

26 CFR 1.382-10T: Special rules for determining time and manner of acquisition of an interest in a loss corporation (temporary).

T.D. 9063

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Distributions of Interests in a Loss Corporation From Qualified Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 382 of the Internal Revenue Code of 1986. The temporary regulations affect loss corporations and provide guidance on whether a loss corporation has an ownership change where a qualified trust described in section 401(a) distributes an ownership interest in an entity. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG-108676-03 on page 523) on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective June 27, 2003.

Applicability Date: For dates of applicability, see §1.382-10T(a)(4).

FOR FURTHER INFORMATION CONTACT: Martin Huck (202) 622-7750 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

Section 382 in General

Section 382 limits the amount of taxable income that may be offset by certain loss carryovers and recognized built-in losses following an ownership change of a loss corporation. Section 382(g) defines an ownership change as a change in the percentage of ownership of the loss corporation's stock owned by the 5-percent shareholders of more than 50 percentage points

(by value) over a 3-year period. Congress intended the section 382 limitation to apply when new shareholders that did not bear the economic burden of the losses acquire a controlling interest in the loss corporation. See H.R. Rep. No. 99-426, 1986-3 C.B. (Vol. 2) 256; S. Rep. No. 99-313 1986-3 C.B. (Vol. 3) 232.

Constructive Ownership Rules

Section 382(l)(3) provides that in determining the ownership of stock of a loss corporation, the constructive ownership rules of section 318 apply, with certain exceptions. Section 382 (by reference to the rules of section 318) and the regulations thereunder generally attribute stock owned by an entity such as a corporation or a partnership to its shareholders or partners, respectively. Therefore, if a corporation makes a *pro rata* distribution of an interest in a loss corporation to its shareholders, the distribution does not result in an acquisition of that interest by the shareholders that must be taken into account in determining whether the loss corporation has an ownership change. On the other hand, section 382 and the regulations thereunder do not attribute stock owned by a qualified trust described in section 401(a) (qualified trust) to participants in the qualified plan under which the trust is established. In particular, although section 318(a)(2) provides for attribution of stock owned by a trust to its beneficiaries, it excepts qualified trusts from the application of this rule. Moreover, §1.382-2T(h)(2)(iii) provides that a qualified trust is treated as an individual unrelated to any other direct or indirect owner of the loss corporation. Accordingly, the participants under a qualified plan are not treated as owning any interest in a loss corporation owned by the trust. Therefore, if a qualified trust owns directly 5 percent or more of a loss corporation, a distribution of an interest in the loss corporation from the trust to plan participants (or their beneficiaries) results in an acquisition of that interest by the participants (or their beneficiaries) that must be taken into account in determining whether the loss corporation has an ownership change.

Explanation of Provisions

In General

Treasury and the IRS are concerned that, under the current rules, a distribution of an ownership interest in an entity from a qualified trust may cause an ownership change, even though that event may not change the ultimate beneficial ownership of the loss corporation. To prevent this result, these temporary regulations set forth new rules.

Distributions From Qualified Trusts

The temporary regulations provide that if a qualified trust distributes an ownership interest in an entity, then for testing dates on or after the date of the distribution, the distributed ownership interest will be treated as having been acquired by the distributee on the date and in the manner acquired by the trust. Furthermore, the distribution itself does not give rise to a testing date. Because the rule applies only for testing dates on or after the date of the distribution, a distribution does not retroactively cause (or undo) an owner shift that would (or would not) have occurred if the distributee had actually acquired the ownership interest on the date and in the manner acquired by the qualified trust.

To determine which ownership interests have been distributed, the loss corporation must account for all dispositions of ownership interests by the qualified trust either by specifically identifying the ownership interest disposed of, or by using a first-in, first-out (FIFO) method. The loss corporation, however, must apply the same method to all dispositions by the qualified trust.

Effective Dates

The temporary regulations apply to all distributions from qualified trusts after June 27, 2003. The loss corporation may choose to apply the rules retroactively in one of two ways: (1) to all distributions from qualified trusts on or before June 27, 2003, and within a testing period that includes June 27, 2003; or (2) to all distributions from qualified trusts after December 31, 1986. Retroactive application will affect a taxpayer's items of income, gain, deduction, or loss only in open years.

