of target before and after transaction.

* + - * RR 57-518:
				+ It’s ok to hold back some non-operating assets, so long as there is a business reason.

Look at the type of asset and reason why it was held back.

Paying off debt would be good.

* + - * RR 88-48:
				+ Ok to sell some historic assets to unrelated party for cash BEFORE the transfer of operating assets to purchaser.

There they sold 50% of the assets and the remaining line of business transferred to purchaser.

As long as none of the sales proceeds were retained by T or its shareholders, then there was a transfer of all of its assets to the acquiring corporation.

* + *2) Solely for Voting Stock – the solely relaxation rules:*
		- § 368(a)(1)(C): provides that if it is just voting stock and assumption of liabilities, the solely for voting stock requirement is met.
			* Must be voting stock.
			* Debt assumption by acquirer is disregarded.
		- § 368(a)(2)(B)(i-iii): Relaxes the boot rules further:
			* Voting stock must constitute 80% of the consideration paid.
				+ Consideration paid will include all debt and money if money is also paid.
			* Formula: Gross FMV of T’s assets \* 80% = X
				+ X is the minimum value of voting stock that must be given.
	+ Liquidation of Target to SHs – § 368(a)(2)(G):
		- Must distribute the stock/securities received pursuant to the reorg plan.
			* Any distribution to target’s creditors will be treated as part of the plan of reorg.
	+ Judicial Requirements:
		- COBE
		- COPI – superseded by statute with the *solely* for voting stock req.
		- COBP
* Tax Consequences:
	+ Target:
		- Exchange:
			* § 361(a): no g/l recognized if the corporation is a party to a reorg. And exchanges property with another party to the reorg. In pursuance of a plan of reorg.
			* If debt is exchanged, § 357(a) tells us § 361 can still apply.
				+ RR 2004-78

10 years = security

Less than 5, not a security.

* + - * § 361(b): if there is boot received, no g/l recognized so long as (a) would have applied and the corporation distributes the property immediately.
				+ § 361(b)(1)(A): if target gets stock + cash and dist. right away, non g/l recognized.
		- Liquidation:
			* § 361(c): no g/l recognized on liquidation of T to T’s shareholders if the distribution is qualified property.
			* Transfers to creditors:
				+ § 361(c)(3): transfers to creditors will be treated the same as transfers to shareholders – no g/l recognized.
			* Distribution of appreciated property – § 361(c)(2):
				+ If the corp. distributes property other than qualified property and the FMV of the other property is > than the AB, gain will be recognized as if it were sold for FMV.

Qualified property – § 361(c)(2)(B):

Any stock in the distributing corporation or stock in another corporation that is a party to the reorg.

Cash won’t cause a problem because FMV = AB

* + Target Shareholders:
		- § 354: no g/l recognized when trading stock for stock.
			* Reg. § 1.354-1(a):
				+ Stock for stock = good
				+ Securities for stock = ok
				+ Securities for securities ok IF:

Securities are same principal amount OR

Lesser than principal amount without recognition of g/l to the holder.

* + - * + Stock for securities = no good.
		- Boot is taxed under § 356:
			* Recognition:
				+ Other property – § 356(a)(1)(A): gain recognized is to the lesser of boot received or gain realized.
			* Character:
				+ § 356(a)(2): if an exchange has the effect of a dividend under  §318, then treat boot as gain as a dividend:

*Clark*:

1) pretend SH only received stock;

2) pretend there is a redemption of stock in exchange for boot;

3) test for the redemption safe harbors in § 302.

* + - Basis:
			* §358(a): basis is going to be the basis in the property exchanged.
				+ OG Basis
				+ FMV boot rec’d
				+ + G recognized
				+ – liabilities received that don’t qualify under § 357(c)(3)
				+ New Basis
	+ Target Creditors:
		- Bonds are securities for this purpose.
		- § 361(c): focused on tax consequences to target on the liquidation where bondholders are treated like SHs.
			* With a different analysis:
				+ § 354(a)(2) limitations:

If securities are received but not surrendered, it is not a tax free exchange. But bondholders are giving up securities for stock.

