

Understanding Corporate Taxation

CAROLINA ACADEMIC PRESS UNDERSTANDING SERIES

- Understanding Administrative Law,
Sixth Edition
William Fox, Jr.
- Understanding Alternative Dispute Resolution
Kristen M. Blankley and Maureen A. Weston
- Understanding Animal Law
Adam Karp
- Understanding Antitrust and Its Economic
Implications, Seventh Edition
E. Thomas Sullivan and Jeffrey L. Harrison
- Understanding Bankruptcy, Fourth Edition
Jeffrey Ferriell and Edward J. Janger
- Understanding California Community
Property Law
Jo Carrillo
- Understanding Capital Punishment Law,
Fourth Edition
Linda E. Carter, Ellen S. Kreitzberg,
and Scott W. Howe
- Understanding Civil Procedure, Sixth Edition
Gene R. Shreve, Peter Raven-Hansen, and
Charles Gardner Geyh
- Understanding Civil Procedure:
The California Edition
Walter W. Heiser, Gene R. Shreve,
Peter Raven-Hansen, and Charles Geyh
- Understanding Civil Rights Litigation,
Second Edition
Howard M. Wasserman
- Understanding Conflict of Laws,
Fourth Edition
William M. Richman, William L. Reynolds,
and Chris A. Whytock
- Understanding Constitutional Law,
Fourth Edition
John B. Attanasio and Joel K. Goldstein
- Understanding Contracts, Fourth Edition
Jeffrey Ferriell
- Understanding Copyright Law,
Seventh Edition
Marshall A. Leaffer
- Understanding Corporate Law,
Fifth Edition
Arthur R. Pinto and Douglas M. Branson
- Understanding Corporate Taxation,
Fourth Edition
Leandra Lederman and Michelle Kwon
- Understanding Criminal Law, Eighth Edition
Joshua Dressler
- Understanding Criminal Procedure:
Vol. 1: Investigation, Seventh Edition
Joshua Dressler, Alan C. Michaels,
and Ric Simmons
- Understanding Criminal Procedure:
Vol. 2: Adjudication, Fourth Edition
Joshua Dressler and Alan C. Michaels
- Understanding Disability Law, Third Edition
Mark C. Weber
- Understanding Election Law
and Voting Rights
Michael R. Dimino, Bradley A. Smith,
and Michael E. Solimine
- Understanding Employee Benefits Law,
Second Edition
Kathryn L. Moore
- Understanding Employment
Discrimination Law, Third Edition
Thomas R. Haggard and Bruce N. Cameron
- Understanding Employment Law,
Third Edition
Paul M. Secunda, Richard A. Bales,
and Jeffrey M. Hirsch
- Understanding Environmental Law,
Third Edition
Philip Weinberg and Kevin A. Reilly
- Understanding Estate and Gift Taxation,
Second Edition
Brant J. Hellwig and Robert T. Danforth
- Understanding Evidence, Fifth Edition
Paul C. Giannelli
- Understanding Family Law, Fourth Edition
John Gregory, Peter N. Swisher,
and Robin Wilson
- Understanding Federal and
California Evidence
Paul C. Giannelli
- Understanding Federal Courts
and Jurisdiction, Second Edition
Linda Mullenix, Martin H. Redish,
and Georgene Vairo
- Understanding Federal Income Taxation,
Sixth Edition
J. Martin Burke and Michael K. Friel