Request for Comments and Future Regulations

Treasury and the IRS request comments regarding whether there are other events that, under current rules, are taken into account in determining whether an ownership change occurs, but do not cause the ultimate beneficial ownership of the loss corporation to change. In this regard, Treasury and the IRS have been studying the constructive ownership rules as they apply to members of a family, and the effect of those rules on the determination of whether a loss corporation has an ownership change. Subject to certain exceptions, §1.382-2T(h)(6)(ii) treats an individual, his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), his children, his grandchildren, and his parents as one individual, and aggregates shares owned by those persons for purposes of determining whether a loss corporation has an ownership change. Treasury and the IRS are concerned that, under the current rules, a change in the composition of a family may be interpreted to cause an ownership change. Treasury and the IRS believe that, as in the case of a distribution from a qualified trust, when a change in family composition does not change the ultimate beneficial ownership of the loss corporation, it should not be taken into account in determining whether a loss corporation has an ownership change. For example, a change in family composition that results from a marriage of two individuals does not change the ultimate beneficial ownership of the loss corporation and, therefore, should not cause an ownership change. Accordingly, Treasury and the IRS intend to promulgate regulations to address changes in family composition that result from marriage, birth, adoption, divorce, death, or other events in which an individual joins or leaves a family. It is anticipated that these regulations will be electively retroactive on terms similar to those applicable to the rules regarding distributions from a qualified trust.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order

12866. Therefore, a regulatory assessment is not required. These temporary regulations provide relief to qualifying loss corporations that might be affected by an unintended consequence of the operation of the statute. The regulations relieve a restriction on the ability of qualified trusts that distribute interests in a loss corporation without causing an ownership change. In addition, it is necessary to provide immediate guidance to taxpayers. Accordingly, good cause is found for dispensing with prior notice and comment pursuant to 5 U.S.C. 553(b) and for dispensing with a delayed effective date pursuant to 5 U.S.C. 553(d). For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), see the notice of proposed rulemaking on this subject in this issue of the Bulletin. The IRS and Treasury request comments from small entities that believe they might be adversely affected by these regulations. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact.

Drafting Information

The principal author of these regulations is Martin Huck, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.382-10T is also issued under 26 U.S.C. 382(m). * * *

Par. 2. Section 1.382-1 is amended by adding an entry in numerical order to read as follows:

§1.382-1 *Table of contents.*

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§1.382–10T Special rules for determining time and manner of acquisition of an interest in a loss corporation.

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Par. 3. Section 1.382–10T is added to read as follows:

§1.382–10T Special rules for determining time and manner of acquisition of an interest in a loss corporation (temporary).

(a) *Distributions from qualified trusts*—(1) *In general.* For purposes of §1.382–2T, if a qualified trust described in section 401(a) (qualified trust) distributes an ownership interest in an entity (as defined in §1.382–3(a)(1)), then for testing dates on or after the date of the distribution, the distributed ownership interest is treated as having been acquired by the distributee on the date and in the manner acquired by the trust and not as having been acquired or disposed of by the trust. The distribution does not cause the day of the distribution to be a testing date.

(2) *Accounting for dispositions*—(i) *General rule.* For purposes of this paragraph (a), in order to determine which ownership interest in an entity is distributed from a qualified trust, a loss corporation must either specifically identify the ownership interests that are the subject of all dispositions by the qualified trust of ownership interests in an entity, or apply the first-in, first-out (FIFO) method to all such dispositions.

(ii) *Special rules.* For purposes of this paragraph (a)(2):

(A) The FIFO method must be applied on a class-by-class basis; and

(B) The term dispositions includes distributions, sales, and other transfers.

(3) *Examples.* The following examples illustrate the principles of this paragraph (a). For purposes of these examples, unless otherwise stated, the nomenclature and assumptions of the examples in §1.382–2T(b) apply, all corporations file separate income tax returns on a calendar year basis, the only 5-percent shareholder of a loss corporation is a public group, and the facts set forth the only acquisitions of stock by any participants in a qualified plan and the only owner shifts with respect to the loss corporation during the testing period. The examples are as follows:

Example 1—(i) *Facts.* In 1994, E, a qualified trust established under Plan F, acquires 10 percent of L

stock. A is a participant in Plan F. On January 1, 2002, A acquires 4 percent of L stock, and B, who is not a participant or a beneficiary of a participant in Plan F, acquires 5 percent of L stock. On January 1, 2004, E distributes 2 percent of L stock to A. On July 1, 2004, A acquires 1 percent of L stock.

