

[Federal Register: March 18, 1994]

DEPARTMENT OF THE TREASURY
26 CFR Parts 1, 301 and 602

[TD 8530]
RIN 1545-AQ60

Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change; Special Rule for Value of a Loss Corporation Under the Jurisdiction of a Court in a Title 11 Case

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations that provide guidance on determining the value of a loss corporation following an ownership change to which section 382(l)(6) of the Internal Revenue Code of 1986 applies. Under sections 382 and 383, the value of the loss corporation, together with certain other factors, determines the rate at which certain pre-change tax attributes may be used to offset post-change income and tax liability. These rules are needed to provide guidance to taxpayers concerning compliance with sections 382 and 383.

DATES: These regulations are effective as of March 17, 1994.
For date of applicability of Sec. 1.382-9, see Sec. 1.382-9(p).

FOR FURTHER INFORMATION CONTACT: Robert Liquerian of the Office of the Assistant Chief Counsel (Corporate), Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20224 (Attention CC:DOM:CORP:T:R) or telephone (202) 622-7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1324. The estimated annual burden per respondent with respect to the Sec. 1.382-9(i) election varies from 5 to 30 minutes, depending on individual circumstances, with an estimated average of 15 minutes. The estimated annual burden per respondent with respect to the Sec. 1.382-9(p)(2) election varies from 5 to 30 minutes, depending on individual circumstances, with an estimated average of 15 minutes.

These estimates are approximations of the average time expected to be necessary for a collection of information. They are based on such information as is available to the Internal Revenue Service. Individual respondents or recordkeepers may require more or less time, depending on their particular circumstances.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn:

Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

The collections of information in this regulation are in Secs. 1.382-9(i) and 1.382-9(p)(2). This information serves as evidence of an election to apply section 382(l)(6) of the Internal Revenue Code (Code) in lieu of section 382(l)(5) and an election to apply retroactively the provisions of the final regulations. The information is required by the Internal Revenue Service to assure that a loss corporation uses the proper amount of carryover attributes following specified types of ownership changes.

Background

This document contains final regulations to be added to 26 CFR part 1 under section 382 of the Code. The Service published proposed amendments to the regulations under section 382 in the Federal Register on August 6, 1992 (57 FR 34736). See also 1992- 2 C.B. 616. The rules are effective with respect to any ownership change occurring on or after March 17, 1994. However, a loss corporation may elect to apply the rules in the final regulations in their entirety to any ownership change occurring before March 17, 1994, including ownership changes to which section 382(l)(5) applied. Written comments were received, but no public hearing was held as none was requested.

Explanation of Provisions

Section 382(l)(6) of the Code provides a special valuation rule for certain ownership changes that result from a title 11 or similar case to which section 382(l)(5) does not apply. Under this special valuation rule, the value of the loss corporation reflects any increase in value resulting from any surrender or cancellation of creditors' claims in the bankruptcy transaction. The proposed regulations provide rules regarding the application of this special valuation rule and the coordination of that rule with other statutory rules related to the value of a loss corporation.

The proposed regulations, with a few changes to respond to comments, are adopted as final regulations. The changes, as well as certain comments and suggestions that were not adopted in the final regulations, are discussed below.

The proposed regulations provide that the value of a loss corporation under the special valuation rule of section 382(l)(6) of the Code is the lesser of the value of its stock immediately after the ownership change, or the value of its assets (determined without regard to liabilities) immediately before the ownership change. The proposed regulations further provide that the value of the loss corporation's pre-change assets is reduced by the amount of any capital contribution to which section 382(l)(1) applies. The proposed regulations could be read to require such a reduction even in cases in which the value of the pre-change assets would not reflect the value of the contributed assets, as would be the case, for example, when the contribution is concurrent with the ownership change. To avoid this possibility, the final regulations provide that the value of the pre-change assets of the loss corporation is determined without regard to any capital contribution to which section 382(l)(1) applies.

