PROBLEM #IV - Transfers to Controlled Corporation

IV-1 X Corporation had 100 shares of voting common stock outstanding, all of which were owned by individual F. The fair market value of X's stock was $1,000 per share. F owned Blackacre (undeveloped land) in which he had a basis of $10,000. The fair market value of Blackacre was $32,000, and it was not encumbered. What would be the tax consequences in each of the following alternative circumstances?

(a) F transferred Blackacre to X in exchange for 32 shares of X's voting common stock. In answering this question, you will assume that § 351 applies to the exchange.

(b) The same exchange took place as was described in (a); but, in determining the tax consequences, you will assume that § 351 is not applicable to the exchange.

(c) F transferred Blackacre to X, and F received nothing in exchange.

IV-2 X Corporation had 100 shares of common stock outstanding of which A owned 50 shares and B owned the other 50 shares. A owned a valuable patent in his individual capacity which he wished to exploit. In Year One, A and C agreed that C will transfer a manufacturing business to X for 100 shares of X common stock and A will assign his patent to X in exchange for 50 shares of X common stock. C made his exchange on July 10 of Year One, and A made his exchange on August 2 of Year One. C realized a gain of $30,000 on his exchange ($12,000 of which was attributable to a recapture of depreciation); and A realized a gain of $48,000 on his exchange. What amount of gain was recognized by C and by A?

IV-3 D owned all 60 shares of outstanding stock of Y Corporation. E, the son of D, exchanged unimproved Blackacre for 190 shares of Y stock. E realized a gain of $14,000 on that exchange.

(a) What amount of gain did E recognize?

(b) If instead of realizing a gain on the exchange, E had realized a loss of $16,000, would E be allowed a deduction for that loss? Would E be allowed a deduction for the loss he realized on the exchange if E were not related to D?

IV-4 Ring, Inc. has two shareholders—Abel and Baker. Abel has 100 shares of Ring's voting common stock having a fair market value of $1,000 per share. Baker has 100 shares of Ring's Class A nonvoting 8% preferred stock having a fair market value of $10 per share and a par value of $10 per share.

What are the tax consequences to Abel for exchanging unimproved land having a basis of $5,000 and a fair market value of $20,000 for either:

(a) 20 shares of Ring's voting common stock or

(b) 20 shares of Ring's Class B 8% preferred nonvoting stock having a par value of $1,000 per share and a fair market value of $1,000 per share?

IV-5 A, an individual, owned all the outstanding stock of X Corporation. A also owned and operated another business as a sole proprietorship. The aggregate fair market value of the assets of the proprietorship was substantially greater than A's basis in those assets. Pursuant to a prearranged plan, A transferred the assets of the proprietorship to X in exchange for additional shares of X stock, and then A transferred all of his X stock to Y Corporation (an unrelated corporation) in exchange for Y voting stock (this latter exchange qualified as a “B” reorganization and, as such, would qualify the exchange for nonrecognition treatment). A did not acquire control of Y. Did A recognize a gain on these transactions? See Rev. Rul. 70-140, 1970-1 Cum. Bull. 73.

IV-6 A owned all 50 outstanding shares of stock of X Corporation. Pursuant to a plan, B transferred Blackacre to X in exchange for 150 shares of X stock, and C received 50 shares of X stock in exchange for services. B realized a gain of $18,000 on his exchange of Blackacre for stock. Will B recognize any of that gain?

IV-7 A owned all 50 outstanding shares of stock of X Corporation. Pursuant to a plan, B transferred Blackacre for 155 shares of X stock, C transferred Whiteacre for 20 shares of X stock, and C also contributed services in exchange for an additional 25 shares of X stock. The X stock had a value of $1,000 per share. B had a basis of $90,000 in Blackacre; and C had a basis of $35,000 in Whiteacre. What were the tax consequences to B and to C? What would have been the tax consequences to B and to C if the value of Whiteacre had been only $4,000, and if C had received only four shares of X stock for Whiteacre and had received 41 shares of X stock for his contribution of services?

IV-8 In exchange for W’s common stock, the following contributions were made to the newly formed W Corporation: A contributed unimproved land having a value of $30,000 in which A had a basis of $10,000; B contributed $30,000 cash; C contributed $18,000 cash, and D contributed personal services valued at $22,000. A, B, C, and D received 30 shares, 30 shares, 18 shares, and 22 shares of W’s common stock respectively. What basis did W acquire in the land that A transferred to it?

