In problem 11-8(a), SH A received S stock (FMV 45) and cash (5). Since it was a good C reorg, A doesn’t recognize any G/L with respect to the S shares (§354(a)(1)), but since boot was also received, A recognizes gain to the extent of the boot. §356(a)(1). A’s basis in his stock was 10, and the AR was 45, so A realized as gain of 35 (45-10), and under §356(a)(1), he must recognize 5. Basis review: A’s basis in the S stock is: 10 (COB) + 5 (gain recognized) – 5 (cash received). §358(a)(1).

Character of Boot Gain

One additional item that I failed to analyze was the character of the boot gain. Under §356(a)(2), boot gain recognized under §356(a)(1) can be treated as a dividend if the exchange “has the effect of the distribution of a dividend.” A bit vague, no?

As mentioned in the Yin excerpt that I distributed, under *CIR v. Clark*, *489 US 726* (1988), the transaction is treated as if the acquiring (issuing) corporation—in this case, S--issued only stock to A, and then S redeemed some of the stock for the boot (in this case, 5). Dividend equivalence is then determined under §302—not essentially equivalent to a dividend, disproportionate redemption, etc.

If S is widely held and T is small than S, then the boot will generally be treated as CGs. For example, assume that immediately after the reorg, A owns say 10% of S (treating for this purpose S as having received all stock of S). Under *Clark*, S is treated as redeeming 5 of the S stock received for cash. S would therefore go from owning 10% of S to a bit under 9% (5/45 or 11.11%). This should qualify as not essentially equivalent to a dividend under §302(b)(1).

What difference does it make? For individuals, since CGs and dividends are taxed at the same rate, there is generally no difference, but if a TP has CLs, for example, TP may prefer CGs. For corporations, an amount treated as a dividend under §356(a)(2) is treated as a redemption, which in some instances can be treated as an extraordinary dividend—basis reduction, etc. §1059(e)(1)(B) and (A). If not, the dividend could benefit from the DRD.

Using 356(a)(2) to create a dividend

As we discussed in class, sometimes TPs want a dividend, especially in cross border transactions. §356(a)(2) gives a roadmap to such treatment.

Assume that S owns all of the stock of both foreign X corp and foreign Y corp. In exchange for all of X’s assets, Y pays X 100, and X liquidates distributing the 100 to S. As we discussed in class, this is probably a good “D” reorg, and Y would be treated as issuing a nominal share of its stock to X, which would distribute the nominal share w/ the 100. The 100 is boot, and under §356(a)(2), dividend treatment is tested under §302. Since S owns all of the shares of Y before and after, S’s gain would be a dividend under §302.

Under foreign law, the transaction will probably be treated as a sale of assets and liquidation, both of which may be non-taxable, but who knows. Importantly, the foreign jurisdiction of Y corp will almost certainly not treat the 100 as a dividend distribution, which would be subject to WH tax. In the past, that dividend could bring with it foreign tax credits, etc.