Section 382(l)(5)(H) of the Code allows a loss corporation to elect not to have the provisions of section 382(l)(5) apply. The proposed regulations provide that this election must be made by the due date (including extensions) of the loss corporation's return for the taxable year in which the ownership change occurs. The proposed regulations also provide that this election is irrevocable. One commenter suggested that the final regulations allow a taxpayer to file an election after the prescribed due date upon a showing of reasonable cause. The commenter also suggested that taxpayers be allowed to revoke an election.

The Treasury and the Service believe that the general standards and procedures under Sec. 301.9100-1 of the Procedure and Administrative Regulations provide adequate relief for taxpayers seeking to make a retroactive election under section 382(l)(5)(H) of the Code for an ownership change occurring on or after March 17, 1994. A specific regulatory provision allowing an election after the prescribed due date or allowing revocation of an election would inappropriately allow the loss corporation the benefit of hindsight to determine the relative advantages of sections 382(l)(5) and 382(l)(6). Therefore, the final regulations retain the rules of the proposed regulations that the election is irrevocable and must be made on the return of the loss corporation for the taxable year including or ending with the change date. Because of uncertainties that existed with respect to the application of sections 382(l)(5) and 382(l)(6) before issuance of final regulations, transitional rules are provided in Secs. 1.382-9(d)(6)(ii) and (p)(2) that allow taxpayers to retroactively file or revoke a prior section 382(l)(5)(H) election for an ownership change occurring before March 17, 1994.

A commenter suggested that the final regulations clarify that a loss corporation need not use liquidation value in determining the value of its gross assets, and that the corporation may take into account the value of any intangible assets, such as goodwill and going concern value. The Treasury and the Service have determined that the proposed clarification is unnecessary. The valuation rule refers to "the value of the loss corporation's pre-change assets," without limitation to either liquidation value or tangible assets. Therefore, if a loss corporation is able to establish the existence and value of any intangible assets, that value may be taken into account.

The proposed regulations provide that the amount received by a loss corporation for the issuance of debt is treated as a capital contribution that must be excluded from the value of its pre-change assets if the issuance of the debt is part of a plan a principal purpose of which is to increase the value of the loss corporation under the rules of the proposed regulations. A commenter questioned the appropriateness of treating an issuance of debt as a capital contribution. The commenter also suggested that, if the proposed rule is retained, it should be subject to an exception for cases in which the loss corporation uses the proceeds of the debt to fund operating expenses.

The final regulations retain the rule of the proposed regulations regarding the treatment of certain debt issuances as capital contributions. The Treasury and the Service believe that this rule effectuates the principles of section 382(l)(1) of the Code. The Treasury and the Service will consider possible exceptions to this rule in the context of providing general guidance under section 382(l)(1).

Section 382(l)(5)(D) of the Code provides that, if a second ownership change occurs within two years after an ownership change to which section 382(l)(5) applies, the section 382 limitation with respect to the second ownership change is zero. A commenter suggested that the final regulations provide that the zero limitation applies only to losses incurred prior to the first ownership change. The final regulations do not provide such a rule because it would be inconsistent with the language of section 382(l)(5)(D).

The proposed regulations provide that the value of the stock of a loss corporation does not include stock issued with a principal purpose of increasing the section 382 limitation without subjecting the investment to the entrepreneurial risks of corporate business operations. A commenter requested that the final regulations provide further guidance regarding the stock subject to this rule. The Treasury and the Service believe that additional guidance is not necessary because the test sufficiently limits the scope of this anti-abuse provision.

The proposed regulations provide that the value of any stock issued in connection with the ownership change cannot exceed the value of the

property received by the loss corporation in consideration for the stock. A commenter questioned the appropriateness of this limitation. The final regulations, however, retain the limitation to preclude any claims that the stock is worth more than what was paid for it. The limitation avoids the valuation disputes that would result from these claims. Further, the limitation on losses provided by section 382(a) of the Code is intended to measure the earnings power of the corporation. When a loss corporation issues stock, it increases its earnings power by the value of the property it receives, regardless of whether that value represents a fair price for the stock.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking for the regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Robert Liquerman, Office of the Assistant Chief Counsel (Corporate), Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, in matters of both substance and style.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301 and 602 are amended to read as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entry for Sec. 1.382-9 to read as follows:

Authority: 26 U.S.C. 7805 * * * Section 1.382-9 also issued under 26 U.S.C. 382(l)(1)(B), (l)(3), and (m).

