

The Federal Bar Association

24th Annual Insurance Tax Seminar

Corporate Tax/Consolidated Return Developments

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PLR 201210015

Affiliation of Insurance Companies

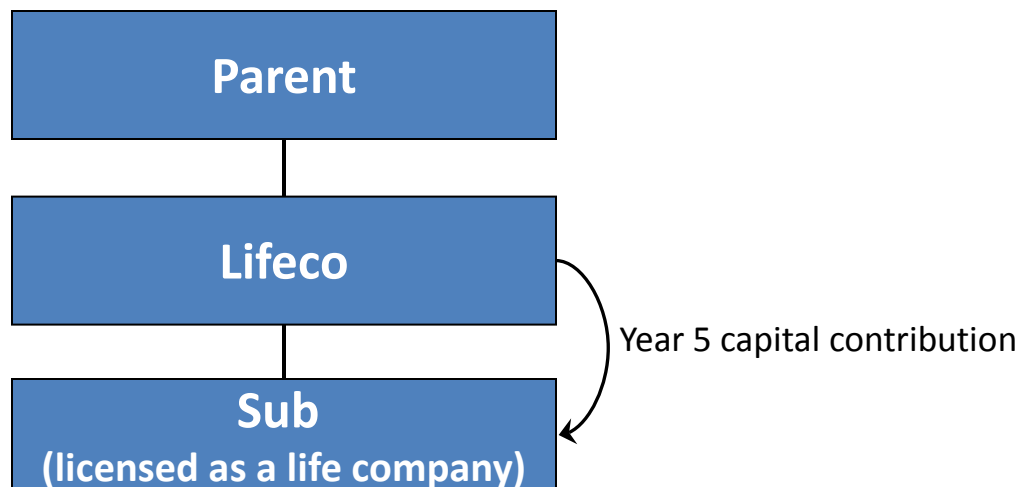
Life-Nonlife Eligibility Requirements

- Reg. § 1.1502-47(d)(12) defines when a life insurance company becomes eligible to join a life-nonlife consolidated group. In order to be eligible, a corporation must
 - Be in existence and a member of the group for the five taxable years immediately preceding the group's taxable year for which the determination of eligibility is made;
 - Be engaged in the active conduct of a trade or business;
 - Must not have undergone a change in tax character attributable to acquisition from outside the group in a transaction not conducted in the ordinary course of business;
 - » In an important exception to the eligibility requirement on tax character, if a corporation relies on the tacking rules, then a change in tax character attributable to an asset acquisition from *within* the group also can cause a corporation to become ineligible, and
 - Must not have undergone a disproportionate asset acquisition.

The Tacking Rule

- Under the tacking rule, the period during which an old corporation is in existence and is engaged in an active business tacks onto the period for a new corporation if several requirements are met.
- In order for the tacking rule to apply, four conditions must be met:
 - At any time, 80 percent or more of the new corporation's assets (other than in the ordinary course of its trade or business) were acquired from the old corporation in one or more transactions described in section 351 or section 381;
 - At the end of the taxable year during which the first condition is met, both the old corporation and the new corporation must have the same tax character;
 - At the end of the year during which the first condition is met, the new corporation has not undergone a disproportionate asset acquisition (a disproportionate asset acquisition in general, has not occurred unless 75% of either the reserves, or fmV of assets or premiums are attributable to acquisitions outside of the group in transactions not in the ordinary course of business); and
 - If there is more than one old corporation, the first two conditions apply to all of the corporations.

PLR 201210015



1. Parent is the common parent of a life-nonlife consolidated group.
2. Lifeco was formed in Year 2 and joined the life-nonlife group in Year 4 as a life company.
3. Sub was formed in Year 3 and joined the life-nonlife group as a nonlife company. Sub did not engage in a business, but apparently did have income from investment assets.
4. Lifeco plans to make a capital contribution in Year 5 such that after the contribution, at least 80% of Sub's assets (based on FMV without regard to liabilities) will have been acquired from Lifeco.
5. At the end of Year 5, both Lifeco and Sub will qualify as life insurance companies.
6. Taxpayer represented that Sub did not undergo a disproportionate asset acquisition.