IV-9 X Corporation had 20 shares of stock outstanding, and A owned all 20 shares. B owned a building valued at $75,000, and B had a basis of $40,000 in the building. B performed valuable services for X, and shortly thereafter B received 80 shares of X's stock—5 shares of which were given as payment for B's services and 75 shares of which were given as payment for the building which B simultaneously deeded to X. The fair market value of X's stock was $1,000 per share.

What are the tax consequences to B of the foregoing events? What basis did X acquire in the building that B deeded to it? What was the tax consequence to X of those events?

IV-10 B is the sole shareholder of X Corporation. B owns unimproved Blackacre in which he has a basis of $30,000. The fair market value of Blackacre is $55,000. B transfers Blackacre to X in exchange for preferred stock of X valued at $35,000, five 10-year bonds of X having a combined value of $5,000, cash of $3,000, and common stock of Z Corporation valued at $12,000. What amount of gain or loss did B and X recognize? In answering this question and questions **IV-11(a)-(c)** below, first assume that the preferred stock of X is not subject to any agreement or right concerning its redemption or purchase and that its dividend rate is 5% of its par value. Then, answer the question on the assumption that B has an option (a put) to require X to redeem the preferred stock at its par value.

IV-11 (a) Assume the same facts as in **IV-10** except that B's basis in Blackacre was $45,000. What amount of gain or loss did B recognize on the exchange?

(b) Assume the same facts as in **IV-10** except that B's basis in Blackacre was $65,000. What amount of gain or loss did B recognize on the exchange? If any loss was recognized, can B deduct that loss?

(c) Assume the same facts as in **IV-11(b)** above except that instead of receiving $35,000 of X's preferred stock, B received $10,000 of X's preferred stock plus $25,000 of X's common stock. What amount of gain or loss did B recognize on the exchange?

IV-12 (a) A, B, C, and D formed X Corporation. In exchange for appreciated assets, X gave each of the shareholders an equal amount of its common voting stock which is redeemable at par value at the option of the shareholder (or his executor) upon the death or permanent disability of the shareholder. Is the shareholder's right to have his stock redeemed at his death or disability a ``put'' or option to sell—that is, a separate item from the stock itself which constitutes boot to the shareholder? If so, the value of such a ``put'' can cause the shareholder to recognize gain under § 351(b) at the time of the exchange for X's stock. On the other hand, the shareholder's redemption right may simply be a nonseverable attribute of the stock (especially in light of the limited circumstances in which the ``put'' is exercisable) so that no gain will be recognized on the exchange. This issue was noted but not resolved by the Commissioner in L.R. 8022049.

(b) The same facts as those stated in (a) except that some of the shares of X stock that A, B, C, and D received were preferred stock and some were common stock.

IV-13 Individual A transferred his promissory note in the face amount of $20,000 and Blackacre (unimproved land) to X Corporation in exchange for 10 shares of X voting common stock having a fair market value of $40,000. Prior to the exchange, X had 90 shares of voting common stock outstanding, of which A owned 80 shares and B (an unrelated individual) owned the remaining 10 shares. At the time of the exchange, A had a basis of $10,000 in Blackacre, the fair market value of Blackacre was $50,000, and Blackacre was encumbered by a $30,000 mortgage to the Friendly National Bank. X took Blackacre subject to the $30,000 mortgage. Also, at the time of the exchange, the fair market value of the promissory note that A transferred to X was equal to the note's face amount of $20,000. Assuming that the Second Circuit's decision in *Lessinger* is correct and assuming that that decision applies to the exchange that took place between A and X, what basis does A have in the 10 shares of X stock that he acquired in that exchange? If the Ninth Circuit's decision in *Peracchi* is correct, what basis does A have in the 10 shares of X stock?

