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Opportunities and Pitfalls under Sections 351 and 721 (Slides)

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OPPORTUNITIES AND PITFALLS UNDER SECTIONS 351 AND 721

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EXAMPLE 1 (Corporation)
A transfers Properties X and Y to Newco for 50% of the Newco common stock
   Basis of X is 50, FMV is 100
   Basis of Y is 75, FMV is 50
B transfers 150 cash to Newco for 50% of the Newco common stock
No liabilities are transferred

EXAMPLE 1 (Partnership)
A transfers Properties X and Y to Newco LLC for a 50% Newco membership interest
   Basis of X is 50, FMV is 100
   Basis of Y is 75, FMV is 50
B transfers 150 cash to Newco LLC for a 50% Newco membership interest
No liabilities are transferred

EXAMPLE 2 (Corporation)
A transfers Properties X and Y to Newco for 50% of the Newco common stock and the assumption of 150 of liabilities
   Basis of X is 50, FMV is 250
   Basis of Y is 75, FMV is 50
B transfers 150 cash to Newco for 50% of the Newco common stock

EXAMPLE 2 (Partnership)
A transfers Properties X and Y to Newco LLC for a 50% Newco membership interest and the assumption of 150 of liabilities
   Basis of X is 50, FMV is 250
   Basis of Y is 75, FMV is 50
B transfers 150 cash to Newco LLC for a 50% Newco membership interest

EXAMPLE 3 (Corporation) Alternative 1
A transfers Properties X and Y to Newco for 37.5% of the Newco common stock
   Basis of X is 50, FMV is 100
   Basis of Y is 75, FMV is 60
B transfers 150 cash to Newco for 37.5% of the Newco common stock
C receives 25% of the Newco common stock for services
No liabilities are transferred
EXAMPLE 3 (Partnership)  
Alternative 1
A transfers Properties X and Y to Newco LLC for a 37.5% Newco membership interest  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers 150 cash to Newco LLC for a 37.5% Newco membership interest  
C receives a 25% Newco membership interest for services  
No liabilities are transferred

EXAMPLE 3 (Corporation)  
Alternative 2
A transfers Properties X and Y to Newco for 37.5% of the Newco common stock  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers 150 cash to Newco for 37.5% of the Newco common stock  
C receives Newco common stock which constitutes 25% of Newco's equity value but possesses only 10% of the voting power of Newco stock, for services  
No liabilities are transferred

EXAMPLE 3 (Partnership)  
Alternative 2
A transfers Properties X and Y to Newco LLC for a 37.5% Newco membership interest  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers 150 cash to Newco LLC for a 37.5% Newco membership interest  
C receives a 25% Newco membership interest, but only 10% voting interest, for services  
No liabilities are transferred

EXAMPLE 3 (Corporation)  
Alternative 3
A transfers Properties X and Y to Newco for 37.5% of the Newco common stock  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers 150 cash to Newco for 37.5% of the Newco common stock  
C receives Newco nonvoting common stock which constitutes 25% of Newco's equity value, for services  
No liabilities are transferred

EXAMPLE 3 (Partnership)  
Alternative 3
A transfers Properties X and Y to Newco LLC for a 37.5% Newco membership interest  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers 150 cash to Newco LLC for a 37.5% Newco membership interest  
C receives a 25% Newco nonvoting membership interest for services  
No liabilities are transferred

EXAMPLE 3 (Corporation)  
Alternative 4
A transfers Properties X and Y to Newco for 50% of the Newco common stock  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers 150 cash to Newco for 50% of the Newco common stock  
C receives a 25% interest in Newco's future profits for services  
No liabilities are transferred
EXAMPLE 3 (Partnership)  
Alternative 4  
A transfers Properties X and Y to Newco LLC for a 37.5% profits interest and 50% initial capital interest in Newco  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers $150 cash to Newco LLC for a 37.5% profits interest and 50% initial capital interest in Newco  
C receives a 25% profits interest in Newco for services  
No liabilities are transferred

