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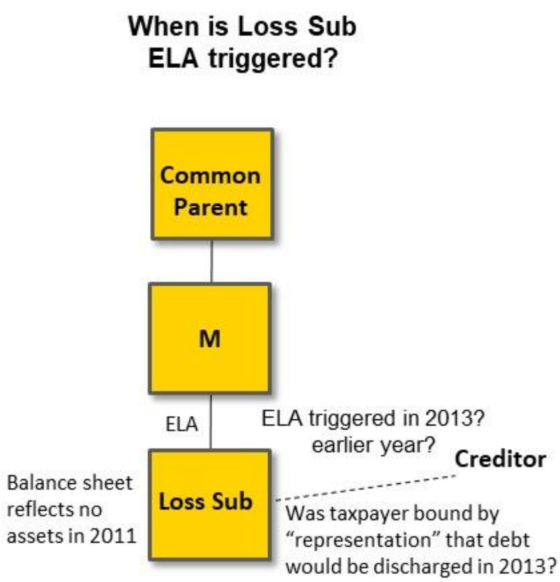
Technical Developments and Musings

Worthlessness, ELAs and open tax years. A recent Tax Court memorandum opinion contains an extensive—if not rare—discussion of the scope of consolidated return rules addressing “excess loss accounts,” or ELAs, and the events that cause such negative stock basis to be included in the income of a consolidated return group. The issue addressed by the court in *Belmont Interests, Inc. v. Comm’r* was as much procedural as substantive, hinging on whether the consolidated group had made binding representations as to when external debt owed by lower-tier subsidiary members would be treated as non-collectible and give rise to cancellation-of-indebtedness income, in 2012 or 2013. In addition, because the loss subsidiaries in question had no other assets by 2011, the timing of such subsidiary’s “worthlessness” also raised the question of when the group would be treated as disposing of its stock in the debtor subsidiary. Not surprisingly, Judge Halpern’s opinion reaffirms that, under Reg. §1.1502-19(c)(1)(iii)(A), when a subsidiary member with an ELA disposes of all of its assets, its shareholder member must include in income in the year of disposition any ELA in such member’s stock. Perhaps the more significant ruling, however, is procedural. The court granted summary judgment to the taxpayer on the question of whether the group was bound to an earlier taxpayer “representation” that the debt would be treated as worthless in 2013, concluding that both the taxpayer and the IRS made a mutual mistake as to the application of Texas law on this question. The court thus rejected an IRS claim that a common law duty of consistency required an ELA income inclusion of more than $90 million for the 2013 taxable year. This summary judgment opinion, however, left unresolved whether the IRS will be able to establish an ELA trigger for an earlier, open tax year.



Complete liquidations and Form 952. A financially troubled consolidated group member and the effect of the statute of limitations on assessment was also the subject of a non-binding IRS Chief Counsel Memorandum (AM 2022-002), albeit in the context of multi-year complete liquidations under §332. The memo serves as a reminder to corporate taxpayers about the importance of filing Form 952 for multi-year liquidations, which extends the parent's period of assessment for at least four years for each tax year for which it is filed. The memo also notes that failure to file Form 952 may result in the IRS denying nonrecognition treatment to a subsidiary’s complete liquidation. For further info, see Tax Alert 2022-1371.

Taxpayer cannot accelerate Section 367(d) deemed royalty. Finally, another non-binding memorandum—AM 2022-003—concludes that §367(d) does not permit taxpayers the option to accelerate annual deemed royalty inclusions under §367(d)(2)(A)(ii)(I), except in limited circumstances involving “other property or money” transferred by a transferee foreign corporation to a US transferor. An initial outbound transfer of intangibles to a foreign corporation gives rise to deemed royalties based on the useful life of the intangibles, which often span multiple years. The memo concludes that nothing in §367(d), its regulations or Notice 2012-39 permits an advance payment by the foreign corporation to the US transferor.