IV-14 Individual C owned Blackacre and Whiteacre, both of which were unimproved land. C had a basis of $100,000 in Blackacre, which had a fair market value of $150,000. C had a basis of $110,000 in Whiteacre, which had a fair market value of $150,000. In March, Year One, C borrowed $210,000 from the Friendly National Bank. The loan was secured by mortgages on both Blackacre and Whiteacre in the full amount of the debt, and the debt was nonrecourse. On June 4, Year Two, C formed two corporations, the X Corporation and the Y Corporation. On that date, in exchange for 100 shares of X stock, which are the only outstanding shares of X, C transferred Blackacre to X, and X took Blackacre subject to the mortgage thereon, the unpaid balance of which was then $200,000. On that same date, in exchange for 100 shares of Y stock, which are the only outstanding shares of Y, C transferred Whiteacre to Y, and Y took Whiteacre subject to the mortgage thereon, the unpaid balance of which (as noted above) was then $200,000. The exchanges between C and the two corporations qualified as § 351 transactions. Did C recognize income under § 357(c) on either or both of those exchanges? See LR 9032006, revoking LR 8730063 and stating that the latter ruling is not correct.

IV-15 X Corporation owns 100% of the outstanding stock of both the S1 Corporation and the S2 Corporation. The three corporations do not file a consolidated return. The stock of X is held by ten unrelated individuals each of whom owns 10% of X's outstanding stock. S1 sells a building to S2 for $300,000 cash. S1 had a basis of $120,000 in the building which it had owned for more than one year and had used in its business. You will assume that S1 had no recapture of depreciation under §§ 291(a)(1), 1245 or 1250 on the sale. How is S1's gain from that sale characterized?

IV-16 Individual A owns 90% of the outstanding stock of Corporation X. A also owns two shares of stock of Y, a publicly held corporation. Y purchases a building from X for cash, and X recognizes a gain on that sale. X had owned the building for more than one year and had used it in its business. You will assume that X had no recapture of depreciation under §§ 291(a)(1), 1245 or 1250 on the sale. Does § 1239 apply to that sale?

IV-17 (a) John Jones and his wife, Helen, each owned 30 shares of stock of the High-Tor Corporation, and no other shares were outstanding. Each share of stock had a value of $3,000. John Jones owned an automobile which he operated for his personal use, and which had a basis of $2,000 and a fair market value of $3,000. John exchanged the automobile for one share of High-Tor stock. What is the tax consequence to John and to High-Tor of the exchange?

(b) Two years later, Helen transferred to the corporation unimproved land having a basis of $5,000 and a fair market value of $15,000 in exchange for five shares of High-Tor stock having a value of $3,000 per share. What is the tax consequence to Helen and to High-Tor?

IV-18 The Winterest Corp. had 90 shares of stock outstanding. Fred Kulp owned 30 shares, his wife, Joan, owned 11 shares, and his niece, Mary, held 49 shares. Fred transferred improved real estate (an office building) having a basis of $50,000 and a fair market value of $200,000 to the corporation in exchange for 10 shares of Winterest's common stock (thus increasing to 100 the number of shares of common stock that Winterest had outstanding). Fred had owned the building for more than one year. Each share of Winterest's stock has a fair market value of $20,000. What is the tax consequence of the exchange?

IV-19 B is the sole shareholder of X Corporation. B exchanged Blackacre for 100 shares of X stock. B's basis in Blackacre was $40,000, and Blackacre was subject to a mortgage of $10,000. The fair market value of Blackacre was $50,000. What basis does B have in the 100 shares of X stock he received on the exchange? What basis does X have in Blackacre? What basis would B have in the 100 shares of X stock if the fair market value of Blackacre was $35,000?

IV-20 A, an individual, transfers the following assets, having the indicated values and bases and subject to the indicated liability, to X Corporation in an exchange for X stock that qualifies under § 351:

Assets	**FMV**	**Basis**	**Liability to Which Subject**
Blackacre	$ 75,000	$ 75,000	$ 65,000
Whiteacre	100,000	15,000	85,000
A Truck	25,000	30,000	0
Total	$200,000	$120,000	$150,000

What basis will X acquire in the three assets that A transferred to it?

IV-21 Smith, Wilkie, and Nod cause the formation of Peacedale, Inc. Smith transfers $30,000 cash to the corporation; Wilkie transfers machinery and equipment having a basis of $5,000 and a fair market value of $30,000; and Nod assigns to the corporation certain contracts, plans, and patents having a basis of $2,000 and a fair market value of $30,000. The original cost of the equipment and machinery transferred by Wilkie was $25,000. The corporation issues 10 shares of its common stock each to Smith, Wilkie, and Nod. What taxable gain is recognized by each of the transferors and by the corporation on the exchange, and what is the basis of the shareholders' stock and of the assets transferred to the corporation?

