INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-113832-00/CC:CORP:B2

LMSB; Natural Resources

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Year Involved:
Date of Conference:

LEGEND:

New Parent =

Old Parent =

Shareholder =

State M =

Business =

a =

b =

c =

d =

e =

f =

g =

h =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 1 =

ISSUE:

Whether an I.R.C. § 301(c)(1) stock dividend distributed by Old Parent to New Parent, under the facts described, is eliminated under Treas. Reg. § 1.1502-14(a)(1)?[1]

CONCLUSION:

The election under Treas. Reg. § 1.1502-76(b)(5)(i) resulted in New Parent being treated as a member of the same consolidated group as Old Parent at the time the stock dividend was distributed. Accordingly, the stock dividend from Old Parent to New Parent is eliminated under Treas. Reg. § 1.1502-14(a)(1).

FACTS:

The information submitted indicates that, during the year in question, Old Parent was a State M corporation engaged in Business and the common parent of a consolidated group (the "P group"). Old Parent was a calender year taxpayer using the accrual method of accounting. As of the end of Year 1, Old Parent had accumulated earnings and profits ("E&P") of $a. Old Parent had outstanding a single class of voting common stock. Shareholder, an individual, owned b% of Old Parent's stock. Corporation X, an unrelated corporation that was the common parent of another consolidated group,

[1] All references to sections of the Internal Revenue Code and the Income Tax Regulations are references to the Code and Regulations in effect for the taxable year at issue.

owned the remaining c% of Old Parent's stock.

On Date 1, Shareholder incorporated New Parent as a State M corporation, contributing sufficient cash to satisfy state minimum capitalization requirements. The information submitted indicates that Shareholder personally provided the funds used to capitalize New Parent, and did not act as the agent or nominee of Old Parent in forming New Parent.

On Date 2, Shareholder transferred all his Old Parent stock (i.e., representing b% of such stock) to New Parent in exchange for 100% of New Parent's common stock.

On Date 3, Old Parent declared a dividend of $d to the shareholders of record as of Date 3, payable at the shareholder's election in either cash or Old Parent common stock. On Date 4, Corporation X elected to receive its share of the dividend in cash, receiving a distribution of $e in cash on the same day. On Date 5, New Parent elected to receive its share of the dividend in Old Parent common stock, receiving a distribution of $f in Old Parent common stock on the same day. The stock dividend had the effect of increasing New Parent's ownership interest in Old Parent's stock to g% (which amount is greater than 80%) and decreasing Corporation X's interest to h%.

For the Year 1 taxable year, the P group continued to file a consolidated return, listing New Parent as the common parent. The Year 1 consolidated return included an election under § 1.1502-76(b)(5)(i) (the "30-Day Election") for New Parent to be treated as a member of the P group as of the first day of New Parent's taxable year (i.e., Date 1). The Year 1 return treated the $f stock dividend received by New Parent from Old Parent as eliminated under Treas. Reg. § 1.1502-14(a)(1).

Examination has raised the issue whether the stock dividend is subject to elimination under Treas. Reg. § 1.1502-14(a)(1) where the distributing and distributee corporations were not members of the same consolidated group at the time of the distribution. Examination contends that New Parent's acquisition of more than 80% of Old Parent's stock on Date 5 terminated the P group under Treas. Reg. § 1.1502-75(d)(1), such that New Parent was not eligible to make the 30-Day Election; specifically, the P group's termination would have prevented New Parent from becoming a member of such group during the first 30 days of New Parent's taxable year as required by § 1.1502-76(b)(5)(i). Examination maintains that absent a valid 30-day election, the stock dividend from Old Parent to New Parent was not a dividend distributed from one member to another during a consolidated return year, and, consequently, would not be eliminated under Treas. Reg. § 1.1502-14(a)(1).

The taxpayer responds that it was entitled to eliminate the dividend, based on having made a 30-Day Election. In support of its position, taxpayer first asserts that New Parent acquired Old Parent through a reverse acquisition within the meaning of Treas. Reg. § 1.1502-75(d)(3)(i), such that New Parent became a member of the continuing P

group. The taxpayer further asserts that because New Parent joined the P group within the first 30 days of New Parent's taxable year, New Parent was eligible to make the 30-Day Election to be treated as a member of the P group as of Date 1, the first day of New Parent's taxable year. The taxpayer concludes that the Date 5 stock dividend from Old Parent to New Parent was a dividend distributed from one member to another during a consolidated return year that is eliminated under Treas. Reg. § 1.1502-14(a)(1).

