

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily will affect affiliated groups of corporations, which tend to be larger businesses. Moreover, the number of taxpayers affected is minimal and the regulations will simplify basis determinations. Pursuant to section 7805(f) of the Internal Revenue Code, these proposed regulations will be submitted to the Chief Counsel of Advocacy of the Small Business Administration for comment on their impact.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the proposed regulations. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Marlene Oppenheim and Ross Poulsen, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be 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 * * *

Par. 2. Section 1.1502-31 is amended by revising paragraphs (b)(2), (d)(2)(ii), (g), and (h) to read as follows:

§ 1.1502-31 Stock basis after a group structure change.

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(b) * * *

(2) *Stock acquisitions.* If a corporation acquires stock of the former common parent in a transaction that is a group structure change, the basis of the members in the former common parent's stock immediately after the group structure change (including any stock of the former common parent owned before the group structure change) that has, or would otherwise have, a basis determined in whole or in part by reference to the basis of the property exchanged for such stock is redetermined in accordance with the results for an asset acquisition described in paragraph (b)(1) of this section. For example, if all of T's stock is contributed to P in a group structure change to which section 351 applies, P's basis in T's stock is T's net asset basis, rather than the amount determined under section 362. Similarly, if S merges into T in a group structure change described in section 368(a)(2)(E) and P acquires all of the T stock, P's basis in T's stock is the basis that P would have in S's stock under paragraph (b)(1) of this section if T had merged into S in a group structure change described in section 368(a)(2)(D).

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(d) * * *

(2) * * *

(ii) *Stock acquisitions.* If less than all of the former common parent's stock is subject to the redetermination described in paragraph (b)(2) of this section, the percentage of the former common parent's net asset basis taken into account in the redetermination equals the percentage (by fair market value) of the former common parent's stock subject to the redetermination. For example, if P owns less than all of the former common parent's stock immediately after the group structure change and the basis of such stock would otherwise be determined in whole or in part by reference to the basis of the property exchanged for such stock, only an allocable part of the basis determined under this section is reflected in the shares owned by P (and the amount allocable to shares owned by nonmembers has no effect on the basis of their shares). Alternatively, if P acquired 10 percent of the former common parent's stock in a transaction in which the stock basis was determined by P's cost, and P later acquires the remaining 90 percent of the former common parent's stock in a separate transaction that is described in paragraph (b)(2) of this section, P retains

its cost basis in its original stock and the basis of P's newly acquired shares reflects only an allocable part of the former common parent's net asset basis.

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(g) *Examples.* For purposes of the examples in this section, unless otherwise stated, all corporations have only one class of stock outstanding, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, all transactions are between unrelated persons, and tax liabilities are disregarded. The principles of this section are illustrated by the following examples:

Example 1. Forward triangular merger. (i) *Facts.* P is the common parent of one group and T is the common parent of another. T has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. T's shareholders have an aggregate basis of \$50 in T's stock. In Year 1, pursuant to a plan, P forms S and T merges into S with the T shareholders receiving \$100 of P stock in exchange for their T stock. The transaction is a reorganization described in section 368(a)(2)(D). The transaction is also a reverse acquisition under § 1.1502-75(d)(3) because the T shareholders, as a result of owning T's stock, own more than 50% of the value of P's stock immediately after the transaction. Thus, the transaction is a group structure change under § 1.1502-33(f)(1), and P's earnings and profits are adjusted to reflect T's earnings and profits immediately before T ceases to be the common parent of the T group.

(ii) *Analysis.* Under paragraph (b)(1) of this section, P's basis in S's stock is adjusted to reflect T's net asset basis. Under paragraph (c) of this section, T's net asset basis is \$60, the basis T would have in the stock of a subsidiary under section 358 if T had transferred all of its assets and liabilities to the subsidiary in a transaction to which section 351 applies. Thus, P has a \$60 basis in S's stock.

(iii) *Pre-existing S.* The facts are the same as in paragraph (i) of this *Example 1*, except that P has owned the stock of S for several years and P has a \$50 basis in the S stock before the merger with T. Under paragraph (b)(1) of this section, P's \$50 basis in S's stock is adjusted to reflect T's net asset basis. Thus, P's basis in S's stock is \$110 (\$50 plus \$60).

(iv) *Excess loss account included in former common parent's net asset basis.* The facts are the same as in paragraph (i) of this *Example 1*, except that T has two assets, an operating asset with an \$80 basis and \$90 fair market value, and stock of a subsidiary with a \$20 excess loss account and \$10 fair market value. Under paragraph (c) of this section, T's net asset basis is \$60 (\$80 minus \$20). See sections 351 and 358, and § 1.1502-19. Consequently, P has a \$60 basis in S's stock. Under section 362 and § 1.1502-19, S has an \$80 basis in the operating asset and a \$20 excess loss account in the stock of the subsidiary.