Case Western Reserve Law Review

Volume 12 | Issue 2

1961

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ruling should not be interpreted as requiring proof of a business purpose for the decision to incorporate, where the transfer is to a corporation intended to have a continuing existence. The courts have never stated such a requirement for a nontaxable incorporation. On the contrary, a nontaxable incorporation has been approved, despite findings that the principal purpose for the transfer to the corporation was to achieve tax savings.[45]

Whenever liabilities are assumed, it is, of course, necessary under section 357(b) to show a business purpose for the assumption of the liabilities, in order to avoid realization of a gain as a result of the assumption.[46] Moreover, whenever a transfer is made to a foreign corporation, it is not only necessary to demonstrate a business purpose for the transfer, but it is also required that prior to the transfer a ruling be obtained to the effect that the transaction is prompted by business considerations rather than any tax avoidance purpose. Section 367 provides that section 351 will not apply to a transfer to a foreign corporation, unless such a ruling is first obtained.[47]

IV

CHOOSING AND CREATING THE APPROPRIATE CORPORATE STRUCTURE

B. J. Adelson

After the decision has been reached to incorporate, the organizers must determine the type and amount of corporate securities to be issued. The simplest solution is to issue solely common stock to all persons investing in the corporation, but simplicity is the only virtue of this solution. The issuance of bonds or notes and/or different classes of stock should be given careful consideration. The issuance of nonvoting common stock or preferred stock can be a useful tool in estate planning and in balancing the interests of investor-shareholders and employee-shareholders.[1]

45. W & K Holding Corp., 38 B.T.A. 830 (1938), *nonacq.*, 1939-1 CUM. BULL. 69 (Pt. 1).

46. See discussion pp. 197-98.

47. Sections 1491-94 impose an excise tax upon certain transfers of stock or securities to foreign companies unless a prior ruling is secured as to the absence of tax avoidance purposes.

ADVANTAGES AND DANGERS OF USE OF DEBT

Investors will normally desire to take a portion of the earnings out of the corporation, and the use of debt provides the most effective means of giving them a return on their investment in the form of cash in their pockets. If they own only common stock they must cause the corporation to declare a dividend to get cash, but if the investors own both stock and notes they will receive interest on the notes. Although the investor's income tax will be almost identical whether he receives dividends or interest,[2] the effect upon the corporation will be quite different: the corporation can deduct the interest payments in computing taxable income, but cannot deduct dividend payments. Another, and frequently more important advantage, arises when the corporation retires its debt obligations. The funds received by the investor will not be subject to any tax; the repayment of a loan does not create income. Such a return of initial investment from a corporation with only common stock outstanding can only be made in the form of a distribution which is taxed as a dividend.[3]

The use of debt can also postpone the time when the corporation will be vulnerable to the imposition of the accumulated earnings tax.[4] This tax is levied upon corporations with accumulated earnings and profits in excess of $100,000, and which accumulate earnings and profits beyond the reasonable needs of the business. If the corporation has accumulated earnings and profits but has no freely available assets with which to pay dividends, or will need such assets to retire debts, the corporation is not subject to the tax.[5] Creation of debt at the time of incorporation can limit the availability of cash for dividend payments and forestall the imposition of the accumulated earnings tax.[6] The cash generated by the earnings of the corporation will generally be used to retire the original debt and to expand the business. Thus, even though the corporation shows a large surplus on its balance sheet, it will not have sufficient cash available to pay dividends. The only disadvantage of debt securities is that losses on funds loaned to an unprofitable corporation will normally be deductible only as short-term capital losses,[7]

1. See discussion pp. 216-17.

2. Both dividends and interest are taxed at ordinary income rates, but dividends are subject to the $50 exclusion of INT. REV. CODE OF 1954, § 116 and the 4% credit of § 34. (Hereinafter cited as §).

3. Pro rata redemptions of stock are normally taxed as dividends. § 302.

4. §§ 531-37.

