[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9458]

RIN 1545-BI72

Modification to Consolidated Return Regulation Permitting an Election to Treat a Liquidation of a Target, Followed by a Recontribution to a New Target, as a Cross-Chain Reorganization

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 1502 of the Internal Revenue Code (Code). The change to the consolidated return regulations is necessary in light of the regulations under section 368 that were issued in October 2007 addressing transfers of assets or stock following a reorganization. The temporary regulations modify the election under which a consolidated group can avoid immediately taking into account an intercompany item after the liquidation of a target corporation. The temporary regulations apply to corporations filing consolidated returns. The text of these temporary regulations also serves as the text of the proposed regulations (REG-139068-08) set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective on [**INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**

Applicability Date: The changes reflected in these temporary regulations

(§1.1502-13T(f)(5)(ii)(B)(1) and (2)) generally apply to transactions in which T's liquidation into B occurs on or after the effective date of the §1.368-2(k) regulations, October 25, 2007. For transactions in which T's liquidation into B occurs before October 25, 2007, §1.1502-13(f)(ii)(B)(1) and (2) in effect prior to October 25, 2007 as contained in 26 CFR part 1, revised April 1, 2009, continue to apply.

FOR FURTHER INFORMATION CONTACT: Concerning the temporary regulations, Mary W. Lyons, (202) 622-7930; concerning submission of comments and the hearing, Oluwafunmilayo (Funmi) Taylor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1433. Responses to this collection of information are required in order for the parent of a consolidated group to make the election found in §1.1502-13T(f)(5)(ii)(B).

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.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the

cross-referencing notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

Books or records relating to a 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

Section 1.1502-13(f)(5) provides that S's (the selling member in an intercompany transaction) intercompany item from a transfer to B (the buying member in an intercompany transaction) of the stock of another corporation (T) is taken into account in certain circumstances even though the T stock is never held by a nonmember of the consolidated group after the intercompany transaction. For example, if S sells all of T's stock to B at a gain, and T subsequently liquidates into B in a separate transaction to which section 332 applies, S's gain is taken into account under the matching rule. This result would also be obtained in other transactions in which B's basis in its T stock is permanently eliminated in a nonrecognition transaction, including a merger of B into T under section 368(a), a distribution by B of its T stock in a transaction described in section 355, and a deemed liquidation of T resulting from an election under section 338(h)(10). However, an election to apply §1.1502-13(f)(5)(ii)(B) is available that allows a taxpayer whose intercompany gain on subsidiary (T) stock was taken into account upon the subsidiary's liquidation to reincorporate the subsidiary to prevent the intercompany gain from being taken account at such time. Section 1.1502-13(f)(5)(ii)(B) provides:

> If section 332 applies to T's liquidation into B, and B transfers T's assets to a new member (new T) in a transaction not otherwise pursuant to the same plan or arrangement as the liquidation, the transfer is nevertheless treated for all Federal income tax purposes as pursuant to the same plan or arrangement as the liquidation. For example, if T liquidates into B, but B forms new T by transferring substantially all of T's former assets to new T, S's intercompany gain or loss generally is not taken into account solely as a result of the liquidation if the liquidation and transfer would qualify as a reorganization described in section 368(a). (Under [§ 1.1502-13(j)(1)], B's stock in new T would be a successor asset to B's stock in T, and S's gain would be taken into account based on the new T stock.)

1. Results Prior to the Issuance of §1.368-2(k) Regulations.

Prior to the issuance of the regulations under §1.368-2(k) (the -2(k) regulations) in October 2007, the election to apply §1.1502-13(f)(5)(ii)(B) triggered the application of the step transaction doctrine. Under the step transaction doctrine, the liquidation of a corporation followed by a contribution of substantially all its assets to a new corporation generally is recharacterized as a cross-chain reorganization. In a cross-chain reorganization, B's basis in the new T stock is determined by reference to its basis in the old T stock. Therefore, under §1.1502-13(j), the new T stock is a successor asset to the old T stock, and S's gain on the old T stock is not taken into account upon the liquidation of old T, but instead is taken into account by reference to the new T stock. By not immediately taking the gain into account, the purpose of §1.1502-13, that is, to provide rules that clearly reflect the income and tax liability of the group by preventing intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income or consolidated tax liability, is accomplished. See §1.1502-13(a)(1)).

2. Results After the Issuance of §1.368-2(k) Regulations.

The issuance of the -2(k) regulations created a conflict with the language of §1.1502-13(f)(5)(ii)(B). Section 1.368-2(k) provides, in general, that a transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided that the requirements of §1.368-1(d) are satisfied and the transfer(s) are described in either §1.368-2(k)(1)(i) or (ii). Under the -2(k) regulations, which are generally effective for transactions occurring on or after October 25, 2007, the liquidation of old T followed by the contribution of substantially all the old T assets to new T would now be characterized as an upstream C reorganization (if it so qualifies) followed by a section 368(a)(2)(C) drop of assets, and would no longer be recharacterized as a cross-chain reorganization. Thus, B's basis in its new T stock would not be determined by reference to B's basis in the old T stock, but by reference to the basis of old T's assets.

