ABA Section of Taxation May Meeting
Corporate Tax Committee

Current Developments in Corporate Tax

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Agenda

• Priority Guidance Plan
• Regulations Update: Sections 301 and 355, COI, Etc.
• Section 355 Update: PLR Procedures, ATB Income Requirement
• NOL Carryforwards – Technically Incorrect?
• Proposed O-Zone Regulations – Inclusion Events
• May Company Regulations
• Final Section 965(h) Regulations – What (and When) is “Substantially All”
• Proposed Section 382(h)(6) Regulations?
Priority Guidance Plan: Update
Public Comment Invited on Recommendations for 2019-2020 Priority Guidance Plan

Notice 2019-30

The Department of the Treasury (Treasury Department) and the Internal Revenue Service (Service) invite public comment on recommendations for items that should be included on the 2019-2020 Priority Guidance Plan.

The Treasury Department’s Office of Tax Policy and the Service use the Priority Guidance Plan each year to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance. The 2019-2020 Priority Guidance Plan will identify guidance projects that the Treasury Department and the Service intend to actively work on as priorities during the period from July 1, 2019, through June 30, 2020.

The Treasury Department and the Service recognize the importance of public input in formulating a Priority Guidance Plan that focuses resources on guidance items that are most important to taxpayers and tax administration. Published guidance plays an important role in increasing voluntary compliance by helping to clarify ambiguous areas of the tax law. The published guidance process is most successful if the Treasury Department and the Service have the benefit of the experience and knowledge of taxpayers and practitioners who must apply the rules implementing the tax laws.

On December 22, 2017, P.L. 115-97, “An Act to provide for the reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year
Regulations Update:
Sections 301 and 355, COI, etc.
Withdrawal of COI Regulations

• As of April 1, 2019, Treasury/IRS withdrew proposed COI regulations that addressed how to value the issuing corporation’s stock for COI purposes (where the signing date rule does not apply)

• The proposed regulations permitted the use of an average of the trading prices of the issuing corporation’s stock over a number of days in lieu of the actual trading price on the Closing Date

• Rev. Proc. 2018-12 is still in effect, which provides certain safe harbors that allow a taxpayer to use trading prices over a number of days
  • Average of (i) Daily Volume Weighted Average Prices, (ii) Average High-Low Daily Prices or (ii) Daily Closing Prices permissible
  • Measuring period must be at least 5 but not more than 35 consecutive trading days
Update to Section 301 Regulations

• On March 26, 2019, Treasury/IRS issued proposed regulations updating section 301 regulations

  • Scope of changes is limited to (i) deleting regulatory provisions made obsolete, (2) making minor additions and revisions to regulatory provisions to reflect statutory changes, and (3) making certain non-substantive changes for purposes of clarity and readability

  • Update existing regulations to reflect statutory changes made by the Technical and Miscellaneous Revenue Act of 1988

    • For example, such changes provide that the amount of a distribution of property by a corporation to its shareholders is the fair market value of the distributed property

    • Eliminate distinctions between corporate and non-corporate distributees
Withdrawal of Stock Basis Regulations

• Treasury/IRS withdrew 2009 Proposed Regulations regarding the allocation and recovery of stock basis in redemptions, having determined “it is unlikely that the approach of the 2009 Proposed Regulations can be implemented in comprehensive final regulations without significant modification”

• Treasury/IRS continue to believe that, under current law, a section 301 distribution should derive from the consideration received by a shareholder in respect of each share of stock, notwithstanding designations otherwise

  • In other words, a dividend-equivalent redemption results in a pro rata share-by-share distribution to all shares of the redeemed class held by redeemed shareholder

  • See Johnson v. United States, 435 F.2d 1257 (4th Cir. 1971); See also Illinois Tool Works Inc. v. Comm’r, T.C. Memo 2018-121 (citing Johnson)
Withdrawal of Stock Basis Regulations

- Treasury/IRS continue to believe that, under current law, with respect to redemptions governed by section 302(d), any unrecovered basis in the redeemed stock of a shareholder may be shifted to other stock only if such an adjustment is a proper adjustment within the meaning of Treas. Reg. § 1.302-2(c)
  - One of the more controversial provisions in the 2009 Proposed Regulations prohibited the shift of unrecovered basis in redeemed stock to stock attributed to the redeemed shareholder and instead created a suspended loss for such shareholder
  - Treasury/IRS note that they do not believe all shifts of a redeemed shareholder’s unrecovered basis result in proper adjustments and certain basis adjustments can lead to inappropriate results
  - See, for example, Notice 2001-45, regarding transactions that shift basis of non-US taxpayer to US taxpayer
Stock Basis Regulations: What’s next?