5. Little Rock Towel & Supply Co., 11 CCH Tax Ct. Mem. 36 (1952); Gazette Tel. Co., 19 T.C. 692 (1953); Sauk Inv. Co., 34 B.T.A. 732 (1936).

6. Gazette Tel. Co., 19 T.C. 692 (1953).

7. § 166. It is exceedingly rare for an investor in this type of situation to be able to prove he is in the business of lending money to corporations. See Treas. Reg. § 1.166-5; (Herein-

whereas losses on stock acquired at the time of incorporation may be deducted as ordinary losses if care is exercised to comply with the provisions of section 1244 when the stock is originally issued.[8]

Accordingly, in almost every case, it will be advantageous for the corporation to issue notes as well as stock in return for the initial investment, and the important question will be how much of the original investment can be represented by notes. The primary danger in the issuance of too much debt is the possibility that the Internal Revenue Service and the courts will treat the "debt" as "stock." This article does not attempt to analyze this much-discussed area, but is limited to a short review of the results of the treatment of "debt" as "stock" and the factors the courts use in determining whether "debt" securities are to be so treated.[9] If the determination is adverse to the taxpayer, and the so-called "debt" is considered "stock," all the desired advantages of debt obligations will be lost: the "interest" payments will be considered dividends and the corporation will lose the anticipated interest deduction; the repayments of the "loan" will be treated as dividends and taxed as such to the recipients; and, if the corporation has elected Subchapter S treatment, the election will be ineffective because the "debt" will be construed as a second class of stock.[10]

The criteria normally used by the courts to determine whether the "debt" is to be recognized as such for tax purposes are: (1) Does the obligation have a definite maturity date, fixed interest rate and other terms consistent with debt securities?[11] (2) Is it likely that the corporation will be able to repay the obligations at maturity, or will the notes have to be renewed?[12] (3) Is the ratio of debt to stock reasonable?[13] (4) Is the equity capital of the corporation sufficient to operate the business?[14] (5) Are the debt obligations held by the same parties and in the same ratio as the equity securities?[15] Recent cases indicate

after cited as Reg.); H. Beale Rollins, 32 T.C. No. 54 (1959) (loans to seventeen enterprises in which lender has stock does not constitute business of lending money).

8. See discussion pp. 238-43.

9. For a detailed discussion see Calkins, Coughlin, Hacker, Kidder, Sugarman & Wolf, *Tax Problems of Close Corporations: A Survey*, 10 WEST. RES. L. REV. 1, 26-40 (1959); Schlesinger, *Acceptable Capital Structures: How Thin Is Too Thin?*, 1952 TULANE TAX INST. 26 (1953); Schlesinger, *"Thin" Incorporations: Income Tax Advantages and Pitfalls*, 61 HARV. L. REV. 50 (1947). Cases cited in this article are recent illustrations of the principles enunciated in earlier cases and discussed in the above articles.

10. Reg. § 1.1371-1(g).

11. *E.g.*, O. H. Kruse Grain & Milling v. Commissioner, 60-2 U.S. Tax Cas. ¶ 9490 (9th Cir. May 22, 1960); Gokey Properties, Inc., 34 T.C. No. 84 (Aug. 12, 1960).

12. *E.g.*, Brake & Elec. Sales Corp. v. United States, U.S. 60-2 Tax Cas. ¶ 9594 (D. Mass. July 16, 1960); *cf.* Gooding Amusement Co. v. Commissioner, 236 F.2d 156 (6th Cir. 1956).

13. *E.g.*, Bruce v. Knox, 180 F. Supp. 907 (D. Minn. 1960).

14. *E.g.*, R. C. Owen Co. v. United States, 180 F. Supp. 369 (Ct. Cl. 1960); Truck Terminals, Inc., 33 T.C. 100 (Feb. 12, 1960).