3. Reason for Change.

Section 1.1502-13(j)(1) provides that an asset is a successor asset if its basis is determined by reference to the basis of the first asset. In a cross-chain reorganization, the result prior to the issuance of the -2(k) regulations, B's basis in the new T stock would be determined by reference to the basis of the old T stock, thus the new T stock would clearly fall within the meaning of successor asset in §1.1502-13(j)(1). However, in an upstream reorganization followed by a drop of the assets to new T, the result after the issuance of the -2(k) regulations, B's basis in new T would be determined by reference to the basis of the old T assets, not the old T stock. Thus, the new T stock would not be a successor asset to the old T stock in an upstream reorganization.

Permitting an election to apply §1.1502-13(f)(5)(ii)(B) while treating the transaction as an upstream reorganization would be inconsistent with the purposes of §1.1502-13. For example, assume S sells its stock in T to B for $1,000,000 and T has a basis in its assets of $3,000,000. T then liquidates into B, which recontributes the assets to new T. If the transaction is treated as an upstream reorganization under section 368(a)(1)(C), followed by a drop of the assets under section 368(a)(2)(C), B would receive a basis in T's assets of $3,000,000 under section 362(b), and, on the drop of the assets to new T, would receive a basis in its new T stock of $3,000,000 under section 358(a). This increase in basis in the new T stock over the basis of the old T stock is inconsistent with allowing S's continued deferral of the gain on the old T stock and the purposes of §1.1502-13.

Therefore, in order to satisfy the purposes of §1.1502-13, these regulations provide that if the election to apply §1.1502-13T(f)(5)(ii)(B) is made for a transaction in which old T liquidates into B on or after the effective date of the -2(k) regulations, followed by B's transfer of substantially all of old T's assets to new T, then, for all Federal income tax purposes, old T's liquidation into B and B's transfer of substantially all of old T's assets to new T will be disregarded and, instead, the transaction will be treated as if old T transferred substantially all of its assets to new T in exchange for new T stock in a reorganization described in section 368(a). This election is available only if a direct transfer of the old T assets to new T would qualify as a reorganization. Thus, S's gain from the sale of the T stock to B is not taken into account upon the liquidation of T but instead is taken into account with respect to the new T stock, the successor asset to the old T stock.

4. Previous Intercompany Transaction With Respect to the T Stock.

Under current §1.1502-13(f)(5) and these regulations, the election so described is available only if the old T stock had previously been transferred in an intercompany transaction. Comments are requested on whether the election should be available even when there has not been a previous intercompany transaction with respect to the old T stock.

5. Effective/Applicability Date.

The changes reflected in these temporary regulations (§1.1502-13T(f)(5)(ii)(B)(1) and (2)) generally apply to transactions in which T's liquidation into B occurs on or after the effective date of the -2(k) regulations, October 25, 2007. For transactions in which T's liquidation into B occurs before October 25, 2007, §1.1502-13(f)(ii)(B)(1) and (2) in effect prior to October 25, 2007 as contained in 26 CFR part 1, revised April 1, 2009, continue to apply. Generally, pursuant to §1.1502-13T(f)(5)(ii)(B)(2) and §1.1502-13(f)(5)(ii)(E), the election described in these temporary regulations is made by entering into a written plan to transfer the T assets from B to new T on or before the due date of the consolidated tax return for the tax year that includes the date of the liquidation and including the statement described in §1.1502-13(f)(5)(ii)(E) on or with such timely filed return. However, consolidated groups for which the liquidation of the target corporation occurred on or after October 25, 2007, and whose tax return for the year of liquidation was filed before [**INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]** may make this election by entering into the written plan on or before **[INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]** and

including the statement on or with an original tax return or an amended tax return for the tax year that includes the liquidation filed before **[INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].** In either case, the transfer of substantially all of T's assets to new T must be made within 12 months of the filing of such original or amended return.

Special Analyses

It has been determined that this temporary regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that these regulations will not have a significant impact on a substantial number of small entities. This certification is based on the fact that these regulations do not have a substantial economic impact because they merely provide for an election in the context of a taxpayer that has triggered deferred gain on subsidiary stock upon the liquidation of the subsidiary. Moreover, the regulations apply only to transactions involving consolidated groups which tend to be larger businesses. Accordingly 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 Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business**.**

Drafting Information

The principal author of these temporary regulations is Mary W. Lyons of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS

and Treasury Department 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.

