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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9487]

RIN 1545-BG03

Built-in Gains and Losses under Section 382(h)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that apply to loss corporations that have undergone an ownership change within the meaning of section 382. These regulations provide guidance regarding the treatment of prepaid income under the built-in gain provisions of section 382(h).

DATES: Effective Date: These regulations are effective on **[INSERT DATE**

THIS DOCUMENT IS FILED FOR PUBLIC INSPECTION WITH THE OFFICE OF FEDERAL REGISTER].

Applicability Date: For dates of applicability see §1.382-7(b).

FOR FURTHER INFORMATION CONTACT: Keith E. Stanley, (202) 622-7750
(not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR Part 1. On June 14, 2007, temporary regulations (TD 9330; 72 FR 32792) regarding the treatment of prepaid income under the built-in gain provisions of section 382(h) were published in the **Federal Register**. A notice of proposed rulemaking (NPRM) (REG-144540-06) cross-referencing to temporary regulations was published in the **Federal Register** for the same day (72 FR 32828). The temporary regulations provided that prepaid income is not recognized built-in gain (“RBIG”) for purposes of section 382(h). They further provided that prepaid income means any amount received prior to the change date that is attributable to performance occurring on or after the change date. Examples of prepaid income include, but are not limited to, income received prior to the change date that is deferred until the five year section 382 recognition period under section 455, §1.451-5, or Rev. Proc. 2004-34 (2004-1 CB 991 (June 1, 2004)) (or any successor revenue procedure) (see §601.601(d)(2)(ii)(b)). These prepaid income provisions permit deferral in order to better match the taxpayer’s income with the expenses incurred to earn that income and, as a result, to more clearly reflect the taxpayer’s income both in the year of receipt and in the year of performance. The IRS and the Treasury Department therefore view such income to be properly attributable to the period when included in gross income, which may be within the recognition period. Accordingly, such income is not “attributable to periods before the change date” and so is not RBIG under section 382(h)(6)(A).

One comment was received and no public hearing was requested or held. The public comment focused on companies in the business of providing

extended warranty coverage for automobiles or other products. The commenter presented an example under the facts of which the commenter argued that a portion of the prepaid income deferred to the recognition period should be treated as RBIG.

After giving consideration to the comment, the IRS and Treasury continue to believe that none of the prepaid income taken into account during the recognition period in the example should be RBIG. As noted above, where prepaid income is properly deferred from gross income under a permissible method of accounting, such deferral reflects a judgment that the income has not been earned, or, in the parlance of section 382(h)(6)(A), is not “attributable to” prior performance. The premise of this Treasury decision is that, for purposes of section 382, there is not a compelling policy underlying section 382(h) that warrants a different timing answer for the treatment of properly deferred prepaid income.

Accordingly, the proposed regulations set forth in the NPRM (REG-144540-06), which cross-referenced to the temporary regulations for their substance, are adopted with no substantive change by this Treasury decision, and the corresponding temporary regulations are removed.

Special Analyses

It has been determined that this regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to 5 U.S.C. 553(d)(3), it has been determined that good cause exists to dispense with a delayed effective date on grounds that this

regulation, which is substantively identical to currently effective temporary regulations, merely continues to provide necessary guidance to taxpayers with respect to the treatment of prepaid income under the built-in gain provisions of section 382(h). It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. These regulations only apply in the rare circumstance in which a qualifying loss corporation that uses a particular accounting method undergoes an ownership change. 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 final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Keith E. Stanley of the Office of Associate Chief Counsel (Corporate). Other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements

Adoption of 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 entries in numerical order to read in part as follows:

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

Section 1.382-7 also issued under 26 U.S.C 382(m). * * *

Par. 2. Section 1.382-1T is added to read as follows:

§1.382-1T Table of contents (temporary).

This section lists the captions that appear in the regulations for §1.382-2T.

1.382-2T Definition of ownership change under section 382, as amended by the Tax Reform Act of 1986 (temporary).

(a) *Ownership change.* (1) In general.

(2) Events requiring a determination of whether an ownership change has occurred.

(i) Testing dates prior to November 5, 1992.

(ii) [Reserved]

(iii) Records to be maintained by loss corporation.

(b) *Nomenclature and assumptions.*

(c) *Computing the amount of increases in percentage ownership.* (1) In general.

(2) Example.

(3) Related and unrelated increases in percentage stock ownership.

(4) Example.

(d) *Testing period.* (1) In general.

(2) Effect of a prior ownership change.

(3) Commencement of the testing period.

(i) In general.

(ii) Exception for corporations with net unrealized built-in loss.

(4) Disregarding testing dates.

(5) Example.