IV-22 Stephan King is the sole shareholder of Cribbet, Inc. King owned improved land. King's basis in the land alone was $20,000, and the fair market value of the land was $30,000; King's basis in the improvements on the land was $55,000, and the fair market value of the improvements was $80,000. King also owned 100 shares of XYZ common stock in which he had a basis of $20,000. The fair market value of the 100 shares of XYZ stock was $10,000. On February 4 of Year One, King transferred the 100 shares of XYZ common stock plus the land and improvements thereon to Cribbet for 10 shares of Cribbet's common stock (having a total fair market value of $100,000) plus Cribbet's promissory demand note in the amount of $20,000, bearing interest at an adequate rate. The exchange did not trigger a recapture of depreciation. A demand note does not qualify for installment reporting. § 453(f)(4)(A). XYZ is a publicly held corporation.

(a) Did King recognize a gain on the exchange with Cribbet, and if so, in what amount?

(b) If King recognized a gain on the exchange with Cribbet, how should that gain be characterized for tax purposes?

(c) What basis does King have in Cribbet's promissory demand note? In the 10 shares of Cribbet's stock received in the exchange?

(d) What basis does Cribbet have in the property it received from King?

IV-23 A, an individual, owned machinery and equipment having a fair market value of $30,000 and subject to a $10,000 liability. A had a basis of $40,000 in that machinery and equipment. A organized X Corporation and transferred the machinery and equipment to X in exchange for all 10 outstanding shares of X’s common stock, and X took the property subject to the $10,000 liability.

(a) What basis did A acquire in the 10 shares of X's stock?

(b) What basis did X acquire in the machinery and equipment?

(c) What would be the answer to (a) and (b) if instead of receiving 10 shares of X’s stock, A had received 9 shares of X stock plus a $5000 demand note of X bearing interest at an adequate rate?

IV-24 A and B form XYZ Corporation. Immediately after formation of the corporation, A transferred Blackacre with a fair market value of $100,000 and a basis of $40,000 for 100 shares of XYZ stock. A transferred Blackacre subject to a $50,000 mortgage. At the same time, B transferred Whiteacre having a fair market value of $60,000 and a basis of $50,000 for 100 shares of XYZ stock. B transferred Whiteacre subject to a mortgage of $10,000. Did A or B recognize any gain on the exchange? What basis did A and B acquire in the stock they received in the exchange?

IV-25 A is the sole shareholder of X Corporation. X’s common stock has a value of $1,000 per share.

(a) A owned unimproved Greenacre valued at $50,000, and the outstanding balance of the mortgage on Greenacre was $10,000. A's basis in Greenacre was $30,000. On January 11 of Year One, A borrowed $15,000 from the Friendly National Bank and secured the loan with a second mortgage on Greenacre. On January 13, of Year One, A transferred Greenacre to X for 25 shares of X's common stock; and X took Greenacre subject to the outstanding first and second mortgages.

(i) Did A recognize any income on the exchange?

(ii) What basis did A acquire in the 25 shares of X’s common stock?

(iii) What basis does X have in Greenacre?

(b) The same facts as in (a) except that A's basis in Greenacre was only $10,000, and Greenacre's fair market value was only $40,000. In addition to transferring Greenacre, A also transferred to X machinery having a fair market value of $10,000, a basis to A of $10,000, and subject to a chattel mortgage of $5,000. In exchange for these transfers, A received 20 shares of X's stock. X took the transferred properties subject to the outstanding mortgages. What amount of income did A recognize on the exchange? What basis does X have in the properties transferred to it?

IV-26 A transferred all of the assets of his sole proprietorship having a value of $200,000 and a basis of $100,000 to the newly formed W Corporation in exchange for all 100 shares of outstanding stock of W. A had paid his employees at the end of each calendar month, and the exchange was made on June 16 of Year One. A reported his income on the cash method. On June 30 of Year One, W paid wages to its employees of $5,000 for work performed from June 1 to June 30. How is that payment by W treated for tax purposes?

IV-27 In Year One, X Corporation redeemed 100 shares of its common stock from A, and X paid to A $50,000 for those 100 shares of its stock. X did not cancel the redeemed 100 shares of stock but rather held them as treasury stock.

Y Corporation had 20 shares of common stock outstanding all of which were owned by B, an individual. B had no stock interest in X. In Year Two, X transferred its 100 shares of treasury stock (that X had previously acquired from A) to Y in exchange for 80 shares of Y's common stock. Thus, after this exchange, Y had 100 shares of stock outstanding (80 of which were owned by X and 20 of which were owned by B), and Y owned 100 shares of X's stock.

