

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 8825]

RIN 1545-AU33

Regulations Under Section 382 of the Internal Revenue Code of 1986; Application of Section 382 in Short Taxable Years and With Respect to Controlled Groups

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Final and temporary regulations

SUMMARY: This document contains final regulations relating to limitations on net operating loss carryovers and certain built-in losses following an ownership change of a corporation. The regulations implement the statutory authority under section 382(m) of the Internal Revenue Code to prescribe regulations concerning short taxable years and controlled groups of corporations. Additional rules are adopted relating principally to corporations that cease to exist following a merger (or similar transaction) or that have two or more ownership changes. These final regulations replace temporary regulations that provided guidance on these topics.

DATES: Effective Dates: These regulations are effective June 25, 1999.

Applicability Dates: For dates of application and special transition rules, see Effective Dates under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Lee A. Kelley at 202-622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1434. Responses to this collection of information are required to obtain a benefit relating to the value of a controlled group member.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent is one quarter hour.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS: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.

Books and records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On February 4, 1991, the IRS and Treasury issued a notice of proposed rulemaking, CO-077-90 (56 FR 4183) (the 1991 controlled group proposed regulations), setting forth rules regarding the application of section 382 to controlled groups of corporations and to corporations that undergo a merger or similar transaction. The 1991 controlled group proposed regulations

also related to the determination of the section 382 limitation following an ownership change in the case of short taxable year, and to the valuation of the stock of a loss corporation for purposes of determining the amount of the section 382 limitation. On the same day, the IRS and Treasury also issued proposed regulations relating to the application of section 382 to affiliated groups of corporations filing consolidated returns (CO-132-87, 56 FR 4194), and to the use of built-in deductions and net operating losses and capital losses, including the carryover and carryback of separate return year (SRLY) losses, of members of consolidated groups (CO-078-90, 56 FR 4228). A public hearing regarding the three sets of proposed regulations was held on April 8, 1991.

On June 27, 1996, the IRS and Treasury published temporary regulations (TD 8679, 61 FR 33313) (the 1996 controlled group temporary regulations) relating to section 382. Except for the addition of a provision relating to the effects of successive ownership changes, these regulations were substantially identical to the 1991 controlled group proposed regulations. A notice of proposed rulemaking cross-referencing the temporary regulations was published in the Federal Register on the same day (CO-026-96, 61 FR 33391) (the 1996 controlled group proposed regulations) and the 1991 controlled group proposed regulations were withdrawn. No written comments were received on the 1996 controlled group proposed regulations and no public hearing was held. Also on June 27, 1996, the IRS and Treasury published temporary regulations relating to the application of section 382 to affiliated groups of corporations filing consolidated returns (TD 8678, 61 FR 33335) and the SRLY limitation (TD 8677, 61 FR 33321). Notices of proposed rulemaking cross-referencing these temporary regulations were published on the same day (CO-025-96, 61 FR 33395 and CO-024-96, 61 FR 33393), and the corresponding proposed

regulations published in 1991 were withdrawn.

The 1996 controlled group proposed regulations are adopted as revised by this Treasury decision and the corresponding temporary regulations are removed. The final regulations are substantially the same as the 1996 controlled group proposed regulations, with one significant change relating to built-in losses of a member of a controlled group of corporations. This change is discussed below.

Under section 382, if an ownership change occurs with respect to a loss corporation (as defined in section 382 and the regulations thereunder), the amount of the loss corporation's taxable income for a post-change year that may be offset by the net operating loss carryovers arising before the ownership change are subject to a limitation known as the section 382 limitation. The section 382 limitation for a post-change taxable year of the loss corporation generally equals the fair market value of the stock of the corporation immediately before the ownership change multiplied by the long-term tax exempt rate (a rate of return published periodically in the Internal Revenue Bulletin).

In addition to net operating loss carryovers, the recognized built-in losses of corporations that have a net unrealized built-in loss on the ownership change date are also subject to the section 382 limitation. In general, a corporation has a net unrealized built-in loss on its ownership change date if the adjusted basis of its assets exceeds their fair market value, and such excess is greater than the threshold amount under section 382(h)(3)(B). In general, recognized built-in losses are losses with respect to assets held on the change date that are recognized within the 5-year period beginning on the ownership change date. The recognized built-in loss on an asset, however, is limited to the lesser of the loss recognized on its disposition or the amount by which

the adjusted basis of the asset exceeded its fair market value on the change date.