Swapping securities for securities = non-taxable exchange – Reg. § 1.354-1(a).

**VII. “B” Reorganizations:**

* B Reorganization Defined º § 368(a)(1)(B):
	+ the acquisition by one corporation, in exchange *solely for all or a part of its voting stock* (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), *of stock of another corporation* if, *immediately after the acquisition, the acquiring corporation has control of such other corporation* (whether or not such acquiring corporation had control immediately before the acquisition)
		- There is no liquidation in a B reorg.
			* If there is a liquidation, it is likely to be a C reorg.
	+ Why use a B reorg:
		- Avoid state transfer taxes;
		- Regulatory problems can be avoided;
		- Keep T’s goodwill;
		- Don’t have to worry about transferring individual assets;
		- May not need a SH vote.
		- Generally speaking, no dissenters’ rights.
* B Reorganization Requirements:
	+ 1) Acquisition of T’s stock solely for P voting Stock:
		- *Solely for voting stock*:
			* Must be voting stock:
				+ This is in an issue any time there is a requirement that payment be made in voting stock.

There are all kinds of ways this issue has arisen.

Usually it is considered voting if the holders can vote for directors.

What if they can only for vote for a limited number of the board – Service has said you don’t have to have the right to vote for the entire board.

Contingent voting rights:

May become voting stock later (cumulative preferred only has the right to vote is dividends in arrears) it is not voting stock until the contingency has arisen – so not voting stock.

* + - * + Convertible bonds, warrants, or options are not voting stock.
			* Boot busts the B Reorg:
				+ RR 85-139: *solely for voting stock* applies to the entire transaction.

Might try to argue that the transaction with A & B is separate from the transaction with C.

Not a good argument; won’t work.

* + - * If all are being bought out at the same time and some get voting and some get cash, it is not a good B reorg.
			* Issue: does taking on the debt ruin the B reorg because it is no longer solely for voting stock. P is issuing debt.
				+ RR 98-10: The Service has said that a transaction like this is fine.

Service is narrowly focused on what T shareholders were getting for their stock – here, they were getting solely voting stock.

What matters in this first issue is what is the consideration exchanged for the target stock.

* + - * + What if the shares of target stock and debt held of target are not held proportionally – i.e., Would the gov be concerned if the bonds of T and the shares of T were held proportionally?

Ex. Debt held proportionally by the shareholders – A 50%, etc.

What were the shareholders paid with?

The concern would be that some portion of the debt issued/dist./paid by P was being paid for by P’s stock.

This would be a fundamental issue of whether it is a good B reorg.

Because the debt was held by not shareholders, the value of the debt is presumed to be reasonable; but if the creditors are shareholders, the concern is some of the debt is for the stock.

* + - * + Exchange of P bonds for T’s debt.

Ruling held that since P & T are parties to the reorg; there is a good reorg; and the exchange of debt is part of the plan of reorg. This means that if the principal amount of debt exchanged for P’s bonds, the exchange is a nonrecognition transaction.

§ 354 & 356.

The key is P & T are parties to the reorg and the debt for debt exchange is viewed as pursuant to a plan of reorg.

Can be a hook on which a conclusion is reached.

* + - * + If the only people getting cash are debtholders of target, this will not ruin the B Reorg – RR 98-10.
			* Redemption/Buyout of Minority Shareholders:
				+ RR 68-285:

Redemption by T of T shareholders prior to the reorg is ok.

Facts: Good reorg where target set up escrow fund to redeem T shareholders for cash, even though after transaction. No cash payments made by P.

* + - * + If T obtained the cash it used to redeem the shareholders from a bank loan, close in time to the reorg.

P contributes cash as a capital contribution & T uses cash to repay the loan.