15. *E.g.*, Gloucester Ice & Cold Storage Co., 19 CCH Tax Ct. Mem. 1015 (Sept. 21, 1960).

that the courts are scrutinizing the transactions closely; in one case a court specifically stated that the ratio of debt to equity was reasonable, but then held the "debt" was not to be treated as debt because, viewing the situation from the time of incorporation, it did not appear that the corporation would be in a position to pay the obligation at maturity.[16] The salient fact used by the court to justify its conclusion was that the five-year-note, was, in fact, not paid at maturity but was extended for another five years, a point which should be borne in mind both in setting up maturities upon incorporation and also later when the corporate obligations mature. The contrary opinions stress the fact that the funds "loaned" to the corporation were intended to be at the risk of the business.[17] Although many courts have used this criterion of whether the funds were intended to be at the risk of the business, the use of such a criterion seems unwarranted. The proceeds of almost every business loan, whether from a bank, finance company or individual, will be used in the business of the borrower and consequently will be at the risk of the business. Presumably the corporation would not borrow if it did not need the funds in the conduct of its business. It would seem that the important inquiry is not whether the funds are at the risk of the business, but whether the funds are so essential to the operation of the business that it is highly unlikely that the corporation will be in a position to repay the loan at maturity.

CHOOSING THE PROPERTY TO BE TRANSFERRED TO THE CORPORATION

Another problem arises if an existing proprietorship or partnership is to be incorporated: the owners must decide whether a portion or all of the property being used in the business should be transferred to the corporation. Retention of certain assets by the proprietor or partner will often result in substantial tax savings.

The advantages to be derived from a "thin" incorporation, a transfer to the corporation for notes as well as stock, can often be attained when incorporating a going business by excepting from the assets transferred to the corporation most of the cash and trade receivables. By withholding these assets the stockholders will be able to withdraw more cash without having the corporation pay dividends; as the receivables are collected the cash will be retained by the shareholders. However, if, upon collection, the receivables are transferred to the corporation, the cash collected will be in the corporation and normally it cannot be distributed

16. Brake & Elec. Sales Corp. v. United States, 60-2 U.S. Tax Cas. ¶ 9594 (D. Mass. July 16, 1960).

17. See particularly Gloucester Ice & Cold Storage Co., 19 CCH Tax Ct. Mem. 1015 (Sept. 21, 1960).

to the shareholders except in the form of a dividend. To facilitate billing and collection, the corporation often agrees to collect and distribute the receivables as the agent of the proprietor or partners. In this situation, the corporation does not issue stocks or securities in exchange for the accounts receivable; the accounts are never transferred to the corporation.

If some of the receivables are to be transferred, and if the proprietorship or partnership uses special accounting methods, care must be exercised in choosing the receivables to be transferred. If the old business reports some sales on the installment method, attention must be given to the possible acceleration of the reporting of income. The Regulations specifically provide that no gain or loss shall be recognized in a transfer which qualifies under section 351.[18] However, if the incorporation will result in gain being recognized to the transferor, the entire amount of gain realized on the disposition of the installment obligations through transfer to the corporation will be taxable to the transferor in the year of transfer; the measure of gain will be the difference between the fair market value of the obligations and their bases.[19] Furthermore, if the partnership or proprietorship is reporting construction contracts on the completed contract method of accounting and the contracts are transferred to the corporation, the individuals may be required to include the unreported income on their individual returns. In the converse situation, where a corporation using the completed contract method liquidates, the corporation must accrue the unreported income in the year of liquidation.[20] The Internal Revenue Service has not indicated whether it will seek the same treatment in an incorporation situation, whether it will permit transfer of such contracts without accrual of unreported income, or whether it will adopt rules similar to those established for the disposition of installment obligations — requiring accrual of income in a taxable incorporation but not in a tax-free incorporation.

