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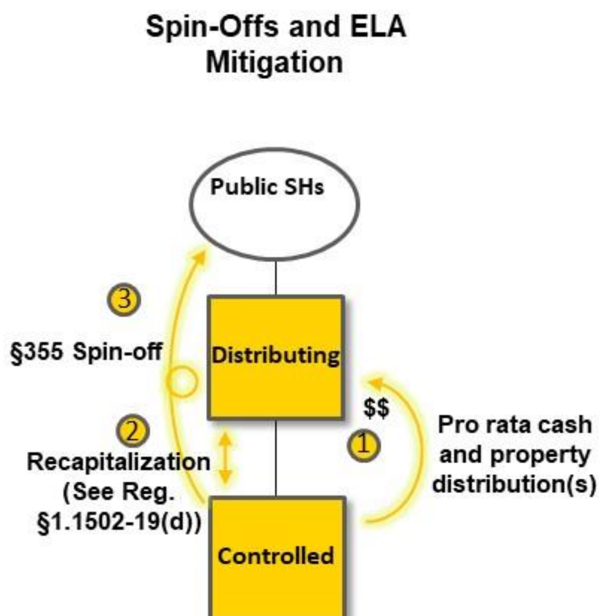
Technical Developments and Musings

Spin-offs and ELA mitigation. A recent spin-off PLR serves as a reminder that negative stock basis—an "excess loss account," or ELA—that would otherwise exist in a block of shares may be mitigated through a basis adjustment event that "smooths out" and potentially eliminates an ELA. In PLR 202305010, Distributing was a publicly-traded corporation that owned all of Controlled's sole class of stock, which it intended to spin-off under §355. Distributing had acquired its stock in Controlled over time and as a result did not have a uniform basis in each of its Controlled shares. Prior to the spin-off, however, the controlled subsidiary would make one or more distributions to Distributing consisting of cash, proceeds of third-party borrowings, and/or intercompany receivables to Distributing, intended to achieve the desired leverage and appropriate capital structure for Controlled. Such distribution would result in a basis adjustment that apparently would create an ELA in at least some of the Controlled shares, at least on a pro rata basis. (Notably, even if there is not an ELA in the *aggregate*, and even if a disposition qualifies under §355, Distributing would otherwise recognize gain under Reg. §1.1502-19(c) with respect to any share or block of shares with negative basis.) But the spin-off was preceded by a §368(a)(1)(E) recapitalization, a "basis determination" event under Reg. §1.1502-19(d). Thus, to the extent the distribution would otherwise create an ELA in certain Controlled shares, the IRS ruled that Distributing's basis in such shares at the time of the recapitalization will be determined by allocating basis first "to equalize and eliminate any ELA with respect to any share" of Controlled stock. Thus, a pre-spin basis adjustment event can often soften the blow of an ELA.



Treasury quickly finalizes Section 951(a)(2)(B) regulations. The government finalized—without modification—proposed regulations issued in December that treat members of a consolidated group as a single US shareholder for certain purposes under §951(a)(2)(B). The special rule applies for purposes of determining the part of the year during which such shareholder did not own (within the meaning of §958(a)) CFC stock. Notably, the February 23, 2023, effective date means that, under §1503(a), consolidated groups—including calendar-year taxpayers—who engaged in applicable CFC share transfers in 2022 are subject to the rule. For further background on the proposed regs, see Tax Alert 2022-1933.

The mistaken REIT. PLR 202305005 is somewhat unusual for the type of "9100 relief" sought, i.e., relief under a regulatory provision authorizing the IRS to grant a taxpayer a reasonable extension of time to make a regulatory or statutory election. The ruling here did not involve one of the common types of missed elections, such as a late "check-the-box" election. Rather, it involved a corporation that had erroneously filed a REIT tax return and then filed a "regular" amended return. Based upon multiple representations, including that the taxpayer intended to file a REIT return only when it qualified as such, IRS permitted the taxpayer to be treated as though it had not made a REIT election on the erroneously filed 1120-REIT return.