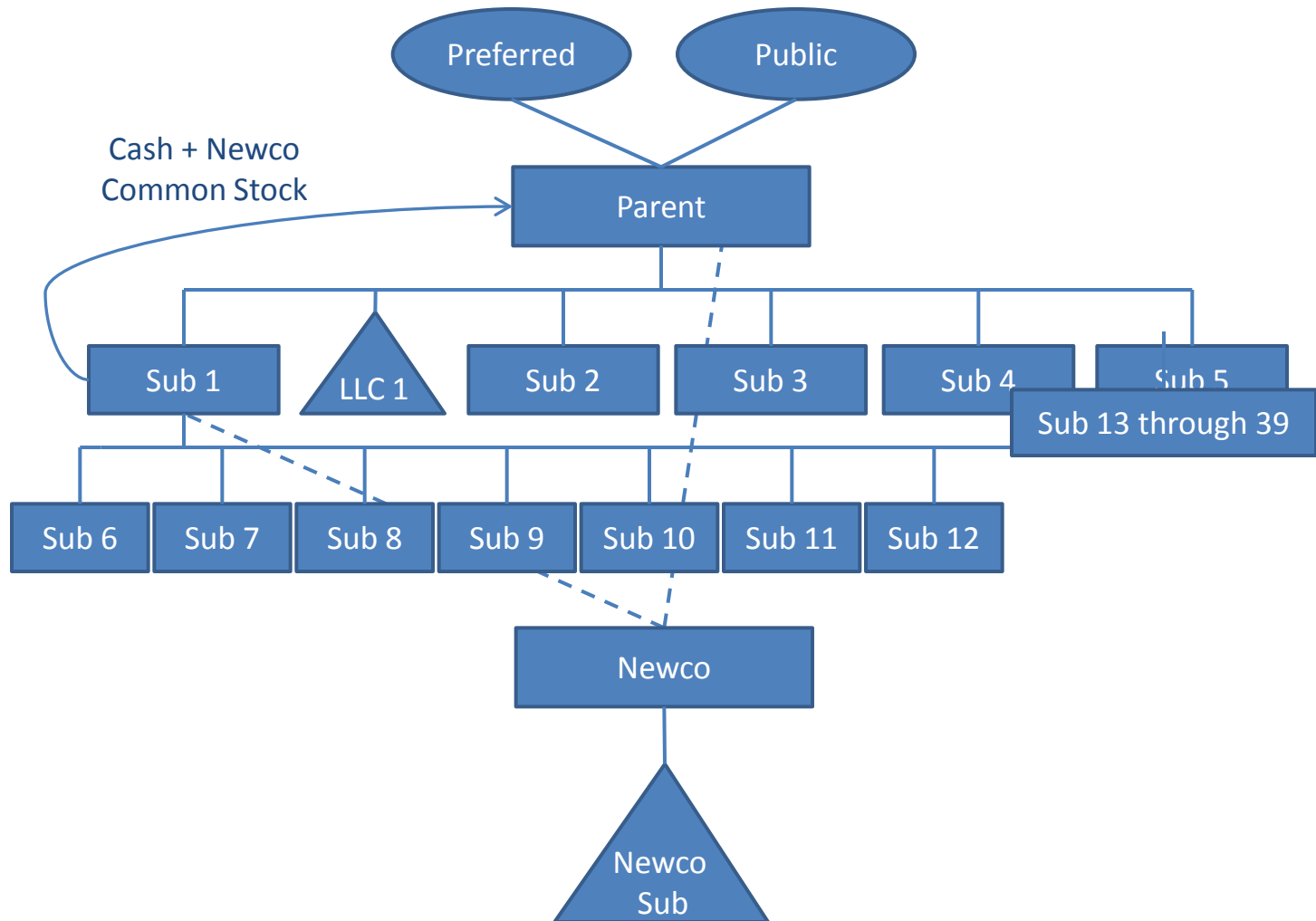
Issue: When does Sub become an eligible life insurance company that can join the life-nonlife group?

Held: Sub is an eligible life company in Year 5.

PLR 201145007

Qualified Stock Purchase

PLR 201145007



The P consolidated group engages in Business A and Business B. P desires to separate Business A from Business B and sell the entities holding Business A to an unrelated corporation (Acquiring).

Transaction Steps

- Parent forms Newco. Newco forms Newco Sub as an LLC (and checks the box for Newco Sub to be taxed as a corporation).
- Parent and Sub 1 enter into a binding agreement to sell mandatorily redeemable non-voting preferred stock (the “preferred stock”) of Newco to investors. Sub 8, which conducts both Business A and Business B, reinsures its Business A policies to Sub 6.
- Parent transfers Subs 2, 3, 4, 5 and Sub 1 transfers Sub 7, Sub 8, Sub 9, Sub 10, Sub 11 and Sub 12 to Newco in exchange for the Newco common and preferred stock. These subsidiaries all engage in Business B.
- In accordance with the agreement, Parent and Sub1 sell the Newco preferred they receive to investors.
- Sub 1 distributes the Newco common stock and cash to P.
- Acquiring forms a merger sub. The merger sub merges into P, with the former P shareholders receiving the Newco common stock.
- When the dust clears, Acquiring owns P, which now holds Business A. P owns the Newco common stock and the investors own the preferred stock of Newco, which now holds Business B.

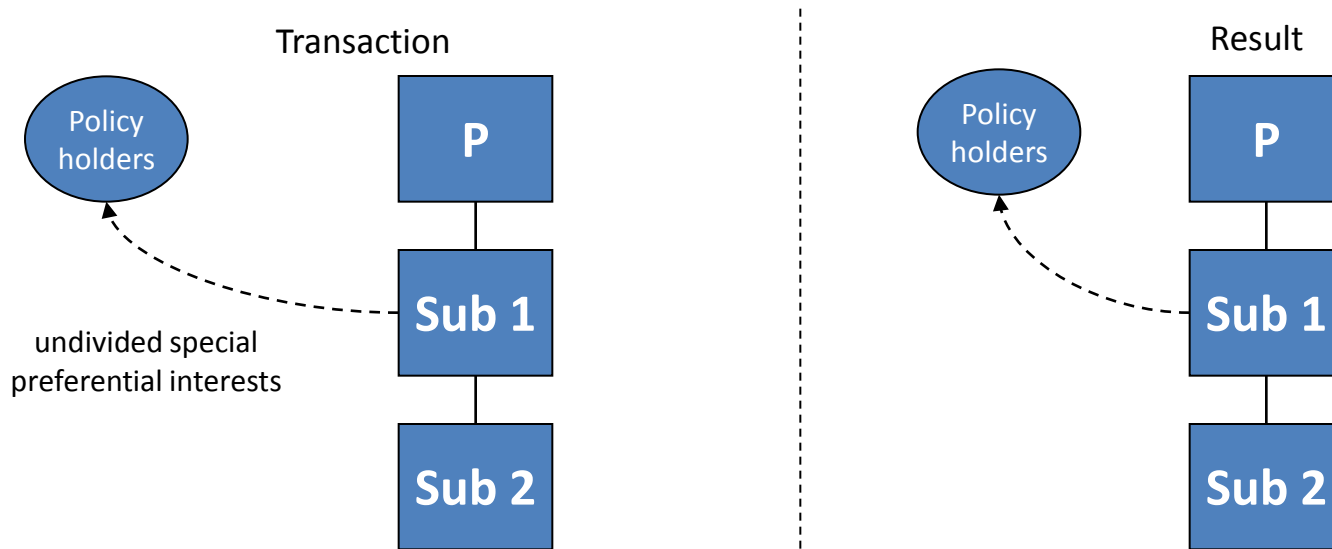
Was this a Qualified Stock Purchase for 338 Purposes?