• Treasury/IRS continue to study issues addressed in 2009 Proposed Regulations
  • Particular focus on sections 301(c)(2) and 304 and Treas. Reg. § 1.302-2(c)
  • 2009 Proposed Regulations included amendments to current regulations under section 304 that would have updated those regulations to reflect statutory amendments to that section
  • 2009 Proposed Regulations also provided a methodology for determining gain under section 356 and stock basis under section 358
    • The 2009 Proposed Regulations provided that if solely cash is received in exchange for shares in a transaction that otherwise qualifies as a reorganization, section 302 governs the tax consequences rather than section 356 thereby permitting a loss (provided that the cash does not have the effect of a dividend distribution).
    • The 2009 Proposed Regulations also included examples permitting allocations of consideration based on shareholder elections.
    • Is IRS considering addressing these provisions in future regulations?
• 2016 Proposed Regulations under section 337 required that a successor to D or C in a section 355 distribution that engaged in a conversion transaction involving a REIT within 10 years of distribution be treated as making a deemed sale election

• Such rule could result in successor recognizing gain greatly in excess of amount that would have been recognized if D or C had directly engaged in transaction
  • For example, assume C is acquired by Acquiring, which converts to a REIT within 10 years of distribution of C, the built-in gain in Acquiring’s assets would be recognized under the 2016 Proposed Regulations

• New proposed regulations limit the amount of gain recognized on the deemed sale election to gain on property traceable to the section 355 distribution
  • Property owned by D or C or the SAG of D or C immediately after the section 355 distribution and other property the basis of which is determined in whole or in part by reference to that property

• 2019 proposed regulations do not provide relief where D is acquired by successor that is a REIT or becomes a REIT as requested by commentator
  • In such case, built-in gain in D’s assets continues to be recognized, and is not limited by amount of C’s built-in gain
Section 355 Update: PLR Procedures, ATB
On March 12, 2019, the IRS announced that the pilot program for PLRs pursuant to which the IRS will issue rulings addressing the general tax consequences of Section 355 distributions has been extended indefinitely.

In Rev. Proc. 2017-52, the IRS created the pilot program for distributions.

- Taxpayers may obtain rulings on the general federal income tax consequences of these distributions and related transactions; rulings are no longer limited to significant issues.
- The program does not change the no-rule regarding device, business purpose, and Section 355(e).

Rev. Proc. 2017-52, which has been amplified and modified by Rev. Proc. 2018-53, also includes procedures for ruling requests on these matters.

• IRS suspended Rev. Rul. 57-464 and Rev. Rul. 57-492 pending completion of study by Treasury and IRS regarding the active trade or business (ATB) requirement under sections 355(a)(1)(C) and (b)

  • According to the Internal Revenue Manual, a revenue ruling can be suspended “only in rare situations to show that previously published guidance will not be applied pending some future action, such as ... the outcome of a Service study”

• Treasury and IRS are conducting a study to determine “whether a business can qualify as an ATB if entrepreneurial activities, as opposed to investment or other non-business activities, take place with the purpose of earning income in the future, but no income has yet been collected.”

• The ATB analysis in the suspended rulings focuses, in significant part, on the lack of income generated by the activities under consideration. Therefore, the IRS notes that these rulings could be interpreted as requiring income generation for a business to qualify as an ATB.
On May 6, 2019, the IRS requested information to assist in identifying what types of entrepreneurial ventures should qualify as ATBs absent a five-year track record of income collection. For example:

• In what industries or industry segments do the types of R&D ventures described above, as well as in the September 2018 IRS statement, exist?

• How are these ventures created? If no income is collected for extended periods, how are these ventures funded?

• In what circumstances do these ventures typically receive grants or similar funding? What types of organizations make these grants and on what terms?

• Is it common for investments in, or grants to, these ventures to include rights to acquire interests in potential products of the research, rights to use such products, or similar rights?

• What types of managerial and operational activities of these ventures generally are conducted by employees? What types of activities generally are conducted by independent contractors or their employees?

