

**Office of Chief Counsel
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memorandum

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date: August 1, 2003

to: Associate Area Counsel CC:SB:7:SEA:1

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subject: Reporting of Settlement Proceeds

This Chief Counsel Advice responds to your memorandum dated November 19, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUE

What are the tax consequences to taxpayers of the receipt of settlement proceeds for lost fishing income, devaluation of a fishing permit, and devaluation of fishing boats?

CONCLUSION

The tax consequences to taxpayers of the receipt of settlement proceeds for lost fishing income, devaluation of a fishing permit, and devaluation of fishing boats are set forth below.

FACTS

Due to an environmental event ("Event") impairing State commercial fishing, a qualified settlement fund was created by a federal court ("Court") to allocate economic and punitive damages among claimants.

Commercial fishing in State can be engaged in only by possession of a valid fishing permit. Under State law, the Commercial Fisheries Entry Commission ("Commission") is authorized to issue fishing permits only to individuals. Originally, these permits were issued to fishers for no consideration; accordingly, the initial holder of a fishing permit has no basis therein.

The Commission sets an annual fee for fishing permit holders. It is illegal to lease the permit, except in certain situations approved by the Commission. A fishing permit may be transferred to another individual, with the approval of the Commission. Although State law requires that only individuals hold fishing permits, fishers engage in business practices which ignore this law. For example, the holder of a fishing permit may "contribute" the permit to a partnership, an S corporation or a C corporation ("Partnership/S Corporation/C Corporation") that conducts fishing activities. All fishing income earned from the use of the permit is reported by the Partnership/S Corporation/C Corporation.

In the litigation, the Court established a five year loss period beginning with the year of the Event, Year 5, and ending in Year 10 ("Loss Period"). Some fishers contributed their boats and fishing permits to Partnerships/S Corporations/C Corporations created before, during and after this loss period and in some instances have requested that the Fund pay the compensatory damages for lost fishing income, boat devaluation and fishing permit devaluation to the entity for years predating its creation. The Fund requires such claimants to execute a form assigning each claim to the entity and issues two Forms 1099 in the identical amount, one to the individual and the other to the entity.

Fact Pattern One:

In Year 5, an individual was engaged in fishing as a Schedule C business and owned a fishing permit and a boat. The individual transferred the boat, the fishing permit, and a claim for damages for boat devaluation, lost fishing income and permit devaluation either two years after the Event, ("Year 7") or eleven years later ("Year 16"), to a newly formed Partnership/S Corporation/C Corporation.

The Partnership/S Corporation/C Corporation claimed depreciation on the boat. The Partnership/S Corporation/C Corporation did not amortize the permit because the individual who transferred the permit to the Partnership/S Corporation/C Corporation acquired the permit before the effective date of § 197 of the Internal Revenue Code. Each claim for damages was an asset on the entity's balance sheet. If the entity was a corporation, the required information in § 1.351-3(a) and (b) of the Income Tax Regulations was filed with the shareholders' and corporation's returns, and reflected each claim for damages as a separate item.

The Fund required that the individual make a special assignment of each claim for damages to the Partnership/S Corporation/C Corporation in order for the Fund to recognize the earlier transfer of claims. The individual assigned each claim for damages for boat devaluation, lost fishing income and permit devaluation to the Partnership/S Corporation/C Corporation and the Fund paid these damages to the Partnership/S Corporation/C Corporation.

In the alternative, the individual did not assign each claim for damages for boat devaluation, lost fishing income and permit devaluation to the Partnership/S Corporation/C Corporation, but after receiving these damages from the Fund, transferred these damages to the Partnership/S Corporation/C Corporation.

Fact Pattern Two:

An individual was engaged in fishing as a Schedule C business and owned a fishing permit and a boat. Four years before the Event ("Year 1"), the individual transferred the boat and the fishing permit to a newly formed Partnership/S Corporation/C Corporation.

The Partnership/S Corporation/C Corporation claimed depreciation on the boat. The Partnership/S Corporation/C Corporation did not amortize the permit because the individual who transferred the permit to the Partnership/S Corporation/C Corporation acquired the permit before the effective date of § 197.

The Partnership/S Corporation/C Corporation filed a claim for damages for boat devaluation, lost fishing income and permit devaluation. The Fund paid the damages for boat devaluation and lost fishing income to the Partnership/S Corporation/C Corporation. However, the Fund paid the damages for permit devaluation to the individual, the owner of the permit under State law. The individual then transferred the damages for permit devaluation to the Partnership/S Corporation/C Corporation.

In the alternative, the individual assigned the claim for permit devaluation damages to the Partnership/S Corporation/C Corporation and the Fund paid damages for boat devaluation, lost fishing income and permit devaluation to the Partnership/S Corporation/C Corporation.

Fact Pattern Three:

In Year 5, an individual was engaged in fishing as a Schedule C business and owned a fishing permit and boat. In Year 7, or in the alternative, Year 16, the individual transferred the boat and a claim for damages for boat devaluation and lost fishing income to a newly formed Partnership/S Corporation/C Corporation.

The Partnership/S Corporation/C Corporation claimed depreciation on the boat. Each claim for damages was an asset on the entity's balance sheet. If the entity was a corporation, the required information in § 1.351-3(a) and (b) was filed with the shareholders' and corporation's returns, and reflected each claim for damages as a separate item.

The individual did not transfer the permit to the Partnership/S Corporation/C Corporation, determining that such a transfer would be in violation of State law. If the entity was a corporation, the entity paid the individual a higher crew share as compensation for the entity's use of the individual's fishing permit. If the entity was a partnership, the partnership's allocations of income, expenses, and distributions to the individual compensated the individual for the partnership's use of the individual's permit. The individual had to be on board at all times and participate in the fishing activity for the Partnership/S Corporation/C Corporation to use the individual's fishing permit.

The Fund required that the individual make a special assignment of each claim for damages to the Partnership/S Corporation/C Corporation in order for the Fund to recognize the earlier transfer of the claims. The individual assigned the claim for damages for boat devaluation and lost fishing income, but not damages for permit devaluation to the Partnership/S Corporation/C Corporation. The Fund paid damages for boat devaluation and lost fishing income to the Partnership/S Corporation/C Corporation and damages for

permit devaluation to the individual. After receiving the permit devaluation damages, the individual transferred these damages to the Partnership/S Corporation/C Corporation.

In the alternative, the individual assigned the claim for damages for boat devaluation, lost fishing income and permit devaluation to the Partnership/S Corporation/C Corporation and the Fund paid these damages to the Partnership/S Corporation/C Corporation.

Fact Pattern Four:

An individual was engaged in fishing as a Schedule C business and owned a fishing permit and boat. In Year 1, the individual transferred the boat to a newly formed Partnership/S Corporation/C Corporation. The Partnership/S Corporation/C Corporation claimed depreciation on the boat.

The individual did not transfer the permit to the Partnership/S Corporation/C Corporation, determining that such a transfer would be in violation of State law. If the entity was a corporation, the entity paid the individual a higher crew share as compensation for the entity's use of the individual's fishing permit. If the entity was a partnership, the partnership's allocations of income, expenses, and distributions to the individual compensated the individual for the partnership's use of the individual's permit. The individual had to be on board at all times and participate in the fishing activity for the Partnership/S Corporation/C Corporation to use the individual's fishing permit.

The Partnership/S Corporation/C Corporation filed a claim for damages for boat devaluation, lost fishing income and permit devaluation. The Fund paid the damages for boat devaluation and lost fishing income to the Partnership/S Corporation/C Corporation. However, the Fund paid the damages for permit devaluation to the individual, the owner of the permit under State law. The individual then transferred the permit devaluation damages to the Partnership/S Corporation/C Corporation.

In the alternative, the individual assigned the claim for permit devaluation damages to the Partnership/S Corporation/C Corporation and the Fund paid damages for boat devaluation, lost fishing income and permit devaluation to the Partnership/S Corporation/C Corporation.

Fact Pattern Five:

In Year 5, an individual was engaged in fishing as a Schedule C business and owned a fishing permit and boat. In Year 7, or in the alternative, Year 16, the individual transferred the boat to a newly formed Partnership/S Corporation/C Corporation. The Partnership/S Corporation/C Corporation claimed depreciation on the boat.

The individual asserts that a claim for damages for boat devaluation, lost fishing income and permit devaluation was also transferred to the newly formed Partnership/S Corporation/C Corporation. However, these claims for damages were not recorded as assets on the entity's balance sheet and other facts and circumstances indicate that the claims were never transferred. The individual asserts that if the purported transfer is not respected by the Service, the individual will currently transfer and assign these claims for damages to the entity.

