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)
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
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 (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, C receives from Newco an option to purchase 25% of the Newco membership interest; the exercise price is FMV on the date of grant  
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 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% 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 Proper 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, or

Only A transfers cash to Company LLC 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 Subsidiary Inc common stock in return.

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