EXAMPLE 3 (Corporation)  
Alternative 5  
A transfers Properties X and Y to Newco for 50% of the Newco common stock  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers $150 cash to Newco for 50% of the Newco common stock  
For providing services to Newco, C receives from Newco an option to purchase 25% of the Newco common stock; the exercise price is FMV on the date of grant  
No liabilities are transferred

EXAMPLE 3 (Partnership)  
Alternative 5  
A transfers Properties X and Y to Newco LLC for a 50% Newco membership interest  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers $150 cash to Newco LLC for a 50% Newco membership interest  
For providing services to Newco LLC, C receives from Newco LLC an option to purchase a 25% Newco membership interest; the exercise price is FMV on the date of grant  
No liabilities are transferred

EXAMPLE 3 (Corporation)  
Alternative 6  
A transfers Properties X and Y to Newco for 37.5% of the Newco common stock  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers $150 cash to Newco for 37.5% of the Newco common stock  
C receives 25% of the Newco common stock for services, but C's stock is not vested and will not vest unless C is still employed by Newco in 3 years  
No liabilities are transferred

EXAMPLE 3 (Partnership)  
Alternative 6  
A transfers Properties X and Y to Newco LLC for a 37.5% Newco membership interest  
Basis of X is 50, FMV is 100  
Basis of Y is 75, FMV is 50  
B transfers $150 cash to Newco LLC for a 37.5% Newco membership interest  
C receives a 25% Newco membership interest for services, but C's membership interest is not vested and will not vest unless C is still employed by Newco in 3 years  
No liabilities are transferred

EXAMPLE 4 (Corporation)  
Alternative A  
A and B each have owned 50% of the common stock of Company for 2 years  
D transfers Property Z to Company for 20% of the common stock of Company  
Basis of Z is 50, FMV of Z is 100  
No liabilities are transferred
EXAMPLE 4 (Partnership) Alternative A
A and B each have owned 50% of the membership interests in Company LLC for 2 years

D transfers Property Z to Company LLC for a 20% membership interest in Company LLC
Basis of Z is 50, FMV of Z is 100

No liabilities are transferred

EXAMPLE 4 (Corporation) Alternative B
A and B each have owned 50% of the common stock of Company for 2 years

D transfers Property Z to Company for 20% of the common stock of Company
Basis of Z is 150, FMV of Z is 100

No liabilities are transferred

EXAMPLE 4 (Partnership) Alternative B
A and B each have owned 50% of the membership interests in Company LLC for 2 years

D transfers Property Z to Company LLC for a 20% membership interest in Company LLC
Basis of Z is 150, FMV of Z is 100

No liabilities are transferred

EXAMPLE 4 (Corporation) Alternative C
A and B each have owned 50% of the common stock of Company for 2 years

D transfers Property Z to Company for 20% of the common stock of Company
Basis of Z is 50, FMV of Z is 100

A and B each transfer cash to Company for an additional 1% membership interest
A and B each transfer cash to Company for an additional 5% membership interest
Only A transfers cash to Company for an additional 10% membership interest

No liabilities are transferred

EXAMPLE 4 (Partnership) Alternative C
A and B each have owned 50% of the membership interests in Company LLC for 2 years

D transfers Property Z to Company LLC for a 20% membership interest in Company LLC
Basis of Z is 150, FMV of Z is 100

A and B each transfer cash to Company LLC for an additional 1% membership interest
A and B each transfer cash to Company LLC for an additional 5% membership interest
Only A transfers cash to Company LLC for an additional 10% membership interest

No liabilities are transferred

EXAMPLE 4 (Corporation) Alternative D
A and B each have owned 50% of the common stock of Company for 2 years

D transfers Property Z and provides services to Company for 20% of the common stock of Company
Basis of Z is 50, FMV of Z is 100

A and B each transfer cash to Company for an additional 1% of the common stock
A and B each transfer cash to Company for an additional 5% of the common stock
Only A transfers cash to Company for an additional 10% of the common stock

No liabilities are transferred
EXAMPLE 4 (Partnership)
Alternative D

A and B each have owned 50% of the membership interests in Company LLC for 2 years.