- Understanding the First Amendment,
Seventh Edition**
Russell L. Weaver
- Understanding Immigration Law,
Third Edition**
Kevin R. Johnson, Raquel Aldana,
Bill Ong Hing, Leticia M. Saucedo,
and Enid Trucios-Haynes
- Understanding Insurance Law, Sixth Edition**
Robert H. Jerry, II and Douglas Richmond
- Understanding Intellectual Property Law,
Fourth Edition**
Tyler T. Ochoa, Shubha Ghosh,
and Mary LaFrance
- Understanding International Business
and Financial Transactions,
Fourth Edition**
Jerold A. Friedland
- Understanding International Criminal Law,
Third Edition**
Ellen S. Podgor and Roger S. Clark
- Understanding International Law,
Second Edition**
Stephen C. McCaffrey
- Understanding Jewish Law, Second Edition**
Steven H. Resnicoff
- Understanding Juvenile Law, Fifth Edition**
Martin Gardner
- Understanding Labor Law,
Fifth Edition**
Douglas E. Ray, Calvin William Sharpe,
and Robert N. Strassfeld
- Understanding the Law of Terrorism,
Second Edition**
Erik Luna and Wayne McCormack
- Understanding the Law of Zoning
and Land Use Cwontrols, Third Edition**
Barlow Burke
- Understanding Lawyers' Ethics, Fifth Edition**
Monroe H. Freedman and Abbe Smith
- Understanding Local Government,
Second Edition**
Sandra Stevenson
- Understanding Modern Real Estate
Transactions, Fourth Edition**
Alex M. Johnson, Jr.
- Understanding Negotiable Instruments
and Payment Systems, Second Edition**
William H. Lawrence
- Understanding Nonprofit and Tax Exempt
Organizations, Second Edition**
Nicholas P. Cafardi and Jaclyn Fabean Cherry
- Understanding Partnership
and LLC Taxation, Fourth Edition**
Jerold A. Friedland
- Understanding Patent Law, Third Edition**
Amy L. Landers
- Understanding Products Liability Law,
Second Edition**
Bruce L. Ottley, Rogelio A. Lasso,
and Terrence F. Kiely
- Understanding Property Law,
Fourth Edition**
John G. Sprankling
- Understanding Remedies, Third Edition**
James M. Fischer
- Understanding Sales and Leases of Goods,
Third Edition**
William H. Henning, William H. Lawrence,
and Henry Deeb Gabriel
- Understanding Secured Transactions,
Fifth Edition**
William H. Lawrence, William H. Henning,
and R. Wilson Freyermuth
- Understanding Securities Law,
Seventh Edition**
Marc I. Steinberg
- Understanding Taxation of Business Entities**
Walter D. Schwidetzky and Fred B. Brown
- Understanding Torts, Sixth Edition**
John L. Diamond, Lawrence C. Levine,
and Anita Bernstein
- Understanding Trade Secret Law,**
John G. Sprankling and Thomas G. Sprankling
- Understanding Trademark Law, Fourth Edition**
Mary LaFrance
- Understanding Trusts and Estates,
Sixth Edition**
Roger W. Andersen and Susan Gary
- Understanding White Collar Crime,
Fourth Edition**
J. Kelly Strader

Understanding Corporate Taxation

FOURTH EDITION

Leandra Lederman

WILLIAM W. OLIVER PROFESSOR OF TAX LAW
INDIANA UNIVERSITY MAURER SCHOOL OF LAW

Michelle Kwon

ASSOCIATE PROFESSOR OF LAW
UNIVERSITY OF TENNESSEE COLLEGE OF LAW



CAROLINA ACADEMIC PRESS

Durham, North Carolina

Copyright © 2020
Carolina Academic Press, LLC
All Rights Reserved

Library of Congress Cataloging-in-Publication Data

Names: Lederman, Leandra, author. | Kwon, Michelle, author.

Title: Understanding corporate taxation / by Leandra Lederman, Michelle Kwon.

Description: Fourth edition. | Durham, North Carolina : Carolina Academic Press, LLC, [2020] | Series: Understanding Series. | Includes bibliographical references and index.

Identifiers: LCCN 2020016081 (print) | LCCN 2020016082 (ebook) | ISBN 9781531018030 (paperback) | ISBN 9781531018047 (ebook)

Subjects: LCSH: Corporations--Taxation--Law and legislation--United States. | Income tax--Law and legislation--United States. | LCGFT: Textbooks.

Classification: LCC KF6464 .L426 2020 (print) | LCC KF6464 (ebook) | DDC 343.7305/267--dc23

LC record available at <https://lcn.loc.gov/2020016081>

LC ebook record available at <https://lcn.loc.gov/2020016082>

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

Printed in the United States of America

This book is dedicated to corporate tax students—past, present, and future.

Contents

Acknowledgments	xxiii
Preface	xxv
Chapter 1 · Introduction to Corporate Taxation	3
§ 1.01 Introduction to the “Corporate Tax” and Double Taxation	3
[A] The Double-Tax Regime	3
[B] Pass-Through Taxation	6
[1] Introduction to Pass-Through Taxation	6
[2] A Brief Introduction to the Deduction for Qualified Business Income	7
§ 1.02 Avoiding Double Taxation	8
[A] Avoiding the Corporate Form—Partnerships and Limited Liability Companies	9
[1] A Very Brief Overview of the Partnership Tax Regime	9
[2] LLCs and Other Unincorporated Entities	10
[a] A Brief History of the Taxation of Unincorporated Entities	10
[b] The “Check-the-Box” Rules	11
[B] Avoiding Subchapter C—Introduction to Subchapter S	12
[C] Avoiding Subchapter C—Corporation as Agent	14
[D] Disguised Dividends	16
[1] Introduction to Debt versus Equity	17
[2] Dividends Disguised as Salary	17
[E] Introduction to the Integration of Corporate and Shareholder- Level Taxes	17
§ 1.03 The Relevance of “Sale or Exchange” Treatment to Corporate Taxation	18
§ 1.04 Introduction to Doctrines Backstopping the Corporate Tax System	19
[A] Substance-Over-Form Doctrine	19
[B] Economic Substance Doctrine	20
[1] The “Economic Substance” Prong	21
[2] The “Business Purpose” Prong	22
[C] The Step-Transaction Doctrine	23
[1] In General	23
[2] The Three Tests for a “Step Transaction”	24

