Tax M&A Update

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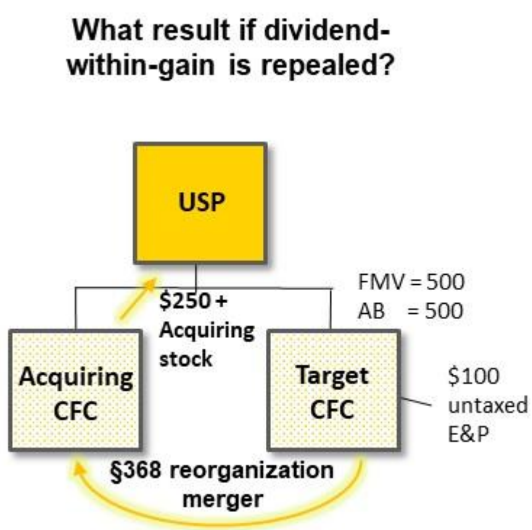
Technical Developments and Musings

Treasury recycles proposal to repeal dividend-within-gain. Although Treasury's leveraged spin-off proposal discussed in last month's *Update* was new, some of the tax-related revenue proposals in the FY24 Treasury Greenbook have been recycled from earlier administrations, including several earnings and profits-related proposals last seen in 2015. Among this group is a proposal to repeal the "dividend within gain" rule of §356, under the general rubric of taxing "corporation distributions as dividends." Longstanding law treats boot (i.e., "other property or money") received by an exchanging target corporation shareholder in a §368 reorganization as a dividend only to the extent of gain realized in the exchange. According to Treasury, "there is not a significant policy reason to vary the tax treatment of a distribution received in a reorganization (and currently subject to the boot-within-gain limitation of [§]356) with the treatment afforded ordinary distributions under [§]301." But the tax landscape has changed since 2015 and it is not clear what Treasury finds troubling about the dividend-within-gain rule as applied to current, commonplace transactions. For example, most public company §368 reorganizations with boot will not trigger dividend treatment to target shareholders, under the *Clark* test for dividend-equivalency; for internal restructurings among a group of corporations filing a consolidated return, dividend status isn't meaningful. And perhaps most importantly, the treatment of boot dividends from CFCs, as depicted here, has changed significantly since 2015 given Code changes that include, for example, the potential under §245A for a US corporation that is an exchanging shareholder to fully deduct dividends received from a specified 10-percent owned foreign corporation.



Tax Court unimpressed with "gain disappearing act." A recent full opinion of the Tax Court addresses individual taxpayers' disposition of appreciated real estate by transferring it to a charitable remainder annuity trust (CRAT), which then disposed of the property and purchased a single premium immediate annuity for the taxpayers' benefit. The taxpayers in *Gerhardt v. Comm'r,* 160 TC No. 9, asserted that the CRAT distributions, following the real estate disposition, were not subject to tax and represented trust corpus, notwithstanding that, under §1015, the CRAT generally takes a carryover basis in contributed property. The court rejected the taxpayers' assertion that built-in gains simply converted to trust principal. Judge Toro opined that the "gain disappearing act" attributed to the CRAT "is worthy of a Penn and Teller magic show. But it finds no support in the Code, regulations, or caselaw."

IRS lacked authority to assess information return penalties. Another full Tax Court opinion, *Farhy v. Comm'r*, 160 TC No. 6, concludes that the IRS is not authorized to assess penalties under §6038, an information return provision. In that case, there was no dispute that an individual taxpayer willfully failed to report foreign income on Form 5471, "Information Return of U.S Persons With Respect to Certain Foreign Corporations." But the court stated that "Congress has explicitly authorized assessment with respect to myriad penalty provisions in the Code, but not for [§]6038(b) penalties." Rather than levies, the IRS may, however, pursue penalties through a civil action. For further info, see Tax Alert 2023-0703.