1966

Advanced Income Tax: Final Examination (May 28, 1966)

William & Mary Law School

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I. A summary of the elemental reorganization pattern - Please cite the applicable IRC definitional provisions on which you would rely in advising a client that the following exchanges would be tax-free:

(a) Corp. A owns all the voting stock of Corp. B. Corp. B gives 5% of the voting stock of Corp. A to Corp. C in exchange for 85% of C's voting stock. Afterwards, B controls C; C owns 5% of A's voting stock; and, A controls B.

(b) Corp. A gives 5% of its voting stock to Corp. B in exchange for all of B's assets. Afterwards, Corp. A owns B's assets and B owns 5% of A's voting stock.

(c) Corp. A gives 50% of its voting stock to Corp. B in exchange for 85% of B's voting and non-voting stock. Afterwards, Corp. A is the Parent and Corp. B is A's subsidiary.

(d) Corp. A gives 99% of its assets to Corp. B in exchange for 90% of B's voting stock and then Corp. A distributes all of B's stock held by it to B's shareholders. Afterwards, Corp. A controls B before A distributes B's stock, then after the distribution, A's stockholders control B. Corp. A is then left with no assets.

(e) Corp. A and Corp. B transfer all their assets to new Corp. C in exchange for C's stock. Afterwards, Corps. A and B distribute their pro-rata share of C's stock to their respective shareholders and dissolve.

(f) Corp. A's stockholders own both A's voting stock and long time mortgage bonds. Corp. A exchanges additional voting stock for all the bonds. Afterwards, Corp. A has only voting stock outstanding.

(g) Corp. A is incorporated in Ohio. It reincorporates in Delaware. As a result it issues new stock certificates giving effect to the Delaware situs in exchange for all stock outstanding.

(h) Corp. A incorporated in 1950. Corp. A transfers half of its assets to Corp. B for 100% of B's stock. Afterwards, Corps. A and B are engaged in active business; and, Corp. A distributes all of Corp. B's stock to A's stockholders to compensate them for their share of the assets transferred to B.

(i) Corp. A transfers 80% of its voting stock to Corp. B in exchange for 95% of B's assets. Afterwards, Corp. A owns most of B's assets and A owns most of B's stock.

II. Special Rules - What is the reason for the special rule contained in sec. 368(a)(2)(A)?
III. Basic authority for tax-free exchanges. Sec. 1002 lays down the general rule that all exchanges are taxable, except as otherwise provided by Title 26. One major exception is sec. 1031, providing for non-recognition of gain in the case of exchanges of like property held for productive use, but such does not include stock, inventory, etc. Yet, in parts (a) and (b), and in some of the other parts, of Question I above, stock of one company is exchanged tax-free for stock of another company, and stock of one company is exchanged tax-free for assets of another company.

(a) What IRC operational section, or sections, would you cite to your client to show that such transfers are not taxable to the companies that are parties to the exchange?

(b) What IRC section, or sections, would you cite to show that the stockholders can exchange the stock they hold in one company for stock in another company without being taxable where both companies are parties to the exchange. (It is obvious that stock exchanged in one company for stock of another company that is not a party to the transaction would be taxable under the general rule of sec. 1002).

IV. Boot - Since it is not always possible to make even swaps of stock of one company for stock of another company held by a stockholder where both companies are parties to a reorganization, the differences are equalized by items other than voting stock, such as short term notes, money, stock of other companies not a party to the transaction, and other types of property. These items are commonly referred to as "boot." Please indicate how the "boot" is to be treated for tax purposes by the stockholders in the following situations:

(a) Individual Stockholder A was asked to surrender one share of X Co. stock for which he had paid $50 (but now worth $200) for one share of Y Co. stock (worth $150) and cash of $50. X Co.'s accumulated E. and P. at the time was $1,000.

(b) Assume Individual Stockholder A in question (a) above had paid $300 for his share of X Co. stock. What then?

(c) Individual Stockholder B was asked to surrender one share of M Co. stock for which he had paid $50 (but now worth $200) and one M Co. Bond (Principal amount, $500; cost, $500; fair market value $500) in exchange for one share of N Co. stock (worth $150) and one N Co. Bond (Principal amount, $650; fair market value, $675). M Co's accumulated E. and P. at the time was $1,000.
V. Motives and requirements underlying the Reorganization provisions - Irrespective of strict literal compliance with the statutory rules, many reorganizations are taxable events because they fail to meet the "intended" purposes of these provisions. Please discuss these purposes and requirements from the standpoint of "business objectives" and "continuity of ownership."

VI. Carry-overs in Corporate Reorganization

(a) Net operating losses - Indicate a few of the principles governing the allowance and disallowance of net operating losses of an acquired corporation by the acquiring corporation in a tax-free reorganization.

(b) Carry-over of Earnings and Profits - If Corporation X, in a tax-free reorganization, acquires Corporation Y at a time when X has post 1913 E. and P. of $100,000 and Y has a post-1913 deficit in E. and P. of $50,000; and, during the first taxable year following the reorganization Corporation X has current E. and P. of $25,000 - to what extent will a current year dividend distribution of $150,000 be taxable as a dividend under sec. 301? (Please give the reason for your answer)

VII. Summary - Very briefly list a few of the basic reasons for the reorganization provisions; and, list some of the dangers to the revenue inherent in them which the Code and the Courts have attempted to hold to a minimum.