The individual did not transfer the permit to the Partnership/S Corporation/C Corporation, determining that such a transfer would be in violation of State law. If the entity was a corporation, the entity paid the individual a higher crew share as compensation for the entity's use of the individual's fishing permit. If the entity was a partnership, the partnership's allocations of income, expenses, and distributions to the individual compensated the individual for the partnership's use of the individual's permit. The individual had to be on board at all times and participate in the fishing activity for the Partnership/S Corporation/C Corporation to use the individual's fishing permit.

Fact Pattern Six:

In Year 5, an individual was engaged in fishing as a Schedule C business and owned a fishing permit and boat. In Year 7, or in the alternative, Year 16, the individual transferred the boat to a newly formed Partnership/S Corporation/C Corporation. The Partnership/S Corporation/C Corporation claimed depreciation on the boat.

The individual did not transfer the claim for damages for boat devaluation, lost fishing income and permit devaluation to the newly formed Partnership/S Corporation/C Corporation. However, the individual wants to currently transfer these claims for damages to the entity. The individual did not assign the claim for boat devaluation, lost fishing income and permit devaluation to the Partnership/S Corporation/C Corporation. Since there was no assignment of the claims to the entity, the Fund will pay the individual the damages for boat devaluation, lost fishing income and permit devaluation. However, the Fund may recognize a current transfer and assignment of the claims to the entity. In that case, the Fund will pay the Partnership/S Corporation/C Corporation the damages for boat devaluation, lost fishing income and permit devaluation.

The individual did not transfer the permit to the Partnership/S Corporation/C Corporation, determining that such a transfer would be in violation of State law. If the entity was a corporation, the entity paid the individual a higher crew share as compensation for the entity's use of the individual's fishing permit. If the entity was a partnership, the partnership's allocations of income, expenses, and distributions to the individual compensated the individual for the partnership's use of the individual's permit. The individual had to be on board at all times and participate in the fishing activity for the Partnership/S Corporation/C Corporation to use the individual's fishing permit.

LAW AND ANALYSIS

I. GENERAL CONCLUSIONS

A. Taxability of compensatory damages for lost fishing income

Under § 61, gross income means all income from whatever source derived. The Supreme Court of the United States has long recognized that the definition of gross income sweeps broadly and reflects Congress' intent to exert the full measure of its taxing power and to bring within the definition of income "any accession to wealth." *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430 (1955); *Commissioner v. Schleier*, 515 U.S. 323, 327 (1995); *United States v. Burke*, 504 U.S. 229, 233 (1992). Accordingly, any receipt of funds by a taxpayer is presumed to be gross income unless the taxpayer can demonstrate that the

accession fits into one of the exclusions provided by other sections of the Code. *Glenshaw Glass Co.*, 348 U.S. at 430-431.

One of these exclusions, § 104(a)(2), permits a taxpayer to exclude from gross income the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or periodic payments) on account of personal physical injuries or physical sickness. The Supreme Court, however, has consistently employed the corollary of § 61(a)'s expansive interpretation in holding that exclusions from gross income, such as § 104(a)(2), must be narrowly construed. *United States v. Centennial Savings Bank FSB*, 499 U.S. 573, 583-84 (1991), *United States v. Burke*, 504 U.S. 229, 248 (1992) (Souter, J. concurring). The party claiming the exemption bears a heavy burden of establishing clear and unambiguous entitlement to the exemption. *United States v. Wells Fargo Bank*, 485 U.S. 351, 354 (1988).

In *Schleier*, the Supreme Court enunciated a two-pronged test for determining whether a taxpayer may exclude an accession from gross income under § 104(a)(2). First, the taxpayer must demonstrate that the cause of action giving rise to the recovery was based upon "tort or tort-type rights"; and second, the taxpayer must show that the damages were received on account of personal injuries or sickness. *Schleier*, 515 U.S. at 337. Subsequently, the Court concluded that the § 104(a)(2) exclusion did not encompass a recovery of punitive damages in a tort action for personal injuries. *O'Gilvie v. United States*, 519 U.S. 79 (1996).

After *Schleier* was decided, Congress amended § 104(a)(2) to limit the exclusion to compensatory damages received for personal physical injuries or physical sickness. See Small Business Job Protection Act of 1996, § 1605, Pub. L. No. 104-188, 110 Stat. 1838. Damages received for emotional distress are no longer excludable but compensation for medical expenses paid to treat such distress would qualify for exclusion. The amendment applies to amounts received after August 20, 1996, the date of enactment, and does not apply to amounts received under a written, binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

In *Burke*, taxpayers sought to exclude under § 104(a)(2) back pay recovered for gender discrimination proscribed by Title VII of the Civil Rights Act of 1964. The Court held that to come within the § 104(a)(2) exclusion, taxpayers must demonstrate that Title VII redresses a tort type personal injury. Noting that personal injury damages were not available under Title VII of the Civil Rights Act, the Court concluded that taxpayers failed to satisfy their burden because Title VII redressed economic damages only.

In the present case the Court dismissed plaintiffs' claims for non-economic damages, including damages for personal injuries. Accordingly, we conclude that the remaining claims against the defendants encompassed claims for economic damages only and that any compensatory damages recovered for lost fishing income are includible in gross income.¹ *Burke, supra; Schleier, supra.*

¹ In any event, we do not believe taxpayers can prove that a physical injury precipitated their economic loss as is now required.

As indicated above, some claimants have requested that their payment for damages for lost fishing income be made to a business entity. The entity may have been formed prior to, during, or after the end of the loss period. Thus, you have asked whether the claimant or the entity should be taxed on such payment.

Under § 61(a), it is fundamental as “the first principle of income taxation: that income must be taxed to the person who earns it.” *Commissioner v. Culbertson*, 337 U.S. 733, 739-40 (1949). The corollary to this basic rule is that the taxpayer earning the income cannot avoid taxation by diverting that income to another taxpayer because anticipatory assignments of income are ineffective as a means of avoiding tax liability. *United States v. Basye*, 411 U.S. 940 (1973). Accordingly, income from personal services must be included in the income of the individual who performs the services as the true earner thereof. See, e.g., *Lucas v. Earl*, 281 U.S. 111 (1930). As a consequence, a taxpayer will not be permitted to “escape all tax by giving away his right to income in advance of payment.” *Helvering v. Horst*, 311 U.S. 112 (1940).

However, the courts and the Service have long recognized that the assignment of income doctrine does not apply to every transfer of a future income right. For example, in *Hempt Bros., Inc v. United States*, 490 F.2d 1172 (3rd Cir. 1974), the court concluded that the assignment of income doctrine does not apply to the transfer of accounts receivable in a transaction described in § 351(a) where there was a valid business purpose for the transfer of the accounts receivable. In Rev. Rul 80-198, 1980-2 C.B. 113, the Service adopted the court’s position in *Hempt Bros.*, but ruled that the assignment of income doctrine should be invoked if a tax avoidance purpose underlies the transfer. Similarly, where income-producing property such as an interest in a claim is transferred in an arm’s length transaction for valid consideration, the assignment of income doctrine should not apply and the income should be taxed to the transferee when ultimately received. Income to the transferor is measured by the amount realized in the transfer. See *Cotlow v. Commissioner*, 228 F.2d 186 (2nd Cir. 1955); *Schulze v. Commissioner*, T.C. Memo. 1983-263.

In the present case, the damages should generally be taxed as ordinary income to the taxpayer who would have earned, and thus been taxed on, the fishing income had the Event not occurred. However, if a taxpayer transferred his/her right to damages to an entity in a transaction in which the primary motive was not the avoidance of tax, the income from such damages should be taxed to the entity that acquired the claim. Any tax consequences to the individual transferor should occur at the time of the transfer of such damage claim to the entity. For this purpose, a non-tax motivated transfer of an individual’s damage claim includes a tax-free transfer under § 351 or § 721, or any other arm’s-length transfer of such claim for consideration. Further, if an individual’s transfer of his/her damage claim is non-tax motivated, the claim would be taxed to the transferee entity even if the entity was formed after the damage claim was incurred.

You also requested that we address whether the gain to be recognized on the lost fishing income is capital or ordinary where the claim is transferred to an entity before settlement is reached. We believe this issue was resolved in *Nahey v. Commissioner*, 111 T.C. 256 (1998), *aff’d*, 196 F.3d 866 (7th Cir. 1999), *cert. denied*, 531 U.S. 812 (2000). There, the Wehr Corporation filed suit against Xerox Corporation seeking damages for breach of

contract, fraud and misrepresentation. Taxpayers' S corporations, Venturedyne, Inc. and Carnes Co., Inc. acquired the assets of the Wehr Corporation, including the pending claim for damages. After settlement of the claim, the S corporations reported the proceeds as long term capital gain. Taxpayers similarly reported their pass-through share as long term capital gain on their individual income tax return.

