You can't tax business. Business doesn't pay taxes. It collects taxes.

Ronald Reagan

Code and Regs:

- §§304(a), (b)(1)-(3)(A) and (B)(i), (c) (skim lightly)
- §1.304-2(a), (c), Ex. 1

1. B Corporation and C Corporation each have 100 shares of common stock outstanding. Ferris owns 80 shares of B Corp stock (with a total basis of $40,000, or $500 per share) and 60 shares of C Corp stock (with a total basis of $9,000, or $150 per share.)

   The remaining B Corp and C Corp shares are owned by one person who isn't related to Ferris.

   B Corp has no current or accmulated E&Ps. C Corp has no current but $5,000 of accumulated E&Ps.

   Describe the tax consequences to the various parties in the following alternative transactions, and remember to focus on ownership (before and after) and the type of consideration received.

   (a) Ferris sells 20 of his C Corp shares to B Corp for $4,000. Ferris's basis in the C Corp shares is $3,000.

   (b) Ferris sells all of his C Corp shares to B Corp for $12,000.

   (c) Same as (a) above, except that Ferris receives $3,000 and one share of B Corp (FMV of $1,000) in exchange for his 20 C Corp shares.

   (d) Same as (a) above, except that Ferris receives one share of B Corp (FMV of $1,000) and B Corp takes the 20 C Corp shares subject to a $3,000 liability that Ferris incurred to buy the 20 shares of C Corp.

2. Mutual funds and exchange traded funds (ETFs) can be broadly classified as either active or passive. Very generally, the manager of an active fund picks stocks or securities based on his or her belief that the stock or security chosen will appreciate after it is purchased. In contrast, a passive fund typically picks stocks or securities that comprise an index, *e.g.*, the S&P 500 or Russell 1000, without regard to their expected future performance. The two largest mutual funds in the U.S. are both index funds: the Vanguard Total Market Fund and Vanguard 500 Index Fund–by the way, either is

an excellent investment choice. Last year for the first time, passive funds' ownership of U.S. equities surpassed that of active funds.

Passive funds that track an index typically purchase a stock based on the portion of its market capitalization (number of shares times price per share) to the total market capitalization of the index componets. For instance, as of 15 March 2023, Apple comprises about 7% of the S&P 500 and Microsoft about 6%. Consequently, each fund that tracks the S&P 500 will have 7% of its capital invested in Apple and 6% in Microsoft.

Driven by the growth of passive investing, the largest shareholders of many S&P 500 stocks are the large mutual fund families. For instance, the Vanguard Group owns about 8% of Apple and 8.6% of Microsoft; BlackRock owns about 6.5% of Apple and 7% of Microsoft. An important point of clarification: the actual shares and securities are owned by the various Vanguard and BlackRock funds and not by the investment manager, Vanguard or BlackRock, which vote the shares.

Assume that Company 220 in the S&P 500 acquires Company 340 for cash.

(a) In a sale of stock for cash, what are the general tax consequences to the selling shareholders?

(b) If §304 applies to the sale, what are the general tax consequences to the selling shareholders? What if a selling shareholder were a foreign person?

(c) How would you determine whether §304 potentially applies to the acquisition? *See, e.g.*, Priv. Ltr. Rul. 202141005 (skim very lightly).

(d) Assume that 15 passive U.S. mutual funds each own 4% of both Company 220 and Company 340. Does §304 apply? Should it?

(e) Ok, a bit more realistic fact pattern. P and T are publicly traded companies each with 10,000 shares outstanding. T shareholders (mutual funds, ETFs, individual shareholders) own 3,000 shares of P before the acquisition.

    P aquires T, and each T shareholder will receive $1 cash and 0.5 shares of P in exchange for each T share held–P is paying a total of $10,000 and 5,000 shares of consideration. T continues to exist as a wholly owned subsidiary of P, and assume that the transaction is taxable.

    Immediately after the transaction, former T shareholders now own 8,000 shares P (5,000 acquired in the acquisition plus 3,000 owned before), which is 53.33% (8,000 / 15,000) of P. Baby bear shareholder A owned 20 shares of P and 10 shares of T before the acquisition, and 25 shares of P when the transaction closes.

Does §304 apply to baby bear shareholder A? *See* §304(c)(2)(A).