

# *IRS business plan includes important corporate tax guidance*

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## *In brief*

The 2013-2014 IRS-Treasury Priority Guidance Plan, commonly referred to as the "business plan," includes 21 guidance projects addressing consolidated return issues or other issues relating to corporations and their shareholders. While most of these items have been carried over from previous business plans, there are several important new items. The items on the new business plan cover a wide range of corporate transactions and other activities, and therefore should be of interest to most Subchapter C corporations. This WNTS Insight addresses several of the corporate tax projects in the new business plan.

## *In detail*

### **Consolidated returns**

The most noteworthy of the four consolidated return projects is item 2, "Regulations under § 1502 affecting consolidated groups, including regulations regarding loss transfers of member stock."

This carryover item from previous plans refers to technical corrections to the final unified loss rules issued in 2008. Soon after those regulations were issued, practitioners called attention to aspects of the regulations that require changes. While this project seems to be expanding in scope, the specific issues that it will address are unclear.

### **Corporations and their shareholders**

#### *Earnings and profits*

A carryover project from last year's plan is item 3, "Final regulations under § 312 regarding the allocation of earnings and profits between a transferor and transferee corporation when assets are transferred in connection with a reorganization." Proposed regulations were published on April 16, 2012.

The current earnings and profits (E&P) regulations under Section 312 were promulgated soon after enactment of the 1954 Code, and various issues now merit revisions.

- Under the current regulations, E&P following a stand-alone tax-free Section 351 contribution transaction

is treated differently from E&P following a Section 351 transaction that takes place immediately after an asset reorganization. The issue of whether the parent's E&P should be transferred to the subsidiary would be useful for the IRS to address.

- In a tax-free spin-off transaction, E&P -- unlike other tax attributes -- is allocated to the controlled subsidiary. The key issue is the proper allocation formula. The current regulations do not provide a clear answer. Instead, they simply provide two formulas -- one based on fair market value of assets, the other based on basis in assets -- with no guidance on which is more appropriate.

- By contrast, in the strictly international context -- that is, similar transactions involving two controlled foreign corporations -- under proposed Section 367(b) regulations, allocation of E&P based on basis is the preferred method. The preamble to those regulations states that taxpayers may use any reasonable method, but taxpayers would have to justify the use of another method.

**Observation:** The proposed regulations issued in 2012 would clarify the proper adjustment and allocation of E&P in the second domestic context described above, but would not clarify the Section 351 issue. For additional discussion of the E&P regulations under Section 312, see PwC's comment letter dated [September 24, 2012](#), which includes several suggested modifications to the proposed regulations.

### Section 355 issues

The IRS in June issued Rev. Proc. 2013-32, which restricts the scope of letter rulings the IRS will issue under various provisions of Subchapter C of the Code, including Section 355. The IRS no longer will rule on whether transactions qualify for nonrecognition treatment under Section 355. Rather, the IRS will rule only on "significant issues" raised by such transactions or significant issues under related Code sections that address the tax consequences that result from the application of Section 355. (For further discussion of Rev. Proc. 2013-32, see WNTS Insight, ["IRS narrows scope of letter rulings it will issue on certain corporate transactions."](#) June 28, 2013.) Rev. Proc. 2013-32 amplifies and modifies Rev. Proc. 2013-3, the IRS's annual "no-rule" list of issues on which it ordinarily will not issue a private letter ruling.

Three new items on the new business plan address issues listed in Rev. Proc. 2013-3 on which the IRS still could rule under the guidelines of Rev. Proc. 2013-32:

- Item 6: "Guidance regarding when a transfer by a person to a corporation and a transfer by that corporation to that person, ostensibly in two separate transactions, should be respected as two separate transactions for Federal income tax purposes";
- Item 7: "Guidance regarding whether a corporation is a 'controlled corporation' within the meaning of §355 if, in anticipation of the distribution of its stock, the distributing corporation acquires or retains putative control of the controlled corporation through the use of classes of shares having different voting powers"; and
- Item 8: "Guidance regarding the application of §§355 and 361 to a distributing corporation's use of its controlled corporation's stock or securities to retire its putative debt issued in anticipation of the distribution of the stock of the controlled corporation."

**Observation:** The new business plan does not indicate in what form -- regulations, revenue procedures, etc. -- these guidance items will be issued.

One of the carryover Section 355 projects is item 9 -- "Regulations relating to the active trade or business requirement under §355(b)" -- which refers to IRS efforts to finalize proposed regulations (REG-123365-03) that provide guidance on the ATOB requirement under Section 355(b) and that were issued mainly to address amendments made to Section 355(b)(3).