P is reimbursing T for cash paid to the shareholders.

In essence, P’s money was used in the redemption.

RR 75-360: gov said that this would make it a taxable transaction. Cash can be viewed as coming from P

Pre-Reorg redemption funds must come from T – cannot

* + - * Infusion of Cashin into T by P – either by cash or purchase of unissued stock:
				+ This shouldn’t be a problem either way. The solely for voting stock rule is concerned only with payments to the t shareholders for their stock. As long as the cash does not constitute consideration paid directly or indirectly to the shareholders, it won’t ruin the B.
			* Dividends to T shareholders from T:
				+ RR 68-435: delayed closing of transaction; T paid dividend to SH from its own funds; did not ruin the B, even though it was based upon the dividend that would have been received from P.
				+ RR 69-443: 3 months between declaration of div and payment date; P acquired all of the stock of T; then div was paid out of T’s own funds to the SH as of the date of declaration. Did not adversely affect the B reorg.

Dividend wasn’t even viewed as part of the consideration the SHs received.

* + - * + RR 70-172: dist. immediately prior to exchange from T to T’s shareholders of its own funds; did not bust the B.
			* Costs of Registering common stock of P:
				+ RR 670275: No, this will not ruin the B reorg. The registration will promote orderly market.
			* Payment of transfer taxes arising from exchange:
				+ The problem arises in 2 factual circumstances:

1) Payment made for expenses of the shareholders, rather than the target;

2) if the fee that is being covered by P and related to the reorg is reimbursed to T or T SHs, it could ruin the B reorg.

* + - * + Legal and accounting fees would likely be the same treatment.
			* Subsequent Sales of stock by T Shareholders:
				+ RR 85-139:

Subsidiary of P cannot acquire remaining T stock for cash; will bust the entire B Reorg.

Reg. § 1.368-2(e)(8), ex. 9 – example of this.

* + 2) Control of T Immediately After:
		- § 368(c): 80% of vote **and** 80% of each class of outstanding stock.
		- RR 75-123:
			* Cannot distribute 80% stock and 20% cash pro rata because the cash is boot and ruins the B.
				+ You can just exchange with 80% of the shareholders and leave the remaining 20%.
		- *Immediately after*:
			* Reg. 1.368-2(c): tells us that events taking place in a relatively short period of time (12-month period) are viewed together.
				+ The creeping B Reorg.
			* Reg. § 1.368-2(j)(6), ex. 4 & 5:
				+ If there is an acquisition and then the B Reorg separated by 16 years, then the acquisitions are viewed as separate.

“old and cold”

No clear answer as to what is a long enough time.

16 years good

12 months no good.

* + - * P can cleanse the tainted stock for the creeping B Reorg:
				+ RR 72-354: If P sells the tainted interest it previously purchased for cash to an unrelated party, it is possible later exchanges for stock can satisfy a B reorg.

Must be a real sale – unconditional, not dependent on later reorg; buyer of tainted stock has no obligation to resell the stock back to B, although could tender the stock acquired along with other shareholders, but there cannot be a tie between the sale and the tender back.

The risk is that P could lose the 30% block because of its inability to force the unrelated buyer to sell it back.

P will then be unable to get the 80% control requirement

* + - * RR 68-562: Controlling shareholder of P buys B interest for cash; a relatively short time afterwards P exchanges. Might work. Service noted that controlling SH was under no obligation to exchange and was not reimbursed.
				+ Cash used did not come directly or indirectly from acquirer.
				+ Possible to cure this problem
* Tax Consequences:
	+ Target:
		- Nothing happens to the Target
	+ Target Shareholders:
		- Exchange:
			* No g/l under § 354(a)(1) so long as exchange was solely for stock.
				+ Reg. § 1.354-1(a):

Stock for stock = good

Stock for securities = no good – boot

Securities for Securities = ok

RR 98-10: debt for debt will not ruin the B; the debt exchange is treated as a separate exchange pursuant to the plan of reorg.