• What proportion of these ventures’ managerial and operational activities is conducted by employees, as compared to independent contractors?

• What steps are necessary to obtain regulatory approval of products developed in the R&D phase of these ventures, and how do these steps vary by industry
 IRS Request for Information re ATB Requirement

(continued)

• Is it possible to generalize about the amounts of time necessary to accomplish these regulatory approval steps?

• Is it possible to generalize about the nature of activities and the levels of activity required to accomplish these regulatory approval steps?

• What types of opportunities exist to collect income from the results of research before any marketable product is developed? Do opportunities to collect income from these sources increase as a result of preliminary approval by a regulator or accomplishment of particular steps toward final regulatory approval? If so, do these opportunities vary by industry?

• Is it possible to describe situations in which, either before or after a corporate separation, activities of a separated R&D venture could be interrupted or could cease permanently due to an inability to raise capital or for any other reason?

• Is it possible to generalize as to amounts of expenditures, or amounts of time spent, at which, in various industries, a decision is likely to be made whether to continue R&D on a particular project?

• In what situations might an R&D venture benefit from separating part of its activities?

• Following such a separation, how likely is it for Spinco to provide services to Parent or vice versa, or that other business relationships between Parent and Spinco continue?

• What types of entrepreneurial ventures, in addition to R&D, potentially would satisfy the ATB requirement in the absence of income collection?
NOL Carryforwards: Technically Incorrect?
Section 172: Application of 80% Limitation

• Section 172(a) allows a taxpayer to claim an NOL deduction (NOLD) for a tax year in an amount equal to the lesser of:
  1) the taxpayer’s NOL carryovers to the year, plus the NOL carrybacks to the year, or
  2) 80% of the taxpayer’s taxable income for the year, computed without regard to the NOLD

• Section 172(a) as amended by the TCJA is effective with respect to NOLs arising in tax years beginning after December 31, 2017

• Prior to amendment by TJCA, there was no 80% limitation

• The NOL carryback is generally eliminated for NOLs arising in tax years ending after Dec. 31, 2017

• How do you apply 80% limitation if you have pre-2018 NOLs and post-2017 NOLs?
  • Pre-2018 NOLs – NOLs arising from taxable years beginning before Jan. 1, 2018
  • Post-2017 NOLs – NOLs arising from taxable years beginning after Dec. 31, 2017
JCT Bluebook Explanation

- The JCT Bluebook states that the limitation should be applied as follows:
  1) the taxpayer is entitled to an NOLD in the amount of its pre-2018 NOL carryovers without limitation and
  2) the taxpayer is entitled to an additional NOLD equal to the lesser of:
     a) its post-2017 NOL carryovers or
     b) 80% of the excess (if any) of the taxpayer’s taxable income (before any NOLD attributable to post-2017 NOL carryovers) over the NOLD attributable to pre-2018 NOL carryovers

- The Bluebook acknowledges that a technical correction may be necessary to reflect this intent

- Chairman Brady’s draft “Tax Technical and Clerical Corrections Act” would amend section 172(a) to be consistent with the Bluebook’s interpretation of the 80% limitation
  - Amendment would take effect as if included in the TCJA
Example: Corporation X has $90 of pre-2018 NOLs generated in tax years ending or before Dec. 31, 2017 and $30 post-2017 NOLs generated in tax years beginning after Dec. 31, 2017. For its 2019 tax year, Corporation X has pre-NOLD taxable income of $100.

- First, Corporation X may use $90 of its pre-2018 NOLs to offset $90 of its taxable income.
- Second, Corporation X may use $8 of its post-2017 NOLs to offset its remaining $10 of income (80% of ($100-$90)).
- Corporation X will have $2 of taxable income after its NOLD.
Example: No Technical Correction

- Assuming the same facts as the prior slide, how should the 80% limitation apply in the absence of technical correction?
  - Again, Corporation X may use $90 of its pre-2018 NOLs to offset $90 of its taxable income.
- Section 172(a), as amended, states: 80% of the taxpayer’s taxable income for the year, computed without regard to the NOLD
  - Literal reading of statute would allow Corporation X to use $10 of post-2017 NOLs to offset remaining $10 of income
  - 80% of the taxpayer’s taxable income for the year without regard to the NOLD is $80
  - Another possible alternative would apply the 80% limitation so that none of the post-2017 NOLs could be used (as the 80% limitation of $80 has been exceeded by use of pre-2018 NOLs)
O-Zone Regulations:
Inclusion Events
Corporations in the O-Zone

• Brief Overview of Section 1400Z-2
• Definition of an Inclusion Event
• Results of Certain Common Corporate Transactions under the Inclusion Event rules
Section 1400Z-2 Generally

• Section 1400Z-2(a) generally allows gain from the sale or exchange of property to be deferred to the extent it is invested by the taxpayer in a “qualified opportunity fund” within 180 days following such sale or exchange.