D transfers Property Z and provides services to Company LLC for a 20% membership interest in Company LLC. Basis of Z is 150, FMV of Z is 100.

A and B each transfer cash to Company LLC for an additional 1% membership interest. Only A transfers cash to Company for an additional 10% membership interest.

No liabilities are transferred.

EXAMPLE 5 (Corporation)
Alternative A

A and B each have owned 50% of the common stock of Company for 4 years.

E and F each own 50% membership interests in Target LLC, which has high value, low basis assets and negative capital of 100 (E and F each have negative capital accounts of 50).

Target LLC merges into Company, and E and F (in exchange for their membership interests in Target LLC) each receive Company common stock constituting 20% of all the common stock outstanding after the merger.

EXAMPLE 5 (Partnership)
Alternative A

A and B each have owned 50% membership interests in Company LLC for 4 years.

E and F each own 50% membership interests in Target LLC, which has high value, low basis assets and negative capital of 100 (E and F each have negative capital accounts of 50).

Target LLC merges into Company LLC, and E and F (in exchange for their membership interests in Target LLC) each receive Company LLC membership interests constituting 20% of all the membership interests outstanding after the merger.

EXAMPLE 5 (Corporation)
Alternative B

A and B each have owned 50% of the common stock of Company for 4 years.

E and F each own 50% membership interests in Target LLC, which has high value, low basis assets and negative capital of 100 (E and F each have negative capital accounts of 50).

To effect a business combination with Target LLC, Company forms Subsidiary Inc and transfers all its assets and liabilities to Subsidiary Inc, receiving solely a membership interest in Subsidiary LLC in return.

Target LLC merges into Subsidiary Inc, and E and F (in exchange for their membership interests in Target LLC) each receive Subsidiary Inc common stock constituting 20% of all the common stock outstanding after the merger.

EXAMPLE 5 (Partnership)
Alternative B

A and B each have owned 50% of the common stock of Company for 4 years.

E and F each own 50% membership interests in Target LLC, which has high value, low basis assets and negative capital of 100 (E and F each have negative capital accounts of 50).

To effect a business combination with Target LLC, Company forms Subsidiary LLC and transfers all its assets and liabilities to Subsidiary LLC, receiving solely a membership interest in Subsidiary LLC in return.

Target LLC merges into Subsidiary LLC, and E and F (in exchange for their membership interests in Target LLC) each receive a 20% membership interest in Subsidiary LLC.

EXAMPLE 5 (Corporation)
Alternative C

A and B each have owned 50% of the common stock of Company for 4 years.

E and F each own 50% membership interests in Target LLC, which has high value, low basis assets and negative capital of 100 (E and F each have negative capital accounts of 50).

Holdco Inc is formed to effect a business combination of Company and Target LLC.

And B each transfer their Company stock to Holdco Inc in exchange for 30% of the Holdco Inc common stock, and E and F each transfer their membership interests in Target LLC to Holdco Inc in exchange for 20% of the Holdco Inc common stock.
EXAMPLE 5 (Partnership)
Alternative C

A and B each have owned 50% of the common stock of Company for 4 years.

E and F each own 50% membership interests in Target LLC, which has high value, low basis assets and negative capital of 100 (E and F each have negative capital accounts of 50).

Holdco LLC is formed to effect a business combination of Company and Target LLC.

And B each transfer their Company stock to Holdco LLC in exchange for 30% membership interests in Holdco LLC, and E and F each transfer their membership interests in Target LLC to Holdco LLC in exchange for 20% membership interests in Holdco LLC.