[a] Binding Commitment Test	24
[b] Mutual-Interdependence Test	24
[c] End Result Test	25
§ 1.05 Conclusion	25
Chapter 2 · Tax Consequences of Transferring Property to a New or Existing Controlled Corporation	27
§ 2.01 Introduction	27
§ 2.02 Tax Consequences to Shareholders	29
[A] Non-Recognition Treatment and Corresponding Basis Rules	29
[1] General Non-Recognition Treatment under Section 351	29
[a] “Property”	30
[b] “Control”	31
[c] The “Transferor Group”	32
[i] In General	32
[ii] The “Accommodation Transferor” Problem	32
[2] The “Immediately After” Requirement	35
[i] In General	35
[ii] Application of the Step-Transaction Doctrine	35
[e] Business Purpose	39
[2] The Effects of the Receipt of “Boot”	39
[a] General Recognition Rules	39
[b] Timing of Recognized Gain and Installment Sale Rules	40
[c] Character of Recognized Gain	43
[i] Allocation of Boot	43
[ii] Special Characterization Issues	44
[d] Dividend Treatment	45
[3] Treatment of Liabilities	46
[a] General Non-Recognition Rule of Section 357(a)	46
[b] Exceptions to Section 357(a)	47
[i] Tax-Avoidance Motive: Section 357(b)	47
[ii] Liabilities in Excess of Basis: Section 357(c)	48
[I] Recognition of Section 357(c) Gain	48
[II] Character of Section 357(c) Gain	49
[III] Effect of a Shareholder Promissory Note	50
[IV] Excluded and Contingent Liabilities	53
[4] Basis Rules	54
[a] Transferor Basis in the Absence of Boot	54
[b] Transferor Basis in the Presence of Boot	55
[c] Effect of Liabilities on Basis	56
[5] Shareholder’s Holding Period	58
[B] Taxable Incorporations	59
[C] Provisions That Override Section 351	60
§ 2.03 Tax Consequences to the Corporation	61

[A] Non-Recognition on Issuance of Stock	61
[B] Basis Rules	61
[1] Corporate Basis If Section 351 Applies	61
[a] Absence of Boot	62
[b] Presence of Boot	64
[c] Effect of Liabilities on Corporate Basis	66
[2] Corporate Basis If Section 351 Does Not Apply	67
[C] Corporation's Holding Period	67
§ 2.04 Contributions to Capital	69
[A] Tax Consequences to Shareholder Contributors	69
[B] Tax Consequences to Non-Shareholder Contributors	71
[C] Tax Consequences to the Corporation	71
[1] In General	71
[2] Transfers by Non-Shareholders	72
[3] Corporation's Basis	72
[a] In General	72
[b] Basis in Property Received from Non-Shareholders	73
Chapter 3 · Capital Structure of a Corporation	75
§ 3.01 Overview of Debt and Equity	75
[A] Introduction to the Tax Consequences of Distributions with Respect to Debt and Equity	75
[B] Introduction to Types of Debt and Equity	80
[1] General Types of Equity	80
[2] General Types of Debt	80
§ 3.02 General Tax Consequences of Debt and Equity	81
[A] Investment	81
[B] Current Payments	81
[C] Return of Investment	82
[D] Worthlessness	83
§ 3.03 Characterization: Distinguishing Debt from Equity	84
[A] Section 385	84
[B] Case-Law Factors	88
[C] Possible Treatment of an Investment as in Part Debt and in Part Equity	93
§ 3.04 Conclusion	95
Chapter 4 · Non-Liquidating Distributions of Property to Shareholders (Dividends)	97
§ 4.01 Introduction	97
§ 4.02 Tax Consequences to the Distributing Corporation	97
[A] Appreciated Property	98
[B] Treatment of Liabilities	100
§ 4.03 Tax Consequences to the Shareholders	100

