

Affiliated Corporations and Consolidated Returns

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Treas. Reg. § 1.1502-76



Taxable Year of Consolidated Group: §1.1502-76 (Current Law)

- ▶ Group must use common parent's taxable year (§1.1502-76(a)(1))
- ▶ Consolidated return must include income of subsidiary only for portion of year it is a member of the group (§1.1502-76(b)(1)(i))
- ▶ The years that begin/end with a subsidiary becoming or ceasing to be a member of a consolidated group are treated as separate tax years for all US federal income tax purposes (§1.1502-76(b)(2)(i))

Taxable Year of Consolidated Group: §1.1502-76 (Current Law)

- ▶ The due date of the first short-period tax return for a subsidiary ending on the day prior to it joining the consolidated group is set forth in §§1.1502-76(b)(4) and (c), which is generally the earlier of the subsidiary's due date determined without regard to §1.1502-76 or the consolidated group's due date
 - ▶ Special consideration must be given to section 381 transactions of the subsidiary on joining the consolidated group or during the consolidated group's tax year in which the subsidiary joins the consolidated group
- ▶ If a departing member has NOLs, only that portion NOT absorbed by the old group through the end of the year of the departure is carried forward by the departing member (§1.1502-21(b)(2)(ii))

Taxable Year of Consolidated Group: §1.1502-76 (Current Law)

▶ Timing

- ▶ Departing/Joining Member is deemed to leave or enter group at close of the day of the event for all US federal income tax purposes (the End of the Day Rule) (§1.1502-76(b)(1)(ii)(A)(1))
- ▶ Appropriate adjustments must be made if another provision of the Code or the underlying regulations contemplate the event occurring before or after S's change in status
 - ▶ For example, S's items accelerated under -13 immediately before it becomes a nonmember are taken into account in determining the basis of S's stock under -32
- ▶ Next day rule: Certain items incurred on the day of change in status are deemed to occur on next day (§1.1502-76(b)(1)(ii)(B))

Taxable Year of Consolidated Group: §1.1502-76 (Current Law)

- ▶ Special rules for S Corporations (§1.1502-76(b)(1)(ii)(A)(2))
 - ▶ An S corporation joining a consolidated group becomes a member at the beginning of the day of the acquisition
 - ▶ This difference in timing for S corporations is intended to avoid a one-day C corporation return prior to joining the consolidated group since the S corporation's S status terminates at the close of the day PRIOR to the acquisition (section 1362)

Next Day Rule: §1.1502-76(b)(1)(ii)(B)

- ▶ “If on the day of S’s change in status as a member, a transaction occurs that is properly allocable to the portion of S’s day after the event resulting in the change, S and all persons related to S under section 267(b) immediately after the event must treat the transaction for all Federal income tax purposes as occurring at the beginning of the following day. A determination as to whether a transaction is properly allocable to the portion of S’s day after the event will be respected if it is reasonable and consistently applied by all affected persons.”

Next Day Rule: § 1.1502-76(b)(1)(ii)(B)

For this purpose, the factors are among those to be considered:

- ▶ Whether income, gain, deduction, loss, and credit are allocated inconsistently;
- ▶ If the item is from a transaction with respect to S stock, whether it reflects ownership of the stock before or after the event;
- ▶ Whether the allocation is inconsistent with other requirements under the Code; and
- ▶ Whether other facts exist, such as a prearranged transaction or multiple changes of S's status.



Taxable Year of Consolidated Group: §1.1502-76

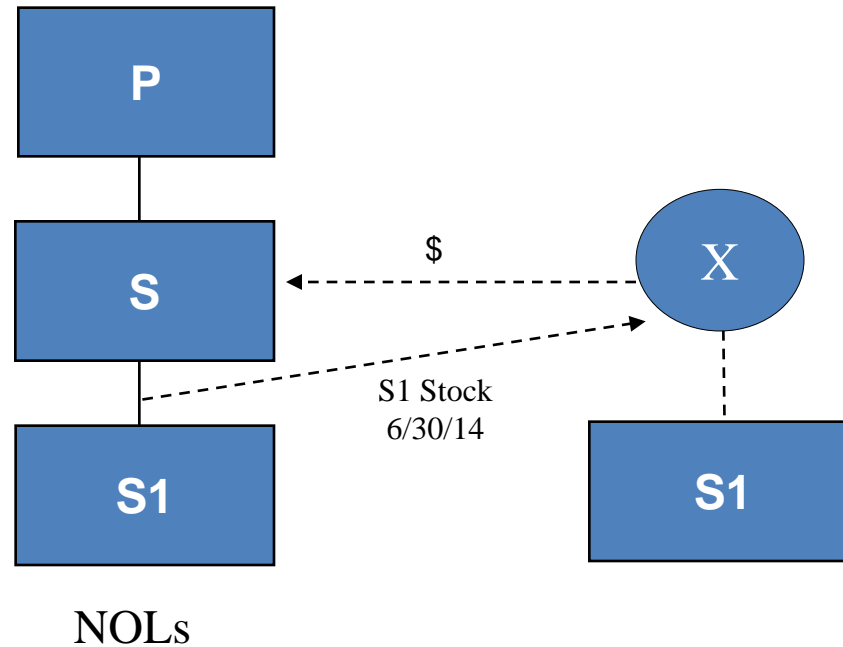
- ▶ Allocation of income between separate return and consolidated return periods
 - ▶ Close the books (§1.1502-76(b)(2)(i))
 - ▶ Pro rata allocation (§1.1502-76(b)(2)(ii))
- ▶ Consolidated group is permitted to “ratably allocate” (as opposed to “closing the books”) the income of a departing/joining member only if the member is not required to change its year end and makes an election to ratably allocate its income for the year.



Taxable Year of Consolidated Group: §1.1502-76

- ▶ Certain extraordinary items may not be ratably allocated:
 - ▶ Section 1231 gains & losses
 - ▶ Capital gains & losses
 - ▶ Income from discharge of indebtedness
 - ▶ Subpart F income
 - ▶ PFIC income
 - ▶ NOL carryovers
 - ▶ Section 481(a) adjustments
 - ▶ Credits from activity or items that are not ratably allocated (e.g., the purchase of property)
 - ▶ Tort settlements
 - ▶ Compensation related deductions
 - ▶ Dividends from section 304 controlled but unaffiliated corporations

Taxable Year of Consolidated Group: §1.1502-76



Suppose P, S and S1 file consolidated returns? Assume P, S and S1 are calendar year taxpayers. During the first half of 2014, S1 has income of \$300. During the last half of 2014, S1 has a loss of \$100. S1 also has NOLs. How is this income/loss reported by the parties? Will S1 be allocated its NOLs?

Proposed Regulations: §1.1502-76

- ▶ On March 5, the Service released proposed regulations that would modify and clarify the rules under §1.1502-76, including a replacement of the Next Day Rule
- ▶ These regulations are generally proposed to be effective for corporations joining/leaving a consolidated group after the regulations are finalized
- ▶ The preamble observes that the regulations are necessary in order to resolve uncertainty regarding the appropriate application of the current Next Day Rule and to tailor the rule to clearly reflect taxable income

Proposed Regulations: §1.1502-76

- ▶ The Proposed Regulations would remove the current Next Day Rule and replace it with a rule that:
 - ▶ Applies only to extraordinary items resulting from transactions on the day of the change in status but AFTER the event causing the change
 - ▶ Is mandatory in its application
 - ▶ Expressly excludes an extraordinary item that occurs simultaneously with the event causing the change in status
 - ▶ Clarifies that fees for services rendered in connection with the change in status constitute an extraordinary item by inclusion as a “compensation-related deduction”
- ▶ The Proposed Regulations would also:
 - ▶ Include a Previous Day Rule similar to the Next Day Rule for situations where an S corporation joins a consolidated group
 - ▶ Modify the End of the Day Rule to restrict its scope to the reporting of the joining/departing member’s tax items
 - ▶ Modify the treatment of items recognized on the acquisition date for purposes of Section 382(h) relating to the treatment of NUBIG and NUBIL and Section 1374 relating to the S corporation built-in gain tax