- In order for a transaction to be a qualified stock purchase
 - there must be an acquisition of 80 percent of the stock (by vote and value);
 - The basis of the stock in the hands of the acquirer must not be determined, in whole or in part, by reference to the basis of the stock in the hands of the person from whom the stock was acquired and the stock cannot be received in a 351, 354, 355, or 356 transaction; and
 - The stock cannot be acquired from a person the ownership of whose stock would be attributed to the person acquiring the stock under 318(a).
- In example 1 of 1.338-3, S is the parent of a group of corporations that are engaged in various businesses. In order to discontinue its involvement in one line of business, S forms a new corporation, Newco. S transfers the stock of the a subsidiary with the unwanted business to Newco in exchange for 100 shares of Newco common stock and a note. Prior to the transaction, S and Underwriter had entered into a binding agreement pursuant to which U would purchase 60 shares of Newco common stock from S and then sell those shares in an IPO. The example holds that transaction is a QSP, and S and Newco are not related because after the sale to U, S owns less than 50 percent of Newco.

PLR 201148002

Affiliation of Insurance Companies

PLR 201148002



•Facts: Parent (“P”) owns Sub 1. Sub 1 owns Sub 2. P, Sub 1, and Sub 2 constitute a consolidated group (the “Parent Group”). A regulator (“Dept.”) issued an order requiring Sub 1 to pay and satisfy each valid claim under an insurance policy issued by Sub 1. The claims were to be satisfied in part with cash and in part by allocating to the insured holding such claim an undivided special preferential interest in Sub 1’s surplus (the “USPIs”).

PLR 201148002 (continued)

- Description of the USPIs (What are they?):

- The USPIs are not evidenced by formal notes or other instruments of indebtedness nor is there a fixed term or maturity date;
- Sub 1 recorded the USPIs in its financial statements;
- The USPIs accrue interest, and the interest payable account is kept separate from the USPI balance (no interest is charged on the interest payable account);
- Payment of the USPIs and associated interest is subject to the future financial performance of Sub 1 and Sub 2 and requires approval from Dept.;
- Payment of the USPIs are senior to any distributions, and have equal priority to payment of all other claims made by policyholders in a liquidation proceeding;
- The financial projections prepared for Sub 1 and Sub 2 indicate that Sub 1 will not be able to satisfy 100 percent of the USPIs;
- The USPIs are generally neither transferable nor convertible into any class of stock of any member of the Parent Group;

PLR 201148002 (continued)

- Description of the USPIs (continued):

- Sub 1 treats the USPIs as debt for US federal income tax purposes and equity for financial statement purposes applicable to insurance companies;
- The USPIs do not provide any of the following to the holders of the USPIs: control over Sub 1 or Sub 2, influence over the management of Sub 1 or Sub 2, the right to participate in the election of corporate directors, the right to receive dividends, the right to receive liquidation proceeds in excess of the USPI balance, nor the right to participate in the management of Sub 1; and
- Under no circumstances could an insured allocated an USPI in Sub 1's surplus ever acquire rights to participate in the management of Sub 1 by reason of its ownership of the USPI.

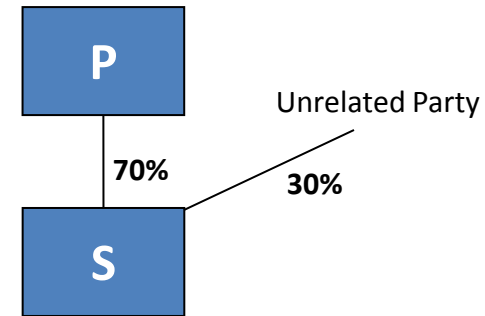
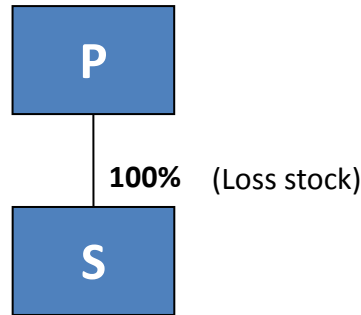
- The Ruling:

- The USPIs do not cause Sub 1 to cease to be a member of the Parent Group.

SECTION 267(f)

Intercompany Loss Transactions

Section 267(f) – Background



- P sells 30 percent of S stock (at a loss) to Unrelated Party. P recognizes and takes into account the loss on the sold stock.
- S liquidates. Section 331 applies to the liquidation (*i.e.*, P recognizes and takes into account the loss on its remaining 70 percent of S stock).
- *See Granite Trust Co. v. United States*, 238 F.2d 670 (1st Cir. 1956); *Commissioner v. Day & Zimmerman, Inc.* 151 F.2d 517 (3rd Cir. 1945).