[A] General Rules under Section 301	100
[B] Amount of the Distribution	101
[C] Calculating the Dividend Amount	102
[1] Introduction to Earnings and Profits	102
[a] Current versus Accumulated Earnings and Profits	102
[b] Calculating Earnings and Profits	103
[i] General Rules	103
[ii] Effects of Discharge of Indebtedness on Earnings and Profits	105
[iii] Effects of Distributions on Earnings and Profits	105
[2] Using Earnings and Profits to Calculate Dividends	106
[a] Single Distribution, Sole Shareholder	107
[b] Single Distribution, Multiple Shareholders	108
[c] Multiple Distributions, Sole Shareholder	109
[d] Multiple Distributions, Multiple Shareholders	111
[e] Special Rule for Calculating Dividend of Corporate 20 Percent Shareholder	112
[D] Tax Treatment of Individuals' Qualified Dividends	112
§ 4.04 Tax Consequences to Corporate Shareholders: Effect of the Dividends Received Deduction	114
[A] Dividends Received Deduction, in General	114
[B] Exceptions and Special Rules	116
[1] Debt-Financed Portfolio Stock	116
[2] Holding Period	117
[3] Extraordinary Dividends	118
§ 4.05 "Bootstrap Acquisitions"	120
§ 4.06 Constructive Dividends	126
Chapter 5 · Redemptions of Stock	131
§ 5.01 Introduction	131
[A] In General	131
[B] Competing Analogies	132
§ 5.02 Constructive Ownership of Stock	132
[A] Family Attribution	133
[B] Attribution from Entities to Investors (Upstream Attribution)	133
[C] Attribution from Investors to Entities (Downstream Attribution)	135
[D] Options	135
[E] Operating Rules	136
§ 5.03 Tax Consequences of Redemptions to Shareholders	137
[A] Overview of Section 302	137
[B] Redemptions Qualifying for Exchange Treatment	137
[1] Complete Termination of Interest	137
[a] In General	137

[b] Attribution of Family-Owned Shares	138
[i] Waiver of Attribution of Family-Owned Shares	138
[I] No Interest in the Corporation Except as a Creditor	139
[II] No Related-Party Transfers within the Previous Ten Years	140
[a] Pre-Redemption Receipt of Shares from Related Person	140
[b] Pre-Redemption Transfer of Shares to a Related Person	140
[III] No Acquisitions within the Succeeding Ten Years	141
[ii] Waiver of Family Attribution by Entities	141
[2] Substantially Disproportionate Redemptions	142
[a] In General	142
[b] Series of Redemptions	145
[3] Redemptions “Not Essentially Equivalent to a Dividend”	145
[a] Majority Shareholder’s Redemption	146
[b] Minority Shareholder’s Redemption	147
[4] Partial Liquidations	148
[C] Redemptions Treated as Distributions	150
[1] In General	150
[2] Basis-Shifting Redemptions	150
[3] The Seagram/DuPont Transaction	152
§ 5.04 Tax Consequences of Redemptions to the Distributing Corporation	153
§ 5.05 Additional Issues Arising in Redemptions	153
[A] Form Versus Substance	153
[1] Sale or Redemption?	153
[2] Charitable Gift or Redemption?	154
[B] Combined Redemptions and Sales	155
[C] Redemptions Incident to Divorce	158
[D] Redemptions to Pay Death Taxes	161
§ 5.06 Redemptions through Related Corporations	162
[A] Introduction	162
[B] The Control Requirement	163
[1] In General	163
[2] Application of Constructive Stock Ownership Rules, as Modified	164
[C] Types of Section 304 Transactions	164
[D] Application of Section 302	166
[1] In General	166
[2] Variations on Constructive Stock Ownership Rules	166
[3] Taxing Redemptions Treated as Section 301 Distributions	167
[E] Overlap of Section 304 with Section 351	169