Proposed Regulations: §1.1502-76

- ▶ The Proposed Regulations would also:
 - ▶ Clarify that the anti-abuse rule in §1.1502-76(b)(3) may apply to a modification of an existing contract or other agreement in anticipation of a member's change in status
 - ▶ Provide that the short taxable years resulting from intercompany transactions to which section 381(a) applies are not taken into account in determining the carryover period for a tax items of the distributor or transferor or for purposes of section 481(a)
 - ▶ Provide that the due date for filing a joining member's short period tax return for the period ending on joining the consolidated group is not accelerated if the member ceases to exist in the same consolidated return year

Proposed Regulations: §1.1502-76

- ▶ The Proposed Regulations also request comments on:
 - ▶ Whether the list of extraordinary items should be modified,
 - ▶ Whether an extraordinary item should be excluded from the Next Day Rule or the Previous Day Rule,
 - ▶ Whether the ratable allocation method should be retained, and
 - ▶ Whether the rules that treat a partnership interest as exchanged for purposes of allocating partnership items between the member's short tax years should be applied to foreign corporations with respect to deemed income inclusions under the Code (e.g., the Subpart F income of a CFC)

Proposed Next Day Rule: §1.1502-76(b)(1)(ii)(A)(1)

- ▶ For purposes of determining the period in which S must report income, gain, deduction, loss, or credit:
 - ▶ S is treated as becoming or ceasing to be a member at the end of the day on which its status as a member changes
- ▶ If an extraordinary item (as defined) results from a transaction that occurs on the day of S's change in status as a member but after the event resulting in the change and the item would be taken into account by S on that day:
 - ▶ The transaction resulting in the extraordinary item is treated as occurring at the beginning of the following day for purposes of determining the period in which S must report the item
 - ▶ The next day rule does not apply to any extraordinary item that becomes includible or deductible simultaneously with the event that causes the change in S's status

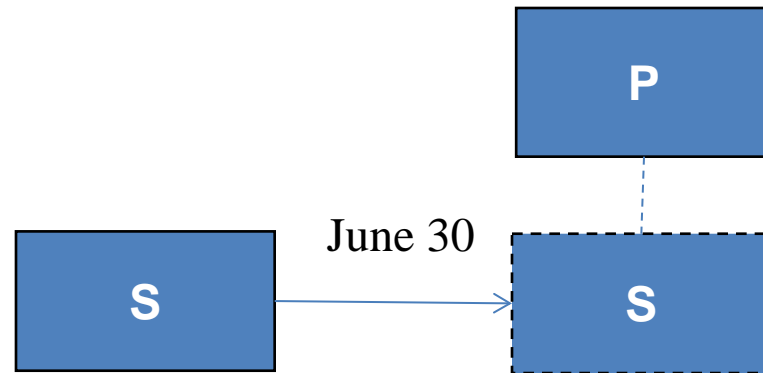
Proposed Previous Day Rule: §1.1502-76(b)(1)(ii)(B)(2)

- ▶ If an S corporation has an extraordinary item (as defined) that results from a transaction that occurs on the day S joins a consolidated group but before the event resulting in the change and the item would be taken into account by S on that day:
- ▶ The transaction resulting in the extraordinary item is treated as occurring at the end of the previous day for purposes of determining the period in which S must report the item

Proposed Regulations: Sections 382 and 1374

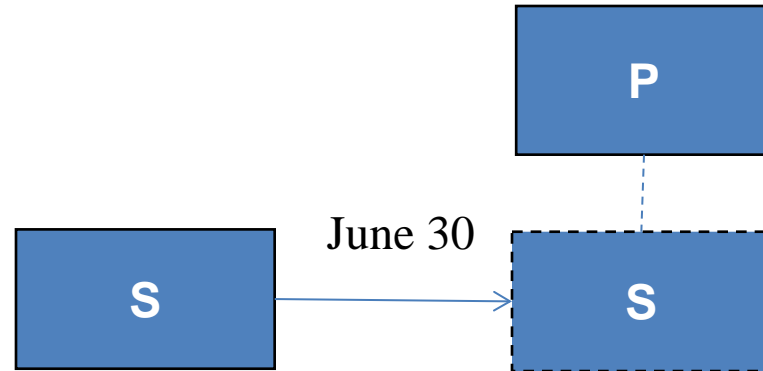
- ▶ The Proposed Regulations would also modify the application of sections 382 and 1374 to corporations joining/departing a consolidated group
- ▶ The proposed change would treat the End of the Day Rule and the Next Day Rule as applicable for purposes of Section 382(h)
- ▶ Accordingly, if the day of S's change in status is also a change date, the determination of NUBIG/NUBIL "will reflect the application of both the End of the Day Rule and the Next Day Rule"
- ▶ Items includible in the taxable year that ends as a result of S's change in status (i.e., on the change date) are not treated as occurring in the recognition period notwithstanding section 382(h)(7)(A), which includes the change date in the recognition period for purposes of section 382(h)

Example 1 – Stock Option Payments



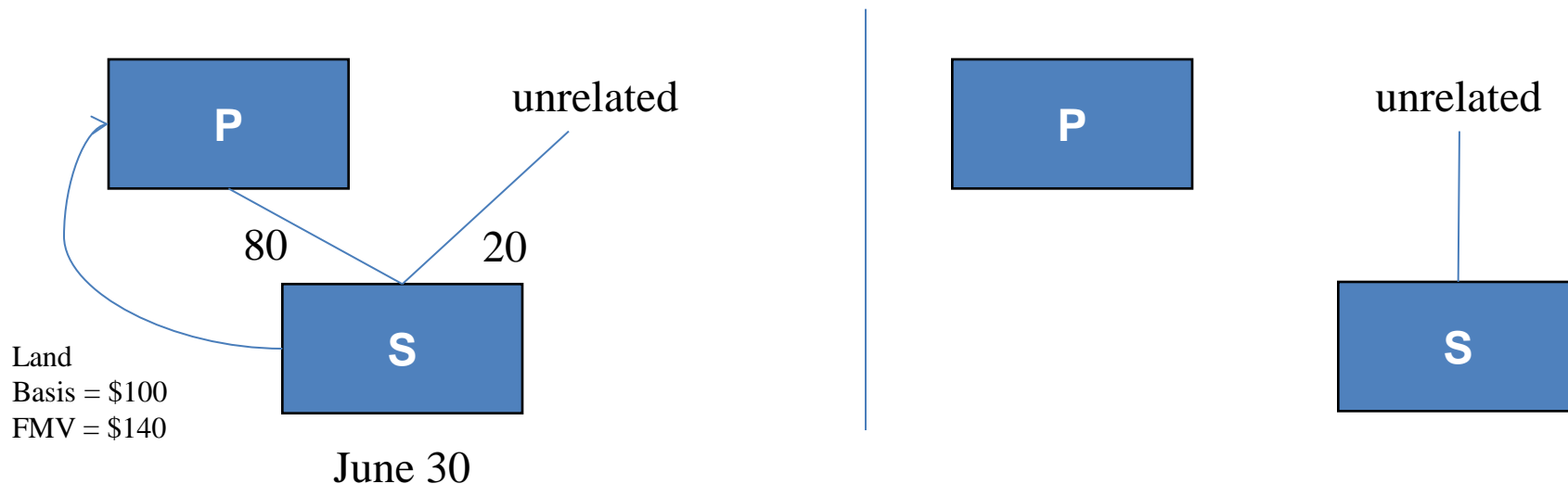
- P purchases S on June 30 pursuant to a stock purchase agreement.
- At the time of the stock purchase, S has outstanding nonqualified stock options to issued to certain employees.
- Under the option agreements, S is obligated to pay its employees certain amounts in cancellation of their stock options upon a change in control. Several days after the closing of the stock purchase, S pays its employees the amounts required under the option agreements.
- Deduction arising from S's liability to pay its employees in cancellation of their stock options in connection with S's change in status is an extraordinary item that cannot be prorated and must be allocated to June 30.
- Next day rule is inapplicable because S's liability to pay its employees becomes deductible on the day of S's change in status.
- Same result for success-based fees paid to consultants contingent on the successful closing of the stock purchase.