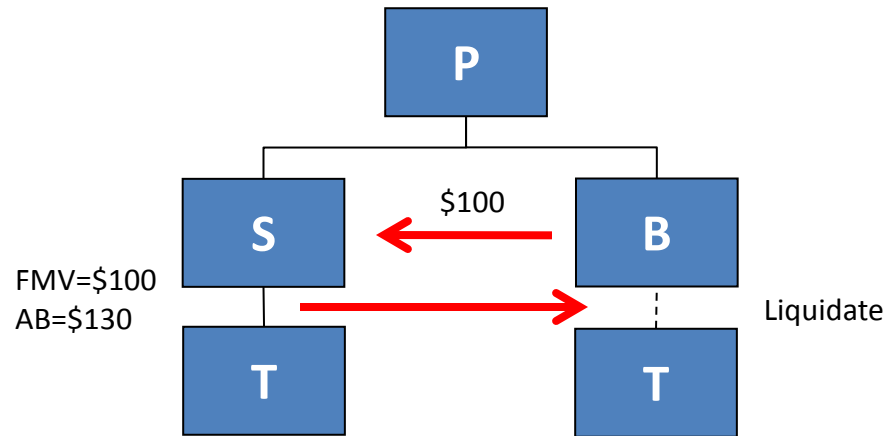
Section 267(f) – Background (Cont'd)

- Section 267(a)(1) – Disallows loss on sales between related persons (as defined in section 267(b)). Does not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.
- Section 267(f)(2) – Defers losses from sales between members of the same controlled group to which section 267(a)(1) would otherwise apply, until the loss is taken into account under consolidated return principles.

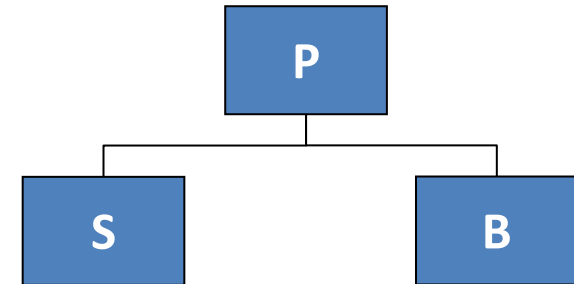
Section 267(f) – Background (Cont'd)

- Losses under section 267(f) are generally deferred until they are taken into account under the timing principles of the matching and acceleration rules of Reg. §§ 1.1502-13(c) and (d). Reg. § 1.267(f)-1(c)(1).
- The attribute redetermination rules of Reg. § 1.1502-13(c) generally do not apply. Reg. § 1.267(f)-1(c)(2).
- However, to the extent S's (the selling member's) loss would be redetermined to be a noncapital, nondeductible amount under the principles of Reg. § 1.1502-13, the loss continues to be deferred and is not taken into account until S and B (the buying member) are no longer in a controlled group relationship. Reg. § 1.267(f)-1(c)(1)(iv).

Intercompany Sale of Stock at a Loss Followed by a Section 332 Liquidation

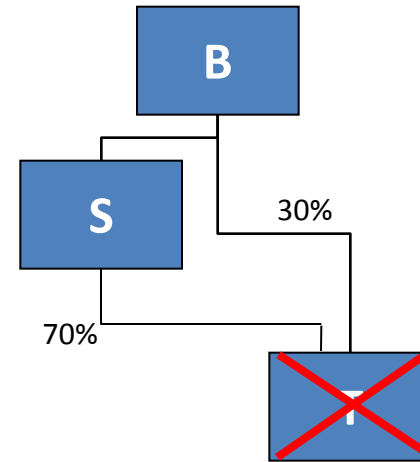
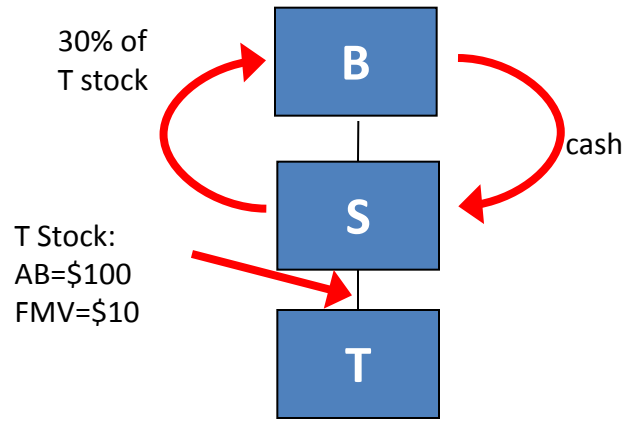


- Year 1 – S sells the stock of T to B for \$100 (recognizing a \$30 deferred loss)
- Year 2 – T liquidates into B under section 332



- Under Reg. § 1.1502-13(c)(6)(i), S's intercompany loss is recharacterized as noncapital, nondeductible (see Reg. § 1.1502-13(f)(7) Ex. (6)(c))

Intercompany Sale of Stock at a Loss Followed by a Section 332 Liquidation



- B, S, and T are members of a consolidated group.
- S sells 30 percent of the T stock to B for \$3 and S's \$27 loss is deferred.
- T later liquidates in a section 332 transaction (before any change in the value of the T stock). Reg. § 1.1502-34.
- The attribute redetermination rule of Reg. § 1.1502-13(c)(1) recharacterizes S's intercompany loss to produce the same results to the group as if S and B were divisions of a single corporation. Thus, S's intercompany loss is redetermined to be a noncapital, nondeductible amount. Reg. § 1.1502-13(f)(7) (Ex. 6(c)).