No g/l to debt holders under §354(a)(1).

Securities for cash: taxable as separate transaction.

* + - Basis:
			* § 358(a)(1): take SH original basis and carryover
				+ OB basis
				+ FMV boot rec’d
				+ Gain recognized
				+ Liabilities assumed that don’t qualify for § 357(c)(3).
				+ = new basis
	+ Purchaser:
		- § 1032: no g/l on exchange of property for corporation’s own stock.
		- § 362: basis is carryover basis from Target shareholders.

**IX. Triangular Reorganizations:**

a. Overview:

* Called triangular because there are 3 corporations:
	+ Target
	+ Acquiring & Parent; or
	+ Target and Sub
* Common for an acquiring corp. to continue operating the target.
* The goals:
	+ Keeping target in place;
	+ Target SH end up with acquiring corp.’s stock

b. C Reorg. With Drop Down:

* § 368(a)(2)(C): does not disqualify a transaction otherwise qualifying under (a)(1) if assets or stock are transferred to a controlled corporation.
* Sequence:
	+ 1) Exchange:
		- Assets & liabilities from T to P
		- P gives T voting stock.
	+ 2) Liquidation of Target
	+ 3) Drop Down:
		- P moves assets and liabilities of T to P’s Sub.
		- Sub. Gives P sub. Stock (351)
* Tax Consequences:
	+ Target:
		- § 361(a): no g/l on the exchange between parties to a reorg in pursuance to a reorg.
		- § 361(c): no g/l on liquidation.
	+ Target Shareholders:
		- § 354: no g/l recognized on the exchange of stock for stock.
		- § 358: carryover basis from T stock to P stock.
	+ Purchaser:
		- Exchange with Target:
			* § 1032: Using its own stock to acquire assets of target; insulated from gain/loss
			* § 362(b): basis in T’s assets is the same as what T had.
			* Reg. § 1.381(a)-1(b)(2): P inherits T’s tax attributes – EP, NOLs.
				+ Stays with P rather than dropping down to Sub.
		- Drop Down to Sub:
			* § 351 Transaction:
				+ No g/l on exchange of assets for Sub stock.

Must have control after

* + - * Basis in Sub Stock:
				+ § 358: same as basis in Target’s assets.

OG Basis – FMV of property rec’d + gain recognized – liabilities assumed by sub = New basis.

* Subsidiary:
	+ Receipt of dropped down assets:
		- § 1032: no g/l on issuance of stock in exchange for the assets.
	+ Basis in Target’s Assets:
		- § 362(b): same as in the hands of P increased by any gain recognized.
	+ Tax Attributes of Target:
		- Does not receive the tax attributes of target – stays with P – Reg. § 1.381(a)-1(b)(1 & 2).

c. Triangular C – Over the Top:

* § 368(a)(1)(C): the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other shall be disregarded;
	+ The consideration cannot be a mix of P and Sub stock – must be one or the other.
	+ § 368(b) provides that both P and Sub are parties to the reorg.
	+ § 368(a)(2)(B): boot relaxation rule for C reorgs.
		- Voting stock must be 80% of the bucks – but can be either P or Sub stock.
		- Sub can contribute nonvoting stock.
* Steps:
	+ 1) P contributes its own stock to Sub.
	+ 2) T and Sub Exchange:
		- T transfers assets & liabilities to Sub
		- Sub transfers P stock to T.
	+ 3) T liquidates and dist. T shareholders the P stock.
* Tax Consequences:
	+ Target:
		- Exchange:
			* § 361(a): no g/l recognized
			* § 357: the liabilities assumed is not treated as boot.
		- Liquidation:
			* § 361(c): no g/l.
	+ Target Shareholders:
		- § 354(a): no g/l on the receipt of stock for stock.
		- Basis:
			* §358(a): carryover basis from T stock to P stock.
	+ Purchaser:
		- Reg. § 1.358: special rules that apply to parent corp. in triangular reorgs.
			* Reg. § 1.358-6(c):
				+ Essentially treated the same way a Triangular C with a drop down would be treated.

