

CORPORATE TAXATION

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CAROLINA ACADEMIC PRESS

Durham, North Carolina

ISBN: 978-1-5310-1773-6 (Paperback)

ISBN: 978-0-32717-439-4 (eBook)

Library of Congress Cataloging-in-Publication Data

Crane, Charlotte.

Corporate taxation / Charlotte Crane, Linda McKissack Beale.

p. cm. -- (Lexisnexis graduate tax series)

Includes index.

ISBN 978-1-4224-1999-1

1. Corporations--Taxation--Law and legislation--United States. I. Beale, Linda McKissack. II. Title.

KF6464.C73 2012

343.73067--dc23

2011046881

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Carolina Academic Press, LLC
700 Kent Street
Durham, North Carolina 27701
Telephone (919) 489-7486
Fax (919) 493-5668
www.caplaws.com

Printed in the United States of America
2019 Printing

PREFACE

This First Edition of *Taxation of Corporations* comes out on roughly the twenty-fifth anniversary of the “repeal of *General Utilities*.” Many at the time saw that development as a high-water mark in the commitment to the corporate tax and to the body of law traditionally associated with a law school course in corporate tax.

Much has changed since then. There is currently enormous pressure on the corporate tax. Although any entity with publicly traded equity is still subject to subchapter C, the percentage of new equity being invested domestically in such entities continues to dwindle. In addition, ever increasing percentages of the equity subject to subchapter C is held by shareholders, including charitable institutions, pension plans and other tax-preferred savings vehicles, which are relatively indifferent to many of the traditional aspects of shareholder taxation. These trends may have made the basic structure of subchapter C seem less important. But the details about its implementation in previously obscure areas — like the use of subchapter C corporations as “blockers” or the special rules applicable when corporations are partners — have become increasingly important, and cannot be understood without understanding the basic structure.

There is much discussion about substantial corporate tax reform ongoing in Congress, but the direction of that reform remains to be seen. The last decade saw changes that reduced both the taxes on shareholder income and the taxes on corporate income. In 2003, Congress enacted a temporary preferential rate for corporate dividends, significantly impacting (at least temporarily) the primary rationale for many of the corporate tax provisions that attempt to prevent a bailout of earnings at capital gains rates rather than the ordinary rates that have typically applied to corporate dividends. The 2004 “American Jobs Creation Act” provided another round of tax breaks for C corporations, along with more anti-abuse rules. The codification of the economic substance doctrine, considered in Congress since at least 1995 and finally enacted in 2010, will likely have an ongoing impact on corporate transactions, but the exact nature of that impact remains unclear. Proposals to remove the disparity between the tax burden on income earned by subchapter C corporations and that earned by other business entities by expanding the scope of the tax to unincorporated enterprises continue to be made, with increasing likelihood that they will be taken seriously.

Even without such politically-charged moves by Congress, the law of subchapter C is no longer the law that was put in place in 1986. The legislative and regulatory responses to the “corporate tax shelters” devised in the decades immediately following *General Utilities*’ repeal have introduced significant complexity in even the most basic provisions. Other regulatory developments, including the “check-the-box” regulations and the streamlining of many aspects of the law surrounding reorganizations, may have provided solutions to the problems perceived by practitioners intent on reducing taxes in connection with transactional planning, but they have done little to make the law as a whole more comprehensible.

Newer pressures have been created by the effort to improve the income tax compliance of shareholders through basis information reporting. At the corporate level, this change has put new emphasis on the concept of the share as the basic unit of property, a concept which if implemented to the fullest has the possibility of producing unexpected results in many transactions and perhaps highly questionable alterations in the reorganization

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provisions. New pressures have also been created by the “globalization” of subchapter C. Its provisions are often used (in the quest for the maximization of foreign tax credits) to calculate the US income of entities not currently subject to US tax. It is safe to say that the drafters of many provisions, especially sections 304, 351(g) and 338, could not have foreseen the role these provisions would come to play.

These developments have clearly made the corporate taxation more of a challenge to teach. This text was therefore developed with the underlying rationale of helping the student establish a solid background in the basic principles of subchapter C, not just as it exists today but as it will evolve in the near future.

Both authors believe that problem solving is critical to learning corporate tax. The text therefore provides relatively simple practice problems for each chapter designed to ensure that students grasp the fundamental operations of those provisions. The text also includes discussion problems that require students to synthesize the materials and consider planning alternatives. In these problems — and sometimes even in the text — the issues raised go beyond issues for which there is clear authority.

Student course materials all too often are prepared so that they address only what can be said is definitely the law, and use only the regulations and the decided cases as the sources both for the questions that are raised and the answers that are provided. This approach leaves both the instructor and the student with a high level of confidence about having mastered the material. But it ultimately shortchanges the student because first, there is a lot of gloss on the statute that doesn’t reveal itself easily in either regulations or decided cases, and, second, this approach does not prepare the student to analyze transactions that are even slightly unusual, much less to understand the pressures that drive the evolution of the law. An appreciation of why there is no authority on a point can be as important as understanding the authorities that do exist.