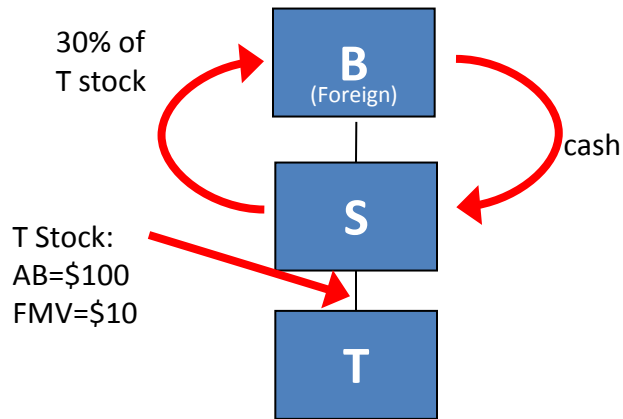
Section 267(f) – Regulations

- To the extent S's loss would be redetermined to be a noncapital, nondeductible amount under the principles of Reg. § 1.1502-13, but is not redetermined under Reg. § 1.267(f)-1(c)(2) (which generally renders the attribute redetermination rule inapplicable to sales between members of a controlled group), S's loss continues to be deferred...If the loss is deferred, it is taken into account when S and B (including their successors) are no longer in a controlled group relationship.
- For example, if S sells all of the T stock to B at a loss (in a transaction that is treated as a sale or exchange for federal income tax purposes), and T subsequently liquidates in an unrelated transaction that qualifies under section 332, S's loss is deferred until S and B are no longer in a controlled group relationship. Similarly, if S owns all of the T stock, sells 30 percent of T's stock to B at a loss (in a transaction that is treated as a sale or exchange for federal income tax purposes), and T subsequently liquidates, S's loss on the sale is deferred until S and B (including their successors) are no longer in a controlled group relationship.

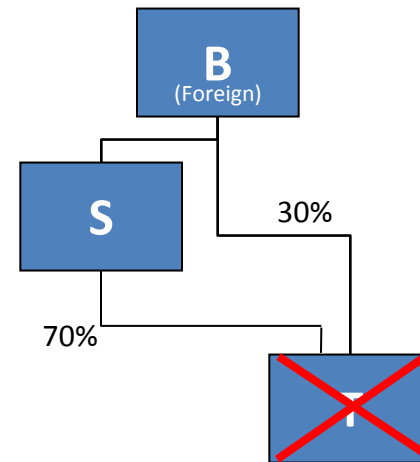
Section 267(f) – Regulations (Cont'd)

- If B recognizes any income or gain on amounts received in a distribution in complete liquidation of T, S will take into account its deferred loss on its sale of T stock to the extent of B's gain.
- For purposes of applying Reg. § 1.267(f)-1(c)(1)(iv), stock held by S, stock held by B, and stock held by all members of S's consolidated group, stock held by any member of a controlled group of which S is a member that was acquired from a member of S's consolidated group, and stock issued by T to a member of the controlled group must be taken into account in determining whether a loss would be determined to be a noncapital, nondeductible amount under the principles of Reg. § 1.1502-13.

Section 267(f)

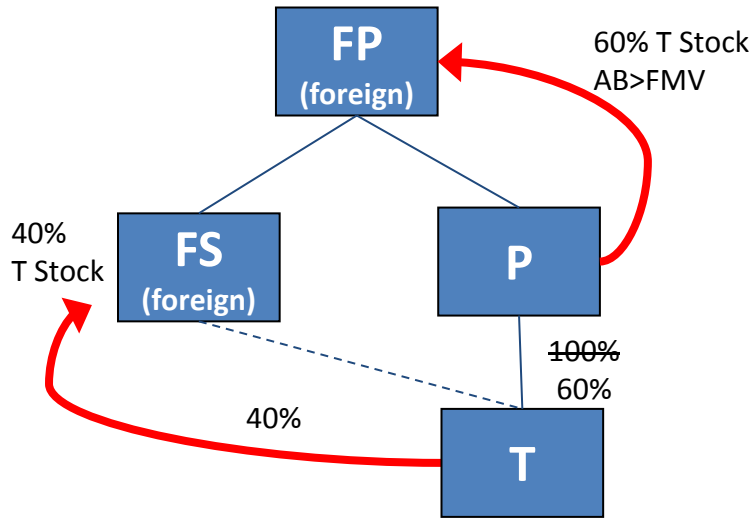


- B is foreign. S and T are members of a consolidated group.
- S sells 30 percent of the T stock to B for \$3 and S's \$27 loss is deferred under section 267(f).

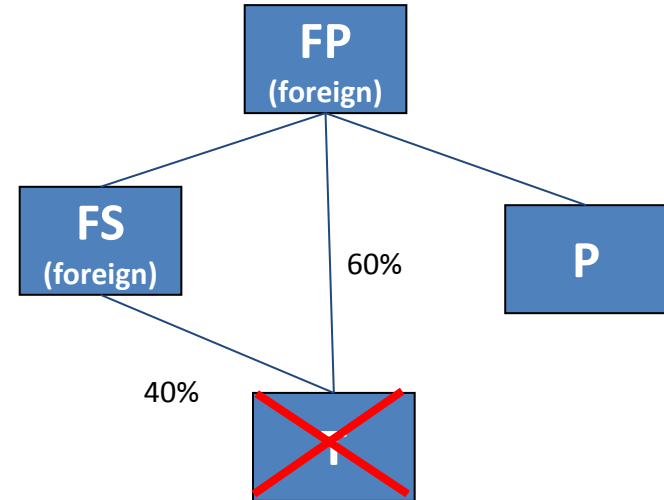


- T later liquidates in a taxable transaction (before any change in the value of the T stock).
- S's \$27 loss continues to be deferred until S and B (and their successors) are no longer in a controlled group relationship.