Pretend that P contributed P voting stock to T and T transferred its assets & liabilities to P.

Pretend P takes the assets & liabilities of T and contributes them to Sub.

* + - * Pretend exchange of P stock for T assets:
				+ § 1032: no g/l.
				+ § 354: Basis = T’s basis carried over.
			* Pretend Drop Down:
				+ § 351: no g/l
				+ Basis: § 358(a): basis is Sub stock is the basis of property transferred – carried over basis from T reduced by liabilities shed.
	+ Subsidiary:
		- Receipt of P’s stock:
			* § 1032 provides no g/l on exchange with P.
		- Exchange with Target:
			* 1032 does not technically protect S corp. from the gain/loss when it uses P stock.
				+ S acquires P stock in a 351 which means its takes P’s basis in its own stock which is 0, and that means where there is an exchange for the T assets, that is a gain transaction. Nothing in the language to protect that from recognition.

The Regs however take care of this.

The Regs are plugging a hole that exists in the statutory language.

If S received the P stock from P pursuant to the plan of reorg, S recognizes no g/l on the exchange – treated as if P actually transferred the stock.

* + - * This solves the problem which would otherwise create a situation where the tax consequences of a tri. C are different than a C drop down.
		- Target’s Tax Attributes:
			* Reg. § 1.381(a)-1(b)(1 & 2):
				+ The tax attributes stay with P because it is treated as though it was a Triangular C with a Drop down.

d. Forward Subsidiary Merger:

* A forward subsidiary merger is a statutory merger that would otherwise qualify under (a)(1)(A) except for the use of controlling company stock.
	+ § 368(a)(2)(D): specifically carves out this exception.
	+ Reg. § 1.368-2(b)(2) make it clear that this is not a reference to state/local merger law; they are concerned with tax law – if there had been a merger into the parent and the other tax rules had been met (COPI, COBE), this is what it refers to.
* Requirements:
	+ Parent Forms Subsidary with P stock and possibly cash.
	+ Sub acquires substantially all of the assets of T.
		- Same requirement imposed on C reorgs. And similar standards apply.
	+ No subsidiary stock can be used – § 368(a)(2)(D)(1) – must be P stock.
		- Debt is not stock, so debt boot is permissible, even if it is debt from the Sub – Reg. § 1.368-2(b)(2).
		- If sub stock is given, check to see if it could qualify as a Triangular C – drop down or over the top.
	+ The transaction would have qualified as an A had T merged directly into P.
		- Has to satisfy COPI, COBE, and COBP.
			* 40% stock minimum in consideration bucket.
			* Boot will be taxed though.
* Steps:
	+ 1) P transfers its own stock to Sub.
	+ 2) Sub exchanges the P stock with T for T’s assets.
	+ 3) T is liquidated, and P’s stock distributed to T shareholders.
* Tax Consequences:
	+ Target Shareholders:
		- Exchange of Stock:
			* § 354(a): no g/l on exchange of stock for stock when both corporations are parties to the reorg and in pursuance of reorg.
				+ § 368(a)(2)(D) provides that P is a party to the reorg which allows this result.
			* If boot rec’d:
				+ Recognized lesser of boot rec’d or gain realized.

Characterize gain based on *Clark* and the pretend redemption.

* + - Basis in stock:
			* § 358: carried over basis
				+ OB Basis
				+ + FMV of boot rec’d
				+ + gain recognized
				+ – liabilities shed
				+ New basis.

§ 357(c)(3) liabilities do not need to be excluded.