• A “qualified opportunity fund” or “QOF” is generally a corporation or partnership for the purpose of investing in qualified opportunity zone property that holds at least 90 percent of its assets in qualified opportunity zone property. Section 1400Z-2(d)(1).

• Section 1400Z-2(b)(1) provides that deferred gain is generally recognized upon the earlier of:
  • A sale or exchange of the investment; or
  • December 31, 2026.

• Proposed regulations provide guidance as to transactions that may cause an inclusion under section 1400Z-2(b)(1)(A) above (“Inclusion Events”).
Inclusion Events

• Under Prop. Reg. § 1.1400Z2(b)-1(c), unless an exception applies, an Inclusion Event generally includes (this list is not exhaustive):
  • A transfer of a qualifying investment that reduces the taxpayer’s interest in the qualifying investment;
  • Receipt of a distribution [with respect to a qualifying interest in a QOF] (even if interest in the QOF is not reduced);
  • Section 165(g) worthlessness;
  • Termination or Liquidation of a QOF;
  • Liquidation of the QOF Owner to extent section 336(a) and not section 337(a) applies to the qualifying investment; and
  • Certain other events.

• Certain exceptions and special rules apply, as discussed below.
Transactions with DREs

- A contribution of a qualifying investment to a disregarded entity, such as a wholly-owned LLC, is not an Inclusion Event. See Prop. Reg. § 1.1400Z2(b)-1(f)(2), Example 2(iii).

- However, if the QOF Shareholder later checks the box on the LLC, then that would be an Inclusion Event. See Prop. Reg. § 1.1400Z2(b)-1(f)(2), Example 2(ii) and (iii).

  - This applies even though the election would otherwise qualify as a section 351.
  - If LLC were checked close as a corporation to begin with, then the initial transfer would have been the Inclusion Event.
Distributions

• A distribution of property (or stock subject to section 305(b)) by a QOF C corporation with respect to a qualifying investment is **not** an Inclusion Event **except** to the extent described in section 301(c)(3).
  
  • Prop. Reg. § 1.1400Z2(b)-1(c)(8).
  • Section 305(c) distributions likewise excluded?

• Section 302(d) Dividend Equivalent Redemptions
  
  • These **are** Inclusion Events by default. Prop. Reg. § 1.1400Z2(b)-1(c)(9).
  • However, these are excluded from Inclusion Transactions if all of the stock of the QOF is held directly by the same shareholder or directly by members of the same consolidated group.
  • Section 302(d) redemptions by QOF S corporations are generally Inclusion Events to the extent they exceed the taxpayer’s basis in the QOF.
Certain Asset Reorganizations

• A transaction is generally not an Inclusion Event if:
  • the assets of a QOF corporation are acquired in a “qualifying section 381 transaction”; and
  • the acquiring corporation is a QOF immediately after the acquisition. Prop. Reg. § 1.1400Z2(b)-1(c)(10)(i)(A).

• Receipt of boot generally causes an inclusion event, unless all of the stock of both the target QOF and the acquiring QOF are directly held by the same shareholder or by members of the same consolidated group.
  • Prop. Reg. § 1.1400Z2(b)-1(c)(10)(i)(C).
  • This is similar to the rule under Prop. Reg. § 1.1400Z2(b)-1(c)(8).
Asset Reorganizations of QOF Shareholder

- A transaction is generally not an Inclusion Event if the assets of a QOF shareholder are acquired in a qualifying section 381 transaction.
  - If, however, not all of the QOF’s shareholder’s qualifying investment is acquired, then there is an Inclusion Event with respect to the portion not acquired.
- There is an Inclusion Event if the qualifying section 381 transaction causes a QOF shareholder that is an S corporation to have an aggregate change in ownership within the meaning of Prop. Reg. § 1.1400Z2(b)-1(c)(7)(iii)(B).
Qualifying Section 381 Transactions