Example 2 – Sale of Unwanted Assets



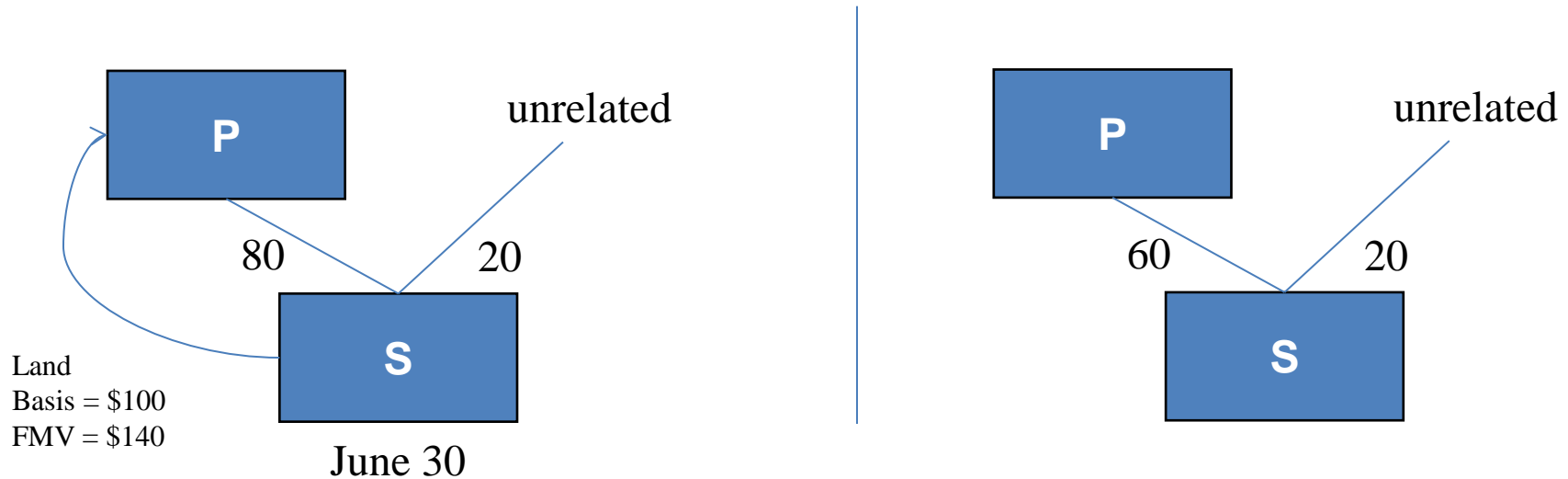
- The facts are the same as in example 1.
- After closing on June 30, S sells to an unrelated party certain assets used in S's trade or business that are not wanted by the P group.
- Gain or loss on the sale of these assets is an extraordinary item that results from a transaction that occurs on the day of S's change in status, but after the event resulting in the change.
- Consequently, under the next day rule, the gain or loss must be reported on S's tax return for the period beginning July 1.

Example 3 - Redemption



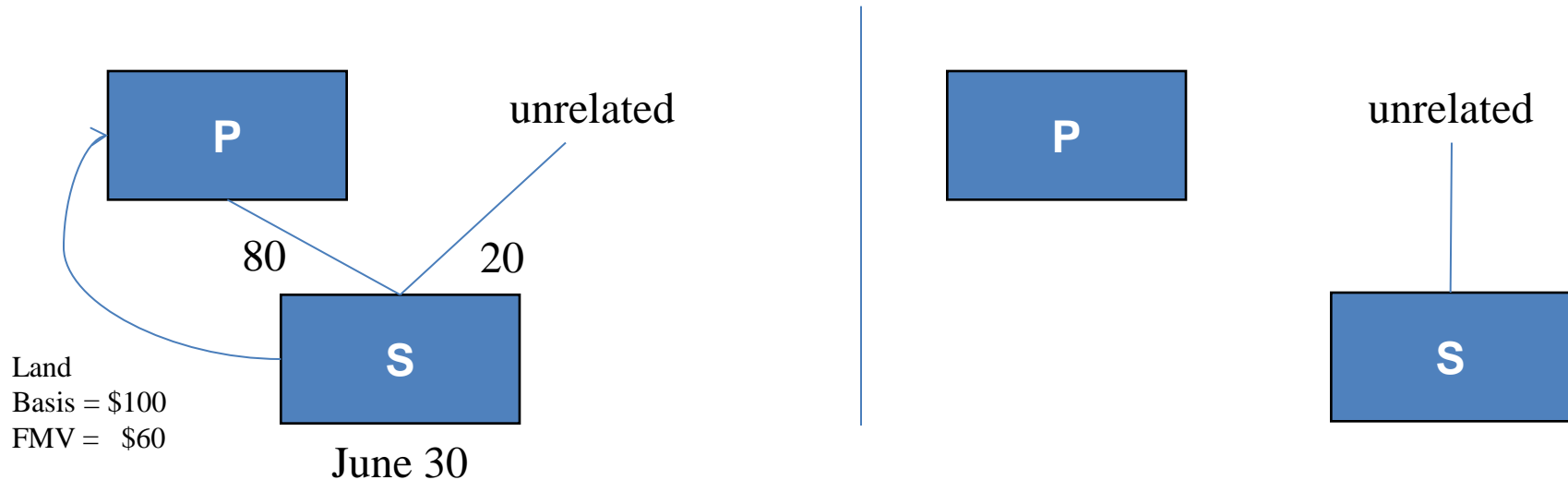
- P owns 80 shares of S's only class of outstanding stock, and an unrelated person owns the remaining 20 shares.
- On June 30, S distributes land with a basis of \$100 and a fair market value of \$140 to P in redemption of all of P's stock in S.
- As a result of the redemption, S ceases to be a member of P's consolidated group on June 30. S will recognize \$40 of gain under section 311(b) on the distribution of the land to P.
- The next day rule is inapplicable because S's gain becomes includible on the day of S's change in status simultaneously with the event that causes S's change in status. Consequently, S's gain must be reported under the end of day rule in its taxable year ending June 30, during which S was a member of the P group.
- Under Treas. Reg. § 1.1502-32(b)(2)(i), P's basis in its S stock is increased to reflect S's \$40 gain immediately before the redemption of S's stock.

Example 4 – Partial Redemption



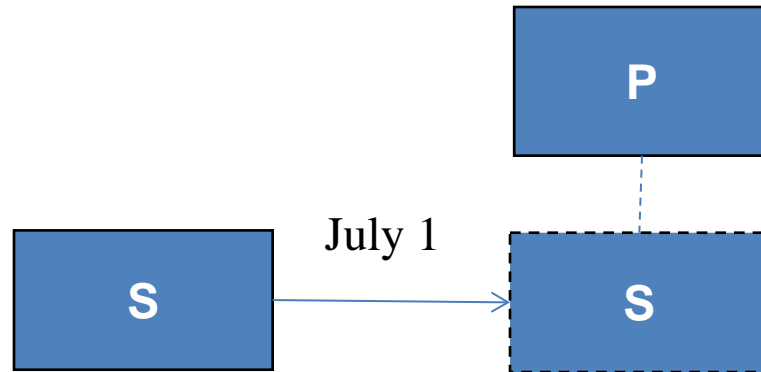
- The facts are the same as in Example 3, except that S distributes the land to P in redemption of 20 shares of P's stock in S. Thus, immediately after the redemption, P owns 75% (60/80) of S's outstanding stock, and S's minority shareholder owns 25% (20/80).
- The redemption does not satisfy the requirements of section 302(b) and is treated under section 302(d) as a distribution to which section 301 applies.
- The end of day rule does not apply for purposes of determining whether P and S are members of the same consolidated group immediately after the redemption. Because P owns only 75% of S's stock immediately after the redemption, the distribution is not an intercompany distribution described in § 1.1502-32(f)(2)(i). That, P may not exclude any amount of the distribution that is a dividend, and P's basis in S's stock is not reduced under § 1.1502-32(b)(2)(iv). P may be entitled to a dividends received deduction under section 243(c)(but see section 1059(e)).
- Because S's gain was simultaneous with the change in status, S's gain under section 311(b) must be reported under the end of the day rule in S's taxable year ending June 30, during which S was a member of the P group.