* + - Basis in securities, if any:
			* § 358(a)(2): FMV of prop
	+ Target:
		- T merges into S.
		- Treated like an A reorg.
			* § 361(a): no g/l recognized on the exchange with Sub.
				+ Stock for stock & securities is good.
			* 357 insulates g/l on the assumption of liabilities.
			* 361(c) no g/l on the dist. of the stock and debt b/c qualified property.
	+ Subsidiary:
		- Exchange:
			* Ends up with T’s assets & liabilities
			* Reg. § 1.103202: subsidiary can use P’s stock for the exchange and have nonrecognition of g/l.
		- Basis:
			* § 362(b): carryover basis from Target.
	+ Purchaser:
		- P’s Basis in T stock:
			* Reg. § 1.368-6(c): we pretend that P engaged in reorg with T and tehn contributed assets and liabilities to Sub for additional stock.
				+ § 362(b): carry over basis in T assets less liabilities.
			* § 351 contribution to Sub.
		- P’s basis in Sub stock:
			* Carryover basis in T’s assets less liabilities shed plus original basis in P’s sub stock.
				+ If there is boot: Reg. § 1.358-6(d)(2)(B): reduced basis by the amount of boot paid.

e. Reverse Subsidiary Merger:

* Overview:
	+ Looks similar to a B Reorg.
		- § (a)(2)(E) – the reverse sub. Merger.
			* There are aspects of this that are more lenient than a B.
			* And to some extent the reverse sub merger is more flexible, but not in all respects.
	+ If you engage in a reverse sub merger, P can eliminate minority SHs.
		- A straight stock for stock exchange might result in not all SHs agreeing to the trans – end up with minority SHs.
			* This is often a concern.
		- In a B reorg, on the other hand, in order to get rid of minority shareholders, you’d have to have 100% of the shareholders of the target agreeing to sell their shares.
			* There are ways to deal with the possibility of minority shareholders:
				+ Redeem them prior to the reorg – but boot is a concern.
		- In a reverse sub. Merger, boot is possible. The statute authorizes, with limitations, boot.
			* But the B reorg does not.
* Requirements for (a)(2)(E):
	+ 1) State merger law; COPI, plan of reorg, COBE, & business purposes. (the exigencies of business).
	+ 2) After the merger, T must hold substantially all of its properties and substantially all of the merged corp’s properties. 1.368-2(j)(3)(iii).
		- Other than the P stock dist. in the merger and other than cash which was put into the merged corp. to make certain payments.
	+ 3) In the transaction, T’s shareholders exchange T stock representing control for the voting stock of P.
		- Sub dissolves; T survives.
	+ 4) The control requirement is amplified in the Regs 1.368-2(j)(3)(i).
* Steps:
	+ 1) P creates S in a 351 transaction;
		- P transfers P *voting* stock to S in return for S’s stock
	+ 2) S merges into T (i.e., target survives);
		- In a statutory merger
	+ 3) The assets & liabilities (if any) are transferred to T
		- This is a function of the merger law.
		- Here, S’s only asset is the P stock.
	+ 4) By operation of law (the merger statute), the sub stock owned by P is converted into target stock.
		- P goes from being parent of sub to parent of T.
	+ 5) S disappears; S stock held by P is canceled.
	+ 6) T’s Shareholder exchanges T shares for P voting stock, acquired by the target in the merger.
		- This is how T’s shareholder becomes a SH of P.
* *Substantially All Requirement*:
	+ Target must hold substantially all of its properties and substantially all of the properties of the subsidiary, other than the stock of P.
		- Rev. Proc. 77-37: (same as C reorg)
			* 70% of FMV of gross assets AND
			* 90% of FMV of net assets
		- Rev. Rul. 2001-25. Substantially all issue in an (a)(2)(E). Target survives and is required to hold substantially all of its assets and all of S’s assets with exceptions for consideration. Facts: merger of S into T, then T sells 50% of its operating assets to an independent third-party. Thereafter T holds that cash + operating assets not sold. Substantially all requirement met in this Rev. Rul. Requirement is to hold substantially all. Cash sale means it fails to hold all of its historical assets. As long as it holds the cash from the sale it seems to be okay. If you distribute the cash you may be in trouble.
* *Control Requirement*:
	+ § 368(a)(2)(E): in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation.
		- Must exchange voting stock in P for an amount of stock which constitutes control in target.
			* Can pay something in addition to voting, but P must be in control of T.
				+ 80% of the bucket has to be voting stock.
	+ Target stock redeemed before the reorg is ignored.
		- Look 1.268-2(j)(3)(i): redeemed shares of target are not treated as outstanding for the purposes of the control test.
		- Question is whether or not in determining sub all the 250 no longer held by T has to be counted? Yes - -1.368-2(j)(3)(iii).
	+ There cannot be a creeping reverse subsidiary merger because control is required to be in bulk transfer.
* Tax Consequences:
	+ Purchaser:
		- § 351: no g/l on transfer of stock to Sub.
		- Basis:
			* Reg. § 1.358-6(c)(2): P’s basis in T’s stock acquired equals basis in P’s Sub stock immediately before the transaction adjusted as if T had merged into Sub in a forward merger.
				+ Start with original basis:
				+ Increased by Drop down of T’s assets (net of liabilities)
				+ New Basis
	+ Sub:
		- Merges into to T and dissolves.
		- Exchange with T:
			* § 361(a): no g/l on transfer of Sub’s sasets for T stock.
		- On liquidation of P stock to T, no gain loss per § 361(c).
	+ Target:
		- Exchange with Sub: no g/l recognized under § 361(a).
		- On distribution to SH: no g/l under § 361(c) b/c qualified property.
	+ Target Shareholders:
		- Exchange of Stock:
			* § 354: no g/l on receipt of:
				+ Stock for stock;
				+ Securities for securities;