(ii) *Analysis.* January 1, 2002, is a testing date because B's acquisition of 5 percent of L stock causes an increase in the percentage ownership of B, a 5-percent shareholder. As of the close of that testing date, A is treated as owning only 4 percent of L stock. Therefore, A is treated as a member of the public group of L. In addition, E is treated as owning 10 percent of L stock that it acquired in 1994.

(iii) As a result of the application of paragraph (a)(1) of this section to E's distribution of 2 percent of L stock to A on January 1, 2004, for testing dates on and after January 1, 2004, A is treated as having acquired that 2 percent interest in L in 1994, and E is treated as having acquired only 8 percent of L stock in 1994. Because there are no owner shifts on January 1, 2004, that date is not a testing date.

(iv) July 1, 2004, is a testing date because on that date A, a 5-percent shareholder, acquires 1 percent of L stock. As of the close of that testing date, A's percentage of ownership of L stock is 7 percent, and A's lowest percentage of ownership of L stock at any time within the testing period is 2 percent (deemed acquired in 1994), representing an increase of 5 percentage points. In addition, as of the close of July 1, 2004, B's percentage of ownership of L stock is 5 percent, and B's lowest percentage of ownership of L stock at any time within the testing period is 0 percent, representing an increase of 5 percentage points. Thus, on July 1, 2004, L must take into account an increase of 10 (5 + 5) percentage points in determining whether it has an ownership change.

Example 2—(i) *Facts.* E is a qualified trust established under Plan F. L, a publicly traded corporation, has 100x shares of stock outstanding. As of January 1, 2006, C owns 5x shares of L stock and is not a participant or beneficiary of a participant in Plan F. At all times prior to January 1, 2006, E owns no L stock. On January 1, 2006, E acquires 10x shares of L stock from members of the public group of L. On December 1, 2007, E distributes 5x shares of L stock to some of the participants in Plan F. No one participant acquires all 5x shares as a result of the distribution. On February 1, 2008, C purchases 1x shares of L stock from the public group of L.

(ii) *Analysis.* Because E's acquisition of 10x shares of L stock on January 1, 2006, is an owner shift, that date is a testing date. As of the close of that date, E's percentage of stock ownership in L has increased by 10 percentage points.

(iii) As a result of the application of paragraph (a)(1) of this section to E's distribution of 5x shares of L stock to some Plan F participants on December 1, 2007, for testing dates on and after December 1, 2007, those distributees are treated as having acquired those shares of stock on January 1, 2006, from members of the public group of L, and E is not treated as having acquired those shares on that date. E's distribution of the 5x shares is not an owner shift. Therefore, December 1, 2007, is not a testing date.

(iv) February 1, 2008, is a testing date because on that date an owner shift results from C's purchase of 1x shares of L stock. As of the close of that testing date, the distributees of 5x shares of L stock are

treated as members of the public group of L having acquired 5x shares of L stock from other members of the public group of L on January 1, 2006. Because those acquisitions are not by 5-percent shareholders, L does not take them into account. In addition, as of the close of February 1, 2008, E's percentage of stock ownership in L is 5 percent, and E's lowest percentage of stock ownership in L at any time within the testing period is 0 percent, representing an increase of 5 percentage points. In addition, as of the close of February 1, 2008, C's percentage of stock ownership in L is 6 percent, and C's lowest percentage of stock ownership in L at any time within the testing period is 5 percent, representing an increase of 1 percentage point. Therefore, on February 1, 2008, L must take into account an increase of 6 (5 + 1) percentage points in determining whether it has an ownership change.

(4) *Effective date*—(i) *General rule.* This section applies to all distributions after June 27, 2003.

(ii) *Retroactive application.* Notwithstanding paragraph (a)(4)(i) of this section, a loss corporation may apply the rules of this section retroactively to:

(A) All distributions on or before June 27, 2003, that are within a testing period that includes June 27, 2003; or

(B) All distributions after December 31, 1986.

(b) [Reserved]

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 18, 2003.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 26, 2003, 8:45 a.m., and published in the issue of the Federal Register for July 27, 2003, 68 F.R. 38177)