LAW AND ANALYSIS:

The primary issue is whether the stock dividend from Old Parent to New Parent is eliminated under Treas. Reg. § 1.1502-14(a)(1). Treas. Reg. § 1.1502-14(a)(1) provides that a dividend distributed by one member to another member during a consolidated return year shall be eliminated.[2] In the instant case, Old Parent and New Parent were not members of the same consolidated group at the time of the distribution, but became affiliated upon New Parent's receipt of the stock dividend.

The Year 1 consolidated return included an election pursuant to Treas. Reg. § 1.1502-76(b)(5)(i). The 30-Day Election permits a corporation that becomes a member of a consolidated group within the first 30 days of its taxable year to be considered to have become a member of the group as of the first day of its taxable year. Treas. Reg. § 1.1502-76(b)(5)(i).[3] The threshold question, therefore, is whether New Parent may avail itself of the 30-Day Election in order to treat itself as a member of the P group prior to the date of the stock distribution, thereby qualifying the dividend for elimination under Treas. Reg. § 1.1502-14(a)(1). In this case, the validity of the 30-Day Election depends on whether the P group continued in existence, and whether New Parent became a member of the P group during the first 30 days of New Parent's taxable year.

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[2] Treas. Reg. 1.1504-14(a)(1) further provides that the term "dividend" means a distribution which is described in § 301(c)(1) other than a distribution described in § 243(c)(1).

[3] Treas. Reg. § 1.1502-76(b)(5) provides two elections, both of which apply for purposes of the consolidated return regulations under § 1502. The second election, which is not at issue in this case, allows a corporation that has been a member of a consolidated group for 30 days or less during a consolidated return year to be considered not a member of the group during such year. Treas. Reg. § 1.1502-76(b)(5)(ii). The elections, which were removed by T.D. 8560, 1994-2 C.B. 200 (effective for corporations becoming or ceasing to be members of consolidated groups on or after January 1, 1995), were rules of administrative convenience, intended to relieve corporations from the burden of filing two federal income tax returns by disregarding the short year created when a corporation joins or leaves a group during a consolidated return year.

Treas. Reg. § 1.1502-75(d)(1) sets forth the general rule that a consolidated group remains in existence if the common parent corporation remains as the common parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group in a prior year and whether or not one or more corporations have ceased to be subsidiaries at any time after the group was formed. Under this general rule, New Parent's acquisition of more than 80% of Old Parent's stock on Date 5 would have terminated the P group because Old Parent would have ceased to be the common parent.

An exception the general rule of Treas. Reg. § 1.1502-75(d)(1) is provided by Treas. Reg. § 1.1502-75(d)(3)(i), for transactions characterized as reverse acquisitions. The reverse acquisition rule functions, in part, to identify which group will be subject to the continued filing requirement of Treas. Reg. § 1.1502-75(a), and to determine which group or corporation's taxable year will be used for the filing of the consolidated return. See Rev. Rul. 72-322, 1972-1 C.B. 287. If New Parent acquired Old Parent through a reverse acquisition described in Treas. Reg. § 1.1502-75(d)(3)(i), New Parent would be treated as joining the P group even though, in form, New Parent obtained more than 80% of Old Parent's stock.

Treas. Reg. § 1.1502-75(d)(3)(i) provides, in pertinent part, that if a corporation (the "first corporation") acquires stock of another corporation (the "second corporation"), and as a result the second corporation becomes (or would become but for the application of this subparagraph) a member of a group of which the first corporation is the common parent, in exchange (in whole or in part) for stock of the first corporation, and the stockholders (immediately before the acquisition) of the second corporation, as a result of owning stock of the second corporation, own (immediately after the acquisition) more than 50% of the fair market value of the outstanding stock of the first corporation, then any group of which the first corporation was the common parent immediately before the acquisition shall cease to exist as of the date of acquisition, and any group of which the second corporation was the common parent immediately before the acquisition shall be treated as remaining in existence (with the first corporation becoming the common parent of the group).