Agreeing with the Commissioner, the Tax Court and the Seventh Circuit held that the settlement proceeds were ordinary income because they did not constitute gain from the sale or exchange of a capital asset. The Tax Court cited a line of cases holding that a compromise or collection of a debt is not considered a sale or exchange because no property or property rights passes to the debtor other than the discharge of the obligation. *Nahey*, 111 T.C. at 262. Whatever property or property rights may have existed vanish as a result of the compromise or collection. *Id.* See also *Leh v. Commissioner*, 260 F.2d 489 (9th Cir. 1958), *aff'g* 27 T.C. 892 (1957). The courts also mentioned the fact that the taxpayer did not sell the claim against Xerox but prosecuted it to settlement. 111 T.C. at 262-3; 196 F.3d at 868. Further, the entities which acquired the claims against the defendant did not sell the claims; instead, they negotiated a settlement of those claims. Moreover, the courts reasoned, the origin of the claim against the defendant was not a capital transaction. *Nahey*, 111 T.C. at 266; 196 F.3d at 868.

Similarly, in the instant case, the defendants, upon settlement of the claims, received nothing other than the discharge of their obligation to the plaintiffs; the entities did not sell the claims; and the origin of the claim against the defendants was not a capital transaction. Accordingly, we conclude, like the court in *Nahey*, that the proceeds received for lost fishing income is ordinary income in the hands of the recipient entities.

B. Devaluation of Permit and Fishing Boat

Under § 165, a taxpayer is allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. For casualty losses where the property is not completely destroyed, the calculation of the amount of the loss is defined in Treas. Reg. § 1.165-7 as follows: (b) Amount deductible.—(1) General Rule.—In the case of any casualty loss whether or not incurred in a trade or business or in any transaction entered into for profit, the amount of the loss to be taken into account for purposes of section 165(a) shall be the lesser of either— (i) The amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or (ii) The amount of the adjusted basis prescribed in section Treas. Reg. 1.1011-1 for determining gain or loss from the sale or other disposition of the property involved. The calculation of a casualty loss under § 165(a) proceeds in the following manner. First, the “loss” is determined as the lesser of (1) the difference between the fair market value of the property before the casualty and the fair market value of the property after the casualty (without consideration of proceeds received from insurance or otherwise) and (2) the adjusted basis of the property before the casualty.

Second, the amount of the loss deductible under § 165(a) is the loss not compensated for by insurance or otherwise. Treas. Reg. § 1.165-7(b)(3), Examples. 1-3. If proceeds received from insurance or otherwise exceed the adjusted basis of the property, however, the excess constitutes gain from the disposition of property, and that gain is generally recognized. See §§ 1001(a), 1033(a)(2); *Central Tablet Mfg Co. v. United States*, 417 U.S. 673, 676 (1974).

The Event, because it was sudden and unexpected, constitutes a casualty within the meaning of § 165. We have been advised that, in most cases, the amounts recovered for permit devaluation and boat devaluation are small compared to the taxpayers' bases in these assets. Accordingly, in most cases, taxpayers need only reduce their basis in the permit and in the fishing boat by the amount recovered for the losses sustained to these assets.

Fishers may have contributed their permits, claims for permit devaluations and/or fishing boats to such entities. Thus, your incoming request for advice queries whether the transferee business entity or the individual transferor should be taxed on the payments for the permit devaluation and the fishing boat devaluation.

It is a well-settled principle of tax law that the income from property is taxable to the owner of such property. Helvering v. Horst, 311 U.S. 112 (1940). Further, although federal law controls the manner in which income from property is taxed, the nature and creation of the underlying property interests are controlled by state law. United States v. Mitchell, 403 U.S. 190 (1971).

In 1974, State enacted a comprehensive scheme to protect and maintain its fishing industry. Under State law, the Commission is authorized to issue permits to individuals only. A permit may be transferred to another individual, with the approval of the Commission. In the fact patterns presented, the Fund never paid any damages to the entity, where the permit had purportedly been transferred to the entity but the claim for permit devaluation had not been transferred to the entity.

If a taxpayer is considered to have retained the permit but transferred to an entity his/her interest in the permit devaluation claim in an arm's length transaction for valid consideration, the devaluation payment should be taxed to the transferee entity when such payment is ultimately received. In such case, any tax consequences to the permit holder would be taken into account in the taxable year in which the devaluation claim was transferred. *Cotlow v. Commissioner, supra*; *Schulze v. Commissioner, supra*.

We conclude that if ownership of a fishing boat was transferred to a partnership or other business entity prior to the Event, the entity would bear the tax consequences of any payment for devaluation of the fishing boat as a result of the Event. Similarly, if a taxpayer retained ownership of his/her boat and transferred only the claim for the devaluation of such boat, the devaluation payment should be taxed to the transferee provided the transfer was at arm's length, for valid consideration, and not motivated by tax avoidance purposes.

As to the character of any gain from the devaluation payments, with certain exclusions, § 1221(a) defines the term "capital asset" as property held by the taxpayer (whether or not connected with his trade or business). In determining whether property is a capital asset, the period for which the property is held is immaterial. Treas. Reg. § 1.1221-1(a). Section 1221(a)(2) excludes from the definition of capital asset property, used in a trade or business, of a character that is subject to the allowance for depreciation provided in § 167. See *also*, Treas. Reg. § 1.1221-1(b). A fishing boat used in a trade or business would be subject to depreciation and therefore not a capital asset.

As to the permit, prior to August 11, 1993, it did not constitute property subject to depreciation because its useful life was indeterminable. Effective on that date, Congress enacted § 197 permitting taxpayers to amortize permits, licenses or other rights granted by a governmental unit or an agency or instrumentality thereof. A taxpayer may elect to apply § 197 to all eligible property acquired after July 25, 1991. Thus, unless an election is made, a permit acquired before August 11, 1993, fell within the definition of a capital asset and any gain or loss would be capital in nature. *Compare Caboara v. Commissioner*, T.C.Memo. 1977-355 (loss on sale of liquor license is capital rather than ordinary). However, any permit acquired after August 10, 1993, used by a taxpayer in his/her trade or business, would be excluded from the definition of capital asset for purposes of § 1221.

Accordingly, if the individual transferor is taxed on the payments for the permit devaluation and the fishing boat devaluation, any gain or loss resulting from such payment would be ordinary. Similarly, for the reasons articulated in *Nahey, supra*, if an individual transferred his/her devaluation claim such that the devaluation payment is taxed to a transferee entity, any gain recognized by the entity would likewise be ordinary.

Further, any gain derived after the basis adjustment in these assets would be ordinary income. For example, if the taxpayer has no basis in the permit and the boat was fully depreciated, proceeds received in settlement of those claims would be fully taxed at ordinary income rates.²

C. Taxability of Punitive Damages and Interest

The facts accompanying your request for advice indicate that punitive damages and interest are also to be paid to the plaintiffs. The punitive damages are to be paid to the respective plaintiffs in proportion to the compensatory damages recovered. Interest is to be paid on both the pre-judgment compensatory damages and the punitive damages.

² Section 1231 applies to the disposition (including the involuntary conversion) of certain assets, with the resulting net gains and losses treated as either long-term gains or ordinary losses. If § 1231 gains for the year exceed § 1231 losses, the gain is capital, although this is subject to the possible recapture of prior § 1231 losses as ordinary income. Sections 1231(a)(1) and 1231(c). If § 1231 gains do not exceed § 1231 losses for the year, any resulting § 1231 loss will be ordinary. Section 1231(a)(2).

Specifically, in regard to the present case, § 1231 potentially applies to involuntarily converted property used in a trade or business as well as to involuntarily converted capital assets, held for more than a year in connection with a trade or business or an activity engaged in for profit. Sections 1231(a)(3)(A) and 1231(a)(4)(B). "Involuntary conversions" include the partial or complete destruction of property by a casualty, including a shipwreck. Section 1231(a)(3)(A)(ii); Treas. Reg. § 1.1231-1(e). Gains and losses from involuntary conversions are netted against one another, before they are netted against other § 1231 dispositions. See § 1231(a)(4)(C); Treas. Reg. § 1.1231-1(e). If there is a net gain from involuntary conversions, the rules of § 1231 apply. *Id.* However, if there is a net loss from the involuntary conversions, it will not be a § 1231 loss, but will be treated as an ordinary loss under § 165. *Id.*

In *O’Gilvie v. United States*, 519 U.S. 79 (1996), the Supreme Court concluded that punitive damages recovered in a wrongful death action were not received “on account” of personal injuries but “on account of” the reprehensible actions of the tortfeasor. Subsequently, Congress amended § 104(a)(2) to provide unequivocally that the exclusion does not apply to punitive damages received under the instant circumstances.³ Because no tort claim for personal physical injuries were considered by the jury and Congress has specifically eliminated punitive damages from the § 104(a)(2) exclusion, we conclude that plaintiffs must include in gross income any punitive damages recovered in the action.