Example 5 – Loss Property



- The facts are the same as in Example 3, except the land distributed by S has a FMV value of \$60 instead of \$140.
- The end of day rule applies for purposes of determining the taxable year in which S must take into account its realized loss on the distribution of the land. Thus, under the end of day rule, S's loss on the distribution of the land, which occurs simultaneously with S's ceasing to be a member, is taken into account in S's taxable year that ends as a result of the redemption.
- However, the end of the day rule does not apply for other purposes; for example, the rule does not apply in determining whether the transaction is an intercompany distribution or in determining the attributes (as defined in § 1.1502-13(b)(6)) of the loss. Therefore, because S is not a member immediately after the distribution, S's loss on the distribution is not recognized under section 311(a).
- Under the end of day rule, the loss is taken into account as a noncapital, nondeductible expense on the P group's consolidated return, and under § 1.1502-32(b)(1)(i), P's basis in its S stock is decreased by \$40 immediately before S leaves the group.

Example 6 – S Corporation

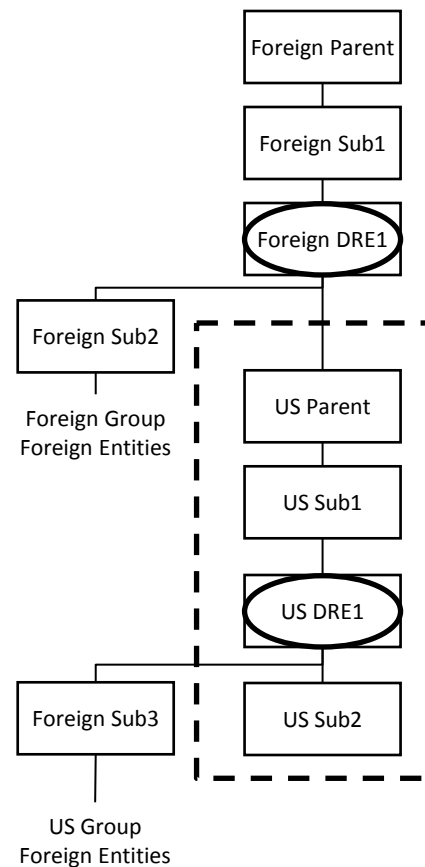


- On July 1, P purchases all of the stock of S, an accrual-basis corporation with an election in effect under section 1362(a) to be treated as a S corporation.
- Prior to the sale, S had engaged a consulting firm to find a buyer for S's stock, and the consulting firm's fee was contingent upon the successful closing of the sale of S's stock.
- To the extent S's payment of the success-based fee to its consultants is otherwise deductible, this item is an extraordinary item that becomes deductible simultaneously with the event that terminates S's election as an S corporation.
- S's obligation to pay the fee is treated as becoming deductible on June 30 under the previous day rule.

Other Recent Developments

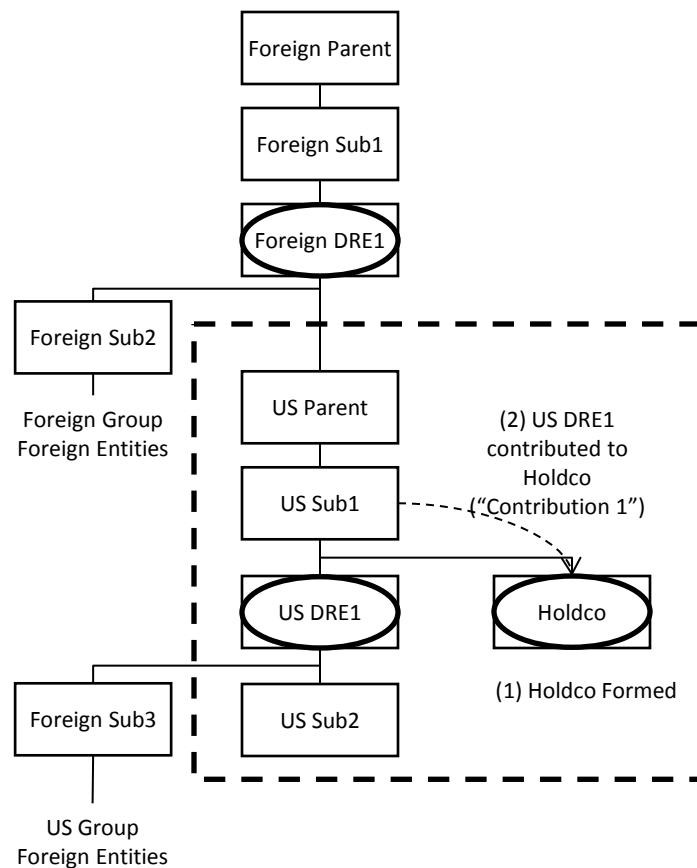
PLR 201452002

- In PLR 201452002, the taxpayer sought to combine a group of foreign entities owned indirectly by the foreign parent with another group of similar foreign entities owned underneath the U.S. group.
- Prior to the transaction, US Parent, US Sub1, and US Sub2 were all members of a U.S. consolidated group (US DRE1 was disregarded) (“US Parent Group”).
- The US Parent Group had a consolidated overall foreign loss (“COFL”) account, a consolidated separate loss limitation (“CSLL”) account, and an overall domestic loss (“ODL”) account.



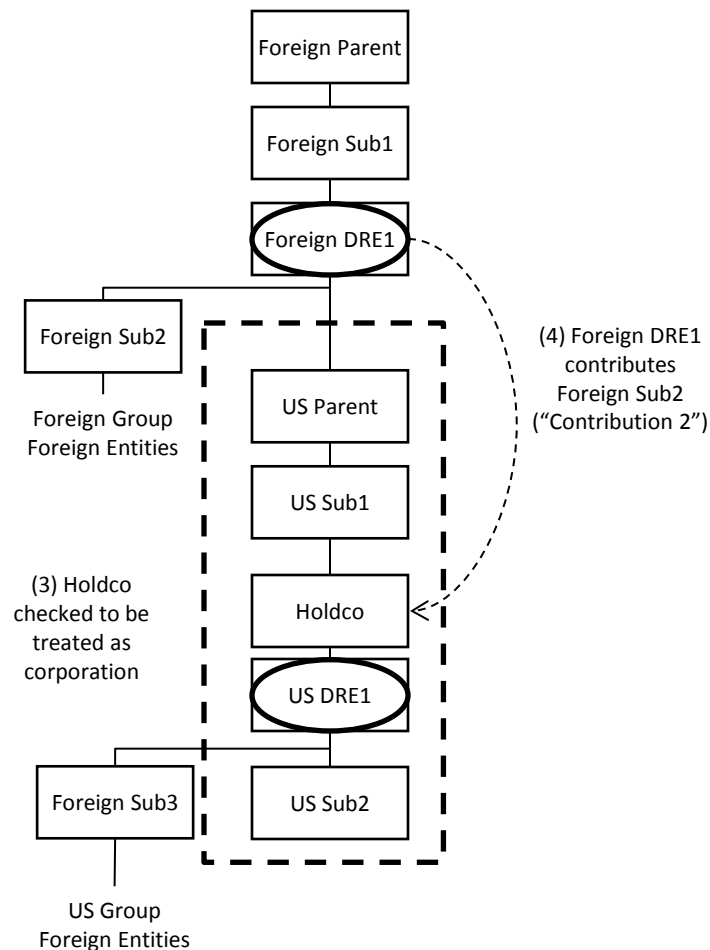
PLR 201452002

- To combine the two groups of foreign entities underneath the US Parent Group, the taxpayer engaged in the following series of transactions.
- First, US Sub1 formed Holdco.
- Second, US Sub1 contributed US DRE1 to Holdco (thereby transferring the ownership interests in US Sub2, Foreign Sub2, Foreign Sub3, and the US Group Foreign Entities).