**Observations:** Guidance that clarifies this complex area would be extremely helpful. One approach would be to adopt the proposed ATOB regulations but also to address two important open issues that have been discussed in comments:

- Prop. Reg. sec. 1.355-3(b)(4)(ii) contains a strict prohibition against use of a corporation's assets to acquire an ATOB in a tax-free transaction. This could be replaced with a facts-and-circumstances test implemented through the Section 355 device regulations.
- Taxpayers will be watching to see if the IRS retains the "affiliate exception" in the current ATOB regulations (Reg. sec. 1.355-3(b)(4)(iii)), rather than adopting the more limited SAG exception in the proposed regulations for transactions in which an ATOB is acquired and gain or loss is recognized.

### Section 382 issues

Item 16 is "Final regulations under § 382 regarding the application of the segregation rules to small shareholders. Proposed regulations were published on December 19, 2011." **Observations:** This project is a mechanical correction that would simplify the existing rules, which are extremely complex. Item 16 is one of the more likely corporate projects to be completed this year, especially now that the Section 362(e) regulations discussed below have been released. For additional discussion of the application of the segregation rules to small shareholders (shareholders who are not five-percent shareholders), see PwC's comment letters dated [March 5, 2012](#), and [July 24, 2013](#).

One noteworthy project remains off the current business plan. This project, which last appeared on the 2008-2009 business plan, involves "Guidance under §382 and §384, including regulations regarding built-in items under §382(h)(6). Built-in items under §382(h)(6) were previously addressed in Not. 2003-65. Temporary regulations regarding the treatment of prepaid income were published on June 13, 2007." Notice 2003-65 is taxpayer-favorable guidance regarding how to determine which items of income and deduction are built-in as of the date of an ownership change; it provides two safe harbors as well as other reasonable methods taxpayers may use. This project would involve converting Notice 2003-65 into regulations that, we understand, might be less flexible.

#### *Basis allocation*

Another carryover project, Item 2 -- "Regulations under §§ 301, 302, and 358 regarding the recovery and allocation of basis in redemptions, organizations, and reorganizations. Proposed regulations were published on January 21, 2009" -- addresses a controversial issue with consequences for transactions involving CFCs owned directly by a US parent.

The proposed regulations, following the Fourth Circuit's 1971 decision in *Johnson v. United States*, would require taxpayers, following certain tax-free transactions, to use "a single model for stock basis recovery by a

shareholder that receives a constructive or actual distribution to which Section 301 applies and a single model for sale and exchange transactions to which Section 302(a) applies, including certain elements of a reorganization exchange." Essentially, this model would require taxpayers to track basis in each individual share of stock; taxpayers could not simply allocate basis among shares on a pro-rata basis.

**Observation:** Because the proposed regulations, which generally are proposed to apply prospectively when finalized, could reduce tax-planning opportunities for taxpayers, taxpayers considering engaging in transactions that would be covered by the regulations may wish to have such transactions occur before the regulations are finalized.

#### *New regulations -- limitations on use of losses*

An item from last year's plan -- "Regulations under §362(e) regarding the importation or duplication of losses" -- has been divided into two items on the new plan:

- Item 12: "Regulations under §362(e)(1) regarding the importation of losses" and
- Item 13: "Final regulations under §362(e)(2) regarding the duplication of losses."

The IRS issued the proposed regulations under Section 362(e)(1) on September 6, and the final

regulations under Section 362(e)(2) on August 30. For discussion of the final Section 362(e)(2) regs, see [\*Tax Notes, September 9, 2013, p. 1071\*](#) (quoting PwC's David Friedel). For discussion of the proposed Section 362(e)(1) regs, see *Tax Notes*, September 16, 2013, p. 1183, and [\*Bloomberg BNA Daily Tax Report, September 9, 2013, 174 DTR G-3\*](#) (both also quoting David Friedel).

#### *Comments requested by the IRS*

Comments on the proposed Section 362(e)(1) regulations are due by December 9, 2013. The IRS specifically has requested comments regarding two issues: (1) the need for, and potential scope of, a rule under which a 'look-through' approach generally would be applied to trusts for purposes of applying the anti-importation provisions, and (2) a provision in the proposed regulations that is intended "to clarify that gain or loss recognized by a passive foreign investment company, as defined in Section 1297(a), is also considered not subject to Federal income tax notwithstanding that it could affect an inclusion under Section 1293(a)."

#### *The takeaway*

These guidance projects address issues related to many common types of corporate transactions and activities, and therefore could affect many Subchapter C corporations. Taxpayers should gain an understanding of how these projects could affect them.

## ***Let's talk***

For a deeper discussion of how this might affect your business, please contact:

### ***Mergers & Acquisitions***

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