- The term “qualifying section 381 transaction” means a transaction described in section 381(a)(2) (not a section 332 liquidation), except for the following transactions:
  - Acquisitions by a QOF shareholder that holds a qualifying investment in the acquired QOF;
  - Acquisitions by a tax-exempt entity;
  - Acquisitions by section 1381 cooperatives;
  - Acquisitions by a QOF of a QOF shareholder that holds a qualifying investment in the acquiring QOF;
  - Section 368(a)(1)(G) reorganizations;
  - A transaction, immediately after which one QOF owns an investment in another QOF; and
  - A triangular reorganization of a QOF within the meaning of Treas. Reg. §§ 1.358-6(b)(2)(i), (ii), or (iii).

- Stock reorganizations are generally Inclusion Events.
  - For example, a section 368(a)(1)(B) acquisition of a QOF corporation is an Inclusion Event even if the acquiring corporation is itself a QOF corporation.
  - Section 351 contributions of a qualifying investment are also Inclusion Events, even if the acquiring corporation is a QOF corporation.
Qualifying Section 381 Transaction (Ex. 7)

- QOF Q merges into Y in a section 368(a)(1)(A) transaction.
  - QOF Shareholders receive no boot in the transaction.
  - Y is a QOF immediately after the merger.
  - This transaction is not an Inclusion Event.
- Likewise, a merger of X into Y is also not an Inclusion Event.
Why are Stock Reorganizations Different?

• The preamble states that all of the Inclusion Events are triggered by either a reduction or termination of the QOF investors’ direct qualifying investment or a “cashing out” of such investment.

• In the case of section 368(a)(1)(B), section 351, and certain triangular reorganization transactions, the above is generally the case only to the extent the acquiring corporation is not itself a QOF corporation.

• If, however, the acquiring corporation is itself a QOF corporation immediately after the acquisition, the QOF shareholder has maintained a direct investment in a QOF.

• For example, a section 368(a)(1)(A) merger of one QOF corporation into another QOF corporation does not appear to be meaningfully different from a section 368(a)(2)(E) acquisition by one QOF corporation of another QOF corporation.
  
  • This is especially the case because the acquiring corporation in an asset reorganization is generally free to contribute the assets to a new corporation.
What happens if, after the reorganization, QOF 2 checks LLC closed or converts it to a corporation?
QOF Separations under Section 355

- Generally, a section 355 distribution by a QOF corporation that is not a “qualifying section 355 transaction” gives rise to an Inclusion Event equal to the fair market value of the controlled corporation stock plus any boot received. Prop. Reg. § 1.1400Z2(b)-1(c)(11).
  - A “qualifying section 355 transaction” generally occurs if BOTH the distributing and the controlled corporations in the section 355 transaction are QOFs immediately after the distribution.
  - Examples confirm that the qualifying section 355 transaction can be a spin-off, split-off, or split-up.
- The distributing corporation must distribute all of the stock and securities in the controlled corporation held by it immediately before the distribution within a 30-day period (the last of such distributions is the “final distribution”).
- Treatment of boot in a section 355 transaction
  - If section 356(a) applies, there is an inclusion event equal to the amount of gain not treated as a dividend under section 356(a)(2); and
  - If section 356(b) applies, see the rule in Prop. Reg. § 1.1400Z2(b)-1(c)(8).
- Distributions by a QOF Shareholder are Inclusion Events to the extent direct ownership is reduced.
Recapitalizations

• Generally, section 368(a)(1)(E) and section 1036 transactions are not Inclusion Events to the extent the transaction does not have the result of decreasing the taxpayer’s proportionate interest in the QOF corporation. Prop. Reg. § 1.1400Z2(b)-1(c)(12)(i)(A).
  • Except as provided by Prop. Reg. § 1.1400Z2(b)-1(c)(8) (regarding section 305(b)).
  • What about recapitalizations that trigger section 305(c) (is that the reason for the (b)-1(c)(8) cross-reference)?

• Boot in a recapitalization
  • If section 301 applies, apply the rules for Distributions in (b)-1(c)(8).
  • If section 356 applies, apply the rules for boot in a qualifying section 381(a) transaction in (b)-1(c)(10).