Section 267(f)



- In Year 1, FS contributes cash to T for new shares that represent 40% of T's outstanding stock afterwards.
- In Year 2, P sells its entire interest in T to FP at a time when P's stock in T has a built-in loss. P's loss is deferred under section 267(f).

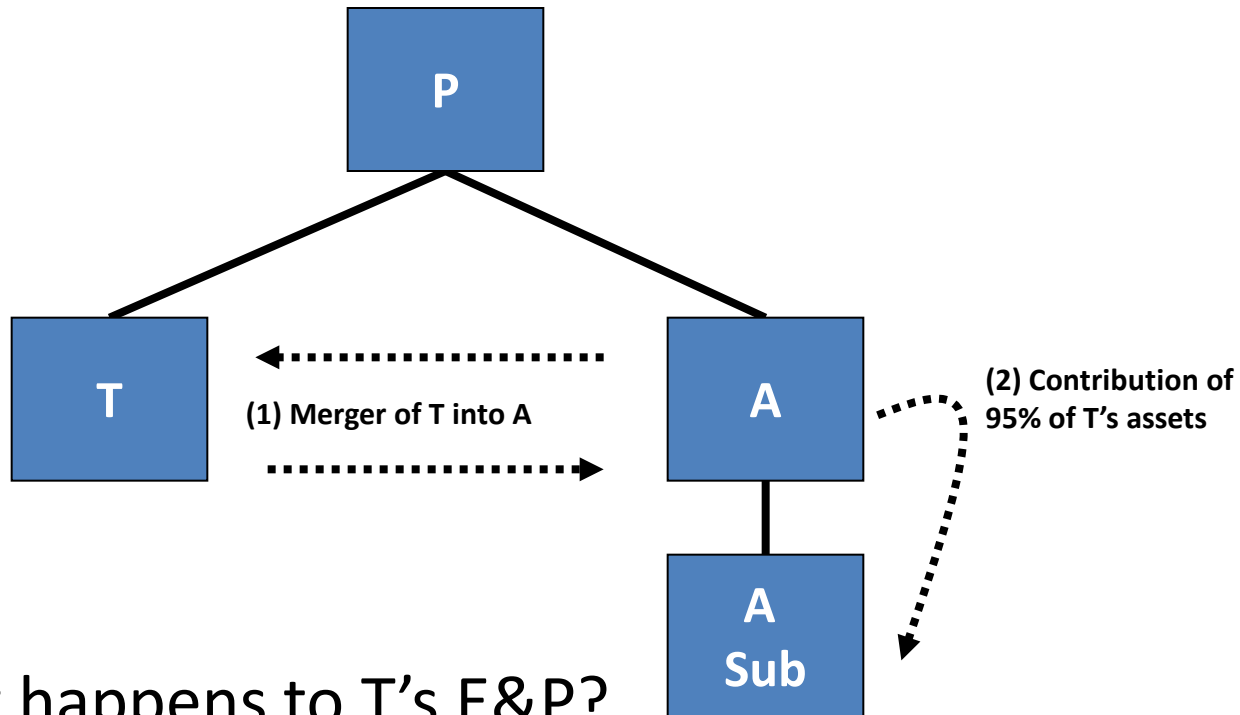


- In Year 3, in an unrelated transaction, T converts under state law to an LLC that is treated as a partnership for federal income tax purposes (*i.e.*, has a deemed liquidation)
- The stock held by FS and the stock held by FP is taken into account, so the deemed liquidation is treated as qualifying under section 332, and P's loss would be redetermined to be a noncapital, nondeductible amount. Therefore, P's loss deferred until P and FP are not in a controlled group relationship.

REG. § 1.312-11

Earnings and Profits Post-merger

Proposed Reg. § 1.312-11



- What happens to T's E&P?

CERT

Net Operating Loss Carrybacks

CERT Rules

- If an “applicable corporation” involved in a “CERT” has an NOL in a “loss limitation year,” the corporation may not be permitted to carry back a portion of the NOL to a tax year preceding the year of the CERT
 - The five-year carryback legislation modifies the CERT rules to conform the determination of the *loss limitation year* with the extended NOL carryback rules
 - The CERT rules only restrict the portion of an NOL generated by interest deductions attributable to certain debt-financed stock acquisitions or distributions
 - Note: the “attributable” determination doesn’t use tracing

CERT Rules (Cont'd)

- The CERT rules generally apply if:
 - There is a CERT
 - A CERT is defined as a “major stock acquisition” or an “excess distribution”
 - These terms are broadly defined
 - The Taxpayer is an Applicable Corporation
 - The CERT rules only apply to a C corporation (or successor corporation to such corporation) (1) that is the acquiring or acquired corporation in a major stock acquisition, or (2) that makes a distribution with respect to its stock (or redeems its stock) in connection with an excess distribution