Similarly, under § 61(a)(4), interest, whether prejudgment or post judgment and whether related to taxable income or income excluded under § 104, is includible in gross income. Treas. Reg. § 1.61-7(a) provides that, as a general rule, interest received by or credited to the taxpayer constitutes gross income and is fully taxable. The regulation further lists examples of such taxable interest, including interest on savings or other bank deposits, interest on a promissory note or mortgage and the interest portion of a condemnation award. See also, *Kieselbach v. Commissioner*, 317 U.S. 399, 403 (1943).

With respect to the proper party to be taxed on the punitive damages and interest, we believe the amounts should be taxed in accordance with the manner in which the underlying damage claim is taxed. Thus, since the punitive damages are to be paid to the plaintiffs in proportion to the compensatory damages recovered, the punitive damages should be taxed to the party that bears the tax consequences of the compensatory damages. Likewise, the interest should be taxed to the party entitled to, and thus taxed on, the award to which the interest relates.

II. FACT PATTERNS

A. Fact Pattern One

1. Partnership

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

A transfer of a boat by the individual to a partnership in exchange for an interest in the partnership is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the boat contributed to the partnership is the adjusted basis of the boat to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.⁴

³ Some commentators have interpreted §104(c) to include within § 104(a)(2) punitive damages recovered in cases involving certain wrongful death statutes. The interpretation of § 104(c) has no legal bearing on the resolution of this case.

⁴ As a general matter, if property contributed to a partnership has a book value at the time of contribution that differs from the individual’s adjusted tax basis, the asset

If the boat is subject to a recourse liability, the partnership is considered to have assumed the liability to the extent it does not exceed the fair market value of the property at the time of contribution. Section 752(c). The individual will recognize gain to the extent that the liability exceeds the fair market value of the property at the time of contribution.

Transfer of the Claim for Damages for Boat Devaluation

If the individual transferred and assigned to the partnership, in exchange for a partnership interest, the claim for damages for boat devaluation during the portion of the loss period during which the individual owned the boat, Year 5 through the date in Year 7 on which the partnership was formed and the boat was transferred, this is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for boat devaluation to the partnership is the adjusted basis of the claim for boat devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Boat Devaluation

If the partnership files a claim for boat devaluation damages, based upon its ownership of the boat beginning from the partnership's formation in Year 7 through Year 10, and receives these damages, the partnership must report the damages as income and allocate this income among its partners in accordance with its partnership agreement.

At the time of the receipt of the damages for boat devaluation, the partnership should reduce the basis in the boat by the amount of damages received. Any boat devaluation damages in excess of the boat's basis constitutes income of the partnership that must be allocated among its partners in accordance with its partnership agreement.

If the Fund pays the partnership damages for boat devaluation based upon the transfer and assignment of individual's claim for boat devaluation for Year 5 through Year 7, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

However, if the individual does not assign the claim for boat devaluation to the partnership, files a claim for boat devaluation during the period the individual owned the boat, Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the partnership in return for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

Transfer of the Claim for Damages for Permit Devaluation

may be § 704(c) property. Treas. Reg. § 1.704-3(a)(3). Therefore, upon disposition of the asset, under section 704(c)(1)(a), any income, gain, loss, and deduction with respect to the asset must be allocated in a manner that allows the built-in gain or loss at contribution to be allocated to the individual who contributed the asset.

If the individual transferred and assigned to the partnership, in exchange for a partnership interest, the claim for damages for permit devaluation during the portion of the Loss Period during which the individual owned the fishing permit, Year 5 through Year 10, this is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for permit devaluation to the partnership is the adjusted basis of the claim for permit devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Permit Devaluation

If the Fund pays the partnership damages for permit devaluation based upon the transfer and assignment of the individual's claim for permit devaluation damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

However, if the individual does not assign the claim for permit devaluation to the partnership, files a claim for permit devaluation, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual. If after receiving these damages from the Fund, the individual transfers these damages to the partnership in return for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

Transfer of the Claim for Damages for Lost Fishing Income

If the individual transferred and assigned to the partnership, in exchange for a partnership interest, the claim for damages for lost fishing income during the portion of the Loss Period during which the individual was engaged in commercial fishing practices, Year 5 through the date in Year 7 on which the partnership was formed to engage in commercial fishing practices, this is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for lost fishing income to the partnership is the adjusted basis of the claim for lost fishing income to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Lost Fishing Income

If the partnership files a claim for damages for lost fishing income during the portion of the Loss Period that the partnership was able to prove to the Administrator of the Fund ("Administrator") that it conducted fishing activity and that its partners paid income tax on income earned from this fishing activity, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

If the Fund pays the partnership damages for lost fishing income based on the transfer and assignment of individual's claim for lost fishing income damages, then the

partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

However, if the individual does not assign the claim for lost fishing income to the partnership, files a claim for lost fishing income for Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the partnership in exchange for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual upon the transfer.

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the partnership was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

2. S Corporation

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual, increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the individual transferred and assigned to the S Corporation, in exchange for stock, the claim for damages for boat devaluation during the portion of the Loss Period during which the individual owned the boat, Year 5 through the date in Year 7 on which the S Corporation was formed and the boat was transferred, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount

of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the S Corporation files a claim for boat devaluation based upon its ownership of the boat beginning from the S Corporation's formation in Year 7 through Year 10, and receives these damages, then the shareholders of the S Corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

At the time of the receipt of the damages for boat devaluation, the S Corporation should reduce the basis in the boat by the amount of damages received. The shareholders of the S Corporation are required to include in income in the taxable year in which the S Corporation's taxable year ends, their pro rata share of any boat devaluation damages in excess of the boat's basis.

If the Fund pays the S corporation damages for boat devaluation based upon the transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

However, if the individual does not assign the claim for boat devaluation to the S Corporation, files a claim for boat devaluation during the period the individual owned the boat, Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the

amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the S Corporation, in exchange for stock, the claim for damages for permit devaluation during the portion of the Loss Period in which the individual owned the permit, Year 5 through Year 10, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the Fund pays the S corporation damages for permit devaluation based upon the transfer and assignment of the individual's claim for permit devaluation, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for permit devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

However, if the individual does not assign the claim for permit devaluation damages to the S Corporation, files a claim for permit devaluation, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received. Any damages for permit devaluation in excess of the permit's basis constitutes income to the individual. If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Lost Fishing Income

If the individual transferred and assigned to the S Corporation, in exchange for stock, the claim for damages for lost fishing income during the portion of the Loss Period during which the individual was engaged in commercial fishing practices, Year 5 through the date in Year 7 on which the S Corporation was formed to engage in commercial fishing practices, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the S Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the S Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the S corporation damages for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S corporation's taxable year ends. Section 1366(a).

If the Fund pays the S corporation damages for lost fishing income based upon the transfer and assignment of the individual's claim for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of

these damages for lost fishing income in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

However, if the individual does not assign the claim for lost fishing income to the S Corporation, files a claim for lost fishing income, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the S Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

3. C Corporation

a. Year 7 Entity Formation and Asset Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the individual transferred and assigned to the C Corporation, in exchange for stock, the claim for damages for boat devaluation during the portion of the Loss Period during which the individual owned the boat, Year 5 through the date in Year 7 on which the

C Corporation was formed and the boat was transferred, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the C Corporation files a claim for boat devaluation during the portion of the Loss Period during which it owned the boat, beginning from the C Corporation's formation in Year 7 through Year 10, and the Fund pays the C corporation damages for boat devaluation, then the C Corporation will be taxed on these damages. The C Corporation should reduce its basis in the boat for these damages received for boat devaluation. Any boat devaluation damages in excess of the boat's basis constitutes income to the C Corporation.

If the Fund pays the C Corporation damages for boat devaluation based upon the transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

However, if the individual does not assign the claim for boat devaluation to the C Corporation, files a claim for boat devaluation damages during the period the individual

owned the boat, Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the C Corporation, in exchange for stock, the claim for damages for permit devaluation during the portion of the Loss Period during which the individual owned the permit, Year 5 through Year 10, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the

corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the Fund pays the C Corporation damages for permit devaluation based upon the transfer and assignment of the individual's claim for permit devaluation for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

However, if the individual does not assign the claim for permit devaluation to the C corporation, files a claim for permit devaluation damages, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual. If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other

classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas.

Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Lost Fishing Income

If the individual transferred and assigned to the C Corporation, in exchange for stock, the claim for damages for lost fishing income during the portion of the Loss Period during which the individual was engaged in commercial fishing practices, Year 5 through the date in Year 7 on which the C Corporation was formed to engage in commercial fishing practices, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated

as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the C Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the C Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the C corporation damages for lost fishing income, then the C Corporation will be taxed on these damages for lost fishing income.

If the Fund pays the C Corporation damages for lost fishing income based upon the transfer and assignment of the individual's claim for lost fishing income for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

However, if the individual does not assign the claim for lost fishing income to the C corporation, files a claim for lost fishing income damages during Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was

recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the C Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

B. Fact Pattern Two

1. Partnership

a. Year 1 Entity Formation and Assets Transfer

Transfer of Boat

A transfer of a boat by the individual to a partnership in exchange for an interest in the partnership is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the boat contributed to the partnership is the adjusted basis of the boat to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

If the boat is subject to a recourse liability, the partnership is considered to have assumed the liability to the extent it does not exceed the fair market value of the property at the time of contribution. Section 752(c). The individual will recognize gain to the extent that the liability exceeds the fair market value of the property at the time of contribution.

Payment of Damages for Boat Devaluation

If the partnership files a claim for boat devaluation damages, based upon its ownership of the boat during the entire Loss Period, and receives these damages, the partnership must report the damages as income and allocate this income among its partners in accordance with its partnership agreement.

At the time of the receipt of the damages for boat devaluation, the partnership should reduce the basis in the boat by the amount of damages received. Any boat devaluation damages in excess of the boat's basis constitutes income of the partnership that must be allocated among its partners in accordance with its partnership agreement.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the partnership, in exchange for a partnership interest, the claim for damages for permit devaluation during the portion of the Loss Period in which the individual owned the fishing permit, Year 5 through Year 10, this is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for permit devaluation to the partnership is the adjusted basis of the claim for permit devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation to the partnership, but receives these damages from the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual. If the individual transfers these damages to the partnership in return for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

However, if the Fund pays the partnership damages for permit devaluation based upon a transfer and assignment of the individual's claim for permit devaluation damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

Payment of Damages for Lost Fishing Income

If the partnership files a claim for damages for lost fishing income during the entire Loss Period, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

2. S Corporation

a. Year 1 Entity Formation and Assets Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual, increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in

exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the S Corporation files a claim for boat devaluation based upon its ownership of the boat during the entire Loss Period, and receives these damages, then the shareholders of the S Corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

At the time of the receipt of the damages for boat devaluation, the S Corporation should reduce the basis in the boat by the amount of damages received. The shareholders of the S Corporation are required to include in income in the taxable year in which the S Corporation's taxable year ends, their pro rata share of any boat devaluation damages in excess of the boat's basis.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the S Corporation, in exchange for stock, the claim for damages for permit devaluation during the portion of the Loss Period in which the individual owned the permit, Year 5 through Year 10, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation damages to the S Corporation, but receives these damages from the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received. Any damages for permit devaluation in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351

may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the S corporation damages for permit devaluation based upon the transfer and assignment of the individual's claim for permit devaluation, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for permit devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

Payment of Damages for Lost Fishing Income

If the S Corporation files a claim for damages for lost fishing income for the entire Loss Period, and the Fund pays the S corporation damages for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S corporation's taxable year ends. Section 1366(a).

3. C Corporation

a. Year 1 Entity Formation and Asset Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the C Corporation files a claim for boat devaluation based upon its ownership of the boat during the entire Loss Period, and the Fund pays the C Corporation damages for boat devaluation, then the C Corporation will be taxed on these damages. The C Corporation should reduce its basis in the boat for these damages received for boat devaluation. Any boat devaluation damages in excess of the boat's basis constitutes income to the C Corporation.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the C Corporation, in exchange for stock, the claim for damages for permit devaluation during the portion of the Loss Period during which the individual owned the permit, Year 5 through Year 10, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation to the C corporation, but receives these damages from the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351

may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the C Corporation damages for permit devaluation based upon the transfer and assignment of the individual's claim for permit devaluation for Year 5 through Year 10, then the C Corporation will be taxed on these damages.

Payment of Damages for Lost Fishing Income

If the C Corporation files a claim for damages for lost fishing income for the entire Loss Period, and the Fund pays the C corporation damages for lost fishing income, then the C Corporation will be taxed on these damages for lost fishing income.

C. Fact Pattern Three

1. Partnership

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

A transfer of a boat by the individual to a partnership in exchange for an interest in the partnership is a § 721 transfer, and therefore, no gain or loss is recognized to the

partnership or to the individual. Under § 723, the basis of the boat contributed to the partnership is the adjusted basis of the boat to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

If the boat is subject to a recourse liability, the partnership is considered to have assumed the liability to the extent it does not exceed the fair market value of the property at the time of contribution. Section 752(c). The individual will recognize gain to the extent that the liability exceeds the fair market value of the property at the time of contribution.

Transfer of the Claim for Damages for Boat Devaluation

If the individual transferred and assigned to the partnership, in exchange for a partnership interest, the claim for damages for boat devaluation during the portion of the loss period in which the individual owned the boat, Year 5 through the date in Year 7 on which the partnership was formed and the boat was transferred, this is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for boat devaluation to the partnership is the adjusted basis of the claim for boat devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Boat Devaluation

If the partnership files a claim for boat devaluation damages, based upon its ownership of the boat beginning from the partnership's formation in Year 7 through Year 10, and receives these damages, the partnership must report the damages as income and allocate this income among its partners in accordance with its partnership agreement.

At the time of the receipt of the damages for boat devaluation, the partnership should reduce the basis in the boat by the amount of damages received. Any boat devaluation damages in excess of the boat's basis constitutes income of the partnership that must be allocated among its partners in accordance with its partnership agreement.

If the Fund pays the partnership damages for boat devaluation based upon a transfer and assignment of individual's claim for boat devaluation for Year 5 through Year 7, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the partnership the claim for damages for permit devaluation, the transfer of the claim for damages for permit devaluation to a partnership in exchange for a partnership interest is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for permit devaluation to the partnership is the adjusted basis of the claim for permit devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation to the partnership, files a claim for permit devaluation, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the partnership in return for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

However, if the Fund pays the partnership damages for permit devaluation based upon a transfer and assignment of the individual's claim for permit devaluation damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

Transfer of the Claim for Damages for Lost Fishing Income

If the individual transferred and assigned to the partnership, in exchange for a partnership interest, the claim for damages for lost fishing income during the portion of the Loss Period in which the individual was engaged in commercial fishing practices, Year 5 through the date in Year 7 on which the partnership was formed to engage in commercial fishing practices, this is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for lost fishing income to the partnership is the adjusted basis of the claim for lost fishing income to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Lost Fishing Income

If the partnership files a claim for damages for lost fishing income during the portion of the Loss Period that the partnership was able to prove to the Administrator that it conducted fishing activity and that its partners paid income tax on income earned from this fishing activity, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

If the Fund pays the partnership damages for lost fishing income based on a transfer and assignment of individual's claim for lost fishing income damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the partnership was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income.

As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

2. S Corporation

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual, increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the individual transferred and assigned to the S Corporation, in exchange for stock, the claim for damages for boat devaluation during the portion of the Loss Period in which the individual owned the boat, Year 5 through the date in Year 7 on which the S Corporation was formed and the boat was transferred, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the S Corporation files a claim for boat devaluation based upon its ownership of the boat beginning from the S Corporation's formation in Year 7 through Year 10, and receives these damages, then the shareholders of the S Corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

At the time of the receipt of the damages for boat devaluation, the S Corporation should reduce the basis in the boat by the amount of damages received. The shareholders of the S Corporation are required to include in income in the taxable year in which the S Corporation's taxable year ends, their pro rata share of any boat devaluation damages in excess of the boat's basis.

If the Fund pays the S Corporation damages for boat devaluation based upon the transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the shareholders of the S Corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the S Corporation the claim for damages for permit devaluation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation damages to the S Corporation, files a claim for permit devaluation, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the

amount of the damages received. Any damages for permit devaluation in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the S corporation damages for permit devaluation based upon a transfer and assignment of the individual's claim for permit devaluation, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for permit devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

Transfer of the Claim for Damages for Lost Fishing Income

If the individual transferred and assigned to the S Corporation, in exchange for stock, the claim for damages for lost fishing income during the portion of the Loss Period in which the individual was engaged in commercial fishing practices, Year 5 through the date

in Year 7 on which the S Corporation was formed to engage in commercial fishing practices, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the S Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the S Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the S corporation damages for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S corporation's taxable year ends. Section 1366(a).