But if principal on securities rec’d is larger, recognize gain

* + - * + Stock for securities = boot.
		- On boot, if any:
			* § 356: recognize gain to the lesser of boot received or gain realized.
		- Basis:
			* § 358(a)(1):
				+ OG basis
				+ – FMV of boot received
				+ + gain recognized
				+ – liabilities shed
				+ New Basis

f. Triangular B Reorgs:

* A Triangular B Reorg is an acquisition by Sub of T stock in exchange for P stock in a transaction that qualifies as a reorganization under § 368(a)(1)(B).
	+ § 368(a)(1)(B): the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition).
	+ The alternative way would be for P to acquire T stock and drop down to Sub.
* Requirements:
	+ *Solely* for P or Sub voting stock – Reg. § 1.368-2(c)
		- Cannot have a mixture of P and Sub stock.
	+ Party to a reorg under § 368(b).
* Steps:
	+ 1) Sub acquires stock of T;
		- No boot can be exchanged.
		- Normal B rules.
	+ 2) in exchange for all or party of P or Sub’s stock
		- Can use either’s stock BUT NOT a mixture of both stock – Reg. § 1.368-2(c).
			* Statutes says “or” and not “and”
	+ 3) P/Sub are in control.
* Tax consequences:
	+ Target’s Shareholders:
		- § 354(a): no g/l for the exchange of stock for stock with parties to a reorg.
		- Basis:
			* § 358: carryover basis – basis in T stock is basis in P stock
	+ Target:
		- No consequences; just different shareholders.
	+ Sub:
		- Reg. § 1.1032-2(c): no g/l to sub on the exchange of its parent’s stock for property.
		- Basis:
			* § 362(b): sub’s basis in target stock is the same as it was in the hands of the target shareholders.
	+ Purchaser:
		- Turn to 1.358-6(c)(3): consequences of a triangular B are analyzed as if P exchanged its own stock for the stock of T and dropped the stock into the sub (over the top).
		- Pretend there is an exchange of P’s tock for T shareholder’s T stock;
		- P has § 362 carryover basis from T’s shareholders;
		- Then the drop down to Sub is a § 351 nonrecognition transaction.