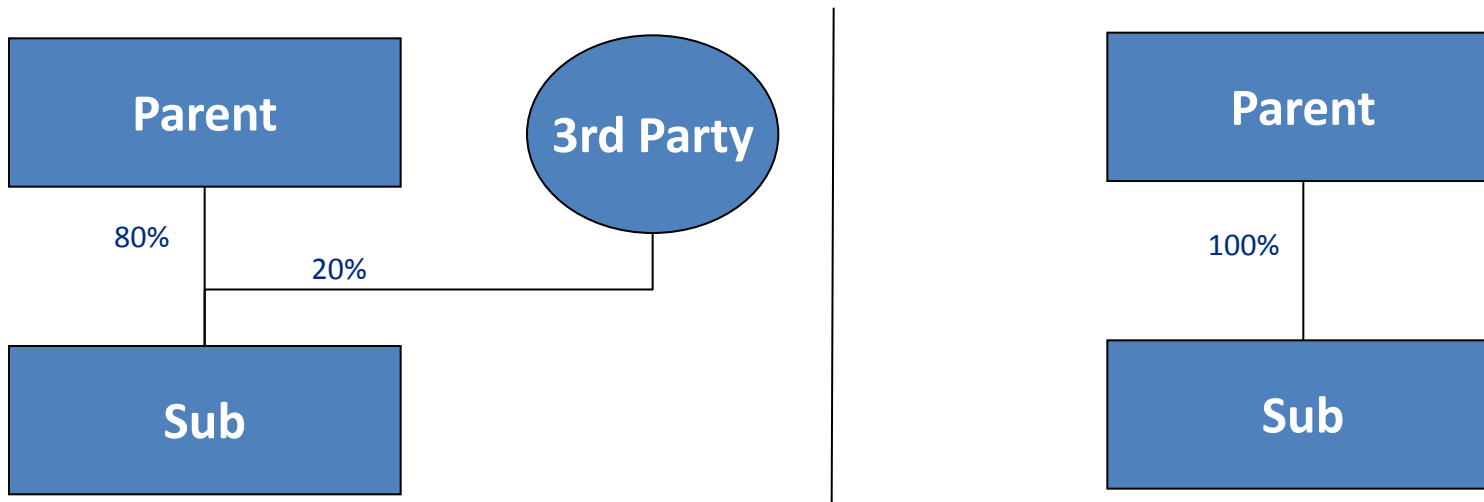
CERT Rules (Cont'd)

- The Loss Occurs in a Loss Limitation Year (LLY)
 - A LLY is the tax year in which the CERT occurred and, generally, each of the two following tax years. If an extended carryback is elected, the loss limitation period is extended to include the CERT year plus one year less than the extended carryback period
 - No adjustment was made to the LLY period for the extended carryback in 2001/2002
- There is a Corporate Equity Reduction Interest Loss (CERIL)
 - The CERIL, which is the portion of the NOL that may be limited for carry back purposes, is generally the portion of a corporation's NOL that is generated by interest deductions with respect to the debt that financed (or could have financed) the CERT
 - In determining the allocable interest deductions taken into account in computing the NOL for any taxable year, taxable income is computed by taking allocable interest deductions into account after all other deductions
 - UNICAP model
 - “3-year average” cap
 - De minimis rule

Consolidated CERT Rules

- Section 172(h)(4)(C): Consolidated groups are treated as one taxpayer
- Impact of single entity approach on CERT rules:
 - “Applicable corporation” status
 - Testing for CERT status
 - Computational aspects of MSAs and EDs
 - CERIL computation
 - NOL vs. CNOL
 - Apportionment of CERIL
 - 3-year average computation
 - Impact of short taxable years?
 - Impact of serial CERTs?

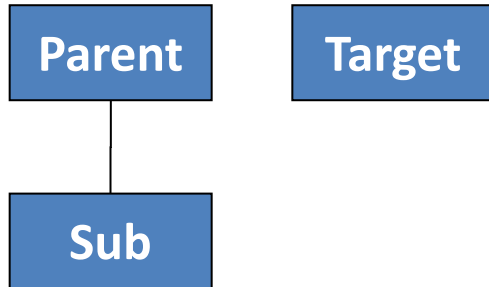
Consolidated CERT Rules – Excess Distributions



- Parent owns 80 percent of Sub and they file a consolidated return
- Parent is worth \$100 and Sub is worth \$20
- Sub redeems the 3rd party stock for \$4
- What fair market value is used for purposes of determining if there is an excess distribution under section 172(h)(3)(C)?

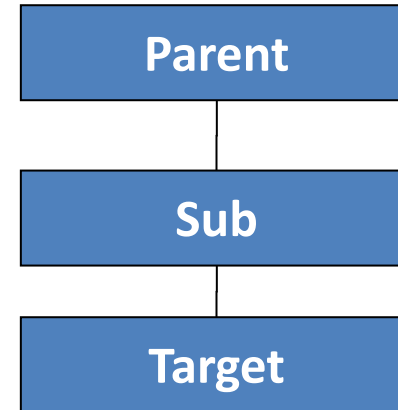
CCA 200305019

Pre-Year 5



- Parent and Sub file a consolidated return and have been profitable
- Target is a stand alone corporation that has been profitable

Year 5

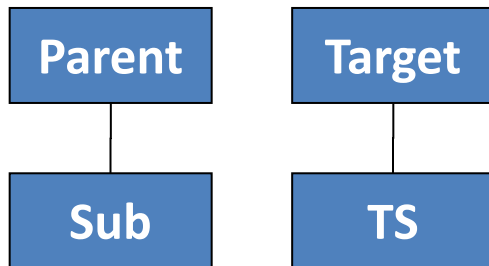


- Sub acquired all of the stock of Target in a transaction debt financed by Sub
- In Year 5, the Parent Group has a CNOL
 - On a separate company basis, Sub generates income and Target generates a loss

