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PRINCIPLES OF

Corporate Taxation

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PRINCIPLES OF CORPORATE TAXATION

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To Jessica, whose support and encouragement has made possible the completion of this book.–DK

To Jessica, animae dimidium meae.–JK

To Yiayia Paraskevi, whose love and nurture are warmly and gratefully remembered.–T.G.P.

Preface

Principles of Corporate Income Taxation is a contracted version of our one volume Hornbook, *Corporate Income Taxation* (6^{th} ed.). This Concise Hornbook is designed as an aide to a student who is taking a course in corporate taxation or business planning.

A significant source of tax law is the Internal Revenue Code. Regulations, administrative decisions, and judicial decisions also are primary sources of tax law. The book discusses all of those sources and how they contribute to creating a body of corporate income tax principles. In addition, the book contains numerous examples to illustrate how the tax law is applied and how the various provisions interact. Those examples will help the student's understanding of the subject.

Following the general structure for the Concise Hornbook series, this book is meant as a study aide to supplement the student's casebook and notes. We have minimized our use of citations. We have not included citations to acquiescences and nonacquiescences; and when we have cited a revenue ruling, we have cited only the number of the ruling and have omitted references to the cumulative bulletins. Those citations are readily available, of course, from a variety of easily accessible on line and hard-copy sources.

Corporate taxation is a complex subject, and not every detail or exception can be covered in a corporate tax course. We have endeavored to provide as much depth and coverage as are consistent with the "concise" nature of the book series. Since the book is designed for students, we have restricted its scope to topics that are covered in most corporate tax courses. For example, we have omitted coverage of consolidated returns and the limitations on certain tax benefits for multiple corporations. If a student needs information about an area omitted from this text or needs more detailed discussion of an area, we recommend that the student consult our Hornbook. Indeed, readers will note that the Concise Hornbook itself occasionally cross-references to our Hornbook in certain instances where we think the reader might be interested in more extensive treatment of a particular topic.

The book does include discussion of a few areas that are omitted from, or covered only briefly in, some corporate tax courses. Corporate divisions and reorganizations are covered. In addition, there is some coverage of a corporation's acquisition of the tax attributes of another corporation and of the limitations on a corporation's utilization of acquired or retained tax attributes.

The organization of the book does not follow the chronological life of a corporation. Instead, the book begins by examining the tax consequences of a corporation's making distributions to its shareholders either on account of or in redemption of their stock. Each instructor will choose the organization of his or her course that suits that instructor best. Whether or not the instructor adopts the organization used in this book, the book will be a useful aide to the student. The book need not be read cover to cover. A student can select the chapter that deals with the material to be covered in class at that time. Each chapter (and parts of chapters) can stand on its own and be read independently of the rest of the book.

Finally, we want to alert the reader to two significant points of legislative uncertainty that exist as we complete our work and that permeate much of the discussion in the book. The first of these points of uncertainty relates to the tax rates that will apply to capital gain and dividend income after the end of 2010. Obviously, the tax treatment of dividends and capital gain affects the significance of many of the corporate tax provisions that we discuss. In addition, to a lesser degree, the uncertainty as to the status of the federal estate tax during 2010 and of the related provisions determining the tax basis of property passing through a decedent's estate also affects some of the issues discussed in the book. As we complete the book, both questions remain uncertain. We have, of course, mentioned these uncertainties at numerous appropriate points in the book. However, both questions (and particularly the tax treatment of dividends and capital gains) are so central to the subject of corporate income taxation that we feel the need to emphasize these points in somewhat more detail in this preface.

Currently, net capital gains realized by individuals are usually taxed at a 15% rate, and most dividends received by an individual are also taxed at the lower capital gain rate. Both of those provisions are scheduled to expire after the close of 2010. It is uncertain what regime will take their place. What is clear, however, is that both capital gain rates and dividend rates will change. Many believe that most net capital gains will be taxed at a 20% rate after 2010, which is what will happen under current law if Congress does nothing. However, that point will not be known for certain until we see whether and how Congress acts on this issue.

Similarly, there are reasons to believe that most dividend income realized by an individual shareholder will continue to be taxed after 2010 at a lower rate than other ordinary income, but that also depends upon whether and how Congress acts. If Congress fails to take any action, then after 2010 dividend income will be taxed to individuals at ordinary income rates, which are scheduled to rise to a maximum of 39.6% after 2010. As with the capital gain tax rate, however, no one can reliably predict at this juncture what path Congress will eventually take on this issue, and thus readers will need to determine how that question is ultimately resolved. Moreover, just as we had completed the book, Congress enacted a 3.8% Medicare tax on dividend income and net capital gain earned by certain high-income individuals, which is scheduled to take effect in 2013 and will then apply in addition to the income tax imposed on such income.

With respect to the federal transfer taxes, the effect of the uncertainty on the topics discussed in the book is narrower in scope but still relevant. For example, the question of the basis that an estate or beneficiary takes in an asset can affect the application of some corporate tax provisions such as § 306. Under current law, the estate and generation-skipping taxes were effectively repealed for 2010 but will come back into force at their pre–2001 levels after the end of 2010. As a result, for deaths occurring in 2010, the normal rule of § 1014 allowing a step-up in basis for assets held by a decedent at death will not apply. Instead, a modified carryover basis regime is in effect. Current law also provides that the basis step-up rule will come back into effect for deaths occurring after 2010. However, such clarity as to the basis rules for 2010 has been undermined by the fact that there have been reliable indications that Congress may retroactively reinstate the § 1014 basis step-up rules for deaths occurring in 2010. Such retroactivity could be included in legislation that would prevent a return in 2011 to the pre–2001 transfer tax rates and exemptions, but would allow the § 1014 basis step-up rules to come back into force. If any new legislation in this area were made retroactive—and that is far from certain at this writing—then it is likely that the basis step-up rule of § 1014, rather than the modified carryover basis regime currently in effect, would apply to deaths occurring in 2010. As a result, we encourage readers to remain alert to what Congress actually does with respect to the basis rules applicable to assets held by decedents dying in 2010.

Unless otherwise stated, all "§" signs used in this text refer to section numbers of the Internal Revenue Code of 1986, as amended. Any reference in this text to the "Internal Revenue Code," or simply to the "Code," refers to the Internal Revenue Code of 1986, as amended. Citations in the text to "Bittker & Eustice" refer to Boris I. Bittker and James S. Eustice, *Federal Income Taxation of Corporations and Shareholders* (7th ed. 2006 and Supps.). Citations to "Ginsburg & Levin" refer to Martin D. Ginsburg and Jack S. Levin, *Mergers, Acquisitions, and Buyouts* (2010). Citations to "Corporate Income Taxation Hornbook" refer to Douglas A. Kahn, Jeffrey H. Kahn, Terrence G. Perris, and Jeffrey S. Lehman, Corporate Income Taxation (6th ed. 2009).

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Summary of Contents

Table of Contents