Consistent with the proposed regulations, the final regulations require appropriate adjustments to the value of a loss corporation that is a member of a controlled group of corporations so that the same value is not included more than once in computing the section 382 limitations for the loss corporations that are members of the controlled group. In general, adjustments are required only when corporations are members of the same controlled group both when a pre-change loss arises and on the date of the ownership change. Thus, adjustments are required if a loss corporation is a component member of the same controlled group as another member (i) on December 31 of the taxable year in which a pre-change loss arises (or the change date, if earlier) and (ii) on the date that the loss corporation has an ownership change. If a loss corporation has pre-change losses that arise in different taxable years, the component members of the controlled group with respect to losses arising in each taxable year may differ. Therefore, as in the 1996 controlled group proposed regulations, the final regulations are applied by determining a controlled group with respect to each year's pre-change loss of the corporation (a controlled group loss).

To avoid duplication of value in connection with a controlled group loss, the value of the stock of each corporation that is a component member of the controlled group with respect to a controlled group loss is reduced by the value of the stock of other component members that it directly owns immediately before the ownership change. A second adjustment (more fully explained in the preamble to the 1991 controlled group proposed regulations) permits a lower tier member to elect to restore some or all of the previously reduced value to a member that directly owns its stock.

In identifying controlled group losses, the determination of the taxable year to which a net operating loss carryover is attributable usually presents no difficulty. The determination of the taxable year in which a net unrealized built-in loss accrues, however, is more problematic. To address some concerns in this area, the final regulations include an irrebuttable presumption that certain built-in losses are attributable to the period before a particular taxable year. The presumption applies to a loss corporation that had an ownership change prior to the first day of the taxable year in question, and whose net unrealized built-in losses became subject to a section 382 limitation as a result of that ownership change. Under the presumption, any built-in loss in such an asset is considered to be attributable to a period prior to the taxable year in question to the extent of the built-in loss in that asset on the previous change date.

Effective Dates

Section 1.382-5 (relating to the section 382 limitation) generally applies to a loss corporation that has an ownership change to which section 382(a), as amended by the Tax Reform Act of 1986, applies. The rules in that section relating to successive ownership changes, however, apply to taxable years of a loss corporation beginning on or after January 1, 1997. Section 1.382-8 (relating to controlled groups of corporations) generally applies to a loss corporation that has an ownership change with respect to a controlled group loss on or after January 1, 1997. Transition rules are provided for members of controlled groups that have ownership changes before that date. The rules in §1.382-1(a)(iv) (relating to separate tracking of certain loss corporations) apply to testing dates on or after January 29, 1991. The rules in §1.382-2 (a) (4) and (a) (5) relating to successor or predecessor corporations in other than corporate reorganizations apply to testing dates on or after January 1, 1997.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It has also been determined that section 553 of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information in this regulation is a statement of election that it is estimated will take less than one hour to prepare. The statement will be filed by electing corporations that are members of a controlled group of corporations (determined by applying a 50% common control requirement) both (1) when a net operating loss carryover (or certain other tax attributes) arises and (2) a member of the controlled group has an ownership change under section 382 of the Internal Revenue Code with respect to that net operating loss carryover (or other attribute). (An affiliated group of corporations that files a consolidated return is treated as a single corporation for this purpose, which reduces the number of potential filers.) Because the election is only filed with respect to an ownership change, it is unlikely that a corporation will file the election frequently. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting information

The principal author of these regulations is Lee A. Kelley of the Office of Assistant Chief Counsel (Corporate). Other personnel from the IRS and Treasury participated in their

development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

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

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing entries for sections 1.382-5T and 1.382-8T and by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.382-5 also issued under 26 U.S.C. 382(m). * * *

Section 1.382-8 also issued under 26 U.S.C. 382(m). * * *

Par. 2. Section 382-1 is amended by:

1. Revising the entry for §1.382-2, paragraph (a)(1)(iv).
2. Adding an entry for §1.382-2, paragraph (a)(1)(v).
3. Adding entries for §1.382-2, paragraphs (a)(5) and (a)(6).
4. Removing the entries for §1.382-2T, paragraphs (f)(1)(i), (f)(1)(ii), and (f)(1)(iii).
5. The entry for §1.382-4 is amended as follows:
 - a. The entry for paragraph (b) is revised.
 - b. Entries for paragraphs (b)(1) and (b)(2) are added.