If the Fund pays the S corporation damages for lost fishing income based upon the transfer and assignment of the individual's claim for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the S Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

3. C Corporation

a. Year 7 Entity Formation and Asset Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include

any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the individual transferred and assigned to the C Corporation, in exchange for stock, the claim for damages for boat devaluation during the portion of the Loss Period in which the individual owned the boat, Year 5 through the date in Year 7 on which the C Corporation was formed and the boat was transferred, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the C Corporation files a claim for boat devaluation during the portion of the Loss Period in which it owned the boat, beginning from the C Corporation's formation in Year 7 through Year 10, and the Fund pays the C corporation damages for boat devaluation, then the C Corporation will be taxed on these damages. The C Corporation should reduce its

basis in the boat for these damages received for boat devaluation. Any boat devaluation damages in excess of the boat's basis constitutes income to the C Corporation.

If the Fund pays the C Corporation damages for boat devaluation based upon the transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred to the C Corporation the claim for damages for permit devaluation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation to the C corporation, files a claim for permit devaluation damages, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages

received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the C Corporation in exchange for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the C Corporation damages for permit devaluation based upon a transfer and assignment of the individual's claim for permit devaluation for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

Transfer of the Claim for Damages for Lost Fishing Income

If individual transferred and assigned to the C Corporation, in exchange for stock, the claim for damages for lost fishing income during the portion of the Loss Period during which the individual was engaged in commercial fishing practices, Year 5 through the date in Year 7 on which the C Corporation was formed to engage in commercial fishing practices, § 1032 provides that the corporation will not recognize gain or loss. Under § 362,

the corporation's basis in the claim for damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the C Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the C Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the C corporation damages for lost fishing income, then the C Corporation will be taxed on these damages for lost fishing income.

If the Fund pays the C Corporation damages for lost fishing income based upon a transfer and assignment of the individual's claim for lost fishing income for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the C Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income.

As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

D. Fact Pattern Four

1. Partnership

a. Year 1 Entity Formation and Assets Transfer

Transfer of Boat

A transfer of a boat by the individual to a partnership in exchange for an interest in the partnership is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the boat contributed to the partnership is the adjusted basis of the boat to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

If the boat is subject to a recourse liability, the partnership is considered to have assumed the liability to the extent it does not exceed the fair market value of the property at the time of contribution. Section 752(c). The individual will recognize gain to the extent that the liability exceeds the fair market value of the property at the time of contribution.

Payment of Damages for Boat Devaluation

If the partnership files a claim for boat devaluation damages, based upon its ownership of the boat during the entire Loss Period, and receives these damages, the partnership must report the damages as income and allocate this income among its partners in accordance with its partnership agreement.

At the time of the receipt of the damages for boat devaluation, the partnership should reduce the basis in the boat by the amount of damages received. Any boat devaluation damages in excess of the boat's basis constitutes income of the partnership that must be allocated among its partners in accordance with its partnership agreement.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the partnership the claim for damages for permit devaluation in exchange for a partnership interest, this is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for permit devaluation to the partnership is the adjusted basis of the claim for permit devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation to the partnership, but receives these damages from the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the partnership in return for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

However, if the Fund pays the partnership damages for permit devaluation based upon a transfer and assignment of the individual's claim for permit devaluation damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

Payment of Damages for Lost Fishing Income

If the partnership files a claim for damages for lost fishing income during the entire Loss Period, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

2. S Corporation

a. Year 1 Entity Formation and Assets Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual, increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property

(except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the S Corporation files a claim for boat devaluation based upon its ownership of the boat during the entire Loss Period, and receives these damages, then the shareholders of the S Corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

At the time of the receipt of the damages for boat devaluation, the S Corporation should reduce the basis in the boat by the amount of damages received. The shareholders of the S Corporation are required to include in income in the taxable year in which the S Corporation's taxable year ends, their pro rata share of any boat devaluation damages in excess of the boat's basis.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the S Corporation the claim for damages for permit devaluation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If

there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation damages to the S Corporation, but receives these damages from the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received. Any damages for permit devaluation in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a

basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the S corporation damages for permit devaluation based upon a transfer and assignment of the individual's claim for permit devaluation, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for permit devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

Payment of Damages for Lost Fishing Income

If the S Corporation files a claim for damages for lost fishing income for the entire Loss Period, and the Fund pays the S corporation damages for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S corporation's taxable year ends. Section 1366(a).

3. C Corporation

a. Year 1 Entity Formation and Asset Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as

a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the C Corporation files a claim for boat devaluation based upon its ownership of the boat during the entire Loss Period, and the Fund pays the C corporation damages for boat devaluation, then the C Corporation will be taxed on these damages. The C Corporation should reduce its basis in the boat for these damages received for boat devaluation. Any boat devaluation damages in excess of the boat's basis constitutes income to the C Corporation.

Transfer of the Claim for Damages for Permit Devaluation

If the individual transferred and assigned to the C Corporation the claim for damages for permit devaluation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the

corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the individual does not assign the claim for permit devaluation to the C corporation, but receives these damages from the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a

basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the C Corporation damages for permit devaluation based upon a transfer and assignment of the individual's claim for permit devaluation for Year 5 through Year 10, then the C Corporation will be taxed on these damages.

Payment of Damages for Lost Fishing Income

If the C Corporation files a claim for damages for lost fishing income for the entire Loss Period, and the Fund pays the C Corporation damages for lost fishing income, then the C Corporation will be taxed on these damages for lost fishing income.

E. Fact Pattern Five

1. Partnership

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

A transfer of a boat by the individual to a partnership in exchange for an interest in the partnership is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the boat contributed to the partnership is the adjusted basis of the boat to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

If the boat is subject to a recourse liability, the partnership is considered to have assumed the liability to the extent it does not exceed the fair market value of the property at the time of contribution. Section 752(c). The individual will recognize gain to the extent that the liability exceeds the fair market value of the property at the time of contribution.

Transfer of the Claim for Damages for Boat Devaluation

If the facts and circumstances establish that the claim for damages for boat devaluation was not transferred, then the claim will not be treated as being transferred upon the partnership's formation in Year 7. If the individual currently transfers the claim to the partnership for damages for boat devaluation and assigns the claim to the partnership as required by the Fund, and the Fund pays the partnership these damages, then the transfer of the claim for damages for boat devaluation to the partnership in exchange for a partnership interest is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for boat devaluation to the partnership is the adjusted basis of the claim for boat devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Boat Devaluation

If the partnership files a claim for boat devaluation damages, based upon its ownership of the boat beginning from the partnership's formation in Year 7 through Year 10, and receives these damages, the partnership must report the damages as income and allocate this income among its partners in accordance with its partnership agreement. At the time of the receipt of the damages for boat devaluation, the partnership should reduce the basis in the boat by the amount of damages received. Any boat devaluation damages in excess of the boat's basis constitutes income of the partnership that must be allocated among its partners in accordance with its partnership agreement.

If the Fund pays the partnership damages for boat devaluation based upon the current transfer and assignment of individual's claim for boat devaluation for Year 5 through Year 7, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

However, if the individual does not currently assign the claim for boat devaluation to the partnership, files a claim for boat devaluation during the period the individual owned the boat, Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the partnership in return for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

Transfer of the Claim for Damages for Permit Devaluation

If the facts and circumstances establish that the claim for damages for permit devaluation was not transferred, then the claim will not be treated as being transferred upon the partnership's formation in Year 7. If the individual currently transfers the claim to the partnership for damages for permit devaluation and assigns the claim to the partnership as required by the Fund, and the Fund pays the partnership these damages, then the transfer of the claim for damages for permit devaluation to the partnership in exchange for a partnership interest is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for permit devaluation to the partnership is the adjusted basis of the claim for permit devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Permit Devaluation

If the Fund pays the partnership damages for permit devaluation based upon the current transfer and assignment of the individual's claim for permit devaluation damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

However, if the individual does not currently assign the claim for permit devaluation to the partnership, files a claim for permit devaluation, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the partnership in return for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

Transfer of the Claim for Damages for Lost Fishing Income

If the facts and circumstances establish that the claim for damages for lost fishing income was not transferred, then the claim will not be treated as being transferred upon the partnership's formation in Year 7. If the individual currently transfers the claim to the partnership for damages for lost fishing income and assigns the claim to the partnership as required by the Fund, and the Fund pays the partnership these damages, then the transfer of the claim for damages for lost fishing income to the partnership in exchange for a partnership interest is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for lost fishing income to the partnership is the adjusted basis of the claim for lost fishing income to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Lost Fishing Income

If the partnership files a claim for damages for lost fishing income during the portion of the Loss Period that the partnership was able to prove to the Administrator that it conducted fishing activity and that its partners paid income tax on income earned from this fishing activity, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

If the Fund pays the partnership damages for lost fishing income based on the current transfer and assignment of individual's claim for lost fishing income damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

However, if the individual does not currently assign the claim for lost fishing income to the partnership, files a claim for lost fishing income for Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving

these damages from the Fund, the individual transfers these damages to the partnership in exchange for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual on the transfer.