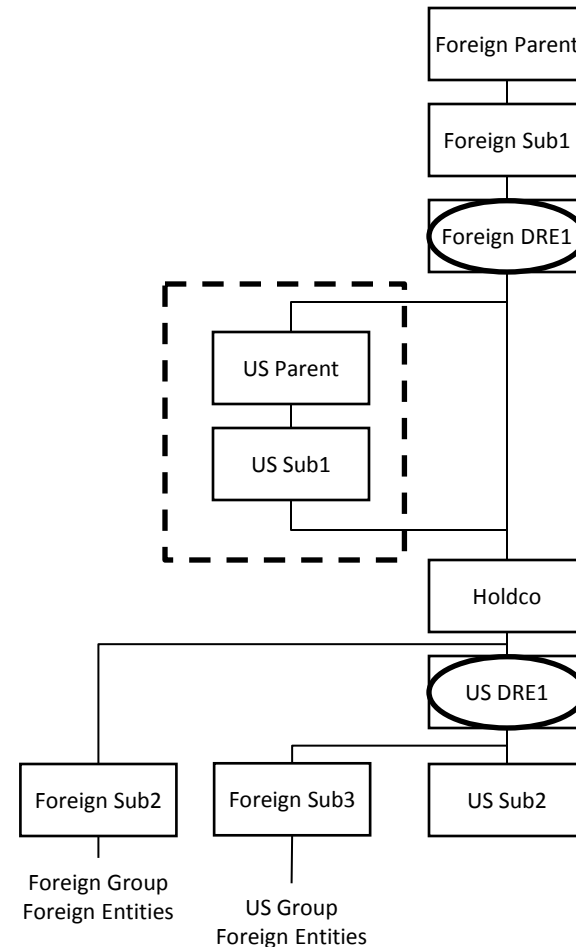
PLR 201452002

- Third, US Holdco checked the box to be treated as a corporation.
- If the transaction stopped here, it is clear that Holdco is a member of the US Parent Group and that the transfer from US Sub1 to Holdco would be an intercompany transaction.
- However, in step 4, Foreign DRE1 contributes Foreign Sub2 to Holdco and takes back more than 20 percent of the stock of Holdco.



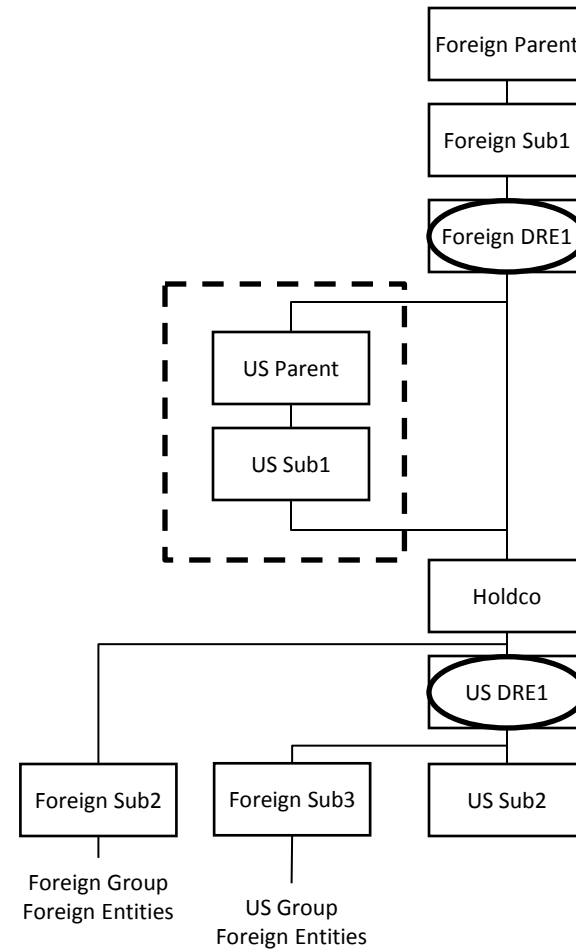
PLR 201452002

- Thus, after all four transaction steps, Holdco is not a member of the US Parent Group.
- Under section 904(f)(3), a disposition can result in recapture of an OFL.
- However, Treas. Reg. § 1.1502-9(b)(6)(i) provides that section 904(f)(3) does not apply to a disposition that is an intercompany transaction to which Treas. Reg. § 1.1502-13 applies.
- Treas. Reg. § 1.1502-9(c) provides that when a member(s) leaves the group, a portion of each of the COFL, CSLL, and CODL must be apportioned between the group and the departing member(s) based on the respective portions of foreign assets (determined under section 861 interest expense apportionment principles).



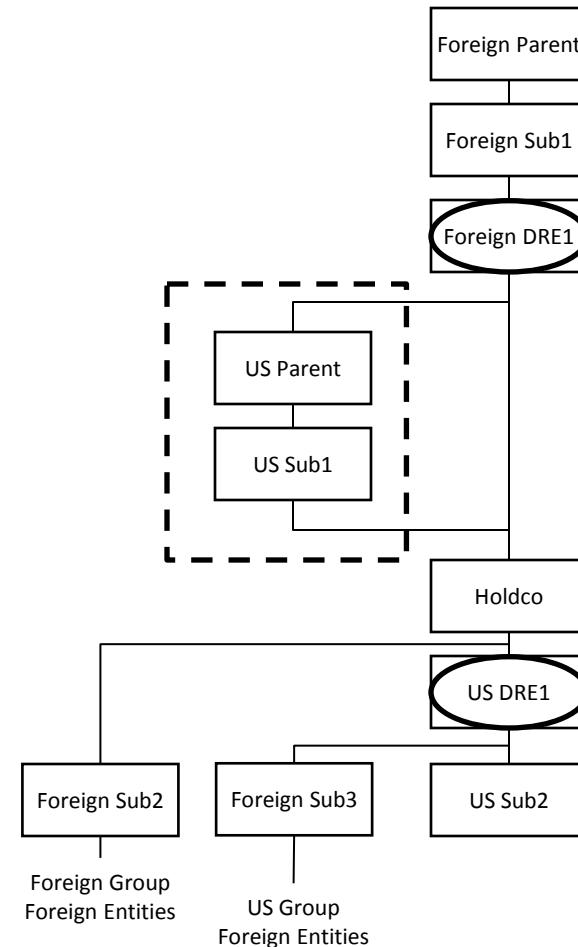
PLR 201452002

- PLR 201452002 determined that:
 - Holdco is considered to be a member of the US Parent Group for the time period from Holdco's formation to the contribution by Foreign DRE (Contribution 2).
 - As a result, the prior contribution by US Sub1 (Contribution 1) is an intercompany transaction and there is no recapture of COFL or CSLL at the time of that transaction.
 - The COFL and CSLL accounts are apportioned at the time of Contribution 2 between the US Parent Group, Holdco, and Sub 2 under Treas. Reg. § 1.1502-9(c) .



PLR 201452002

- PLR 201452002 did not apply step transaction to whether Contribution 1 occurred between members of the same group (and was therefore an intercompany transaction).
- Holdco was able to join and leave the US Parent Group as part of the same overall plan.
- If Contributions 1 and 2 were reversed, the result would arguably be different.
- Compare PLR 201452002 with investment tax credit recapture authorities (e.g., Rev. Rul. 82-20, *Disney v. Comm'r*, 4 F.3d 735 (9th Cir. 1993), *Salomon, Inc. v. United States*, 976 F.2d 837 (2nd Cir. 1992); *Aeroquip-Vickers, Inc. v. Comm'r*, 347 F.3d 173 (6th Cir. 2003)).