6. Removing the entry for §1.382-5.
7. Redesignating the entry for §1.382-5T as § 1.382-5 and revising the section heading.
8. Removing the entry for §1.382-8.
9. Redesignating the entry for §1.382-8T as §1.382-8, revising the section heading, and adding entries for paragraphs (b) (1) and (b) (2).

The revision and additions read as follows:

§1.382-1 Table of contents.

* * * * *

§1.382-2 General rules for ownership change.

- (a) * * *
- (1) * * *
- (iv) End of separate accounting for losses and credits of distributor or transferor corporation.
- (v) Application to other successor corporations.

* * * * *

- (5) Successor corporation.
- (6) Predecessor corporation.

* * * * *

§1.382-4 Constructive ownership of stock.

* * * * *

- (b) Attribution from corporations, partnerships, estates and trusts.
- (1) [Reserved].
- (2) Limitation.

* * * * *

§1.382-5 Section 382 limitation.

* * * * *

§1.382-8 Controlled groups.

* * * * *

- (b) * * *
- (1) In general.

(2) Presumption regarding net unrealized built-in loss.

* * * * *

§1.1382-2 [Amended]

Par. 2a. Section 1.382-2 is amended by removing paragraph (a)(1)(iv).

Par. 3. Section 1.382-2T is amended as follows:

1. In paragraph (e)(2)(iv) Example (2)(ii), remove the reference “paragraph (f)(1)(ii)”

and add “§1.382-2(a)(1)(iv)” in its place.

2. Paragraph (f)(1)(ii) is redesignated as paragraph (a)(1)(iv) of §1.382-2.

3. Paragraph (f)(1) is revised.

4. Paragraphs (f)(4) and (f)(5) are redesignated as paragraphs (a)(5) and (a)(6) of §1.382-

2, respectively.

5. New paragraphs (f)(4) and (f)(5) are added.

6. In paragraph (h)(2)(i)(A), remove the language “and solely for purposes of determining whether a loss corporation has an ownership change”.

The revision and additions read as follows:

§1.382-2T Definition of ownership change under section 382, as amended by the Tax Reform

Act of 1986 (temporary).

* * * * *

(f) Definitions. * * *

(1) Loss corporation. See section 382 and §1.382-2(a)(1) for the definition of a loss corporation.

* * * * *

(4) Successor corporation. See §1.382-2(a)(5) for the definition of successor corporation.

(5) Predecessor corporation. See §1.382-2(a)(6) for the definitions of predecessor corporation.

* * * * *

Par. 4. Section 1.382-2 is amended as follows:

1. In the first sentence of paragraph (a)(1)(iii), remove the reference “§1.382-2T(f)(1)(ii)”

and add “paragraph (a)(1)(iv) of this section” in its place.

2. In the first sentence of newly designated paragraph (a)(1)(iv), remove the reference

“§1.382-2(a)(1)(iii)” and add “paragraph (a)(1)(iii) of this section” in its place.

3. In the first sentence of newly designated paragraph (a)(1)(iv), remove the reference

“§1.382-2(a)(1)(ii)” and add “paragraph (a)(1)(ii) of this section” in its place.

4. In the last sentence of newly designated paragraph (a)(1)(iv), remove the reference

“paragraph (f)(1)(ii)” and add “paragraph (a)(1)(iv)” in its place.

5. Paragraph (a)(1)(v) is added.

6. In the first sentence of paragraph (a)(3)(i), remove the reference “paragraph (f)(18)”

and add “paragraph (a)(3)(i) and §1.382-2T(f)(18)(ii) and (iii)” in its place.

7. In the last sentence of newly designated paragraph (a)(5), remove the reference

“paragraph (f)(4)” and add “paragraph (a)(5)” in its place.

8. In the last sentence of newly designated paragraph (a)(6), remove the reference

“paragraph (f)(5)” and add “paragraph (a)(6)” in its place.

The addition reads as follows:

§1.382-2 General rules for ownership change.

(a) * * *

(1) * * *

(v) Application to other successor corporations. This paragraph (a)(1) also applies, as the context may require, to successor corporations other than successors in section 381(a) transactions. For example, if a corporation receives assets from the loss corporation that have basis in excess of value, the recipient corporation's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the loss corporation's basis, and the amount by which basis exceeds value is material, the recipient corporation is a successor corporation subject to this paragraph (a)(1). This paragraph (a)(1)(v) applies to any testing date occurring on or after January 1, 1997.

* * * * *

Par. 5. Section 1.382-4 is amended by revising paragraph (b) to read as follows:

§1.382-4 Constructive ownership of stock.