• If there is a reduction in proportionate interest, then the Inclusion Event is equal to the reduction in the fair market value of the taxpayer’s qualifying investment in QOF stock.
Other Inclusion Events

- Section 304(a) transactions are Inclusion Events with respect to the full consideration.
  - Presumably the rule for Distributions is not applied here because there is no Inclusion Event exception for a section 351 contribution of a qualifying investment, even if the controlled corporation is itself a QOF.
May Company Regulations
Prop. Reg. § 1.337(d)-3
May Company Regulations


• The proposed rules generally would:
  • Expand the applicable definition of control by expanding the application of section 318
  • Eliminate the “Affiliated Group Exception” (comments requested)
  • Refine the application of the “Value Rule”
  • Conform the exception for current year dispositions of stock with the other proposed rules
Baseline May Company Transaction

- Corporate Partner contributes an asset with a value of $100x and a basis of $0 to partnership.
- Third party contributes stock of Corporate Partner (or cash used by the partnership to acquired stock).
- At some future date, partnership liquidates and Corporate Partner receives its own stock.
- Treasury Concern: This is effectively a redemption by Corporate Partner of $100x of stock without recognition of any section 311(b) gain in the contributed asset.
  - Treas. Reg. § 1.337(d)-3 generally provides for gain recognition in this fact pattern.
- Same rule applies if partnership, instead of acquiring an equity interest in Corporate Partner, instead acquires an equity interest “in a corporation that controls the Corporate Partner” or, if no control, “to the extent that the value of that equity interest is attributable to Stock of the Corporate Partner.”
Expansion of Control

• “Stock of the Corporate Partner” includes “equity interests in a corporation that controls the Corporate Partner within the meaning of section 304(c).” Treas. Reg. § 1.337(d)-3(c)(2).
  
  • For this purpose, current final regulations provide that “section 318(a)(1) and (3) shall not apply” for purposes of determining section 304(c).
  
  • The proposed regulations eliminate the exclusion of section 318(a)(1) and (3), but instead add an additional requirement that the controlled corporation also have “a direct or indirect equity interest in the Corporate Partner.”

• For this purpose, “a direct or indirect ownership of an equity interest in the Corporate Partner includes ownership of Stock of the Corporate Partner that would be attributed to a person under section 318(a)(2) (except that the 50-percent ownership limitation in section 318(a)(2)(C) does not apply) and under section 318(a)(4) (but otherwise without regard to section 318).”
Under current final regulations, stock of USS1, USS2 and USS3 are not in “control” of Corporate Partner because section 318(a)(3) is not applied.

Proposed Regulations would apply section 318(a)(3) causing USS1, USS2 and USS3 to satisfy the control test, but USS3 would not satisfy the new indirect ownership requirement (and thus would not be treated as Stock of the Corporate Partner).

Under current final regulations, stock of USS1 and USS2 are already Stock of the Corporate Partner under the Value Rule. Is there concern that the newly refined Value Rule would not sufficiently govern this fact pattern?

Why does USS3 not owning any stock in Corporate Partner make a difference in this fact pattern? If USS3 owned 1 share of Corporate Partner, the result would be dramatically different.
Affiliated Group Exception

- Current final regulations provide an “Affiliated Group Exception”
  - Stock of the Corporate Partner does not include any stock or other equity interests held or acquired by a partnership if all interests in the partnership's capital and profits are held by members of an affiliated group as defined in section 1504(a) that includes the Corporate Partner.

- Proposed regulations would eliminate this exception
  - Because there may be specific circumstances under which the elimination of the Affiliated Group Exception could adversely impact ordinary business transactions between affiliated group members and group-owned partnerships, the Treasury Department and the IRS request comments describing situations in which a more tailored version of the Affiliated Group Exception would be warranted.
Potential Abuse of Exception

- USP contributes high-basis stock in USS1 (less than 20%) to partnership, and Corporate Partner contributes a low basis asset of equal value.
- Seven years later, partnership liquidates, sending asset to USP and stock to Corporate Partner.
- USP can now dispose of asset using its higher basis originally attributable to the contributed USS1 stock.
- Corporate Partner converts to an LLC and liquidates, eliminating the built-in gain in the USS1 stock.
- This ability to increase the basis of an appreciated asset artificially and to eliminate the built-in gain permanently contravenes the purposes of section 337(d) and these regulations.
  - USP’s basis in USS1 is permanently reduced by this transaction – no new basis is created in this transaction.
  - USS1 could also convert to an LLC, however, eliminating any built-in gain in USP’s hands.
  - Concern seems to be the shifting of stock basis in an affiliated group member to a non-stock asset.
- Consider if it is feasible for the partnership contribution or liquidation to only create a deferred intercompany gain that is later picked up by USP if and when it disposes of the asset (or makes other use of the asset’s basis).
The Value Rule

• Current final regulations provide that, “Stock of the Corporate Partner also includes interests in any entity to the extent that the value of the interest is attributable to Stock of the Corporate Partner.”