Chapter 6 · Stock Dividends	171
§ 6.01 Introduction	171
§ 6.02 Excludible Stock Dividends	172
[A] Section 305(a)	172
[B] Basis in the New Stock and in the Old Stock; Holding Period	173
§ 6.03 Taxable Stock Dividends	174
[A] Section 305(b): Exceptions to Section 305(a)	174
[1] Choice of Stock or Property	174
[2] Disproportionate Distributions	175
[a] In General	175
[b] Series of Distributions	176
[3] Distributions of Common and Preferred Stock to Common Shareholders	176
[4] Distributions to Preferred Shareholders	177
[5] Distributions of Convertible Preferred Stock	178
[B] Deemed Distributions of Stock	178
[C] Basis and Holding Period	181
§ 6.04 “Tainted” Stock (Section 306 Stock)	181
[A] History of the “Preferred Stock Bailout”	182
[B] Section 306 Stock	183
[1] Definition	183
[a] Preferred Stock Received Tax-Free under Section 305(a)	183
[b] Preferred Stock Received Tax-Free in a Reorganization	183
[c] Certain Preferred Stock Received in a Section 351 Transaction	185
[d] Stock with a Basis Obtained from Section 306 Stock	186
[2] Disposition of Section 306 Stock by Gift or Bequest	187
[3] General Tax Consequences on Sale of Section 306 Stock	187
[a] Computing Amount of “Taint”	187
[b] Tax Treatment of Additional Sales Proceeds	188
[4] General Tax Consequences on Redemption of Section 306 Stock	189
[5] Exceptions to General Tax Treatment	189
[a] Complete Liquidation of Corporation	189
[b] Complete Termination of Shareholder Interest in Corporation	190
[c] Transactions Not for Tax Avoidance Purposes	190
 Chapter 7 · Corporate Liquidations and Taxable Acquisitions	 193
§ 7.01 Introduction to Liquidations and Taxable Acquisitions	193
§ 7.02 Partial Liquidations	194
§ 7.03 Tax Consequences of Complete Liquidations	194
[A] Taxable Liquidations	194
[1] Liquidating Corporation Tax Consequences	195
[a] General Rule	195

[b] Historical Importance of Substance-Over-Form Doctrine in Liquidations	196
[c] Distributions of Loss Property	197
[i] Distributions to Related Persons	197
[ii] Distributions of Property with Built-In Losses	199
[d] Earnings and Profits	201
[2] Shareholder Tax Consequences	201
[B] Non-Taxable Liquidation of Controlled Subsidiary	203
[1] Subsidiary Corporation Tax Consequences	204
[2] Controlling Parent Corporation Tax Consequences	204
[a] In General	204
[b] Avoiding the Application of Section 332	206
[3] Minority Shareholders	208
[4] Basis Rules	208
[5] Earnings and Profits	209
[6] Effects of Indebtedness	209
[7] Mirror Transactions	210
§ 7.04 Liquidation-Reincorporation Transactions	211
§ 7.05 Taxable Acquisitions	212
[A] Taxable Asset Acquisitions	212
[B] Taxable Stock Acquisitions: Introduction	213
[C] Section 338 Elections	214
[1] “Qualified Stock Purchase”	214
[2] Consistency Provisions	215
[3] Tax Consequences to Target of a Section 338 Election	215
[4] Calculation and Allocation of Target Corporation’s New Asset Basis	216
[D] Section 338(h)(10) Elections	218
[E] Section 336(e) Elections	219
Chapter 8 · The Pass-Through Regime of Subchapter S	221
§ 8.01 Introduction	221
[A] Overview of the Pass-Through Regime of Subchapter S	221
[B] A Brief Comparison of Subchapter S with the Partnership Pass-Through Regime of Subchapter K	222
§ 8.02 Eligibility for S Corporation Status	223
[A] Restrictions on the Number of Shareholders	223
[B] Types of Permitted Shareholders	224
[C] “One Class of Stock” Rule	225
[D] Ineligible Corporations	227
§ 8.03 Election, Revocation, and Termination of S Status	228
[A] Election	228
[B] Termination	229
[1] Termination by Revocation	229

[2] Termination by Ceasing to Qualify as a Small Business Corporation	230
[3] Termination Based on Excess Passive Investment Income	230
[4] Inadvertent Terminations	231
§ 8.04 Tax Treatment of S Corporation Shareholders	232
[A] Calculation of Taxable Income	232
[B] Pass-Through of Items	232
[1] General Rules	232
[2] Election to Terminate Taxable Year	232
[3] Limitation on Deductions	233
[C] Treatment of Distributions	235
[1] S Corporations with No Earnings and Profits	235
[2] S Corporations with Earnings and Profits	236
[D] Basis Adjustments	238
[1] Increases in Basis	238
[2] Decreases in Basis	239
[3] Order of Basis Adjustments	240
[E] Compensation Issues	240
[F] Net Investment Income Tax	241
[G] Application of Subchapter C Rules to S Corporations	241
[H] Sale of S Corporation Shares	243
§ 8.05 Corporate-Level Taxes Imposed on S Corporations	245
[A] Built-In Gains	245
[B] Excess Net Passive Investment Income	246
§ 8.06 Overview of the Deduction for Qualified Business Income	248
[A] Calculating the QBI Deduction Where Taxable Income Is below the Threshold Amount	249
[B] Calculating the QBI Deduction Where Taxable Income Is above the Phase-In Range	250
[C] Calculating the QBI Deduction Where Taxable Income Is in the Phase-In Range	254
[1] No Specified Service Trade or Business	254
[2] Specified Service Trade or Business	257
Chapter 9 · Reorganizations: Overview	263
§ 9.01 Introduction	263
[A] A Bit of History and Rationales for Non-Recognition in Corporate Reorganizations	263
[B] Statutory and Other Requirements of Valid Reorganizations	264
§ 9.02 Overview of Section 368	264
[A] Definition of “Reorganization”	265
[1] “A” Reorganizations: Statutory Mergers	265