* * * * *

(b) Attribution from corporations, partnerships, estates and trusts. (1) [Reserved].

(2) Limitation. Section 1.382-2T(h)(2)(i)(A) applies solely for purposes of determining whether a loss corporation has an ownership change.

* * * * *

§1.382-5 [Removed]

Par. 6. Section 1.382-5 is removed.

Par. 7. Section 1.382-5T is redesignated as §1.382-5 and amended as follows:

1. The section heading is revised.

2. In paragraph (e), the reference “§1.382-8T” is removed and “§1.382-8” is added in its place.

The revision reads as follows:

§1.382-5 Section 382 limitation.

* * * * *

§1.382-8 [Removed]

Par. 8. Section 1.382-8 is removed.

Par. 9. Section 1.382-8T is redesignated as §1.382-8 and amended as follows:

1. The section heading is revised.
2. Redesignate paragraphs (b) introductory text, (b)(1) and (b)(2) as paragraphs (b)(1) introductory text, (b)(1)(i) and (b)(1)(ii), respectively.
3. A paragraph heading for newly designated paragraph (b)(1) is added.
4. Paragraph (b)(2) is added.
5. The first three sentences of paragraph (f) are revised.
6. The graphics of paragraph (g) Example 1(a) are revised.
7. The graphics of paragraph (g) Example 2(a) are revised.
8. Paragraph (g) Example 4 is amended as follows:
 - a. In the last sentence of paragraph (a), remove the reference “§1.1502-92T(b)(1)(i)” and add “§1.1502-92(b)(1(i))” in its place.
 - b. In paragraph (b)(2), remove the reference “§1.1502-91T(c)” and add “§1.1502-91(c)” in its place.
 - c. In paragraph (c), remove the reference “§1.1502-93T” and add “§1.1502-93” in its

place.

9. In the fifth sentence of paragraph (h)(1), remove the reference “§1.382-8T” and add “§1.382-8” in its place.

10. Paragraph (i) is added.

The additions and revisions read as follows:

§1.382-8 Controlled groups.

* * * * *

(b) Controlled group loss and controlled group with respect to a controlled group loss—(1)

In general. * * *

(2) Presumption regarding net unrealized built-in loss. For purposes of determining whether a net unrealized built-in loss of a loss corporation is attributable to a taxable year (the determination year) with respect to which the corporation is a component member of a controlled group, the built-in loss in a prior change date asset is deemed to be attributable to a period ending before the determination year. A prior change date asset is any asset held by the loss corporation at all times during the period beginning on the change date of its most recent ownership change after 1986 (the first change date), and ending on the first day of the determination year. The built-in loss in a prior change date asset is the amount by which the adjusted basis of the asset on the first change date exceeds the fair market value of the asset on that date. The principles of this paragraph (b)(2) also apply to items described in section 382(h)(6)(B).

* * * * *

(f) Coordination between consolidated groups and controlled groups. Some or all of the component members of a controlled group may also be members of a consolidated group, and a

controlled group loss may be subject to a consolidated section 382 limitation or subgroup section 382 limitation determined under §1.1502-93. Except as otherwise provided in this paragraph (f) and §§1.1502-91 through 1.1502-99, §1.1502-93 applies instead of this section when both sections, by their terms, are otherwise applicable. This section is applicable and may require an adjustment to value if a member of a consolidated group, a loss group, or loss subgroup (as those terms are defined in §§1.1502-1(h) and 1.1502-91) is also a component member of a controlled group with respect to a controlled group loss. * * *

(g) ***

Example 1. * * *(a)***

* * * * *

Example 2. * * *(a)***

* * * * *

(i) References to former temporary regulations. As the context requires, a reference in this section to §1.382-8 includes a reference to §1.382-8T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised as of April 1, 1999, a reference to §§1.1502-91, 1.1502-92, 1.1502-93, and §§1.1502-91 through 1.1502-99 includes a reference to §§1.1502-91A, 1.1502-92A, 1.1502-93A and §§ 1.1502-91A through 1.1502-99A.

* * * * *

PART 602-OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 10. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 11. In § 602.101, paragraph (b) is amended in the table by removing the entry for 1.382-8T and adding an entry in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

<u>CFR part or section where identified and described</u>	<u>Current OMB control No.</u>
1.382-8.....	1545-1434
* * * * *	

John M. Dalrymple
Acting Deputy Commissioner of Internal Revenue

Approved: June 18, 1999

Donald C. Lubick
Assistant Secretary of the Treasury