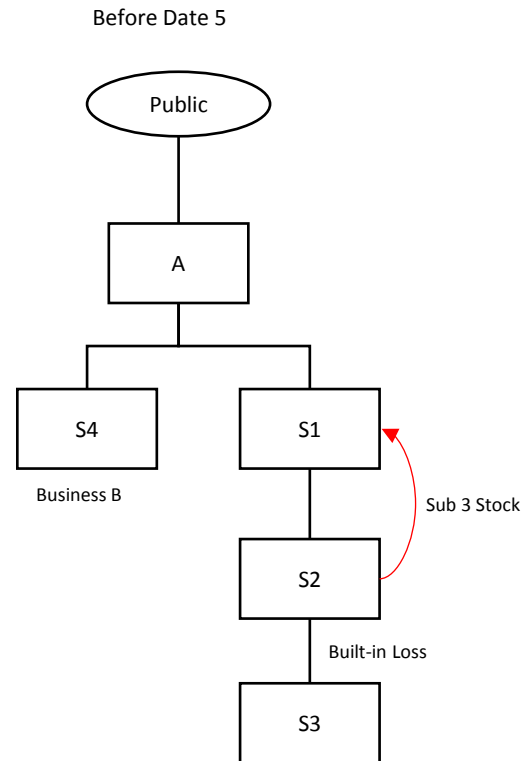
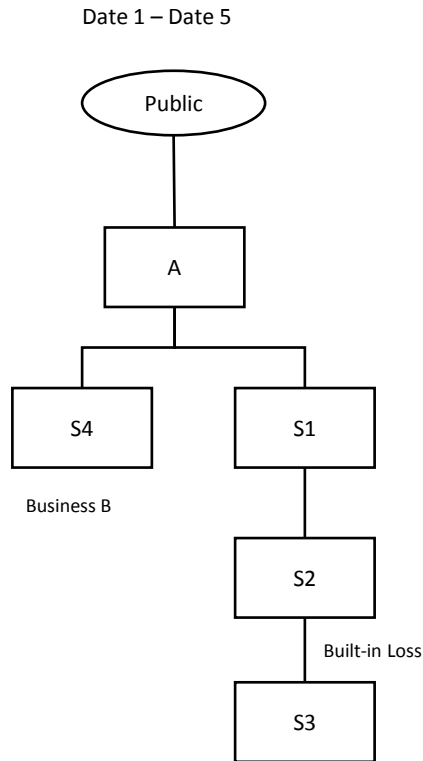
Treas. Reg. § 1.1502-32(b)

- As a general rule, M's basis in S's stock is increased by positive adjustments and decreased by negative adjustments.
- The amount of the adjustment is the net amount of S's:
 - Taxable income or loss;
 - Tax-exempt income;
 - Noncapital, nondeductible expenses; and
 - Distributions with respect to S's stock

Treas. Reg. § 1.1502-32(b)(3)(iii)

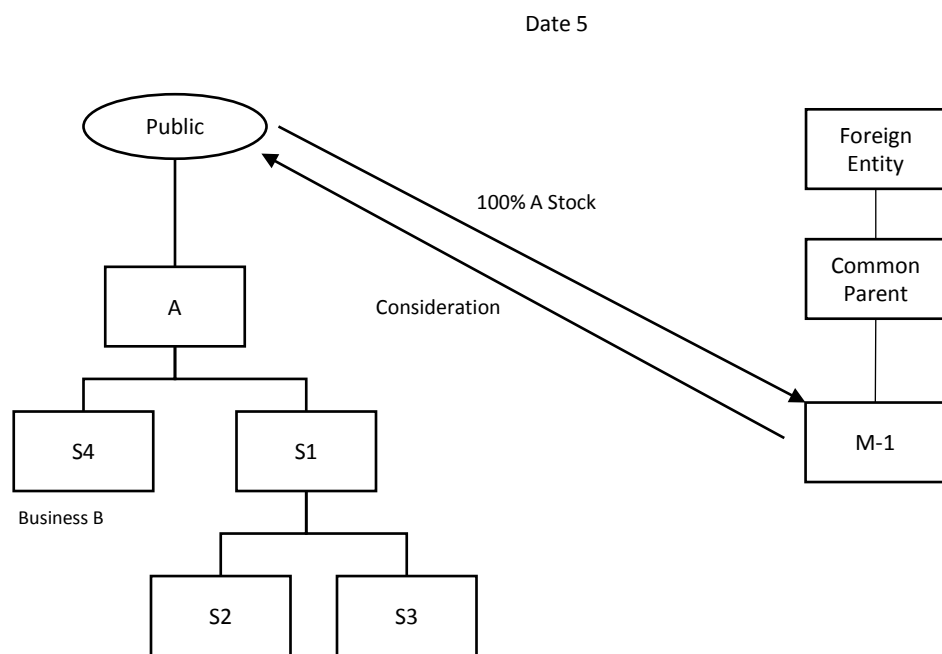
- Noncapital, nondeductible expenses are S's deductions and losses that are taken into account but permanently disallowed or eliminated in determining S's taxable income or loss, and that decrease directly or indirectly, the basis of its assets (or an equivalent amount).
- Examples include:
 - Loss not recognized under section 311(a), i.e., distributions of built-in loss property
 - Federal income taxes described in section 275

PLR 201411007 (Dec. 9, 2013)



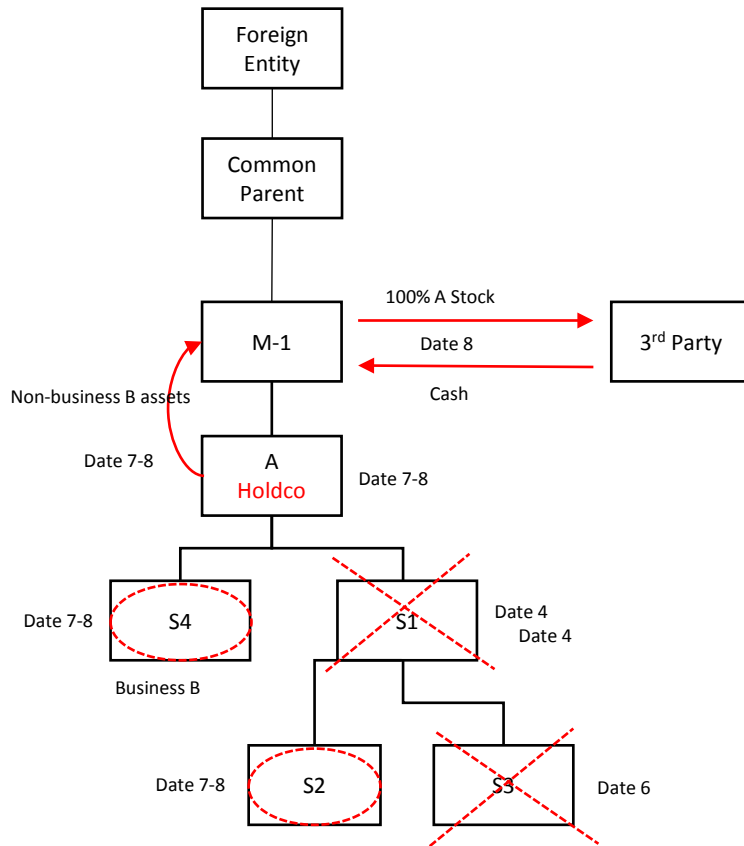
- Sometime before Date 5, S2 distributed the stock of S3 to S1 in a taxable distribution under §§ 301, 1.1502-13(f)(2)
- S2's loss was deferred under § 1.1501-13

PLR 201411007 (Cont.)



- On Date 5, M-1, a member of the Common Parent consolidated group, acquired all of the stock of A from the public.
- The acquisition terminated the A Consolidated Group and caused all of its former members to immediately become members of the Common Parent Group.
- The acquisition did not cause S2 deferred intercompany loss to be taken into account under § 1.1502-13(j)(5).