[2] “B” Reorganizations: Stock-for-Stock Swaps	266
[3] “C” Reorganizations: “De Facto Mergers”	267
[4] Acquisitive and Divisive “D” Reorganizations	268
[5] “E” Reorganizations: Recapitalizations	269
[6] “F” Reorganizations: Changes in Form	269
[7] “G” Reorganizations: Bankruptcy Reorganizations	270
[8] Triangular B and C Reorganizations	270
[9] Section 368(a)(2)(D) Reorganizations: Forward Triangular Mergers	270
[10] Section 368(a)(2)(E) Reorganizations: Reverse Triangular Mergers	271
[11] Ordering Rules	271
[B] Party to a Reorganization	272
[C] “Control”	272
§ 9.03 The “Plan of Reorganization” Requirement	273
§ 9.04 The “Business Purpose” Requirement	274
§ 9.05 The Continuity of Business Enterprise Requirement	275
[A] Acquisition of Target’s Historic Business or Historic Business Assets	276
[B] Continuation of Target’s Historic Business or Use of Target’s Historic Business Assets	276
§ 9.06 The Continuity of Proprietary Interest Requirement	277
[A] Overview	277
[B] Requisite Proprietary Interest	278
[1] Qualitative Aspects	278
[2] Quantitative Aspects	280
[C] Requisite Continuity: Application of the Step-Transaction Doctrine	283
§ 9.07 General Tax Consequences of Transactions Qualifying as Reorganizations	288
[A] Target Shareholders	288
[1] Calculating Gain Recognized	288
[2] Character of Recognized Gain	290
[3] Basis	292
[a] In General	292
[b] Basis with Respect to Securities or Multiple Classes of Stock	293
[4] Holding Period	294
[B] Target Corporation	295
[C] Acquiring Corporation’s Shareholders	295
[D] Acquiring Corporation	296
[E] Introduction to the Carryover of Tax Attributes	296
§ 9.08 Intersection of Section 351 and Section 368	297

Chapter 10 · Acquisitive Reorganizations	299
§ 10.01 Introduction	299
§ 10.02 Mergers Involving Two or Three Corporations	299
[A] Statutory Mergers (“A” Reorganizations)	300
[1] In General	300
[2] “Divisive” Mergers and Mergers with Disregarded Entities	301
[3] Tax Consequences and Basis Rules	302
[B] Triangular Mergers	303
[1] Background	303
[2] Forward Triangular Mergers	304
[a] Formalities	305
[b] Tax Consequences	306
[i] In General	306
[ii] Effect of Liabilities on Triangular Mergers	307
[3] Reverse Triangular Mergers	308
[4] Tax Consequences and Basis Rules	311
§ 10.03 Stock-for-Stock Acquisitions (“B” Reorganizations)	312
[A] The “Solely for Voting Stock” Requirement	313
[1] The “Solely” Requirement	313
[2] Definition of “Voting Stock”	314
[B] The “Control” Requirement	314
[C] Application of the Step-Transaction Doctrine: “Solely” in Creeping B Reorganizations	315
[D] Tax Consequences and Basis Rules	316
[E] Triangular B Reorganizations	316
§ 10.04 Stock-for-Assets Acquisitions (“C” Reorganizations)	317
[A] The “Solely for Voting Stock” Requirement	317
[1] Effect of Liabilities	318
[2] The “Boot Relaxation Rule”	318
[B] “Substantially All of the Properties” Requirement	319
[C] Application of the Step-Transaction Doctrine: “Creeping C” Reorganizations	320
[D] Tax Consequences and Basis Rules	322
[E] Triangular C Reorganizations	323
§ 10.05 Drop-Downs	324
§ 10.06 Transfer of Assets to Controlled Corporation (Acquisitive “D” Reorganizations)	325
[A] Introduction	325
[B] “Substantially All of the Assets” Requirement	326
[C] Distribution Requirement	326
[D] The “Control” Requirement	326
[E] Overlap with C Reorganizations	327
[F] Tax Consequences and Basis Rules	327
§ 10.07 Bankruptcy Reorganizations (“G” Reorganizations)	328