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 continues to read in part as follows:

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

Section 1.1502-13T also issued under 26 U.S.C. 1502 * * *

Par. 2. Section 1.1502-13 is amended by revising paragraph (f)(5)(ii)(B) to read as follows:

§1.1502-13 Intercompany transactions.

* * * * *

(f) * * *

(5) * * *

(ii) * * *

(B)(1) [Reserved]. For further guidance, see §1.1502-13T(f)(5)(ii)(B)(1).

(2) [Reserved]. For further guidance, see §1.1502-13T(f)(5)(ii)(B)(2).

Par. 3. Section 1.1502-13T is amended by:

1. Revising paragraphs (f)(5)(ii)(B)(1) and (B)(2).

2. Adding paragraph (f)(5)(ii)(F).

The revisions and addition read as follows:

§1.1502-13T Intercompany transactions (temporary).

* * * * *

(c)(6)(ii)(D) through (f)(5)(ii)(A) [Reserved]. For further guidance, see §1.1502-13(c)(6)(ii)(D) through (f)(5)(ii)(A).

(B) Section 332--(1) In general. If section 332 would otherwise apply to T's (old T's) liquidation into B, and B transfers substantially all of old T's assets to a new member (new T), and if a direct transfer of substantially all of old T's assets to new T would qualify as a reorganization described in section 368(a), then, for all Federal income tax purposes, T's liquidation into B and B's transfer of substantially all of old T's assets to new T will be disregarded and instead, the transaction will be treated as if old T transferred substantially all of its assets to new T in exchange for new T stock and the assumption of T's liabilities in a reorganization described in section 368(a). (Under §1.1502-13(j)(1), B's stock in new T would be a successor asset to B's stock in old T, and S's gain would be taken into account based on the new T stock.)

(2) Time limitation and adjustments. The transfer of old T's assets to new T qualifies under paragraph (f)(5)(ii)(B)(1) of this section only if B has entered into a written plan, on or before the due date of the group's consolidated income tax return (including extensions), to transfer the T assets to new T, and the statement described in paragraph (f)(5)(ii)(E) of this section is included on or with a timely filed consolidated tax return for the tax year that includes the date of the liquidation (including extensions). However, see paragraph (f)(5)(ii)(F) of this section for certain situations in which the

plan may be entered into after the due date of the return and the statement described in paragraph (f)(5)(ii)(E) of this section may be included on either an original tax return or an amended tax return filed after the due date of the return. In either case, the transfer of substantially all of T's assets to new T must be completed within 12 months of the filing of the return. Appropriate adjustments are made to reflect any events occurring before the formation of new T and to reflect any assets not transferred to new T, or liabilities not assumed by new T. For example, if B retains an asset of old T, the asset is treated under §1.1502-13(f)(3) as acquired by new T but distributed to B immediately after the reorganization.

(f)(5)(ii)(B)(3) through (f)(5)(ii)(E) [Reserved]. For further guidance, see §1.1502-13(f)(5)(ii)(B)(3) through (f)(5)(ii)(E).

(F) Effective/Applicability date--(1) General rule. Paragraphs (f)(5)(ii)(B)(1) and (2) of this section apply to transactions in which old T's liquidation into B occurs on or after October 25, 2007.

(2) Prior periods. For transactions in which old T's liquidation into B occurs before October 25, 2007, see §1.1502-13(f)(5)(ii)(B)(1) and (2) in effect prior to October 25, 2007 as contained in 26 CFR part 1, revised April 1, 2009.

(3) Special rule for tax returns filed before [**INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS TEMPORARY REGULATION IN THE FEDERAL REGISTER]**. In the case of a liquidation on or after October 25, 2007, by a taxpayer whose original tax return for the year of liquidation was filed on or before [**INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS TEMPORARY REGULATION IN THE FEDERAL REGISTER]** then, notwithstanding

paragraph (f)(5)(ii)(B)(2) of this section and §1.1502-13(f)(5)(ii)(E), the election to apply paragraph (f)(5)(ii)(B) of this section may be made by entering into the written plan described in paragraph (f)(5)(ii)(B) of this section on or before [**INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS TEMPORARY REGULATION IN THE FEDERAL REGISTER],** including the statement described in §1.1502-13(f)(5)(ii)(E) on or with an original tax return or an amended tax return for the tax year that includes the liquidation filed on or before [**INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION OF THIS TEMPORARY REGULATION IN THE FEDERAL REGISTER],** and transferring substantially all of T's assets to new T within 12 months of the filing of such original or amended return.

(f)(6) through (f)(7)(i) Example 6 [Reserved]. For further guidance, see §1.1502-13(f)(6) through (f)(7)(i) Example 6.

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Part 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In § 602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers

* * * * *

(b) * * *

CFR part or section where Identified and described	Current OMB control number
* * * * *	
1.1502-13	1545-1433
* * * * *	

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved: August 27, 2009.

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

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