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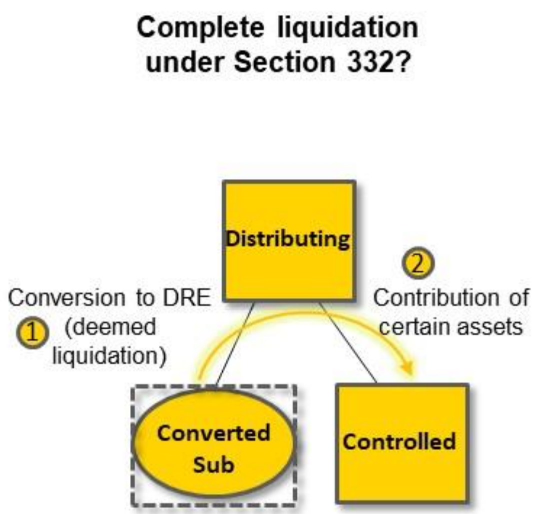
Technical Developments and Musings

Liquidation-reincorporation legacy. The taxation of corporate distributions has a rich history. About 70 years ago—when individual capital gain rates were significantly lower than ordinary rates and corporations could completely liquidate with little corporate-level tax consequence—IRS and the courts began to attack individual taxpayer attempts to extract liquid assets out of a corporation by means of liquidating distributions, where such liquidation was promptly followed by the reincorporation of business assets into a new corporation, usually controlled by the same shareholders. The line of fact-finding and analysis to attack this maneuver became known as the "liquidation-reincorporation doctrine." Where it applied, the liquidating corporation might instead be treated as party to a "sideways" §368 reorganization with the new corporation, among other possibilities. Much has changed in the intervening decades, most notably significant Code changes in 1986 to the taxation of corporate distributions, as well as the treatment of distributions to corporate shareholders. But the doctrine retains an integral role in contemporary corporate tax practice, including IRS ruling practice, as illustrated by PLR 202227008. The ruling, addressing a §355 spin-off, notes that certain subsidiaries of Distributing had, at some earlier time, converted to disregarded entities, a transaction generally treated as a deemed liquidation of a corporation for tax purposes. However, some of the converted entity assets were then contributed by Distributing to Controlled. IRS concluded that the reincorporation of some of the "old" assets would not prevent the earlier conversion from qualifying as a §332 complete liquidation, apparently based on a taxpayer representation that the amount of contributed assets were less than 30% of the gross FMV of assets held by the subsidiary prior to its conversion. Note, however, that the 30% threshold is more of an administrative guideline than a precise rule of law.



Late-election relief to close extraordinary reduction year. So-called 9100 relief is sometimes privately available from IRS for taxpayers who fail to meet a tax regulatory deadline; for example, an affiliated group may effectively be able to make a late election to file an initial consolidated return. A relatively new category of 9100 relief is illustrated by PLR 202226009, by which IRS permitted a "controlling section 245A shareholder" to close a taxable year of a CFC at the end of the date on which an "extraordinary reduction" occurs, under Reg. §1.245A-5(e)(3)(i). Such relief may permit the controlling shareholder to be taxed at lower GILTI tax rates, with foreign tax credits, rather than receiving a non-deductible dividend from a CFC.

Tax legislation after all? The prospects for any significant tax legislation in 2022 followed a frenzied course in July, apparently smothered early in the month only to be rekindled by Senators Schumer and Manchin at month's end. The senators announced climate legislation that would, among other things, tighten the treatment under §1061 of the "carried interest," impose a new corporate minimum tax on the largest companies based on their book profit and increase funding for IRS enforcement. Of course, nothing's over until it's over and it is still uncertain, as of this writing, whether the "Inflation Reduction Act of 2022 will become law. For further general info, see EY Tax News updates, including 2022-1140; for further info on the §1061 proposal, see Tax Alert 2022-1153.

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