• Proposed regulations refine this rule in two ways.
  • First, it only applies to the extent that the value of the equity interest is attributable to Stock of the Corporate Partner.
  • Second, it only applies if either:
    • The Corporate Partner has section 304(c) control of the entity; or
    • The entity owns directly or indirectly 5 percent or more, by vote or value, of the stock in the Corporate Partner.

• Proposed Regulations also clarify that the Value Rule is only relevant if an applicable equity interest is not otherwise treated as Stock of Corporate Partner.
Under this fact pattern, USP would not have section 304(c) control of Corporate Partner, and thus its stock would not be Stock of the Corporate Partner absent the Value Rule.

But, because USP would own 5 percent of the stock of Corporate Partner by value (and possibly by vote too depending how attribution works), stock of USP would be subject to the Value Rule.

Is it clear that Corporate Partner would have access to sufficient information to make this determination?

Even if PE Fund controls Corporate Partner, what if USP has invested in a fund that has invested in PE Fund or agreed to co-invest alongside PE Fund?

What if Partnership invests cash in an index fund or other investment vehicle that may not give Partnership control as to where it invests? Rely on *de minimis* rule only?
Calculating Value Attributable

• The value of an equity interest in an entity that is attributable to Stock of the Corporate Partner under the Value Rule is equal to the product of:
  • The fair market value of the equity interest; and
  • The lesser of:
    • The ratio of (A) the fair market value of the Stock of the Corporate Partner owned directly or indirectly by the applicable entity to (B) the fair market value of all the equity interests in the entity; or
    • One.

• Note that the numerator is a gross value while the denominator is a net value.
  • Consider an entity that owns $100x of Stock of the Corporate Partner, $100X of other assets, and has a liability of ($100x) owning to a third-party.
  • The numerator is $100x (the value of the Stock of the Corporate Partner)
  • The denominator is also $100x (the total equity value of the entity = $200x-$100x).
  • As a result, 100% of the value of this entity is attributable to Stock of the Corporate Partner even though only 50% of its gross assets consist of Stock of the Corporate Partner.

• Consider whether there should be a *de minimis* rule for this fraction (*e.g.*, less than 25% = 0%), particularly if the other assets in the denominator are not cash or cash equivalents.
Exception for Stock Dispositions

- Current final regulations provide an exception for Stock of the Corporate Partner that is disposed of in certain transactions before the due date (including extensions) of its federal income tax return for the taxable year of the transaction that brought it into these rules.

- Proposed regulations would make conforming changes to the language of this exception consistent with the other changes in the proposed regulations.
Final Section 965(h) Regs: What (and When) Is “Substantially All”
Overview of Section 965(h)

- U.S. shareholder of a deferred foreign income corporation may elect an 8-year, back-loaded, interest-free installment payout (section 965(h))
- Tax is assessed in inclusion year (e.g., for 2017, when U.S. shareholder and its deferred foreign income corporations are all calendar year taxpayers)
  - The statute of limitations on assessment is extended to six years for taxpayers making the section 965(h) installment election (section 965(k))
- Each entity that is a member of a consolidated group during a consolidated year has several liability for the group’s U.S. federal income tax for the year (Treas. Reg. § 1.1502-6)
Overview of Section 965(h)

• Liability for unpaid section 965(h) installments can be accelerated (and would be due on the date of the event) if there is:
  • A liquidation, sale, exchange, or other disposition of substantially all the assets of the person (including in a title 11 or similar case, in which case due the day before petition is filed) (Section 965(h)(3); Treas. Reg. § 1.965-7(b)(3)(ii)(B))

• Preamble to final section 965 regulations (84 Fed. Reg. at 1861):
  • “A comment also requested clarification of the meaning of ‘substantially all’ for purposes of the acceleration event and triggering event rules. The phrase ‘substantially all’ is used in various Code provisions and in regulations, and often is determined based on all of the facts and circumstances. Consistent with this general approach, the Treasury Department and the IRS decline to provide a bright-line definition of ‘substantially all’ in the final regulations.”
Deconstructing “Substantially All”