Whether fixed assets should be transferred to a corporation will generally depend upon a number of factors. The most important reason for making an incorporation taxable is usually to obtain a new and higher basis for depreciation. If a building, patent, or other depreciable asset, having a low basis in the hands of the transferor, is transferred to a corporation in a tax-free transaction, the corporation takes the same low basis for depreciation[21] and the transferor-shareholder has that same basis for the shares received in the exchange.[22] Accordingly, in a tax-free

18. Reg. § 1.453-9(c)(2). See discussion pp. 183-94 for requirements of a tax-free transfer under § 351.

19. Reg. § 1.453-9. See discussion pp. 210-12 for the types of transfers which are taxable.

20. Standard Paving Co. v. Commissioner, 190 F.2d 330 (10th Cir. 1951); Jud Plumbing & Heating, Inc., 5 T.C. 127 (1945), *aff'd*, 153 F.2d 681 (5th Cir. 1946).

21. § 362.

22. § 358.

transaction it will normally be preferable to withhold the depreciable assets and lease them to the corporation, thus enabling the former partners or proprietor to draw additional sums out of the corporation in the form of rents or royalties. If the business is transferred in a tax-free incorporation under section 351, but the high tax bracket of the investors makes retention of depreciable assets and receipt of rent or royalties undesirable, transfer of the depreciable assets to a second corporation in a taxable exchange may be advantageous. Such an arrangement insures the benefits of tax-free incorporation for the going business and the advantages of a stepped-up basis of a taxable incorporation of the depreciable assets. Non-depreciable assets such as land may be withheld to produce additional rental income for the transferors, or these assets may be ideal to increase the size of the corporation to enable the transferors to take additional notes in exchange for the assets being transferred.

TAXABLE INCORPORATIONS

Advantages of Taxable Incorporations

The advantage of a tax-free incorporation under section 351 lies in the nonrecognition of gain at the time of incorporation. However, a taxable transfer may be preferable to obtain a new basis for the assets being transferred, particularly when the transfer includes depreciable property with a low basis in comparison to market value. By making the transfer taxable the transferors will cause their capital gain to be recognized immediately for tax purposes,[23] but they will also enable the corporation to obtain larger depreciation deductions against ordinary income because of the stepped-up basis of the assets. In a fully taxable incorporation the corporation takes as its basis for the assets it receives the cost of those assets,[24] which cost will usually be their fair market value.[25] If the transaction is taxable only because the transferors receive boot in addition to stock and securities within the meaning of section 351, the corporation's basis for the assets it receives will be the basis of those assets to the transferor increased by the amount of gain recognized to the transferor in the transaction.[26] A taxable transaction may also be desirable if the market value of the assets is below their basis in the hands

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23. But see discussion pp. 213-14 for problems involved in the transfer of depreciable property.

24. § 1012.

25. In some cases the statutory term "cost" would appear to mean, paradoxically, "fair market value of the assets received." Perhaps, however, this is simply an illustration of the rule that equals are usually traded for equals. See Hacker, *Determining and Allocating "Cost" and Prorating Property Taxes,* 11 WEST. RES. L. REV. 158, n.4 (1960).

26. § 362(a). Boot is any asset other than § 351 stock or securities.

of the transferor — the taxable transfer resulting in a loss to the transferors, which can be used to offset other income.[27]

How to Make the Transaction Taxable

Section 351 is so broad that it is frequently difficult to create a taxable transfer. However, as has been discussed, that section is applicable only if the persons who transfer property to the corporation receive, as a group, stock possessing at least eighty per cent of the combined voting power of all voting stock, and at least eighty per cent of the nonvoting stock.[28] If this requirement is *not* met the transaction will be taxable, whether this amounts to a frustration of the taxpayer's purpose or a deliberate achievement of his intention.[29] The eighty per cent requirement will not be satisfied if the transferors, after receiving all the new company's stock, immediately resell more than twenty per cent of it to others pursuant to a pre-existing contract.[30] Reference must be made to the prior discussion for the detailed rules as to such transfers, but two points should be emphasized for those who choose this route deliberately.

