PROBLEM #V - **Corporate Divisions**

In answering the questions in this Problem # V, ignore § 355(d) and (e). Unless stated otherwise, all stocks mentioned in this Problem # V are voting common stock.

V-1 (a) In Year One, Win All, Inc. acquired 90 of the 100 outstanding shares of stock of Riovin, Inc. On March 5, Year Eighteen, Win All purchased the remaining 10 shares of Riovin stock from John Smith for $12,000 cash. Win All has two equal shareholders, Bond and Spade. On August 10, Year Twenty, for good business reasons, Win All distributed 50 shares of Riovin stock to Bond and 50 shares of Riovin stock to Spade. The fair market value of Riovin stock at the time of the distribution was $1,200 per share. Both corporations had been engaged in the active conduct of a business for more than 10 years. Win All's *e and p* is in excess of $100,000. What were the tax consequences of the distribution? If the fair market value of Riovin stock at the time that Win All distributed its Riovin stock to its shareholders was $1,500 per share, would Win All recognize income because of making that distribution? See § 355(a)(3)(B), (c)(2).

(b) The same facts as in (a) except that Win All acquired only 75 shares of Riovin stock in Year One. Thus, after the purchase from Smith, Win All owned 85 of the outstanding 100 shares of Riovin stock. On August 10, Year Twenty, Win All distributed 42.5 shares of Riovin stock to Bond and 42.5 shares of Riovin stock to Spade. What were the tax consequences of that distribution?

(c) The same facts as in (b) except that immediately after purchasing Smith's 10 shares of Riovin stock, Win All formed W. Holding Co., and Win All transferred its 85 shares of Riovin stock to Holding in exchange for all 100 shares of the common stock of Holding. Then, on August 10, Year Twenty, Win All distributed 50 shares of Holding stock to Bond and 50 shares of Holding stock to Spade. What were the tax consequences of that distribution?

(d) The same facts as in (a) except that immediately after purchasing Smith's 10 shares of Riovin stock, Win All formed W. Holding Co., and Win All transferred its 100 shares of Riovin stock to Holding in exchange for all 100 shares of the common stock of Holding. Then, on August 10, Year Twenty, Win All distributed 50 shares of Holding stock to Bond and 50 shares of Holding stock to Spade. What were the tax consequences of that distribution? Would it matter whether Win All's transfer of the Riovin stock to Holding had a legitimate business purpose and whether Win All transferred other assets to Holding in addition to the Riovin stock?

(e) The same facts as in (d) except that Win All transferred only 90 shares of Riovin stock to Holding and Win All retained 10 shares of Riovin's stock. What were the tax consequences of the distributions to Bond and Spade?

V-2 Individual A owned all 100 shares of the outstanding stock of X Corporation. X is engaged in the warehousing business. X owned all of the stock of Y Corporation, which is engaged in the transportation business. The value of the Y stock constituted 50% of the value of all of the assets owned by X. Individual B, a valuable employee of X, is extremely knowledgeable in the warehousing business. B informed A that she will likely leave the employ of X unless she is given the opportunity to purchase 20% of X's stock. However, B could not afford to purchase that percentage of X's stock. In order to reduce the value of X's stock so that B could afford to purchase the percentage that she desired to hold, X distributed all of its Y stock to A as a spin-off of Y. The X stock thus became affordable for B to purchase. In order to provide B with 20% of X's outstanding stock, A can either sell her 20 shares of his X stock; or, alternatively, A can cause X to issue 25 new shares of its stock which X will then sell to B. For the purpose of determining whether the spin-off of Y stock qualifies as a § 355 distribution, does it make a difference whether A sells B 20 shares of his X stock or whether X sells B 25 shares of its newly issued stock? See Treas. Reg. § 1.355-2(d)(4), Ex. (1).

V-3 Barge, Inc., had been in the shipping business for over 25 years. It was owned equally by A, B and C. A and B had a falling out with C and to settle their differences, Barge transferred its assets to two new corporations—roughly, one-third to Seafaring, Inc., and two-thirds to Seafreighters, Inc. It then distributed the stock of Seafaring to C and the stock of Seafreighters to A and B in exchange for their stock in Barge. Each corporation continued to engage in the shipping business. Each corporation owned a warehouse and docking facility in Baltimore and in Jacksonville and each owned some freighters. What were the tax consequences of this transaction?

What would be the result if the assets of Seafaring consisted of a warehouse and dock facilities in Seattle, and the assets of Seafreighters consisted of such facilities in Baltimore? Seafaring operated a shipping business solely on the West Coast, and Seafreighters operated a shipping business solely on the East Coast. What result would you reach if the East Coast activities had been operated by Barge for 25 years; but the West Coast activities, which were developed from funds generated by Barge from its East Coast operations, had been operated for only three years prior to the distribution?

V-4 Comics Syndicated, Inc., has owned and operated a business of buying and licensing syndicated comic strips for 20 years. During that twenty-year period it has grown from a $100,000 business to one valued at $10,000,000. It has 10 shareholders and one of its shareholders is near retirement age and is no longer interested in the business. Comics transfers to a new subsidiary its rights with respect to the comic strip ``Blue Devils'' and distributes the stock of the subsidiary to the retiring shareholder in redemption of his stock in Comics Syndicated. One week later that shareholder sells the stock of the new corporation to an unrelated party for cash of $1,000,000. What are the tax consequences to the shareholder of these transactions?