Chapter 11 · Corporate Divisions	331
§ 11.01 Introduction to Corporate Divisions	331
§ 11.02 Corporate Divisions under Section 355	332
[A] Types of Section 355 Transactions	332
[1] Spin-Offs	332
[2] Split-Offs	333
[3] Split-Ups	333
[B] “Stock or Securities”	334
[C] “Control” and “Distribution” Requirements	334
[D] “Business Purpose” Requirement	336
[E] The “Device” Prohibition	337
[1] “Device” Factors	339
[a] Pro Rata Distribution	339
[b] Subsequent Sale or Exchange of the Stock Distributed	339
[c] Presence of Non-Business or “Secondary Business” Assets	340
[2] “Non-Device” Factors	340
[a] Corporate Business Purpose	340
[b] Publicly Traded, Widely Held Distributing Corporation	341
[c] Distribution to Domestic Corporations	341
[3] “Non-Device” Transactions	341
[F] Active Trade or Business Requirements	342
[1] Five-Year History	343
[a] Same or Different Business?	344
[b] Acquired Business	345
[2] “Immediately After” the Distribution	346
[G] Continuity of Proprietary Interest	349
[H] Tax Consequences and Basis Rules	350
[1] Shareholders	350
[a] General Tax Consequences	350
[b] Shareholder Basis in Stock or Securities	352
[2] The Distributing Corporation	354
[3] Allocation of Earnings and Profits	355
§ 11.03 Divisive D Reorganizations	355
[A] In General	355
[B] Qualification under Section 355	356
[C] Tax Consequences, Basis, and Earnings and Profits Rules	356
§ 11.04 Divisive G Reorganizations	357
Chapter 12 · Reorganizations Involving Only One Corporation	359
§ 12.01 Introduction	359
§ 12.02 Recapitalizations (“E” Reorganizations)	359
[A] Introduction	359
[B] Business Purpose Requirement	360
[C] Types of Recapitalizations	361

[1] Corporate Stock for Investors' Stock	361
[2] Corporate Stock for Investors' Debt Securities	363
[3] Corporate Debt Securities for Investors' Stock	363
[4] Corporate Debt Securities for Investors' Debt Securities	365
§ 12.03 Changes in Form ("F" Reorganizations)	366
[A] In General	366
[B] Carryback of Tax Attributes	368
Chapter 13 · Carryover of Tax Attributes	371
§ 13.01 Overview	371
[A] Transactions Eligible for Carryover	371
[B] Tax Attributes Subject to Carryover	372
[C] Limitations in Section 381	373
§ 13.02 Limitations on Carryovers	374
[A] History	374
[B] Change-of-Ownership Limitations on Net Operating and Other Losses: Section 382	375
[1] In General	375
[2] Losses Subject to Section 382	376
[3] Definitions	376
[a] "Stock"	376
[b] "Five Percent Shareholder"	378
[c] "Ownership Change"	379
[d] "Testing Period"	381
[4] Mechanics of the Section 382 Limitation	381
[a] General Rules	381
[b] The Long-Term Tax-Exempt Rate	382
[c] Reductions and Increases in the Section 382 Limitation	383
[i] Continuity of Business Enterprise	383
[ii] Effect of Built-In Gains on the Section 382 Limitation	383
[iii] Effect of Unused Section 382 Limitation	384
[d] Valuation Issues	384
[i] Anti-Stuffing Rule	384
[ii] Special Rule for Valuing Corporations with Excess Nonbusiness Assets	385
[iii] Effect of Redemptions and Other Corporate Contractions on Valuation	385
[C] Change-of-Ownership Limitations on Other Tax Attributes: Section 383	387
[1] In General	387
[2] Mechanics of the Section 383 Credit Limitation	388
[D] Limitation on Use of Pre-Acquisition Losses to Offset Built-In Gains: Section 384	390
[1] In General	390