- What is the unit of measurement?
  - Fair market value of assets
    - Need to value assets in absence of an arm’s length transaction
  - Tax basis
    - What about high-value, low-basis assets (such as IP)
    - What about low-value, high-basis assets
  - US GAAP basis
    - What about off-balance sheet assets
    - Could an impairment of goodwill be an “other disposition”
- Should substantially all be based on a gross or net asset approach?
Deconstructing “Substantially All”

- When is substantially all measured?
  - Section 965(a) inclusion date
  - Date of the section 965(h) election
  - Date of section 965(h)(3) acceleration event
  - Combination of dates, or over some period of time

- What about “creeping” dispositions?

- Can a replacement asset theory apply?
  - What might be the parameters
  - See Rev. Rul. 88-48

- What about severe financial declines and value drops?
- What Governmental concern is in issue?
Proposed Section 382(h)(6) Regulations?
Proposed Section 382 Rules?

- Office of Information and Regulatory Affairs (OIRA) website indicates that it received on April 11, 2019 “Guidance regarding the determination of built-in gains and losses [TJCA]”, which is pending review.

- Section 382(h) provides rules for the treatment of built-in gains or losses with respect to assets owned by a loss corporation at the time of an ownership change.

- If, at the time of an ownership change, a loss corporation has a net unrealized built-in gain (NUBIG), any recognized built-in gain (RBIG) for a taxable year within the 5-year recognition period following the ownership change increases the section 382 limitation for that year, but not above the amount of the NUBIG.

- Similarly, if a loss corporation has a net unrealized built-in loss (NUBIL), any recognized built-in loss (RBIL) for a taxable year within the 5-year recognition period is a pre-change loss subject to the section 382 limitation, but not above the amount of NUBIL.
Notice 2003-65

- Notice 2003-65 provides two alternative safe harbor approaches to the determination of RBIG and RBIL: the 338 Approach and the 1374 Approach

- Under the 338 approach, items of RBIG and RBIL generally are identified by comparing the loss corporation’s actual items of income and loss with those that would have resulted if a section 338 election had been made with respect to a hypothetical purchase of all of the outstanding stock of the corporation on the change date

- Under the 338 approach, certain assets generate RBIG or RBIL even if not disposed of during the recognition period

- The 338 approach treats as RBIG or RBIL (as the case may be) the difference between:
  - the loss corporation’s actual allowable cost recovery deduction with respect to an asset and
  - the hypothetical cost recovery deduction that would have been allowable with respect to the asset had an election under section 338 been made for a purchase of the loss corporation’s stock
Facts: LossCo has a NUBIG of $300,000 attributable to various non-amortizable assets with an aggregate fair market value of $710,000 and an aggregate adjusted basis of $500,000, and a patent with a fair market value of $120,000 and an adjusted basis of $30,000. The patent is an amortizable section 197 intangible, for which 10 years of tax depreciation remain. In Year 1 of the recognition period, LossCo has gross income of $75,000.

In year 1, LossCo has $5,000 of RBIG attributable to patent

- $8,000 amortization deduction would have been allowed had a section 338 election been made with respect to hypothetical purchase ($120,000 divided by 15 year amortization period), over
- $3,000 actual allowable amortization deduction ($30,000 divided by 10 year remaining amortization period)
The TJCA amended section 168(k) to extend and modify the additional first year depreciation deduction for qualified property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2027.

- The additional first year depreciation deduction is equal to 100% for qualified property placed in service after Sept. 27, 2017 and before Jan. 1, 2023.
- The TJCA also removed the requirement that the original use of the property had to commence with the taxpayer so that certain used property qualifies for the additional first year depreciation deduction.

Notice 2018-30 provides that Treasury/IRS have determined that the hypothetical cost recovery deduction using the additional first year depreciation allowed under Section 168(k) does not provide a reasonable estimate of the income or expense produced by a built-in gain or loss asset during the recognition period.

- Accordingly, the Notice provides that RBIG and RBIL under the 338 approach (and 1374 approach, to the extent relevant) are determined without regard to section 168(k).

- Notice 2018-30 “is effective for any ownership changes (as defined in section 382(g)) that occur after May 8, 2018.”