**MACC CPAs**

Charlotte, NC

October 28, 2007

**Relevant Facts**

Jane Doe recently received a gift of a building and 5 acres of land from her father. Her father used property in his lawn equipment sales and repair business. Her father wishes to retire. Continuing the business is not feasible.

Jane’s father inherited the land from his uncle in 1985.

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| Value of land on date of death | $ 50,000 |
| Fair market value today | $ 100,000 |

The retail building, which also contains a shop for repair and warranty work, was built by Jane’s father in 1998.

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| Construction costs in 1998 | $ 400,000 |
| Depreciation claimed since 1998 | $ 80,000 |
| Fair market value on date of gift | $ 500,000 |

There is no debt on the property.

The area where the land is located has a large lake. Two local boat dealers (The Boat Place and The Ski Place) have approached Jane about acquiring her property, which is in a perfect location for their businesses.

1. The Boat Place, a corporation, has “off-season” inventory with wholesale value   
   of $200,000. The current owner owns all of the outstanding shares of the corporation. Jane would exchange the land and building for additional shares   
   in the corporation. She would not work in the business.

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| Number of share currently outstanding | 2,000 |
| Number of shares to be issued to Jane | 8,000 |
| Value of shares to be issued to Jane | $600,000 |

1. The Ski Place, a partnership operated by Mr. and Ms. Fun, also has “off-season” inventory of $200,000. Jane’s property would be invested in The Ski Place as a capital investment and she would become a 75% partner. She would not work in the business.

**Specific Issues**

Issue 1: If Jane transfers her property to The Boat Place, what is the amount of her recognized gain or loss? What is the corporation’s recognized gain or loss? What is the basis of the stock acquired by Jane? What is the basis of the property for the corporation?

Issue 2: If Jane transfers her property to The Ski Place, what is her recognized gain or loss? What is the partnership’s recognized gain or loss? What is the basis of the partnership interest acquired by Jane? What is the basis of the property for the partnership?

**Conclusions**

Issue 1: Jane will not recognize any gain on the transfer of property to the corporation, nor will the corporation recognize any gain or loss on the transfer of the shares of stock to Jane. Jane’s basis in the stock will be $370,000 and the corporation’s basis in the land and building will be $50,000 and $320,000 respectively.

Issue 2: There will be no recognized gain to either Jane or the partnership. The basis of Jane’s partnership interest will be $370,000. The partnership’s basis in the land and building will be $50,000 and $320,000 respectively.

**Support**

***Issue 1:***

Internal Revenue Code Section 1001(a) states that the amount of a gain is the excess of the amount realized over the adjusted basis.

Section 1001(b) states that the amount realized from the sale of property is the amount received plus the fair market value of any property received.

Section 1015(a) states that the basis of property received as a gift is equal to the donor’s basis. Jane’s father’s basis in the land was the fair market value of the land at the time of the inheritance, §1014(a)(1). Jane’s father had a basis in the building equal to its cost [§1012], adjusted for depreciation deductions claimed on the property [§1.1016-3(a)(1)].

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| Basis of land to Jane’s father |  | $ 50,000 |
| Cost of constructing the building | $ 400,000 |  |
| Less: Depreciation claimed by her father | $ 80,000 |  |
| Basis of building to Jane’s father |  | $ 320,000 |
| Basis of land and building to Jane |  | $ 370,000 |

Therefore, the realized gain is calculated as follows:

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| Amount realized | $ 600,000 |
| Less: adjusted basis of property | $ 370,000 |
| Gain realized | $ 230,000 |

Section 1001(c) provides that, unless otherwise provided, all of the gain will be recognized. Under §351(a), no gain or loss is recognized if property is transferred to a corporation solely exchange for stock in the corporation and the transferor is in control of the corporation immediately after the transfer, Control of a corporation is defined in §368(c) as ownership of at least 80% of the total combined voting power and at least 80% of the total number of shares of stock of the corporation. Jane will own 8,000 shares of a total 10,000 shares (8,000/10,000=80%). Therefore, Jane will not recognize any gain on the transfer of property to The Boat Place in exchange for stock in the company.

Section 1032(a) provides that a corporation will not recognize any gain or loss on the receipt of property in exchange for its stock,

The basis of the shares of stock received by Jane is equal to the basis of her property exchanged for those shares of stock [§358(a)(1)]. Therefore, Jane’s basis in the 8,000 shares of stock is equal to her basis of the land and building, calculated above as $370,000.

The basis of the land and building to the corporation will be the same as it would be in the hands of the transferor [§362(a)(1)]. In other words, the basis of the land and building to the corporation is the same as it was to Jane. Therefore, the basis of the land will be $50,000 and the basis of the building will be $320,000.

***Issue 2:***

No gain or loss will be recognized when contributing property to a partnership in exchange for interest in the partnership by either the contributing partner or the partnership [§721(a)]. Jane is contributing property to the partnership in exchange for a 75% interest in the partnership. Therefore, both Jane and the partnership have no recognized gain.

Jane’s basis of her interest in the partnership will be equal to the adjusted basis of the property contributed in accordance with §722. The adjusted basis of the land and building as calculated above is $370,000. Therefore, Jane’s partnership interest basis will be $370,000.

Section 723 provides that a partnership’s basis of the property contributed to the partnership by a partner will be the adjusted basis of the property in the hands of the partner. Therefore, the basis of the property to the partnership as calculated above will be $50,000 in the land and $320,000 in the building.

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