In Year Four, Y sold to C the 100 shares of X's stock that Y had acquired from X in Year Two. C paid $40,000 to Y for the 100 shares of X's stock. C had no other stock interest in X or Y. What was the tax consequence to Y of the sale of the 100 shares of X's stock to C? See Rev. Rul. 2006-2. What would the tax consequence to Y have been if it had sold the 100 shares of X's stock to C only six months after Y acquired the shares from X?

IV-28 A and B, who are brothers, form Z Corporation through which to conduct a service business. They each contribute property with a total value of $10,000 to Z in exchange for 10 shares of voting common stock of Z. C is an aunt of A and B who holds improved real estate, Whiteacre, with a basis of $1,000,000 and a fair market value of $500,000. A and B would like to use Whiteacre in their business as a warehouse and office facility. C would like to sell Whiteacre in order to recognize her accrued loss on the property. At the same time, she would like to assist her nephews in their new business venture, provided she can receive a reasonable return on the value of Whiteacre. In conjunction with the creation of Z, C agrees to sell Whiteacre for its fair market value of $500,000. The terms of the sale are that Z will make a down payment of $10,000 and will give a 10-year promissory note for the balance of the purchase price. The note will be secured by a mortgage on Whiteacre and will bear an interest rate that is somewhat above the market rate. The note provides that only interest is payable until its maturity, when the entire principal amount is due. What are the tax consequences to Z and C from Z's purchase of the real estate? What will be the tax treatment to Z and C resulting from the periodic payments of interest on the note?

IV-29 (a) At the beginning of Year One, A forms Newco, Inc., by transferring appreciated property to Newco and receiving Newco voting common stock in exchange. Newco's net worth at the end of Year One was $50,000. At the end of Year Two, Newco's net worth had grown to $100,000 as a result of business operations. B, who is an uncle of A, owns improved real estate, Greenacre, that A feels Newco needs for its business. Greenacre has a value of $3,000,000, and B's basis in Greenacre is $100,000. B and Newco agree on a sale of Greenacre at its fair market value. The terms of the sale are that Newco will pay $50,000 down and will give a 20-year promissory note for the balance, secured by a mortgage on Greenacre, and bearing an above-market interest rate. The note requires the payment of interest only for the first five years and thereafter level amortization of the principal amount. What are the tax consequences to B and Newco from this transaction and from the periodic payments of interest and principal on the note?

(b) Assume the same facts as (a) except that Greenacre has an adjusted basis of $4,000,000. What are the tax consequences of the transaction and the periodic payments on the note?

(c) Assume the same facts as (a) except that B is the father of A. What are the tax consequences of the transaction and the periodic payments on the note?

IV-30 In each of the subquestions below, the stock in question satisfies the definition of "nonqualified preferred stock" in every respect except possibly for the characteristic(s) described in that subquestion. The issue is whether the characteristic(s) described in each subquestion will remove the stock from the category of nonqualified preferred stock.

(a) Each share of stock is convertible into no par common stock of the same corporation at the option of the shareholder.

(b) The shareholder, who is an employee of the corporation, has the right to require the corporation to redeem the shareholder's stock, but this right to a redemption applies only during the 60-day period beginning with the date that the shareholder is no longer employed by the corporation.

(c) There is no agreement concerning a redemption of the shareholder's stock, but there is a cross-purchase agreement between the shareholder and *B*, an individual who owns 60% of the corporation's stock, under which the survivor is obligated to purchase the stock of the one who dies first.

(d) The same facts as those stated in (c) except that the surviving shareholder is not obligated to purchase the decedent's stock, but has an option to purchase that stock.

IV-31 As of March 24, Year One, X Corporation had outstanding 200 shares of common stock and 25 shares of Class A preferred stock. All of the common stock was held by *D*, and all of the Class A preferred stock was held by *B*. On March 25, Year One, *D* transferred Blackacre to X in exchange for 50 shares of X's common stock and 100 shares of Class A preferred stock. The value of the common stock was $1,000 per share, and the value of the Class A preferred stock was $500 per share. *D* had a basis of $25,000 in Blackacre. The class A preferred stock of X was nonqualified preferred stock. What were the tax consequences to *D* and to X of the exchange?