[2] Mechanics	390
[E] Acquisitions with Tax-Avoidance Motive: Section 269	392
[1] In General	392
[2] Mechanics	392
Chapter 14 · Anti-Abuse Measures and Special Provisions	395
§ 14.01 Introduction	395
§ 14.02 The Accumulated Earnings Tax	395
[A] In General	395
[B] Tax-Avoidance Purpose	396
[C] Reasonable Needs of the Business	397
[D] Mechanics	399
§ 14.03 The Personal Holding Company Tax	402
[A] In General	402
[B] Definition of “Personal Holding Company”	402
[C] Types of Personal Holding Company Income	404
[D] Mechanics of the Tax	405
[E] Avoiding the Tax	406
§ 14.04 The Alternative Minimum Tax	407
[A] In General	407
§ 14.05 “Controlled Group” Restrictions	408
[A] Overview of the Definition of “Controlled Group”	409
[B] Parent-Subsidiary Controlled Groups	409
[C] Brother-Sister Controlled Groups	409
[D] Combined Groups	411
§ 14.06 Income Splitting	412
[A] Income Splitting between Corporation and Shareholder	412
[B] Income Splitting Between Corporations	413
[1] In General	413
[2] An Introduction to Reallocation of Income and Deductions under Section 482	414
[a] Overview	414
[b] Selected Case Law on Arm’s-Length Standards	415
[c] Application of the Substantial Valuation Misstatement Penalty	418
[d] Advance Pricing Agreements	418
Chapter 15 · Integration of Corporate and Shareholder Taxes	421
§ 15.01 Introduction	421
§ 15.02 The Current System of Partial Corporate Integration	424
§ 15.03 Major Integration Proposals	426
[A] Dividend Exclusion Methods	427
[1] Treasury’s Dividend Exclusion Prototype	427
[2] President George W. Bush’s 2003 Proposal	429

[B] Treasury's Comprehensive Business Income Tax System	430
[C] Treasury's Shareholder Allocation Prototype	431
[D] Treasury's Imputation Credit Prototype	432
[E] The American Law Institute's Shareholder Credit Proposal	434
§ 15.04 Additional Corporate Integration Possibilities	437
[A] Dividends-Paid Deduction System	437
[B] Split-Rate Systems	438
§ 15.05 Other Avenues of Corporate Tax Reform	438
Chapter 16 · Corporate Tax Shelters	441
§ 16.01 Introduction	441
§ 16.02 A Paradigmatic Corporate Tax Shelter: <i>ACM Partnership v. Commissioner</i>	445
§ 16.03 Subchapter C Shelters	447
[A] Contingent Liability Shelters	448
[B] Basis-Shifting Shelters	451
§ 16.04 Weapons in the War on Abusive Tax Shelters	454
[A] Disclosure Requirements and Penalties Applicable to Advisors	456
[B] Disclosure Requirements and Penalties Applicable to Taxpayers	457
[C] Opinion Practice under Circular 230	458
Table of Cases	461
Table of Statutes	465
Index	481

Acknowledgments

The authors are very grateful to the many friends, colleagues, and students who have been so helpful with suggestions for, and assistance with, the current and previous editions of this book.

Preface

Corporate taxation is a rich but complex area of law that students often find quite challenging. Understanding certain fundamental concepts that reappear throughout corporate taxation—such as nonrecognition and carryover basis rules, “double taxation” of corporate income, and characterization of income—can go a long way toward making sense of the details. This book is intended to facilitate such study of corporate taxation through step-by-step explanations, diagrams of transactions, discussion of important cases and rulings, and numerous examples. It is designed to be used on its own as a primer or to supplement any corporate tax casebook.

The first chapter of the book provides an introduction to corporate taxation, including judicial doctrines such as the economic substance and step-transaction doctrines. This chapter introduces the double taxation that is the hallmark of the classical corporate tax regime, compares that to pass-through taxation of electing small corporations under Subchapter S, and discusses choice of business entity and various ways to avoid double taxation. The next six chapters cover events in the life of a corporation from “cradle to grave,” including transfers to a new or existing controlled corporation; capitalization of a corporation with debt or equity; dividend distributions; redemptions of stock; stock dividends; and corporate liquidations and taxable acquisitions. Following this discussion of the tax treatment of events in the life of a corporation under Subchapter C, the next chapter turns to the study of corporations taxable under Subchapter S.

Four chapters discuss corporate reorganizations. The first of these chapters, Chapter 9, provides an introduction to and overview of reorganizations, including the requirements for a transaction to constitute a reorganization. The next chapter discusses acquisitive reorganizations. The following chapter focuses on divisive reorganizations, and the fourth of these chapters explores reorganizations involving one corporation. After this study of reorganizations, one chapter discusses carryover of tax attributes and a second chapter focuses on anti-abuse and special provisions, such as the corporate alternative minimum tax.

The last two chapters of the book consider specific policy issues. Chapter 15 discusses proposals to eliminate double taxation of corporate income. The final chapter discusses the phenomenon of corporate tax shelters.