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the partnership was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's current transfer and assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

2. S Corporation

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual, increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the facts and circumstances establish that the claim for damages for boat devaluation was not transferred, then the claim will not be treated as being transferred upon the S Corporation's formation in Year 7. If the individual currently transfers the claim to the S Corporation for damages for boat devaluation and assigns the claim to the S Corporation as required by the Fund, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the S Corporation files a claim for boat devaluation based upon its ownership of the boat beginning from the S Corporation's formation in Year 7 through Year 10, and receives these damages, then the shareholders of the S Corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

At the time of the receipt of the damages for boat devaluation, the S Corporation should reduce the basis in the boat by the amount of damages received. The shareholders of the S Corporation are required to include in income in the taxable year in which the S Corporation's taxable year ends, their pro rata share of any boat devaluation damages in excess of the boat's basis.

If the Fund pays the S corporation damages for boat devaluation based upon the current transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

However, if the individual does not currently assign the claim for boat devaluation to the S Corporation, files a claim for boat devaluation during the period the individual owned the boat, Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Permit Devaluation

If the facts and circumstances establish that the claim for damages for permit devaluation was not transferred, then the claim will not be treated as being transferred upon the S Corporation's formation in Year 7. If the individual currently transfers the claim to the S Corporation for damages for permit devaluation and assigns the claim to the S Corporation as required by the Fund, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the Fund pays the S corporation damages for permit devaluation based upon the current transfer and assignment of the individual's claim for permit devaluation, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for permit devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

However, if the individual does not currently assign the claim for permit devaluation damages to the S Corporation, files a claim for permit devaluation, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received. Any damages for permit devaluation in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Lost Fishing Income

If the facts and circumstances establish that the claim for damages for lost fishing income was not transferred, then the claim will not be treated as being transferred upon the S Corporation's formation in Year 7. If the individual currently transfers the claim to the S Corporation for damages for lost fishing income and assigns the claim to the S Corporation as required by the Fund, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the S Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the S Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the S corporation damages for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S corporation's taxable year ends. Section 1366(a).

If the Fund pays the S corporation damages for lost fishing income based upon the current transfer and assignment of the individual's claim for lost fishing income, then the

shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

However, if the individual does not currently assign the claim for lost fishing income for Year 5 through Year 7 to the S Corporation, files a claim for lost fishing income, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the S corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the S Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

3. C Corporation

a. Year 7 Entity Formation and Asset Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the facts and circumstances establish that the claim for damages for boat devaluation was not transferred, then the claim will not be treated as being transferred upon the C Corporation's formation in Year 7. If the individual currently transfers the claim

to the C Corporation for damages for boat devaluation and assigns the claim to the C Corporation as required by the Fund, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the C Corporation files a claim for boat devaluation during the portion of the Loss Period in which it owned the boat, beginning from the C Corporation's formation in Year 7 through Year 10, and the Fund pays the C Corporation damages for boat devaluation, then the C Corporation will be taxed on these damages. The C Corporation should reduce its basis in the boat for these damages received for boat devaluation. Any boat devaluation damages in excess of the boat's basis constitutes income to the C Corporation.

If the Fund pays the C Corporation damages for boat devaluation based upon a current transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

However, if the individual does not currently assign the claim for boat devaluation to the C corporation, files a claim for boat devaluation damages during the period the

individual owned the boat, Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Permit Devaluation

If the facts and circumstances establish that the claim for damages for permit devaluation was not transferred, then the claim will not be treated as being transferred upon the C Corporation's formation in Year 7. If the individual currently transfers the claim to the C Corporation for damages for permit devaluation and assigns the claim to the C Corporation as required by the Fund, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more

persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

If the Fund pays the C Corporation damages for permit devaluation based upon the current transfer and assignment of the individual's claim for permit devaluation for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

However, if the individual does not currently assign the claim for permit devaluation to the C corporation, files a claim for boat devaluation damages during the period the individual owned the boat, Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in

exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Lost Fishing Income

If the facts and circumstances establish that the claim for damages for lost fishing income was not recorded as an asset on the entity's balance sheet, then the claim will not be treated as being transferred upon the C Corporation's formation in Year 7. If the individual currently transfers the claim to the C Corporation for damages for lost fishing income and assigns the claim to the C Corporation as required by the Fund, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1).

Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the C Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the C Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the C corporation damages for lost fishing income, then the C Corporation will be taxed on these damages for lost fishing income.

If the Fund pays the C Corporation damages for lost fishing income based upon the current transfer and assignment of the individual's claim for lost fishing income for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

However, if the individual does not currently assign the claim for lost fishing income to the C corporation, files a claim for lost fishing income damages during Year 5 through Year 7, and is paid by the Fund, the individual must report the damages received as income. If after receiving these damages from the Fund, the individual transfers these damages to the C corporation for stock, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a

member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the C Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

F. Fact Pattern Six

1. Partnership

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

A transfer of a boat by the individual to a partnership in exchange for an interest in the partnership is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the boat contributed to the partnership is the adjusted basis of the boat to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

If the boat is subject to a recourse liability, the partnership is considered to have assumed the liability to the extent it does not exceed the fair market value of the property at the time of contribution. Section 752(c). The individual will recognize gain to the extent that the liability exceeds the fair market value of the property at the time of contribution.

Transfer of the Claim for Damages for Boat Devaluation

If the Fund does recognize a current transfer and assignment and the Fund pays the partnership these damages, then the transfer of the claim for damages for boat devaluation to the partnership in exchange for a partnership interest is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for boat devaluation to the partnership is the adjusted basis of the claim for boat devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Boat Devaluation

If the partnership files a claim for boat devaluation damages, based upon its ownership of the boat beginning from the partnership's formation in Year 7 through Year 10, and receives these damages, the partnership must report the damages as income and allocate this income among its partners in accordance with its partnership agreement.

At the time of the receipt of the damages for boat devaluation, the partnership should reduce the basis in the boat by the amount of damages received. Any boat devaluation damages in excess of the boat's basis constitutes income of the partnership that must be allocated among its partners in accordance with its partnership agreement.

Although the individual currently wants to transfer to the partnership the claim for damages for boat devaluation for Year 5 through the date in Year 7 on which the partnership was formed, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the boat devaluation damages received from the Fund. If the individual wants to then transfer these damages to the partnership in exchange for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual upon the transfer.

However, if the Fund pays the partnership damages for boat devaluation based upon a current transfer and assignment of individual's claim for boat devaluation for Year 5 through Year 7, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

Transfer of the Claim for Damages for Permit Devaluation

If the Fund does recognize a current transfer and assignment of the claim for permit devaluation damages to the partnership, then the transfer of the claim for damages for permit devaluation to a partnership in exchange for a partnership interest is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for permit devaluation to the partnership is the adjusted basis of the claim for permit devaluation to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Permit Devaluation

Although the individual currently wants to transfer the claim for damages for permit devaluation to the partnership, if the Fund does not recognize this transfer because there is

no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the permit devaluation damages received from the Fund. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual. If the individual wants to then transfer these damages to the partnership in exchange for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual upon the transfer.

However, if there was an assignment to the partnership of the claim for permit devaluation, and the Fund pays the partnership damages for permit devaluation based upon the current transfer and assignment of individual's claim for permit devaluation for Year 5 through Year 10, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

Transfer of the Claim for Damages for Lost Fishing Income

If the Fund does recognize a current transfer and assignment of the claim for damages for lost fishing income to the partnership, and the Fund pays the partnership these damages, then the transfer of the claim for damages for lost fishing income to the partnership in exchange for a partnership interest is a § 721 transfer, and therefore, no gain or loss is recognized to the partnership or to the individual. Under § 723, the basis of the claim for lost fishing income to the partnership is the adjusted basis of the claim for lost fishing income to the individual at the time of contribution, increased by the amount (if any) of gain recognized under § 721(b) to the individual at such time.

Payment of Damages for Lost Fishing Income

If the partnership files a claim for damages for lost fishing income during the portion of the Loss Period that the partnership was able to prove to the Administrator that it conducted fishing activity and that its partners paid income tax on income earned from this fishing activity, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

Although the individual currently wants to transfer to the partnership the claim for damages for lost fishing income for Year 5 through the date in Year 7 on which the partnership was formed, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the lost fishing income damages received from the Fund. If the individual wants to then transfer these damages to the partnership in exchange for a partnership interest, this would be a § 721 transfer and no gain or loss would be recognized to the partnership or to the individual upon the transfer.