First, the agreement must be for the *sale* of the stock. A mere intent to donate stock to a third party will not be sufficient even if the donation is actually made after receipt of the stock by the transferor.[31]

Second, the agreement to sell must be carefully drafted. This is an area in which the form of the transaction is controlling, and will produce different tax results even though the end result is the same. If a property owner sells a twenty-five per cent interest in his property to his son, and father and son together transfer the entire ownership of that property to the corporation in return for stock, the incorporation will be tax-free under section 351 because both father and son will be transferors;[32] but if the father agrees to sell to his son twenty-five per cent of the stock he is to receive upon incorporation, only the father is a transferor, and he will not be in control "immediately after the exchange" as required by section 351, so the incorporation will be taxable. Accordingly, if the property owner is to sell more than twenty per cent of his interest and

27. But see discussion p. 213 for problems involved in transfers resulting in losses.

28. §§ 351(a), 368(c). See discussion p. 189.

29. Compare Commissioner v. Day & Zimmerman, Inc., 151 F.2d 517 (3d Cir. 1945); Rhode Island Hosp. Trust Co., 7 T.C. 211 (1946); Young, *Problems in Organizing and Capitalizing New Organizations,* N.Y.U. 14TH INST. ON FED. TAX 613, 619 (1956); *cf.* Rev. Rul. 59-259, 1959-2 CUM. BULL. 115.

30. May Broadcasting Co. v. United States, 200 F.2d 852 (8th Cir. 1953); Hazeltine Corp. v. Commissioner, 89 F.2d 513 (3d Cir. 1937); Bassick v. Commissioner, 85 F.2d 8 (2d Cir. 1936); West Texas Ref. & Dev. Co. v. Commissioner, 68 F.2d 77 (10th Cir. 1933); Maine Steel, Inc. v. United States, 174 F. Supp. 702 (D. Me. 1959). See discussion pp. 201-03.

31. Wilgard Realty Co. v. Commissioner, 127 F.2d 514 (2d Cir.), *cert. denied,* 317 U.S. 655 (1942). See discussion p. 202.

32. Reg. § 1.351-1(a).

desires a nontaxable transaction on the transfer of his remaining interest, it is essential that he sell the interest in the property prior to transferring the remaining interest to the corporation. However, if he wants to increase the basis of his remaining interest he must not sell the property interest, but must agree, before transferring the property, to sell a portion of the stock he is to receive after the corporation is organized.

The issuance of more than twenty per cent of the company's stock for services is another method of defeating the eighty per cent requirement, since only stock issued to those transferring property to the company counts towards the eighty per cent.[33] Indeed, the transaction will be taxable if the total of the stock issued for services, plus the stock subject to an agreement to be sold immediately after receipt by the transferor, exceeds twenty per cent.

If the transferors are unwilling to give as much as twenty-one per cent of the voting common stock for services, or pursuant to pre-existing agreements of sale, another possibility is to have the corporation issue a second and much less valuable class of nonvoting stock. Transfer of twenty-one per cent of a class of nonvoting stock will prevent the transaction from being tax-free.[34] It is doubtful that this provision would be read literally if the value of the nonvoting stock were miniscule in comparison with the value of the voting stock. If the nonvoting stock is issued in substantial quantities and the transferors receive less than eighty per cent of the nonvoting stock, the transfer should be taxable even if the purpose of issuing the stock was to break the control requirement.[35]

In many instances, the investors do not wish to sell more than twenty per cent of the voting or nonvoting stock to outsiders, either for cash or services. The incorporation can still be made partially taxable, and the corporation can obtain a higher basis for depreciation, if property other than stock or securities is distributed by the corporation. Section 351(b) provides that in such a case gain to the transferor shall be recognized but not in excess of "(A) the amount of money received, plus (B) the fair market value of such other property received." The gain recognized controls the increase in the basis of the assets received by the corporation.[36] Thus, the distribution of a sufficient amount of property, other than stock or securities, can accomplish essentially the same result as a completely taxable exchange. In general, short-term notes,[37] open accounts[38] and simi-

33. Fahs v. Florida Mach. & Foundry Co., 168 F.2d 957 (5th Cir. 1948); Mojonnier & Sons, 12 T.C. 837 (1949), *nonacq.*, 1949-2 CUM. BULL. 4. See discussion p. 189.

