Section 35(c)(2) of the Tax Code: A Tax Trap or a Tax Shelter?

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Section 35(c)(2) of the National Internal Revenue Code defers recognition of gain or loss if a person exchanges his property for stock in a corporation which results to his, alone or with others not exceeding four, gaining control of the said corporation. The main objective of the Article is to assess if the abovementioned section is a trap or a shelter to the person who exchanges his property for stock in a corporation.

In achieving this objective, the Author starts by enumerating and briefly discussing the problems in tax-free incorporation. These problems are: the concept of property when read in connection with Section 210 of the same law, the requirement of Section 35(c)(2) that only stock be received in exchange, the control test, the difficulty in determining the gain in case several properties are transferred to the corporation, the lack of statutory basis in treating tax as a boot liability and the adjusted basis of the stockholder and the corporation for the property.

After this, the Article discusses the personal holding company tax connection under Section 63 of the National Internal Revenue Code and the stock transaction tax connection under Section 35(c)(2) in conjunction with Section 2010 of the same Code.

Based on these, the Author concludes that the lack of statutory and judicial tax rules resulted to Section 35(c)(2) being a double-edged sword. He finds that depending on its application, the said section can be a tax trap or a tax shelter.