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Book Review: Tax Planning for Corporations and Shareholders

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BOOK REVIEW

Corporate Tax Planning—A Practitioner's Handbook

TAX PLANNING FOR CORPORATIONS AND SHAREHOLDERS.
BY ZOLMAN CAVITCH. New York: Matthew Bender Company. 1974. Pp.
xii, 766. \$40.00.

I. THE BACKGROUND

An attorney engaged in a business practice regularly confronts a mixture of corporate law, federal tax, and federal securities problems on behalf of his clients. Those clients want solutions to their problems which will enable them to conduct their business activities in a sensible manner without needless legalistic restrictions. The attorney provides valuable service to his corporate clients only to the extent his advice satisfies this desire and permits them to operate their business competitively. *Tax Planning for Corporations and Shareholders* by Zolman Cavitch is designed to help the attorney achieve these goals.

The author, an experienced tax attorney and law school professor, offers this book as a guide for the practitioner who needs an introduction to the basic problems and stratagems of corporate taxation and related areas. Additionally, the author attempts to provide solutions to tax problems which commonly arise in the course of serving small and moderately sized corporate clients. Noting that the attorney has neither the time nor the patience for theoretical analyses, Cavitch "approach[es] the complex subject of corporation and shareholder income taxation in the same way in which the practicing lawyer is confronted with the problem" (p. v).

II. THE BOOK

The structure of this book basically follows the various stages in a corporation's existence from pre-incorporation planning and procedure to liquidation. In addition, excursions are made into specific areas such as executive compensation (chapter 5), tax treatment of collapsible corporations (chapter 12), and the special problems of professional corporations (chapter 13). Primary emphasis is placed on subchapter C considerations.

In chapter 1 Cavitch deals with problems of pre-incorporation planning and procedure, analyzing the factors which affect the decision to incorporate,¹ and the lure and pitfalls of multiple corporations. Chapter 2 pertains to the effect of penalty taxes upon corporate planning, where Cavitch particularly discusses the accumulated earnings tax and the personal holding company tax. The author analyzes various mechanisms traditionally suggested for

1. In addressing the issue of whether to incorporate, Cavitch provides a comparison of the federal income tax rates under various assumptions and includes examples which illustrate how to compute the shareholder's effective tax liability.

dealing with the threat of the accumulated earnings tax, including paying substantial dividends, expanding the present business enterprise, acquiring new businesses, and electing subchapter S treatment. Alternative mechanisms discussed include liquidation of the corporation and the concomitant formation of a partnership or sole proprietorship, and the actual payment of the tax in those situations where the net overall cost is less than the tax generated by distributing substantial dividends.

One of the book's better analyses is contained in chapter 4, which treats various considerations associated with the capitalization of a new corporation. Among the problems discussed are: (1) the allocation of equity participation and, particularly, whether a new corporation should originally issue both common and preferred stock; (2) whether an incorporation should be structured as tax-free or taxable, and the methods for accomplishing either alternative; and (3) the tax advantages available through "thin incorporation" and the precautions which must be observed in "thinning" the corporate structure.

Chapters 6-11 constitute the most valuable section of the book as Cavitch delves into fundamental problems of corporate distributions and adjustments. The nature of a dividend distribution, the definition and computation of earnings and profits, and transactions which may generate constructive dividend treatment (as well as other topics pertinent to the tax treatment of dividends) are surveyed in chapter 6.

Problems and procedures in shifting shareholder control are dealt with in chapters 7 and 8. Chapter 7 approaches the topic in terms of shareholder cross-purchase arrangements and stock redemptions. Special attention is accorded redemptions under IRC § 303 which avoid dividend treatment, the use of life insurance policies to fund stock purchase arrangements, and mechanisms to assure that the price established pursuant to such an agreement will conclusively determine value for federal estate tax purposes. Chapter 8 treats the shifting of corporate control in the context of stock dividends and recapitalizations. Here Cavitch describes the purposes for such arrangements and inserts an interesting discussion of several devices which may unwittingly generate ordinary income tax consequences. These tax traps may occur by application of IRC § 305: when a shareholder is given the choice of stock or other property in a proposed corporate distribution; when some shareholders receive property and others receive an increased equity interest; when some shareholders receive preferred stock and others receive common stock; or when convertible preferred stock is distributed.