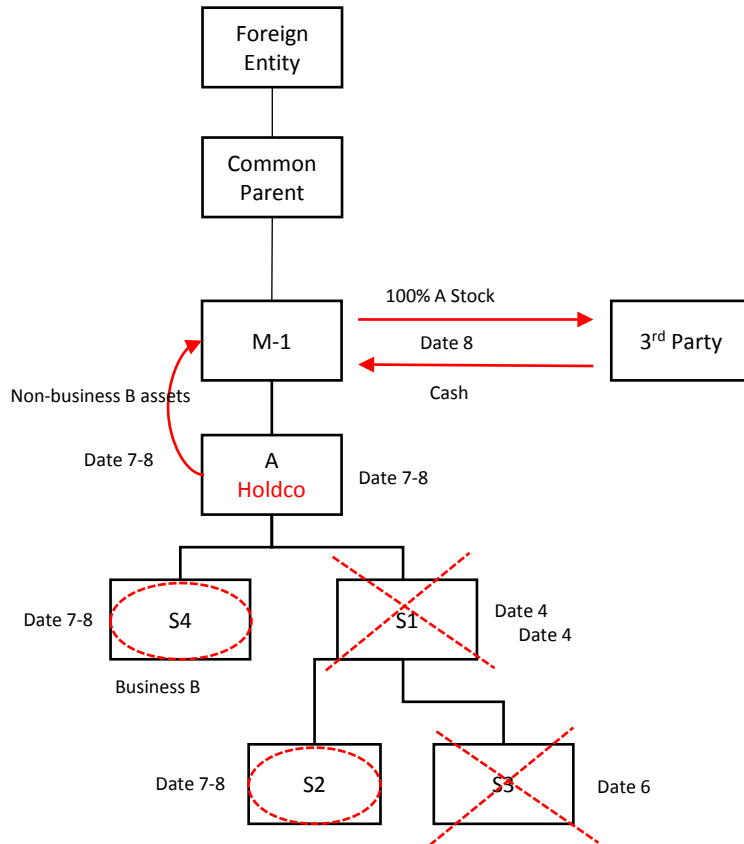
PLR 201411007 (Cont.)



- On Date 4, S1 liquidated into A in a section 332 liquidation.
 - A succeeded to Sub 1's ownership of, and adjusted basis in, the stock of Sub 3.
 - Sub 2 continued to account for the intercompany loss in accordance with § 1.1502-13(j)(2).
- On Date 6, S3 liquidated into A in a section 332 liquidation.
 - The liquidation eliminated Sub 3's stock.
 - As a result, the Sub 2 deferred intercompany loss became a noncapital, nondeductible amount.
- Between Dates 7 and 8:
 - S2 converted to a disregarded entity;
 - S4 converted to a disregarded entity; and
 - A was reorganized in a transaction treated as a section 368(a)(1)(F) reorganization becoming "Holdco."
- On Date 8, Holdco sold A to a 3rd party buyer

PLR 201411007 (Cont.)

- The Service ruled that S2's intercompany loss taken into account as a nondeductible, noncapital amount under § 1.1502-13(c)(1)
 - Is not taken into account in computing the earnings and profits of any Common Parent Group member and
 - Is not treated as a noncapital, nondeductible amount for purposes of § 1.1502-32(b)(2)(iii).
- The taxpayer represented, in part, that neither the A Consolidated Group nor the Common Parent Group has derived, and no taxpayer will derive, any US federal income tax benefit from the
 - Distribution of the S3 stock or
 - Liquidations that eliminated the parties to the distribution for US federal income tax purposes and resulted in redetermination of the intercompany loss as a noncapital, nondeductible amount (including any adjustment to basis in member stock under § 1.1502-32).





Attribute Reduction – Treas. Reg. § 1.1502-36(d)


- If a transferred share is a loss share after the application of the basis reallocation and reduction rules in Treas. Reg. §§ 1.1502-36(b) and (c), S's attributes are reduced by S's attribute reduction amount, which is the lesser of:
 - *Net stock loss*--the excess, if any, of members' aggregate bases in transferred S shares over the aggregate value of those shares.
 - *S's aggregate inside loss*--the excess, if any, of S's net inside attributes (inside asset basis plus losses minus liabilities) over the value of all outstanding shares of S stock.
- *Attribute reduction rule does NOT apply if the attribute reduction amount is less than 5% of the value of the shares transferred.*
 - However, the group may elect to apply the rule, e.g. in order to reattribute S's losses.

Application of Attribute Reduction Amount: The Basics

- S's attribute reduction amount is applied:
 - First, to reduce recognized losses:
 - >> Capital loss carryovers;
 - >> Net operating loss carryovers; and
 - >> Deferred deductions.
 - Then, to reduce asset basis.
- The selling group may specify the losses to which the attribute reduction amount (ARA) is applied. To the extent the group doesn't specify, they are reduced in the following order:
 - Capital loss carryovers (oldest to newest);
 - Net operating loss carryovers (oldest to newest);
 - Deferred deductions (proportionately).

Application of Attribute Reduction Amount: The Basics (cont'd)

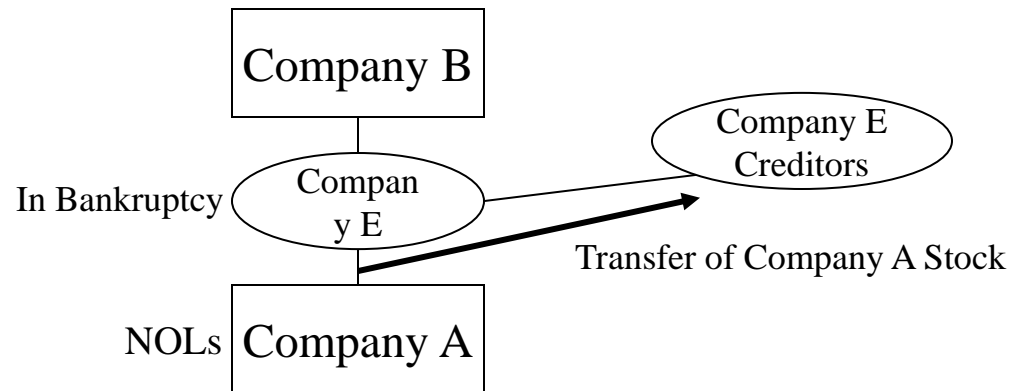
- Any ARA not applied to reduce recognized losses is applied to S's assets, other than assets that are Class I assets in §1.338-6(b)(1) (i.e., cash and certain deposit accounts).
- ARA applied to S's assets is first allocated between S's stock in its subsidiaries and S's other assets based on relative basis.
 - ARA allocated to lower-tier stock is applied under lower-tier stock rules
 - ARA allocated to S's other assets is applied under reverse residual method—
 - ARA allocated first to Class VII assets (reducing basis in that class to \$0); then remaining ARA is allocated to assets in each next lower class successively (other than Class I assets)
 - If ARA is less than basis of assets in a class, basis is reduced proportionately within the class



§ 1.1502-36(d)(6) Election

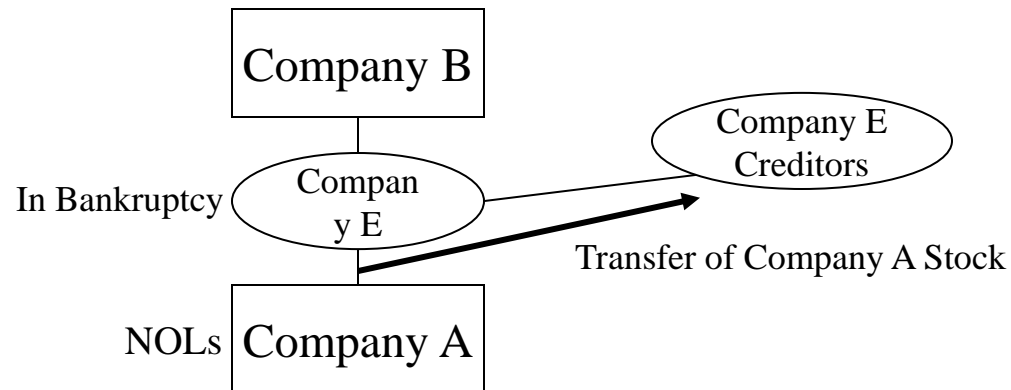
- Group can avoid or reduce attribute reduction by electing to reduce members' bases in transferred loss shares, reattribute S's attributes to P (if S deconsolidates and continues outside group), or both.
 - Can specify amount elected (or not elected).
 - Can only reattribute up to ARA, but only to the extent that the ARA exceeds the insolvency, if any, of the subsidiary
 - Can reattribute section 382 limitation to which reattributed losses are subject.
 - P is treated as a successor of S for purposes of §1.1502-21 if losses reattributed are SRLY losses (despite S's continued separate existence).
 - Stock basis reduction is deemed elected if the stock loss would be permanently disallowed.
- P can specify the losses to be reattributed; otherwise, losses are reattributed in the manner in which they would have been reduced under the default rule.
- The election is made by a statement on or with the group's return for the taxable year of the transfer. Statement by S is not required.