34. § 368(c).

35. See authorities cited note 29 *supra.*

36. § 362.

37. Reg. § 1.368-1(b); Rev. Rul. 56-303, 1956-2 CUM. BULL. 193 (notes maturing in less than four years).

38. Harrison v. Commissioner, 235 F.2d 587 (8th Cir.), *cert. denied,* 352 U.S. 952 (1956).

lar early-maturity evidences of indebtedness are neither stock nor securities.[39] Long-term notes and hybrid securities without fixed maturity dates will normally be classified as "stock or securities." The use of short-term debt to create a partially taxable exchange must be planned carefully with particular regard to the possibility that this "debt" may be regarded as "stock."[40] If there is no reasonable expectation that the "debt" will be paid at maturity, a factor requiring careful scrutiny when large amounts of short term debt are issued, or for any other reason the "debt" is considered to be "stock," the incorporation will be tax-free and the intended purpose of the incorporation will not be accomplished — the corporation will not get an increased basis for the assets.[41] The other dire consequences of the treatment of supposed debt as stock will also occur; the "interest" will not be deductible from the corporation's income, and repayment of the debt will be treated as a dividend to the recipients. In addition, the transferor may pay an unnecessary capital gain tax because the transferor will treat the receipt of the debt as a taxable transaction and report his gain in the year of the exchange. At the time the "debt" obligations are alleged to be "stock," the year of original transfer may be closed by the statute of limitations, and if the Internal Revenue Service is successful in its contention that the "debt" is "stock," no refund of the tax on the capital gain will be available to the shareholders.[42] In view of the disastrous results flowing from a reclassification of the "debt," it is essential that a debt characterization be sustainable beyond doubt.

A partially taxable transaction will also result where the corporation assumes liabilities of the transferor in excess of the basis of the property transferred.[43] Planning to take advantage of this provision will frequently not be desirable because the basis can be increased only to the amount of liabilities,[44] whereas a fully taxable exchange or exchange with boot can be used to increase the basis to fair market value.[45]

Basis of Assets to the Corporation

Assuming it will be possible to make the incorporation taxable, a further study of the consequences should be made. In a fully taxable ex-

39. Weyher & Weithorn, *Capital Structure of New Corporations*, N.Y.U. 16TH INST. ON FED. TAX 277, 285 (1958). Compare Camp Wolters Enterprises, Inc. v. Commissioner, 230 F.2d 555 (5th Cir.), *cert. denied*, 352 U.S. 826 (1956).

40. See discussion pp. 206-07.

41. Gooding Amusement Co. v. Commissioner, 236 F.2d 159 (6th Cir. 1956); Truck Terminals, Inc., 33 T.C. 100 (Feb. 12, 1960).

42. The correction of error provisions of §§ 1311-14 do not apply in this situation.

43. § 357(c).

44. See discussion pp. 197-98.

45. *Cf.* Sarkes Tarzian, Inc. v. United States, 240 F.2d 467 (7th Cir. 1957); Bruce v. Knox, 180 F. Supp. 907 (D. Minn. 1960). See discussion p. 197.

change the gain to the transferor and basis to the corporation will usually be determined by the value of the assets being transferred.[46] In the partially taxable transfer the recognition of gain is limited to the boot received, and the total basis of the assets to the corporation is fixed by the basis of the property in the hands of the transferor, increased by the amount of gain recognized to the transferor. However, the allocation of that basis is governed by the fair market value of the assets.[47] There may be a wide divergence of opinion concerning the fair market value of all of the assets; although the transferor may believe land and other non-depreciable assets have values equivalent to his basis, and believe his business has no goodwill, this may not be the attitude of the Internal Revenue Service or the courts.[48] Accordingly, in a fully taxable transaction, consideration should be given to the possibility that the transferor may have a larger gain than anticipated because of the presence of goodwill or because the assets transferred are worth more than originally believed. Similarly, when a transaction involves boot, it is possible that in allocating the increase in basis over the assets received by the corporation a portion may have to be attributed to goodwill or other non-depreciable assets.[49]