Par. 2. Section 1.382-1 is amended as follows:

1. The entries for Sec. 1.382-9, paragraphs (f), (g), and (h) continue to be reserved.

2. The entries for Sec. 1.382-9, paragraphs (i), (j), (k), (l), (m)(2), (n), and (p) are added to read as follows:

Sec. 1.382-1 Table of contents.

* * * * *

Sec. 1.382-9 Special rules under section 382 for corporations under the jurisdiction of a court in a title 11 or similar case.

* * * * *

- (f) through (h) [Reserved].
- (i) Election not to apply section 382(l)(5).
- (j) Value of the loss corporation in an ownership change to which section 382(l)(6) applies.
- (k) Rules for determining the value of the stock of the loss corporation.
 - (1) Certain ownership interests treated as stock.
 - (2) Coordination with section 382(e)(2).
 - (3) Coordination with section 382(e)(3).
 - (4) Coordination with section 382(l)(1).
 - (5) Coordination with section 382(l)(4).
 - (6) Special rule for stock not subject to the risk of corporate business operations.
 - (i) In general.
 - (ii) Coordination of special rule and other rules affecting value.
 - (7) Limitation on value of stock.
- (l) Rules for determining the value of the loss corporation's pre-change assets.
 - (1) In general.
 - (2) Coordination with section 382(e)(2).
 - (3) Coordination with section 382(e)(3).
 - (4) Coordination with section 382(l)(1).
 - (5) Coordination with section 382(l)(4).
- (m) * * *
- (2) Under section 382(l)(6).
- (n) Ownership change in a title 11 or similar case succeeded by another ownership change within two years.
 - (1) Section 382(l)(5) applies to the first ownership change.
 - (2) Section 382(l)(6) applies to the first ownership change.

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- (p) Effective date for rules relating to section 382(l)(6).
 - (1) In general.
 - (2) Ownership change to which section 382(l)(6) applies occurring before March 17, 1994.

* * * * *

Par. 3. Section 1.382-9 is amended as follows:

1. Paragraphs (f) through (h) continue to be reserved.
2. Paragraphs (i) through (l), (m)(2), (n), and (p) are added to read as follows:

Sec. 1.382-9 Special rules under section 382 for corporations under the jurisdiction of a court in a title 11 or similar case.

* * * * *

- (f) through (h) [Reserved]
- (i) Election not to apply section 382(l)(5). Under section 382(l)(5)(H), a loss corporation may elect not to have the provisions of section 382(l)(5) apply to an ownership change in a title 11 or similar case. This election is irrevocable and must be made by the due date (including any extensions of time) of the loss corporation's tax

return for the taxable year which includes the change date. The election is to be made by attaching the following statement to the tax return of the loss corporation for that taxable year: ``This is an Election Under Sec. 1.382-9(i) not to Apply the Provisions of Section 382(l)(5) to the Ownership Change Occurring Pursuant to a Plan of Reorganization Confirmed by the Court on [Insert Confirmation Date].''

(j) Value of the loss corporation in an ownership change to which section 382(l)(6) applies. Section 382(l)(6) applies to any ownership change occurring pursuant to a plan of reorganization in a title 11 or similar case to which section 382(l)(5) does not apply. In such case, the value of the loss corporation under section 382(e) is equal to the lesser of--

(1) The value of the stock of the loss corporation immediately after the ownership change (determined under the rules of paragraph (k) of this section); or

(2) The value of the loss corporation's pre-change assets (determined under the rules of paragraph (l) of this section).