NSAR 20150301F – Reattribution of NOLs



- **Facts:** The facts were redacted. Based on the analysis and conclusions, it appears that Company B owned all of the interests in Company E, a disregarded entity, and Company E owned all of the stock of Company A. Company E was in bankruptcy and transferred its assets, including the Company A stock, in discharge of its liabilities in bankruptcy. Company B elected to reduce its loss on such transfer and reattribute NOLs of Company A pursuant to Treas. Reg. § 1.1502-36(d)(6).
- **Issues:**
 - Are Company E's liabilities treated as non-recourse with respect to Company B?
 - Will Company B's reattribution of Company A NOLs result in a reduction of Company E's basis in the stock of Company A?
 - Whether the insolvency limitation applies to the reattribution given that Company E is insolvent but Company B is not?
 - Is Company B a successor of Company A for purposes of the SRLY rules under Treas. Reg. § 1.1502-21(f)(1).
 - Are Company A's tax attributes property of Company E?

NSAR 20150301F – Reattribution of NOLs



- **Conclusions:**

- **Company E's liabilities are treated as non-recourse with respect to Company B.**
- **Company B's reattribution of Company A NOLs results in a reduction of Company E's basis in the stock of Company A.**
- **The insolvency limitation in Treas. Reg. § 1.1502-36(d)(6)(iv)(B) does not apply to the reattribution given that Company B is not insolvent, notwithstanding that Company E is insolvent.**
- **Company B is a successor of Company A for purposes of the SRLY rules under Treas. Reg. § 1.1502-21(f)(1) and only post-reattribution taxable income of Company B is included in the SRLY register.**
- **Since Company A is not in bankruptcy, its tax attributes are not property of the bankruptcy estate and the automatic stay does not prevent Company B from making an election under Treas. Reg. § 1.1502-36(d)(6) to reattribute Company A's NOLs.**

Open Issues in Creeping Acquisitions— Pre-Deemed Sale Period—Consolidated Group

If Target is a consolidated group member, and if >20% of its stock is sold to a non-group member during the Pre-Deemed Sale Period; the rest of the Target stock is sold on the Disposition Date; and a §336(e) election is made (presumably valid even though the group owns <80% of the Target stock on the Disposition Date)—

- When does Target leave the group?
- Does the group report the gain or loss on the deemed sale and any Target income or loss from the date of the >20% stock sale through the Disposition Date?
- *See* Reg. §1.336-2(k) Example 6 (§332 applies to the deemed liquidation).
- Same issue if Purchaser is a consolidated group.

Example.

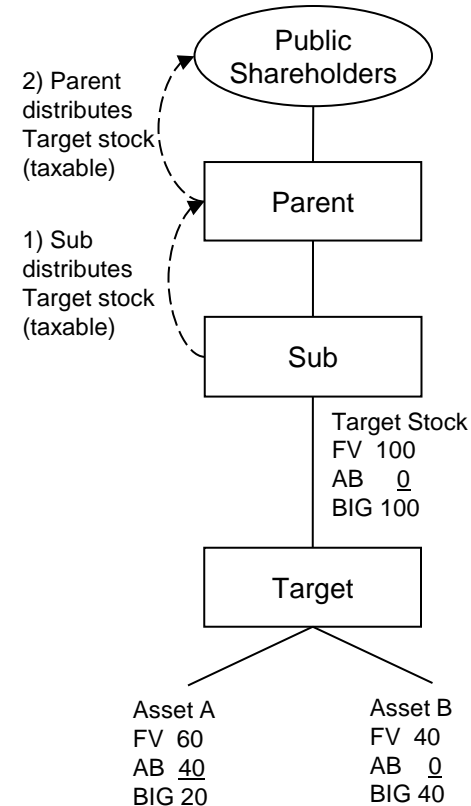
- A and B each is the parent of a consolidated group.
- A owns 80%, and B owns 20%, of the T stock.
- On 01/01/15, A sells 60% of the T stock to B.
- On 07/01/15, A sells the remaining 20% of the T stock to B.
- A makes a §336(e) election.

The Disposition Date is 07/01/15.

During 01/01–07/01/15, is T a member of A's group or B's group?

Intragroup and External Taxable Distributions

- 1) Sub's distribution of Target to Parent is not a QSD, because Parent is a Related Person to Sub.
 - Sub recognizes \$100 gain on distribution of Target stock, deferred under Reg. §1.1502-13 (but accelerated by Step 2).
 - Parent takes \$100 cost basis in the Target stock.
- 2) Parent's distribution of Target stock to Public Shareholders is a QSD, because no Public Shareholder is a Related Person to Seller.
 - If Parent makes a §336(e) election, Target is deemed to sell all its assets to New Target for ADADP.
 - Target recognizes \$60 gain on the deemed asset sale.
 - Target's \$60 gain increases Parent's basis in the Target stock from \$100 to \$160.
 - New Target is deemed to purchase the assets from an unrelated person for AGUB.
 - Target is deemed to distribute the consideration deemed received for the assets to Parent (§332/337 liquidation). Gain on Step 1 is triggered.
 - Parent may elect to apply Reg. §1.1502-13(f)(5)(ii)(C), which treats Target's liquidation as a §331 liquidation (solely to cause Parent to recognize loss on the Target stock). If this election is made, Parent recognizes \$60 loss in the deemed liquidation.
 - \$100 net gain to Parent (\$100 gain on Target stock in Step (1), \$60 gain on deemed asset sale and \$60 loss on deemed taxable liquidation in Step 2). Parent's net gain equals its BIG on the Target stock, not on Target's assets.
 - Parent is deemed to purchase the New Target stock from an unrelated person.
 - Parent is deemed to distribute the New Target stock, with no gain or loss.
 - Target's tax attributes are transferred to Seller.
 - New Target takes AGUB basis in its assets.
 - Public Shareholders receive a \$100 §301 distribution and take \$100 basis in the New Target stock.



Intragroup and External Distributions -- Section 355(e)

1) Sub's distribution of Target stock to Parent is not a QSD, because Parent is a Related Person to Sub.

- Section 355(f) treats Sub's distribution as a taxable distribution.
- Sub recognizes \$100 gain on distribution of Target stock, deferred under Reg. §1.1502-13 (but accelerated by Step 2).
- Parent takes \$100 cost basis in Target stock.

2) Parent's distribution of Target stock to Shareholders is a QSD.

- Target is deemed to sell its assets to an unrelated person for ADADP (\$100).
- Target recognizes \$60 gain.
- This gain increases Parent's basis in the Target stock from \$100 to \$160.
- Target is deemed to purchase its assets from an unrelated person for AGUB (\$100) (sale-to-self).
- Target is not deemed to liquidate, and it retains its own tax attributes.
- If an election is made to apply Reg. §1.1502-13(f)(5)(ii)(C), then, solely for purposes of that regulation, Target is deemed to liquidate into Parent under §331. Parent recognizes \$60 loss.
- Net result: \$100 gain to Parent group = Sub's BIG in the Target stock.
- Parent is deemed to distribute the Target stock at no gain or loss.