What would be the tax result if three years prior to making the distribution to the retiring shareholder, Comics had purchased for cash the assets of Humor, Inc., which owned the rights to ``Blue Devils,'' and if Humor had been producing and syndicating ``Blue Devils'' for 10 years prior to Comics' acquisition of its assets? Would you change your answer if the assets of Humor had been acquired by Comics in a transaction in which neither gain nor loss was recognized by either of the parties to the exchange (i.e., a ``C'' reorganization)?

V-5 Hart, Inc., has owned and operated a shoe factory in Durham, North Carolina, for 15 years. Hart also has owned undeveloped real estate just outside the city limits of Durham. Hart forms the Alsop Corporation and distributes the unimproved real estate to Alsop in exchange for Alsop's stock. Hart then distributes Alsop's stock to Smith, the sole shareholder of Hart. The purpose of the division is to insulate the real estate from the risks of the shoe business (which business had been on a decline in recent years). What are the tax consequences?

V-6 X Corporation has 100 shares outstanding and has two equal shareholders, A and B. A and B are not related. X has accumulated earnings and profits in excess of $200,000. Each shareholder has owned 50 shares of X stock for over 5 years and has a basis in each share of $1,000. X owns all 100 shares of the outstanding stock of Y Corporation with a total fair market value of $100,000, and X owns a $10,000 face amount bond of Y having a fair market value of $10,500. X has owned the Y stocks and bond for more than 10 years. Pursuant to a split-off, X distributes to A the 100 shares of Y stock and the $10,000 bond of Y in exchange for all 50 shares of A's stock of X. What are the tax consequences to A of that exchange?

V-7 The same facts as those stated in **V-6** except that A also owned a bond of X having a face amount and fair market value of $6,000, and A had a basis of $6,000 in that bond. On the exchange for the Y stock and bond, A transferred to X his 50 shares of X stock plus his $6,000 bond of X. What amount of income did A recognize on that exchange with X?

V-8 *A*, an individual, owned 50 shares of common stock of X Corporation, and *A* had a basis of $50,000 in those shares. *X* was in control of the *Y* Corporation, and *X* had a large amount of earnings and profits. Pursuant to a spin-off that qualified under § 356, X distributed to *A* 50 shares of *Y* stock having a fair market value of $50,000 and a security of *Y* having a principal amount and fair market value of $10,000. Immediately after the distribution, the fair market value of *A*'s 50 shares of *X* stock was $150,000. *A* received a dividend distribution to the extent of the $10,000 boot received. What basis does *A* have in the *X* and *Y* stocks and in the *Y* security that *A* holds? If *A* were a corporation, instead of an individual, what basis would *A* have in those properties?

Given the capital gains rates that apply to many dividends, is there any significance to determining whether boot received in a corporate division is a dividend?

V-9 (a) P Corporation had substantial earnings and profits. It owned all 100 shares of the outstanding stock of S Corporation, and both corporations operated businesses that have been conducted for over 8 years. A owned all 200 shares of the outstanding stock of P, and A had owned those shares for more than 5 years. P distributed all 100 shares of S stock plus $5,000 cash to A in exchange for 50 shares of P's stock. The fair market value of the 100 shares of S stock is $9,000 and the fair market value of the 50 shares of P stock is $14,000. A had a basis of $80,000 in the 200 shares of P stock that he owned before the exchange; therefore, he had a basis of $20,000 in the shares that he exchanged. What were the tax results of the exchange? What basis does A have in the 100 shares of S stock?

(b) The same facts as in (a) except that A's basis in the 200 shares of P stock was $44,000; therefore, his basis in the 50 shares of P stock that he surrendered to P in exchange for the S stock was $11,000. What were the tax results of the exchange? What basis does A have in the S stock?

V-10 P Corporation is owned equally by individuals A and B, and P reports its income on a calendar year basis. As of January 1, Year One, P had owned and operated a shoe factory in Toledo and a sweater factory in Cleveland for more than 12 years. On March 5, Year One, P organized the S Corporation and transferred the Cleveland factory to it in exchange for (1) 100 shares of common stock of S having a par value of $100 per share and a fair market value of $100,000, and (2) bonds (which qualify as securities) of S in the principal amount of $10,000 and having a fair market value of $10,000. Since it is assumed in this question that the transactions among P, S and P's shareholders qualify as parts of a ``D'' reorganization, P does not recognize any income from its receipt of S's securities. See § 361(a). The accumulated earnings and profits of P as of January 1, Year One, were $1,000; and P had a net profit of $6,000 for the Year One. The value of the property transferred to S was $110,000. In each of the following circumstances, determine the amount of gain or income recognized, the characterization of such gain or income, and a shareholder's basis in the properties distributed to him (assume that the following distributions or exchanges occurred on July 1, Year

One, and assume that none of the stock involved is section 306 stock, and assume that the transactions among P, S and P's shareholders qualify as a ``D'' reorganization).

(a) A and B each owned 100 shares of stock in P in which they had a basis of $100 per share and which they had held for more than 5 years. A and B also each owned a bond of P in the principal amount of $3,000 with an adjusted basis of $2,500 and a fair market value of $3,000. A transferred to P his $3,000 P bond and 50 shares of P stock in exchange for 50 shares of S stock and bonds of S in the principal amount of $5,000 and having a value of $5,000. B made an identical exchange.

(b) Same facts as in (a) except that neither A nor B transferred any of their P stock or bonds to P (i.e., A and B received the S stock and bonds and gave nothing in exchange).

(c) Same facts as in (a) except that A gave P all of the stock and securities of P that A owned, and A received from P all of the outstanding stock and securities of S. B did not transfer or receive anything.

(d) Same facts as in (c) except that while A received S's stocks and bonds, he transferred nothing to P in exchange. B neither transferred to nor received anything from P.