(e) *Owner shift and equity structure shift.*

(1) Owner shift.

(i) Defined.

(ii) Transactions between persons who are not 5-percent shareholders disregarded.

(iii) Examples.

(2) Equity structure shift.

(i) Tax-free reorganizations.

(ii) Transactions designated under section 382(g)(3)(B) treated as equity structure shifts.

(iii) Overlap of owner shift and equity structure shift.

(iv) Examples.

(f) *Definitions.* (1) Loss corporation.

(2) Old loss corporation.

(3) New loss corporation.

(4) Successor corporation.

(5) Predecessor corporation.

(6) Shift.

(7) Entity.

(8) Direct ownership interest.

(9) First tier entity.

(10) 5-percent owner.

(11) Public shareholder.

- (12) Public owner.
- (13) Public group.
- (14) Higher tier entity.
- (15) Indirect ownership interest.
- (16) Highest tier entity.
- (17) Next lower tier entity.
- (18) Stock.
 - (i) In general.
 - (ii) Treating stock as not stock.
 - (iii) Treating interests not constituting stock as stock.
 - (iv) Stock of the loss corporation.
- (19) Change date.
- (20) Year.
- (21) Old section 382.
- (22) Pre-change loss.
- (23) Unrelated.
- (24) Percentage ownership interest.
 - (g) *5-percent shareholder*. (1) In general.
 - (2) Determination of whether a person is a 5-percent shareholder.
 - (3) Determination of the percentage stock ownership interest of a 5-percent shareholder.
 - (4) Examples.
 - (5) Stock ownership presumptions in connection with certain acquisitions and dispositions of loss corporation stock.

- (i) In general.
- (ii) Example.
- (h) *Constructive ownership of stock.* (1) In general.
 - (2) Attribution from corporations, partnerships, estates and trusts.
 - (i) In general.
 - (ii) Limitation on attribution from entities with respect to certain interests.
 - (iii) Limitation on attribution from certain entities.
 - (iv) Examples.
 - (3) Attribution to corporations, partnerships, estates and trusts.
 - (4) Option attribution.
 - (i) In general.
 - (ii) Examples.
 - (iii) Contingencies.
 - (iv) Series of options.
 - (v) Interests that are similar to options.
 - (vi) Actual exercise of options.
 - (A) In general.
 - (B) Actual exercise within 120 days of deemed exercise.
 - (vii) Effect of deemed exercise of options on the outstanding stock of the loss corporation.
 - (A) Right of obligation to issue stock.
 - (B) Right or obligation to acquire outstanding stock by the loss corporation.
 - (C) Effect on value of old loss corporation.
 - (viii) Options that lapse or are forfeited.

- (ix) Option rule inapplicable if pre-change losses are de minimis.
- (x) Options not subject to attribution
 - (A) Long-held options with respect to actively traded stock.
 - (B) Right to receive or obligation to issue a fixed dollar amount of value of stock upon maturity of certain debt.
 - (C) Right or obligation to redeem stock of the loss corporation.
 - (D) Options exercisable only upon death, disability or mental incompetency.
 - (E) Right to receive or obligation to issue stock as interest or dividends.
 - (F) Options outstanding following an ownership change.
 - (1) In general.
 - (2) Example.
 - (G) Right to acquire loss corporation stock pursuant to a default under loan agreement.
 - (H) Agreement to acquire or sell stock owned by certain shareholders upon retirement.
 - (I) [Reserved]
 - (J) Title 11 of similar case.
 - (K)–(Y) [Reserved]
- (xi) Certain transfers of options disregarded.
- (xii) Exercise of an option that has not been treated as stock.
- (xiii) Effective date.
- (5) Stock transferred under certain agreements.
- (6) Family attribution.
 - (i) [Reserved]

(j) *Aggregation and segregation rules.* (1) Aggregation of public shareholders and public owners into public groups.

(i) Public group.

(ii) Treatment of public group that is a 5-percent shareholder.

(iii) Presumption of no cross-ownership.

(iv) Identification of the public groups treated as 5-percent shareholders.

(A) Analysis of highest tier entities.

(B) Analysis of other higher tier entities and first tier entities.

(C) Aggregation of the public shareholders.

(v) Appropriate adjustments.

(vi) Examples.

(2) Segregation rules applicable to transactions involving the loss corporation.

(i) In general.

(ii) Direct public group.

(iii) Transactions to which segregation rules apply.

(A) In general.

(B) Certain equity structure shifts and transactions to which section 1032 applies.

(1) In general.

(2) Examples.

(C) Redemption-type transactions.

(1) In general.

(2) Examples.

