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FEDERAL INCOME TAXATION
OF CORPORATIONS
AND PARTNERSHIPS

*Fourth
Edition*



Wolters Kluwer

Law & Business

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FEDERAL INCOME TAXATION OF CORPORATIONS AND PARTNERSHIPS

Fourth Edition

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To Dania and Elizabeth

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PREFACE

This book traces its ancestry back to Professor Bittker's one-volume Federal Income Taxation casebook, published in 1955. Over the years, Congress has amended virtually every section of the Internal Revenue Code, almost always in the direction of greater complexity. Professor Bittker's original work has split three-for-one into separate volumes on individual, transfer, and corporate taxation. With the increasing importance of partnership taxation in the world of commerce, the third edition combined both corporate and partnership taxation in a single volume. This fourth edition continues that combination with substantial revisions to account for recent changes in the law. The text can be used to teach corporate taxation, partnership taxation, or a course that combines both areas.

Ironically, the increasing complexity demands a more principled and straightforward treatment of teaching materials than ever before. It is neither possible nor desirable in an introductory course on business taxation to tame the sea of minutiae that now comprise subchapters C, K, and S. Instead, we hope to offer a thoughtful and orderly presentation of the themes that permeate the taxation of business entities, allowing readers to develop the sophistication necessary to confront new challenges in the practice of law.

We have updated every chapter of the book, interspersing new examples and problems throughout and substantially reworking some of the chapters. Recent legislative and administrative developments have been integrated into the discussion. New cases and rulings have been added where helpful, and outdated cases and rulings removed. We have tried to choose illustrative cases that not only describe typical commercial transactions but also emphasize major themes that run through the provisions dealing with entity taxation. We believe that the book can be covered in a three- or four-hour integrated course, or can be used for separate two- or three-hour courses on corporate or partnership taxation.

The taxation of business entities is a difficult subject even under the best of circumstances, and we have tried not to "hide the ball." In most chapters, we begin with a broad overview, and each chapter makes liberal use of examples. We have no doubt that, notwithstanding our approach, students will be left with plenty to ponder. We have tried to clear away some of the underbrush so that students can contemplate the forest. In addition to the cases and note materials, the book features problems in almost every chapter. They can be used to lead students through the

fundamentals of the tax provisions and can form a centerpiece for discussion of the cases and notes.

In exploring the tax consequences of business entities, the fourth edition is divided into three parts. Part I deals with the classical double tax system: tax at the corporate level, and tax at the shareholder level, embodied in subchapter C. Bridging Parts I and III is Part II's discussion of subchapter S, which contains elements of both subchapters C and K. Part III addresses the pass-through paradigm of partnership taxation laid out in subchapter K, where partners are taxed directly as the partnership earns income.

Each part unfolds in a manner calculated to help students master the concepts within. Part I uses a "cradle-to-grave" approach to reveal the mysteries of subchapter C. Starting with the formation of a corporation, including the capital structure, this part discusses the tax implications of corporate operation at the corporate level. Next, nonliquidating distributions are considered, followed by liquidating distributions. This part also considers the world of taxable and non-taxable corporate acquisitions and other reorganizations. It concludes with several chapters on important aspects of corporate operation, including a section on consolidated returns.

Part II first looks at the operation of S corporations with no subchapter C history. It then turns to the treatment of S corporations that had previously been or subsequently become C corporations, considering issues that arise because of that change in status.

Part III explains the taxation of partnerships. Starting with the structure of partnership taxation, this part turns to the seminal issue in partnership taxation — determining distributive shares. It then discusses the treatment of distributions, outside basis, a partner's transactions with the partnership, acquisition and disposition of partnership interests, and a variety of partnership-level issues.

Students of taxation must possess an eye-hand coordination not required of other students. Not only must they read and study the casebook, but at the same time they must closely examine the Internal Revenue Code and corresponding regulations. The ability to digest two or more things at the same time is a residual benefit one receives from the study of taxation. The book refers to the Code constantly, and we rely on students to study the Code as they study the book.

Students should not hesitate to consult additional references when interested. Bittker and Eustice's *Federal Income Taxation of Corporations and Shareholders* (7th ed. 2000) with supplementation is a student's ready companion, offering lucid and more detailed explanations of all areas of corporate taxation. For partnership taxation issues, students may want to consult McKee, Nelson, and Whitmire, *Federal Taxation of Partnerships and Partners* (4th ed. 2007) with supplementation.

A few ministerial comments are in order at this point. First, the book makes ample use of cross-references because tax provisions do not operate in a vacuum. As students learn more and more pieces of the tax puzzle, the pieces will begin to interrelate and form a pattern. Second, the cases have been edited to feature the salient points. We indicate the omissions, but readers should be aware that citations and footnotes in the cases have often been omitted or abridged. Third, we have tried to incorporate some of the themes developed in the individual tax course. Assignment of income, the value of deferral, the interplay of the original issue discount rules with the installment sales rules, and the concepts of recapture are often invoked in the context of corporate transactions. Fourth, while we hope the book

has a certain timeless quality to it, we would be remiss if we failed to note that it is current only through October of 2008.

While our friend and colleague Richard Doernberg did not participate in this revision, we hope that his detailed knowledge of corporate taxation and his clarity of presentation remains intact. The authors are greatly indebted to Professor Bernard Wolfman of the Harvard Law School who taught generations of corporate tax professionals and whose pedagogy is apparent throughout and especially in chapter 5. We express our gratitude to Mr. Fred T. Witt of Deloitte Tax for his insights into the complex issues surrounding cancellation of indebtedness generally as well as his great help in the section on bankruptcy reorganizations more particularly and to Eric Sloan, also of Deloitte Tax, for his help in appreciating many of the subtler aspects of subchapter K. Finally, we would like to thank the American Law Institute for permission to reprint an excerpt from the Reporter's Study of Corporate Tax Integration (Federal Income Tax Project 1993). Copyright © 1993 by the American Law Institute. Reprinted by permission.

Howard E. Abrams
Don A. Leatherman

October 2008

FEDERAL INCOME TAXATION OF CORPORATIONS AND PARTNERSHIPS

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