Treas. Reg. § 1.1502-75(d)(3)(i) further provides that for purposes of determining whether the second corporation becomes (or would become) a member of the group of which the first corporation is the common parent, and for purposes of determining whether the former stockholders of the second corporation own more than 50% of the outstanding stock of the first corporation, there shall be taken into account any acquisitions or redemptions of the stock of either corporation which are pursuant to a plan of acquisition.

The taxpayer contends that New Parent obtained g% of Old Parent's stock through a reverse acquisition, thereby making New Parent eligible to make the 30-Day Election.

Specifically, taxpayer asserts that New Parent acquired at least 80% of Old Parent's stock in exchange (in whole or in part) for New Parent's stock, and Old Parent's stockholder immediately before the acquisition (i.e., Shareholder), as a result of owning Old Parent stock, owned more than 50% of the fair market value of New Parent's outstanding stock immediately after the acquisition.

Based upon the information provided, we conclude that New Parent's acquisition of Old Parent was a reverse acquisition described in Treas. Reg. § 1.1502-75(d)(3)(i). Cf. Rev. Rul. 72-30, 1972-1 C.B. 287 (transactions by which one corporation acquired 30% of another corporation's stock, followed one day later by the acquisition of an additional 52%, were viewed as one transaction constituting a reverse acquisition). Consequently, the P group remained in existence after New Parent's receipt of the stock dividend on Date 5, and New Parent is treated as a subsidiary of the P group for the remainder of the Year 1 taxable year subsequent to the acquisition. Treas. Reg. §§ 1.1502-75(d)(3)(v)(a), 1.1502-76(b)(1).[4] Moreover, because New Parent is treated as becoming a member of the P group, and this change in status occurred within the first 30 days after the beginning of New Parent's taxable year on Date 1 (determined without regard to the required change to Old Parent's taxable year), New Parent was eligible to make the 30-Day Election. Treas. Reg. § 1.1502-76(b)(5)(i).

In this case, the timely 30-Day Election causes New Parent to be considered a member of the P group as of Date 1. Thus, the Date 5 stock dividend from Old Parent to New Parent was a dividend distributed from one member to another during a consolidated year that is eliminated under Treas. Reg. § 1.1502-14(a)(1).[5]

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[4] Treas. Reg. § 1.1502-75(d)(3)(v)(a) provides, in part, that if, in a transaction described in Treas. Reg. § 1.1502-75(d)(3)(i), the first corporation files a consolidated return for the first taxable year ending after the date of acquisition, then the first corporation shall close its taxable year as of the date of acquisition, and shall, immediately after the acquisition, change to the taxable year of the second corporation. Treas. Reg. § 1.1502-76(b)(1) provides, in part, that if § 1.1502-75(d)(3)(v) applies to a group, then for purposes of the application of this paragraph (other than to a group which ceases to exist as a result of the application of Treas. Reg. § 1.1502-75(d)(3)(i)), the second corporation (whether or not it remains in existence) shall be treated as the common parent for the entire taxable year of such corporation in which the acquisition occurs, and the first corporation shall be treated as a subsidiary for the portion of such taxable year subsequent to the acquisition.

[5] Treas. Reg. § 1.1502-32(b)(2)(iii) requires that New Parent make a negative adjustment to its basis in the Old Parent stock to the extent the dividend is a distribution out of earnings and profits accumulated in prior consolidated return years beginning after December 31, 1965.

CAVEAT(S):

The conclusions expressed in this Technical Advice Memorandum are limited to the facts described. No opinion is expressed as to whether, absent the occurrence of a reverse acquisition described in Treas. Reg. § 1.1502-75(d)(3)(i) and the making of a valid 30-Day Election under Treas. Reg. § 1.1502-76(b)(5)(i), the dividend would have been eliminated under Treas. Reg. § 1.1502-14(a)(1).

This technical advice memorandum expresses no opinion about the tax treatment of the above transactions under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions above that are not specifically covered by the above technical advice memorandum.

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.