

Part III - Administrative, Procedural, and Miscellaneous

CAPITAL CONTRIBUTIONS UNDER SECTION 382(l)(1)

This notice provides guidance regarding capital contributions under section 382(l)(1) of the Internal Revenue Code and requests comments on the subject.

NOTICE 2008-78

I. Purpose.

The Internal Revenue Service (Service) and Treasury Department (Treasury) intend to issue regulations under section 382(l)(1) as described below. Pending the issuance of further guidance, taxpayers may rely on the rules set forth in this notice to the extent provided herein.

II. Background.

Section 382(a) of the Internal Revenue Code (Code), as amended, provides that the taxable income of a loss corporation for a year following an ownership change that may be offset by pre-change losses cannot exceed the section 382 limitation for such year. Similarly, section 383 limits the use of certain credits and net capital losses based on the principles applicable under section 382.

The section 382 limitation for a post-change year is generally equal to the fair market value of the stock of the loss corporation immediately before the ownership change multiplied by the applicable long-term tax-exempt rate. Section 382(l)(1)(A) provides that for purposes of section 382 any capital contribution received by a loss corporation as part of a plan a principal purpose of which is to avoid or increase any limitation under section 382 is not taken into account. Under section 382(l)(1)(B), any capital contribution made during the two-year period ending on the change date (as defined in section 382(j)) is, except as provided in regulations, treated as part of a plan described in section 382(l)(1)(A). Therefore, the value of any such capital contribution is excluded from the computation of the section 382 limitation.

Section 382(m) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of sections 382 and 383.

III. Guidance Under Section 382(l)(1) Regarding Capital Contributions.

The Service and Treasury intend to issue regulations regarding the application of section 382(l)(1). These regulations are expected to set forth the rules described in this section of this Notice.

DEFINITIONS.

Except as otherwise provided, any definitions and terms used herein have the same meaning as they do in section 382 and the regulations thereunder.

In addition, any reference herein to terms and definitions in § 1.355-7 have the same meaning as they do in § 1.355-7, taking into account all other terms and definitions in § 1.355-7, but substituting, in each instance, “contribution” for “distribution,” “loss corporation” for “Distributing and/or Controlled,” and “ownership change” for “acquisition.” For example, the phrase “agreement, understanding, arrangement, or substantial negotiations” as used herein has the same meaning as it does in § 1.355-7, taking into account other terms in § 1.355-7 (such as the definition of “controlling shareholder” in § 1.355-7(h)(3)). In addition, for purposes of substituting “ownership change” for “acquisition,” any reference in § 1.355-7 to “the acquisition” shall be treated as a reference to “any acquisition.”

A “related party” is a party related to the loss corporation (within the meaning of section 267(b), and determined immediately after a capital contribution) or one or more persons that, pursuant to a formal or informal understanding, would be treated as becoming a related party under the principles of § 1.355-7(h)(4) (i.e., a “coordinating group”). The phrase “capital contribution” includes a series of related capital contributions.

RULES.

A. Section 382(l)(1)(B).

Notwithstanding section 382(l)(1)(B), a capital contribution shall not be presumed to be part of a plan a principal purpose of which is to avoid or increase a section 382 limitation solely as a result of having been made during the two-year period ending on the change date.

B. Section 382(l)(1)(A).

(1) In general. A capital contribution received by an old loss corporation shall be taken into account (and will not reduce the value of the old loss corporation for purposes of section 382(e)(1)) unless the contribution is part of a plan a principal purpose of which is to avoid or increase a section 382 limitation (hereinafter, a plan). Whether a capital contribution is part of a plan is determined based on all the facts and circumstances, unless the contribution is described in one of the safe harbors in Section III.B.2 below or section 382(l)(1) does not apply to the contribution pursuant to § 1.382-9(k). The fact that a contribution is not described in a safe harbor does not constitute

evidence that the contribution is part of a plan.

(2) Safe harbors. A capital contribution will not be considered part of a plan if -

(a) The contribution is made by a person who is neither a controlling shareholder (determined immediately before the contribution) nor a related party, no more than 20% of the total value of the loss corporation's outstanding stock is issued in connection with the contribution, there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change, and the ownership change occurs more than six months after the contribution.

(b) The contribution is made by a related party but no more than 10% of the total value of the loss corporation's stock is issued in connection with the contribution, or the contribution is made by a person other than a related party, and in either case there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change, and the ownership change occurs more than one year after the contribution.

(c) The contribution is made in exchange for stock issued in connection with the performance of services, or stock acquired by a retirement plan, under the terms and conditions of § 1.355-7(d)(8) or (9), respectively.

(d) The contribution is received on the formation of a loss corporation (not accompanied by the incorporation of assets with a net unrealized built in loss) or it is received before the first year from which there is a carryforward of a net operating loss, capital loss, excess credit, or excess foreign taxes (or in which a net unrealized built-in loss arose).

C. Coordination of Sections 382(l)(1) and 382(l)(4).

If the value of the old loss corporation is subject to reduction under both sections 382(l)(1) and 382(l)(4), appropriate adjustments must be made to ensure that a reduction in value is not duplicated.

IV. Reliance on Notice.

The Service and Treasury intend to issue regulations under section 382(l)(1) that set forth the rules described in Section III of this notice. Taxpayers may rely on the rules described in Section III for purposes of determining whether a capital contribution is part of a plan with respect to an ownership change that occurs in any taxable year ending on or after September 26, 2008, and these rules will continue to apply unless and until there is additional guidance.

V. Request for Comments.

The Service and Treasury request comments regarding (i) the appropriate scope and application of section 382(l)(1) generally, (ii) the appropriate factors that may tend to show that a capital contribution is or is not made as part of a plan, including standards for contributions made by related parties, (iii) the desirability of applying similar standards in § 1.355-7 as safe harbors for purposes of section 382(l)(1), and whether additional safe harbors are needed, and (iv) the appropriate treatment under section 382(l)(1) of options and conversion rights in general, and whether coordinating rules should be issued under § 1.382-4(d).

VI. Instructions.

Comments should be submitted on or before December 22, 2008, and should include a reference to Notice 2008-78. Send submissions to CC:PA:LPD:PR (Notice 2008-78), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:PR (Notice 2008-78), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically via the following email address: Notice.Comments@irs.counsel.treas.gov. Please include the notice number 2008-78 in the subject line of any electronic communication. All materials submitted will be available for public inspection and copying.

The principal author of this notice is Michael J. Wilder of the Office of Associate Chief Counsel (Corporate). For further information regarding this notice contact Michael J. Wilder on (202) 622-7700 (not a toll-free call).