(D) Acquisition of loss corporation stock as the result of the ownership of a right to acquire stock.

(1) In general.

(2) Example.

(E) Transactions identified in the Internal Revenue Bulletin.

(F) Issuance of rights to acquire loss corporation stock.

(1) In general.

(2) Example.

(iv) Combination of de minimis public groups.

(A) In general.

(B) Example.

(v) Multiple transactions.

(A) In general.

(B) Example.

(vi) Acquisitions made by either a 5-percent shareholder or the loss corporation following application of the segregation rules.

(3) Segregation rules applicable to transactions involving first tier entities or higher tier entities.

(i) Dispositions.

(ii) Example.

(iii) Other transactions affecting direct public groups of a first tier entity or higher tier entity.

(iv) Examples.

(v) Acquisitions made by a 5-percent shareholder, a higher tier entity, or a first tier entity following application of the segregation rules.

(k) *Operating rules.* (1) Presumptions regarding stock ownership.

(i) Stock subject to regulation by the Securities and Exchange Commission.

- (ii) Statements under penalties of perjury.
- (2) Actual knowledge regarding stock ownership.
- (3) Duty to inquire as to actual stock ownership in the loss corporation.
- (4) Ownership interests structured to avoid the section 382 limitation.
- (5) Example.
- (6) First tier entity or higher tier entity that is a foreign corporation or entity.
[Reserved.]
- (l) *Changes in percentage ownership which are attributable to fluctuations in value.* [Reserved]
- (m) *Effective date.* (1) In general.
- (2) Plan of reorganization.
- (3) Earliest commencement of the testing period.
- (4) Transitional rules.
- (i) Rules provided in paragraph (j) of this section for testing dates before September 4, 1987.
- (ii) Example.
- (iii) Rules provided in paragraph (j) of this section for testing dates on or after September 4, 1987.
- (iv) Rules provided in paragraphs (f)(18)(ii) and (iii) of this section.
- (v) Rules provided in paragraph (a)(2)(ii) of this section.
- (vi) Rules provided in paragraph (h)(4) of this section.
- (vii) Rules provided in paragraph (a)(2)(i) of this section.
- (5) Bankruptcy proceedings.
- (i) In general.
- (ii) Example.

- (6) Transactions of domestic building and loan associations.
- (7) Transactions not subject to section 382.
 - (i) Application of old section 382.
 - (ii) Effect on testing period.
 - (iii) Termination of old section 382. [Reserved]
- (8) Options issued or transferred before January 1, 1987.
 - (i) Options issued before May 6, 1986.
 - (ii) Options issued on or after May 6, 1986 and before September 18, 1986.
 - (iii) Options issued on or after September 18, 1986 and before January 1, 1987.
- (9) Examples.

Par. 3. Section 1.382-1 is amended by:

- 1. Revising the introductory text.
- 2. Removing the entry for §1.382-1T.
- 3. Removing the entries for §1.382-2T.
- 4. Adding the entries for §1.382-7.

The revisions and the additions read as follows:

§1.382-1 Table of contents.

This section lists the captions that appears in the regulations for §§1.382-2 through 1.382-11.

* * * * *

§1.382-7 Built-in gains and losses.

- (a) Treatment of prepaid income.
- (b) Effective/applicability dates.

* * * * *

Par. 4. Section 1.382-7 is added to read as follows:

§1.382-7 Built-in gains and losses.

(a) Treatment of prepaid income. For purposes of section 382(h), prepaid income is not recognized built-in gain. The term prepaid income means any amount received prior to the change date that is attributable to performance occurring on or after the change date. Examples to which this paragraph (a) will apply include, but are not limited to, income received prior to the change date that is deferred under section 455, §1.451-5, or Rev. Proc. 2004-34 (2004-1 CB 991 (June 1, 2004)) (or any successor revenue procedure) (see §601.601(d)(2)(ii)(b)).

(b) Effective/applicability dates. This section applies to loss corporations that have undergone an ownership change on or after **[INSERT DATE THIS DOCUMENT IS FILED FOR PUBLIC INSPECTION WITH THE OFFICE OF FEDERAL REGISTER]**. For loss corporations that have undergone an ownership change before **[INSERT DATE THIS DOCUMENT IS FILED FOR PUBLIC INSPECTION WITH THE OFFICE OF FEDERAL REGISTER]**, see §1.382-7T as contained in 26 CFR part 1, revised April 1, 2009.

§1.382-7T [Removed]

Par. 5. Section 1.382-7T is removed.

Steven T. Miller
Deputy Commissioner for Services and Enforcement.

Approved: June 8, 2010

Michael Mundaca
Assistant Secretary of the Treasury (Tax Policy).

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