The result, we both hope and fear, is a set of problems that are somewhat challenging. Those instructors who have limited time may prefer to rely on the Practice Problems as the vehicles used for presenting the materials and assign the discussion problems sparingly. In order not to render the material too intimidating, the teacher’s manual provides answers for both types of problems and explores a number of issues that can be raised in the discussion problems at the discretion of the instructor.

On the other hand, we have omitted from the student text many details revealed by decided authorities that sometimes clutter the “notes” sections of traditional casebooks. Our view is that these items tend to overwhelm both the student and the instructor, and all too frequently highlight relatively insignificant parts of the law. Discussion of many such items is nevertheless included in the teacher’s manual. The manual also develops a number of other advanced topics that were not included in the text because they raise difficult conceptual issues or are perhaps too advanced for most J.D. tax courses: the instructor may choose to discuss these topics or not depending on the level of preparation of the students and the intended coverage of the course. The manual also offers suggestions for additional reading, with both more theoretical articles and articles selected from practice that will be of particular interest to those who are teaching the course as a skills-oriented course.

Because the corporate provisions are so dense and changes are frequent and substantial, the authors designed the text to be used flexibly. We do not begin with section 351 and the formation of corporations but rather with operating distributions. This

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approach grounds the student in the aspects of subchapter C that distinguish it from the other regimes under which business income may be taxed, and reduces the chance that the student will associate section 351 only with corporate formation. Nonetheless, for those who wish to continue using the “life cycle” order of introducing topics, the text is set up in free-standing chapters that can be used in whatever order the instructor chooses. An instructor may also opt for in-depth coverage of some areas and less detailed coverage of others.

The text includes almost no original materials from court cases or administrative guidance. We indicate for each chapter the most relevant Code sections and authoritative materials. It is our assumption that students will read relevant materials online before class, and that the instructor will highlight those items that are particularly important for the course as it develops. Our view is that students should encounter these authorities in their full, unedited state, rather than reading a carefully edited excerpt that points them directly to the relevant phrases. We believe that it is important for students to develop an ability to read and understand tax statutes, revenue rulings, regulation preambles and amendments on their own, without being “spoonfed” by text and teacher.

Part I of the text covers the fundamentals of corporate taxation. In Subpart A dealing with the general taxation of corporations, the text begins with a discussion of the corporate tax base (Chapter 1) and distributions from corporations (Chapter 2). It then covers shareholder transfers of property to corporations under section 351 (Chapter 3) and deals separately with liability assumptions in connection with those transactions (Chapter 4). (We hope that this separation will result in more focused attention on the conceptual difficulties inherent in dealing with liabilities that may not be associated with any particular asset or that may not be easily quantified.) The last chapters in Subpart A deal with corporate liquidations and their effects on the corporation and minority shareholders (Chapter 5) and the DRD and liquidations of controlled subsidiaries (Chapter 6). Subpart B covers other building block transactions: redemptions under section 302 (Chapter 7), redemptions through related corporation sales under section 304 (Chapter 8), and stock distributions and similar transactions such as recapitalizations (Chapter 9).

Once these basic building block transactions are introduced, students are prepared to explore choice of entity issues and the pass-through corporate tax entity. Subpart C introduces subchapter S concepts (Chapter 10) and discusses choice of entity and capital structure issues (Chapter 11). Subpart D deals with taxable asset and stock acquisitions (Chapter 12), section 338 recharacterization of stock acquisitions as asset acquisitions (Chapter 13), and the rules for carryovers of tax attributes and limitations on losses after corporate acquisitions and restructurings (Chapter 14).

Subpart E concludes Part I with nontaxable reorganizations. It begins with an overview discussing the sources of rules, basic patterns and consequences to the parties in acquisitive reorganizations, with special emphasis here on A reorgs (Chapter 15). There follows an intensive discussion of boot in reorganizations (Chapter 16); B reorgs (Chapter 17); C reorgs (Chapter 18); and triangular mergers and a discussion of drop-downs and push-ups of acquired stock or assets and multi-step reorganizations generally (Chapter 19). The remaining chapters in this Subpart deal with other acquisitive and nondivisive transactions including acquisitive section 351 transactions, double dummies, and nondivisive D reorgs (Chapter 20); the complications in the implementation of subchapter C resulting from the presence of disregarded entities (Chapter 21); F reorgs

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(Chapter 22); and an extensive discussion of section 355, including the post-General Utilities anti-abuse rules (Chapters 23 – 25).

Part II provides a discussion of advanced topics that some instructors may wish to incorporate along with one of the earlier chapters or pick and choose for a few advanced topics at the end of the course. Subpart A deals with debt and equity issues of particular interest in the corporate context, including section 1032 and the use of a corporation's own stock, options, or tracking stock (Chapter 26) and transactions involving debt of related parties (Chapter 27). Subpart B provides a brief introduction to consolidated returns, as a means of exploring advanced topics in entity organization (Chapter 28).

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