However, if the Fund pays the partnership damages for lost fishing income based on a current transfer and assignment of individual's claim for lost fishing income damages, then the partnership must report these damages as income and allocate this income among its partners in accordance with its partnership agreement.

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the partnership was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, any current transfer and assignment of individual's claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

2. S Corporation

a. Year 7 Entity Formation and Assets Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual, increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to

increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the Fund does recognize a current transfer of the claim for damages for boat devaluation to the S Corporation, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the S Corporation files a claim for boat devaluation based upon its ownership of the boat beginning from the S Corporation's formation in Year 7 through Year 10, and receives these damages, then the shareholders of the S Corporation are required to include in income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

At the time of the receipt of the damages for boat devaluation, the S Corporation should reduce the basis in the boat by the amount of damages received. The shareholders of the S Corporation are required to include in income in the taxable year in which the S Corporation's taxable year ends, their pro rata share of any boat devaluation damages in excess of the boat's basis.

Although the individual currently wants to transfer to the S Corporation the claim for damages for boat devaluation for Year 5 through the date in Year 7 on which the S Corporation was formed, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the boat devaluation damages received from the Fund. If the individual wants to then transfer these damages to the S Corporation, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the S Corporation damages for boat devaluation based upon the transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the shareholders of the S Corporation are required to include in

income their pro rata share of these damages for boat devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

Transfer of the Claim for Damages for Permit Devaluation

If the Fund does recognize a current transfer and assignment of the claim for permit devaluation damages to the S Corporation, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

Although the individual currently wants to transfer the claim for damages for permit devaluation to the S Corporation, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the permit devaluation damages received from the Fund. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received. Any damages for permit devaluation in excess of the permit's basis constitutes income to the individual.

If the individual wants to then transfer these damages to the S Corporation, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the S corporation damages for permit devaluation based upon a current transfer and assignment of the individual's claim for permit devaluation, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for permit devaluation in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

Transfer of the Claim for Damages for Lost Fishing Income

If the Fund does recognize a current transfer of the claim for damages for lost fishing income to the S Corporation, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the claim for damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or

loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the claim for damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the S Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the S Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the S corporation damages for lost fishing income, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S corporation's taxable year ends. Section 1366(a).

Although the individual currently wants to transfer to the S Corporation the claim for damages for lost fishing income for Year 5 through the date in Year 7 on which the S Corporation was formed, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual must report the damages received as income. If the individual wants to then transfer these damages to the S Corporation, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for lost fishing income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is

transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the S corporation damages for lost fishing income based upon a current transfer and assignment of the individual's claim for permit devaluation, then the shareholders of the S corporation are required to include in income their pro rata share of these damages for lost fishing income in the taxable year in which the S Corporation's taxable year ends. Section 1366(a).

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the S Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

3. C Corporation

a. Year 7 Entity Formation and Asset Transfer

Transfer of Boat

If the individual transfers the boat to the corporation in exchange for stock, § 1032 provides that the corporation will not recognize gain or loss. Under § 362, the corporation's basis in the boat received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the boat by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the boat transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 357(c) applies to a § 351 exchange in which the shareholder transfers a boat that has a liability attached to it that exceeds the shareholder's basis in the boat. Section 357(c) provides that if the sum of the liabilities assumed by a corporation exceeds the adjusted basis of the property transferred to the corporation in a § 351 exchange, then the excess will be considered as gain from the sale or exchange of a capital asset or property which is not a capital asset, as the case may be.

If the individual transfers the boat to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the boat transferred to the corporation. Section 1016(a)(1).

Transfer of the Claim for Damages for Boat Devaluation

If the Fund does recognize a current transfer of the claim for damages for boat devaluation to the corporation, § 1032 applies. Section 1032 provides that a corporation will not

recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the claim for damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Boat Devaluation

If the C Corporation files a claim for boat devaluation during the portion of the Loss Period in which it owned the boat, beginning from the C Corporation's formation in Year 7 through Year 10, and the Fund pays the C corporation damages for boat devaluation, then the C Corporation will be taxed on these damages. The C Corporation should reduce its basis in the boat for these damages received for boat devaluation. Any boat devaluation damages in excess of the boat's basis constitutes income to the C Corporation.

Although the individual currently wants to transfer to the C Corporation the claim for damages for boat devaluation for Year 5 through the date in Year 7 on which the C Corporation was formed, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the boat devaluation damages received from the Fund. If the individual wants to then transfer these damages to the C Corporation, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for boat devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for boat devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for boat devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for boat devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for boat devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the C Corporation damages for boat devaluation based upon a current transfer and assignment of the individual's claim for boat devaluation for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

Transfer of the Claim for Damages for Permit Devaluation

If the Fund does recognize a current transfer of a claim for damages for permit devaluation to the C Corporation § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the claim for damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Permit Devaluation

Although the individual currently wants to transfer the claim for damages for permit devaluation to the C Corporation, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the permit devaluation damages received from the Fund. At the time of the receipt of the damages for permit devaluation, the individual should reduce the basis in the fishing permit by the amount of the damages received for permit devaluation. Any permit devaluation damages in excess of the permit's basis constitutes income to the individual.

If the individual wants to then transfer these damages to the C Corporation, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for permit devaluation received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for permit devaluation by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for permit devaluation transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for permit devaluation to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for permit devaluation transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the C Corporation damages for permit devaluation based upon a current transfer and assignment of the individual's claim for permit devaluation for Year 5 through Year 10, then the C Corporation will be taxed on these damages.

Transfer of the Claim for Damages for Lost Fishing Income

If the Fund does recognize a current transfer of the claim for lost fishing income to the C Corporation, § 1032 applies. Section 1032 provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the claim for damages for lost fishing income

received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the claim for damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the claim for damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the claim for damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

Payment of Damages for Lost Fishing Income

If the C Corporation files a claim for damages for lost fishing income during the portion of the Loss Period that the C Corporation was able to prove to the Administrator that it conducted fishing activity and that its shareholders paid income tax on income earned from this fishing activity, and the Fund pays the C Corporation damages for lost fishing income, then the C Corporation will be taxed on these damages for lost fishing income.

Although the individual currently wants to transfer the claim for damages for lost fishing income to the C Corporation, if the Fund does not recognize this transfer because there is no assignment of the claim, the Fund will pay the individual and the individual will be taxed on the lost fishing income damages received from the Fund. If the individual wants to then transfer these damages to the C Corporation, § 1032 applies. Section 1032

provides that a corporation will not recognize gain or loss on the receipt of money or other property in exchange for stock. Under § 362, the corporation's basis in the damages for lost fishing

income received from the individual is the same as it is in the hands of the individual increased by the amount of gain recognized by the individual on the transfer. Section 351 may apply to the contribution of the damages for lost fishing income by the individual to the corporation in exchange for stock. Section 351 provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation. Section 368(c) defines control as the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. If there is more than one transfer of property to the corporation, the entire transaction qualifies as tax free under § 351 if the transferors, as a group, are in control of the corporation immediately after the exchange. In applying the 80 percent test of § 368(c), stock previously owned by a member of the control group is added to the stock received by them in exchange for the transferred property. Treas. Reg. § 1.351-1(a)(1). Under § 358(a)(1), the individual has a basis in the stock the same as that of the damages for lost fishing income transferred (A) decreased by- (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of any money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by- (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

If the individual transfers the damages for lost fishing income to the corporation and does not receive additional stock, then the transfer will be treated as a contribution to capital and § 118 will apply. Section 118(a) provides that, in the case of a corporation, gross income does not include any contribution to the capital of the taxpayer. Correspondingly, the individual is entitled to increase the basis of his shares by the amount of his basis in the damages for lost fishing income transferred to the corporation. Section 1016(a)(1).

However, if the Fund pays the C Corporation damages for lost fishing income based upon a current transfer and assignment of the individual's claim for lost fishing income for Year 5 through Year 7, then the C Corporation will be taxed on these damages.

b. Year 16 Entity Formation and Asset Transfer

The same tax consequences occur as outlined under Year 7 Entity Formation and Asset Transfer. However, the C Corporation was not formed during the Loss Period, and therefore, could not file a claim for damages for boat devaluation and lost fishing income. As a result, the individual's transfer and subsequent assignment of the claim for damages for boat devaluation and lost fishing income would encompass damages for Year 5 through Year 10.

Please call if you have any further questions.

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