The objectives sought to be achieved by corporate divisions (*e.g.*, compromising conflicting shareholder demands, insulating liabilities of different businesses, and disposing of unwanted business assets) and the mechanics for accomplishing these objectives are discussed in chapter 9. The "spin-off" technique of IRC § 355 is the mechanism which provides tax advantages in such divisions. Strategy and tax posturing is important here because the desired tax treatment depends upon (1) identification and documentation of a "business purpose," and (2) precise observance of statutory conditions.

A significant portion of the chapter is devoted to an analysis of the major spin-off issues: whether a single business may be split into two separate businesses; whether a single function of a business may be spun-off; and whether a spin-off of one portion of a business may precede a tax-free disposition of the remaining business. Cavitch also describes the tax consequences when the spin-off treatment cannot be achieved.

Methods of buying and selling a corporate business in both taxable and tax-free transactions are examined in depth in chapter 10. The author identifies the common tax and other factors to be considered in selecting the appropriate sale or purchase method. Concluding that a tax-free method normally will be utilized, the author enumerates various elements which should determine whether the transaction takes the form of a stock-for-assets exchange, or a stock-for-stock exchange, or a statutory merger. In the process he discusses judicially imposed requirements (*e.g.*, the business purpose test) and problems involving the receipt of "boot."

The basic function of the book is completed in chapter 11 with a discussion of the tax considerations surrounding corporate liquidations. Here Cavitch reviews the tax treatment to the shareholder upon receipt of a distribution in liquidation, the special rules which pertain when a controlled subsidiary is liquidated, and the tax basis of the assets received in the liquidation of a controlled subsidiary. Additionally, Cavitch describes the specific rules for avoiding tax at the corporate level upon a sale or liquidation of corporate assets.

III. THE CRITIQUE

Determining whether this book makes a significant contribution to corporate tax-planning literature necessitates a comparison with tools presently available to the practitioner. Certainly the book does not contain the definitive tax analysis evidenced in Douglas Kahn's *Basic Corporate Taxation*,² or *Federal Income Taxation of Corporations and Shareholders*³ by Boris Bittker and James S. Eustice. Moreover, this book does not have the comprehensive corporate law coverage of Cavitch's own ten-volume series, *Business Organizations (with Tax Planning)*.⁴ However, comparing Cavitch's present effort to these books is unfair because it was not offered as an exhaustive or definitive treatment of the nuances of corporate tax planning, but only as a useful tool for the general business lawyer. The closest counterparts to this book are William H. Painter's *Corporate and Tax Aspects of Closely Held Corporations*⁵ and the Institute for Business Planning's looseleaf service entitled *Tax Planning*. Cavitch's book presents a more systematic, analytical, and understandable approach to its subject than either of these volumes.

Despite its practical emphasis, the book does not address many items pertinent to the ordinary daily activities of business organizations. In this regard the author could have treated inventory pricing, accounting methods,

2. 2d ed. 1973.

3. 3d ed. 1971.

4. This is a looseleaf treatise which is kept current with appropriate supplements.

5. 1971, Supp. 1974.

depreciation policies, and ordinary and necessary business expenses. Also, some discussion of bad debt and net operating loss deductions along with transfer pricing problems arising under IRC § 482 could have been included.

A book emphasizing practical problems would seem to require basic forms to accompany the textual analysis. None are included. At the very least the author could have provided more cross-references in his footnotes to other tax tools which incorporate appropriate forms.⁶ Such models, although seldom suitable for direct copying, would be a helpful starting point to the busy practitioner.

The text features an excellent discussion of several methods of compensating the executive. However, the book was published prior to the enactment of the Employees Retirement Income Security Act of 1974,⁷ and thus does not encompass the substantial tax changes made pursuant to that legislation. Therefore, to a significant extent the book's discussion of qualified pension and profit-sharing plans is not current.

Despite these deficiencies, Cavitch achieves his objective and the volume constitutes a useful tool for the corporate practitioner. It is a functional and thoughtful book and deserves a wide following among corporate lawyers and their clients.

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6. Some references are included to forms in J. RABKIN & M. JOHNSON, *CURRENT LEGAL FORMS WITH TAX ANALYSIS*.

7. Pub. L. No. 93-406, §§ 1-4082 (Sept. 2, 1974). The rules in the areas of qualified and non-qualified stock options, deferred compensation, and other fringe benefit arrangements were not changed by the 1974 pension legislation. Hence the book's discussion of these topics is current.

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