INTERNAL REVENUE SERVICE
April 20, 1999

CC:DOM:CORP:4
QCC-100801-99

UIL: 382.00-00
1502.21-00
1502.75-10
Number: **199929017**
Release Date: 7/23/1999

Record of Internal Revenue Service National Office Telephone Response to Telephone Inquiry from a Field Office

This record of response, as well as the telephone response itself, is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

P2 =

P1 =

Target =

B =

$U =

$V =

$W =

$X =

$Y =

Year 1 =

Date 1 =

Date 2 =

Issue/Questions: How to apply § 382 and the consolidated return SRLY rules to the facts of this case, which involve successive ownership changes (OCs) and application of the SRLY subgroup rules.

Facts: Taxpayer (TP), P2, is the common parent of a consolidated group with a January 31st taxable year, which group came into existence near the end of Year 1. Before the group came into existence, P2 was an S-corporation wholly owned by B, an individual, who also partially or wholly owned the stock of other S-corporations that would become members of the P2 Group upon or shortly after its formation (all such S-corporations converting to C status). Former shareholders of those S-corporations generally would receive P2 stock in exchange for their S-corporation stock. Upon P2's conversion to C status, B may initially have owned 100 percent of its stock.

B also owned 100 percent of the stock of P1, a corporation with a March 31st taxable year formed to purchase all the stock of Target & its subsidiaries, which purchase occurred Date 1. Target and its subsidiaries presumably had been a consolidated group (Target Group), which terminated with its purchase by P1, its former members joining with P1 in filing a consolidated return for the P1 Group. The Target Group, which had about $X of NOL carryovers and $Y of capital loss (CL) carryovers at the time of its acquisition, had an OC on Date 1 with respect to which its § 382 limitation was about $U. On Date 2, P1 merged into P2, presumably not a reverse acquisition within the meaning of § 1.1502-75(d)(3). About the same time, P2 issued stock in an IPO to some new shareholders. After these various transactions, B, who previously had owned 100 percent of P1, owned about 40 percent of its successor, P2. Thus, in the course of these transactions, the P1 Group had an OC (on or about Date 2). It is not yet clear what the § 382 limitation was on the 2nd change date. Between the 1st and 2nd change dates, the P1 Group generated about $V of NOLs.

The P2 Group, in the short period between its formation and the date P1 merged into P2, apparently had a NOL of about $W. In subsequent taxable years, the P2 Group apparently had substantial taxable income before NOL carryover deductions.

Telephone Response: (1) *Our advice was given on the presumption P1's merger into P2 did not constitute a reverse acquisition within the meaning of § 1.1502-75(d)(3) of the Income Tax Regulations.* The concept of "reverse acquisition" was discussed generally, and it was noted that language in § 1.1502-75(d)(3)(i) would seem to indicate that, in determining whether P2's acquisition of P1's assets in exchange for P2 stock was a reverse acquisition, any acquisitions or redemptions of the stock of either corporation that were "pursuant to a plan of acquisition described in § 1.1502-75(d)(3)(i)(a) or (b)" would be taken into account. The agent was advised that it is unclear how broadly or narrowly the concept of "plan of acquisition" is to be defined in this context.

(2) Section 1.382-5T(d) provides rules to be applied in the case of successive

OCs of a loss corporation, especially with respect to losses that arise before the 1st change date that are carried to periods after the 2nd change date. Such losses are treated as prechange losses with respect to both OCs. Thus, if the § 382 limitation on the 2nd change date is less than the one on the 1st, it (the limitation on the 2nd change date) applies to all losses arising before the 2nd change date. If the § 382 limitation on the 2nd change date is greater than the one on the 1st, the limitation on the 1st change date continues to apply to losses arising before the 1st change date, and the *aggregate* amount of prechange losses, whenever arising, that can be used in a post-change year after the 2nd change date cannot exceed the limitation for the 2nd change date, with losses from earlier years reducing the amount of unused limitation remaining for losses from later years. These rules apply irrespective of whether § 382(b)(2) has resulted in an increase to either or both of the two limitations.

(3) We noted that further development of the facts could possibly show that the P2 Group had an OC on or about Date 2 (relating to a possible § 382 limitation on its $W of losses arising before that date). It may be a question of facts and circumstances as to which issuances of P2 stock are considered to have occurred upon P2's initial formation.

We also discussed the possible application of the built-in loss rules of § 382(h) re the Date 1 OC.

(4) For purposes of computing the § 382 limitation for the P1 Group on the 2nd change date, the value of the P1 Group is determined by reference to the value of P1's stock immediately before the OC. *See* §§ 382(b)(1) and (e)(1). This might be determined by reference to the value of the P2 stock issued to B *in exchange for his P1 stock* (*not* by the value of all the P2 stock outstanding after the acquisition). *See* § 382(l)(1). Similarly, if P2 had an OC on or about Date 2, the amount of its § 382 limitation (re its $W of losses arising before the OC) would be determined with application of § 382(l)(1), so as not to count the value of the P2 stock issued in exchange for the P1 Group assets, issued in the IPO, or issued re other “capital contributions” within the meaning of § 382(l)(1).

(5) Application of SRLY rules of § 1.1502-21T(c): Section 1.1502-21T(c)(1) provides generally that the aggregate of the NOL carryovers and carrybacks of a member arising in SRLYs that are included in the consolidated NOL deductions for all consolidated taxable years of the group may not exceed the aggregate consolidated taxable income for all consolidated return years of the group determined by reference to only the member’s items of income, gain, deduction, and loss. This generally is known as “the SRLY rule” or “the SRLY limitation.” Section 1.1502-21T(c)(2) provides for a SRLY subgroup limitation. The rules of § 1.1502-21T generally are applicable to consolidated return years beginning on or after January 1, 1997. We are assuming the consolidated groups involved in this case choose to apply those rules to prior periods pursuant to § 1.1502-21T(g)(3).

The former P1 Group, with P1's merger into P2 (if not a reverse acquisition), becomes a SRLY subgroup of the P2 Group with respect to its $V of net operating losses arising between Date 1 and Date 2. The Target Group is a SRLY subgroup with respect to its NOL and capital loss carryovers from periods before Date 1 (even in years after acquisition by P2). *See* § 1.1502-21T(c)(2). For purposes of applying the SRLY subgroup limitation to the P1 SRLY subgroup, P1's successor, P2, becomes a member of the subgroup with P1's merger into P2. *See* § 1.1502-21T(f).

(6) We discussed how the SRLY "register" works when a member has both SRLY NOL carryovers and SRLY capital loss carryovers.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS: Not applicable.

Reviewed By: Charles M. Whedbee Charles M. Whedbee

Office: CC:DOM:CORP:5