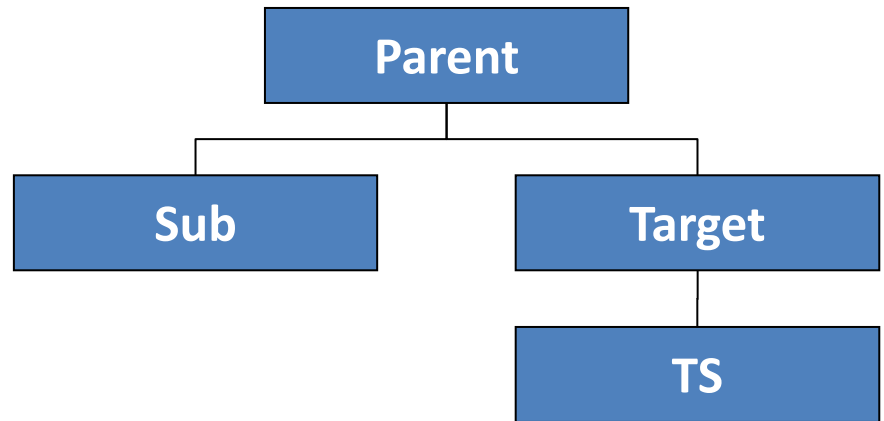
CCA 200305019 (Cont'd)

- The entire group is treated as a single taxpayer so the amount of the CERIL equals
 - The **CNOL** for the taxable year, over
 - The **CNOL** for the taxable year, determined without regard to any allocable interest deductions otherwise taken into account in computing such loss
- Where a portion of a CNOL is attributable to interest deductions arising from a CERT, the CERIL is *apportioned* to *all members* that contributed separate NOLs to the group on a pro rata basis under the general CNOL rules (i.e., under Treas. Reg. Sec. 1.1502-21(b)), rather than apportioned to the specific member that incurred the interest expense related to the CERT

TAM 200432014



- Parent and Sub file a consolidated return as do Target and TS
- Parent and Target each incurred interest expense (both pre and post acquisition)

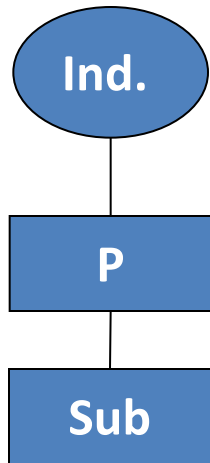


- Parent acquired all of the stock of Target
- How does the acquisition affect the calculation of CERT allocable interest?

TAM 200432014 (Cont'd)

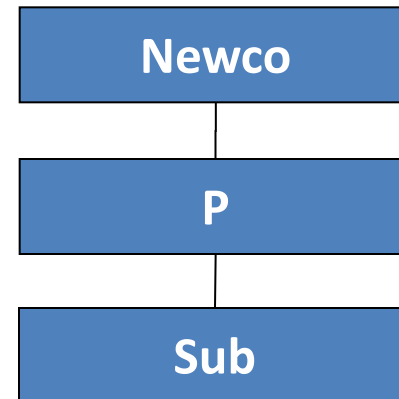
- Target's post-CERT interest expense on its third party debt is taken into account in determining the acquiring group's allocable interest deductions in LLYs under section 172(h)(2)(A)
- Target's pre-CERT interest expense on its third party debt is taken into account in computing the acquiring group's three-year interest expense average for purposes of computing the limitation on allocable interest deductions under section 172(h)(2)(C)

Interest Cap for Newly Formed Corporation



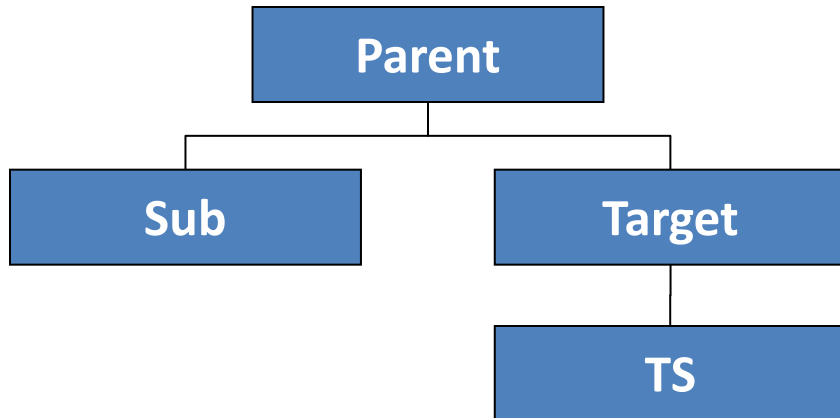
Newco

- Individual owns all of P, the common parent of a consolidated group
- The P group has been in existence for more than three years
- Newco purchases P for cash

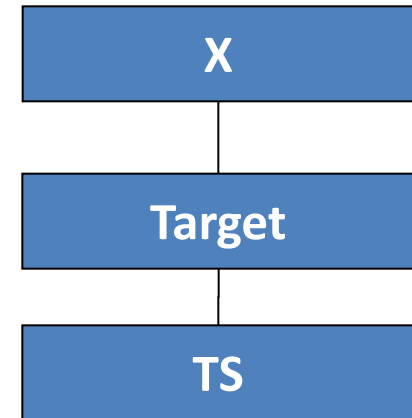


- How is the three-year history computed if Newco does not have any history?
 - Does TAM 200432014 apply?
 - Does section 172(h)(4)(C) require taking the P group's history into account?
 - Do you get a different answer if it is reverse acquisition?

Subsidiaries Departing Group



- Parent group includes Sub, Target, and TS
- Each member of the group historically incurred interest expense
- In Year 4, Parent sells all of the Target stock to X, an unrelated corporation



- What interest history do Target and TS bring into the X group?
- What about excess distributions?