(k) Rules for determining the value of the stock of the loss corporation--(1) Certain ownership interests treated as stock. For purposes of paragraph (j)(1) of this section--

(i) Stock includes stock described in section 1504(a)(4) and any stock that is not treated as stock under Sec. 1.382-2T(f)(18)(ii) for purposes of determining whether a loss corporation has an ownership change; and

(ii) Stock does not include an ownership interest that is treated as stock under Sec. 1.382-2T(f)(18)(iii) for purposes of determining whether a loss corporation has an ownership change.

(2) Coordination with section 382(e)(2). In the case of a redemption or other corporate contraction occurring after and in connection with the ownership change, the value of the stock of the loss corporation under paragraph (j)(1) of this section is reduced under section 382(e)(2).

(3) Coordination with section 382(e)(3). If the loss corporation is a foreign corporation, in determining the value of the stock under paragraph (j)(1) of this section, only items treated as connected with the conduct of a trade or business in the United States are taken into account.

(4) Coordination with section 382(l)(1). Section 382(l)(1) does not apply in determining the value of the stock of the loss corporation under paragraph (j)(1) of this section.

(5) Coordination with section 382(l)(4). If, immediately after the ownership change, the loss corporation has substantial nonbusiness assets (as determined under section 382(l)(4)(B) taking into account only those assets the loss corporation held immediately before the ownership change), the value of the stock of the loss corporation under paragraph (j)(1) of this section is reduced by the excess of the value of such nonbusiness assets over those assets' share of the loss corporation's indebtedness (determined under section 382(l)(4)(D) taking into account the loss corporation's assets and liabilities immediately after the ownership change).

(6) Special rule for stock not subject to the risk of corporate business operations--(i) In general. The value of the stock of the loss corporation under paragraph (j)(1) of this section is reduced by the value of stock that is issued as part of a plan one of the principal purposes of which is to increase the section 382 limitation without subjecting the investment to the entrepreneurial risks of corporate business operations.

(ii) Coordination of special rule and other rules affecting value. If the value of the loss corporation is modified under another rule affecting value, appropriate adjustments are to be made so that such modification is not duplicated under this paragraph (k)(6).

(7) Limitation on value of stock. For purposes of paragraph (j)(1) of this section, the value of stock of the loss corporation issued in connection with the ownership change cannot exceed the cash and the

value of any property (including indebtedness of the loss corporation) received by the loss corporation in consideration for the issuance of that stock.

(l) Rules for determining the value of the loss corporation's pre-change assets--(1) In general. Except as otherwise provided in this paragraph (l), the value of the loss corporation's pre-change assets is the value of its assets (determined without regard to liabilities) immediately before the ownership change.

(2) Coordination with section 382(e)(2). Section 382(e)(2) does not apply in determining the value of the pre-change assets of the loss corporation under paragraph (j)(2) of this section.

(3) Coordination with section 382(e)(3). If the loss corporation is a foreign corporation, in determining the value of the pre-change assets under paragraph (j)(2) of this section, only assets treated as connected with the conduct of a trade or business in the United States are taken into account.

(4) Coordination with section 382(l)(1). For purposes of paragraph (j)(2) of this section, the value of the pre-change assets of the loss corporation is determined without regard to the amount of any capital contribution to which section 382(l)(1) applies. For purposes of applying this paragraph (l)(4), the receipt of cash or property by the loss corporation in exchange for the issuance of indebtedness is considered a capital contribution if it is part of a plan one of the principal purposes of which is to increase the value of the loss corporation under paragraph (j) of this section.

(5) Coordination with section 382(l)(4). If, immediately after the ownership change, the loss corporation has substantial nonbusiness assets (as determined under section 382(l)(4)(B) taking into account only those assets the loss corporation held immediately before the ownership change), the value of the loss corporation's pre-change assets is reduced by the value of the nonbusiness assets.

(m) * * *

(2) Under section 382(l)(6). If section 382(l)(6) applies to an ownership change of a loss corporation, section 382(c) and the regulations thereunder apply to the ownership change.