Additional Pitfalls

If the transaction is made taxable to create a loss, a further hurdle must be cleared. Section 267 provides that no loss shall be allowed in a transaction between an individual and a corporation in which such individual owns more than fifty per cent of the stock. In determining the percentage owned by the individual, stock owned by corporations, estates, trusts and partnerships are proportionately attributed to him, and all stock owned by his partners and members of his family are attributed to him.[50] The rules governing the disallowance are so broad that in a transaction involving some assets with a value greater than basis and others with values below basis, the gains are taxed but no offset is permitted for the losses.[51] In view of these rules the opportunities to create taxable incorporations to establish losses are extremely rare.

There is also an additional problem present in creating a taxable in-

46. See notes 24 and 25 *supra.*

47. *Cf.* Bessemer Limestone & Cement Co., 15 CCH Tax Ct. Mem. 1277 (1956).

48. *Cf.* Particelli v. Commissioner, 212 F.2d 498 (9th Cir. 1954); Williams v. McGowan, 152 F.2d 570 (2d Cir. 1945).

49. See Note, *Considerations in Applying the Rule of Williams versus McGowan,* 13 TAX L. REV. 369 (1958), for a discussion of this allocation problem where the parties are dealing at arms' length.

50. § 267(c).

51. *Cf.* Commissioner v. Whitney, 169 F.2d 562 (2d Cir.), *cert. denied,* 335 U.S. 892 (1948).

corporation to increase the basis of depreciable property. Section 1239 provides that the gain recognized to the transferor in a taxable incorporation will be ordinary income and not capital gain if the transferor, his spouse and minor children and grandchildren own more than eighty per cent of the corporation's stock. The provision covers all depreciable property including buildings[52] and patents.[53] The section 1239 problem is not present if no one person, his spouse and minor children and grandchildren own more than eighty per cent of the depreciable asset; if two unrelated persons each own fifty per cent of a building and transfer it to a corporation in which each owns fifty per cent of the stock, section 1239 will not apply. This section can cause considerable difficulty if one individual owns a building he desires to transfer to a corporation to obtain a new basis for depreciation. If he attempts a transaction with boot, obviously his gain is all taxed as ordinary income.[54] If he transfers twenty-one per cent or more of his interest in the building to a third party and the two individuals transfer the property to a corporation, the transfer is tax-free under section 351. If he agrees to sell twenty-one per cent or more of the stock he will receive upon incorporation to a third party, although the transfer will be taxable, section 1239 may apply and cause all the gain to be taxable as ordinary income. The transaction will not be tax-free under section 351 because the transferor will not be in control of the corporation "immediately after the transfer," but section 1239 seems to provide that gain is ordinary gain if the transferor is in control *at the time of* the transfer rather than *immediately after* the transfer. He will be in control at the time of the transfer since he will receive all the stock in the corporation in return for his building, and therefore probably would have ordinary gain.

52. Ainsworth v. United States, 60-2 U.S. Tax Cas. ¶ 9595 (D. Wis. May 22, 1960). The gain must be allocated between depreciable buildings and non-depreciable land. W. H. Weaver, 32 T.C. 411 (1958), *affirmed sub nom.* Bryan v. Commissioner, 281 F.2d 238 (4th Cir. 1960).

53. Kershaw v. United States, 60-1 U.S. Tax Cas. ¶ 9227 (Ct. Cl. 1960); Royce Kershaw, 34 T.C. No. 44 (June 8, 1960); Rev. Rul. 59-210, 1959-1 CUM. BULL. 217.

54. Rev. Rul. 60-302, 1960 INT. REV. BULL. No. 38 at 10. The ruling also states that § 1239 is applicable to gain recognized under § 357(c) because the liabilities assumed by the corporation are in excess of the basis of the transferor.