(n) Ownership change in a title 11 or similar case succeeded by another ownership change within two years--(1) Section 382(l)(5) applies to the first ownership change. If section 382(l)(5) applies to an ownership change and, within the two-year period immediately following such ownership change, a second ownership change occurs, section 382(l)(5) cannot apply to the second ownership change and the section 382(a) limitation with respect to the second ownership change is zero.

(2) Section 382(l)(6) applies to the first ownership change. If the value of a loss corporation in an ownership change was determined under section 382(l)(6) and a second ownership change occurs within the two-year period immediately following the first ownership change, the value of the loss corporation under section 382(e) with respect to the second ownership change is not reduced under section 382(l)(1) for any increase in value of the loss corporation previously taken into account under section 382(l)(6) with respect to the first ownership change.

* * * * *

(p) Effective date for rules relating to section 382(l)(6)--(1) In general. Paragraphs (i), (j), (k), (l), (m)(2), and (n)(2) of this section apply to any ownership change occurring on or after March 17, 1994.

(2) Ownership change to which section 382(l)(6) applies occurring before March 17, 1994. In the case of an ownership change occurring before March 17, 1994, the loss corporation may elect to apply the rules of paragraphs (j), (k), (l), (m)(2), and (n)(2) of Sec. 1.382-9 in their entirety. The election must be made by the later of the due date (including any extensions of time) of the loss corporation's tax return for the taxable year which includes the change date or the date that the loss corporation files its first tax return after May 16,

1994. The election is made by attaching the following statement to the return: ``This is an Election to Apply Secs. 1.382-9 (j), (k), (l), (m)(2), and (n)(2) of the Income Tax Regulations to the Ownership Change Occurring Pursuant to a Plan of Reorganization Confirmed by the Court on [Insert Confirmation Date].'' In connection with making this election, on the same return the loss corporation may also elect not to apply section 382(l)(5) to the ownership change under paragraph (i) of this section (if the loss corporation has not already done so pursuant to Sec. 301.9100-7T(a) of this chapter). If, under the applicable statute of limitations, the loss corporation may file amended returns for the year of the ownership change and all subsequent years (an open year), an electing loss corporation must file an amended return for each prior affected year to reflect the elections. If, under the applicable statute of limitations, the loss corporation may not file an amended return for the year of the ownership change or any subsequent year (a closed year), an electing loss corporation must file an amended return for each affected open year to reflect the elections and the section 382 limitation resulting from the ownership change must be appropriately adjusted for the earliest open year (or years) to reflect the difference between the amount of pre-change losses actually used in closed years and the amount of pre-change losses that would have been used in such years applying the rules of paragraphs (j), (k), (l), (m)(2), (n)(2) of this section to the ownership change.

PART 301--PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation paragraphs for Sec. 301.9100-7T are removed from the authority citation for part 301, and the following entry is added:

Authority: 26 U.S.C. 7805 * * * Section 301.9100-7T also issued under 26 U.S.C. 42, 48, 56, 83, 141, 142, 143, 145, 147, 165, 168, 216, 263, 263A, 448, 453C, 468B, 469, 474, 585, 616, 617, 1059, 2632, 2652, 3121, 4982, 7701; and under the Tax Reform Act of 1986, 100 Stat. 2746, sections 203, 204, 243, 311, 646, 801, 806, 905, 1704, 1801, 1802, and 1804. * * *

Par. 5. Section 301.9100-7T is amended as follows:

Sec. 301.9100-7T [Amended]

1. The table in paragraph (a)(1) is amended by removing each line, from each column, where the entry for ``section 621(a)'' appears.
2. Paragraph (a)(4)(ii) is amended by removing each line, from each column, where the entry ``621(a)'' appears.

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Sec. 602.101 [Amended]

Par. 7. The table of control numbers in Sec. 602.101(c) is amended by revising the entry for Sec. 1.382-9 to read as follows:

``1.382-91
1545-1260, 1545-1324''.
Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: February 24, 1994.
Leslie Samuels,
Assistant Secretary of the Treasury.
[FR Doc. 94-6086 Filed 3-17-94; 8:45 am]
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