Tax M&A Update

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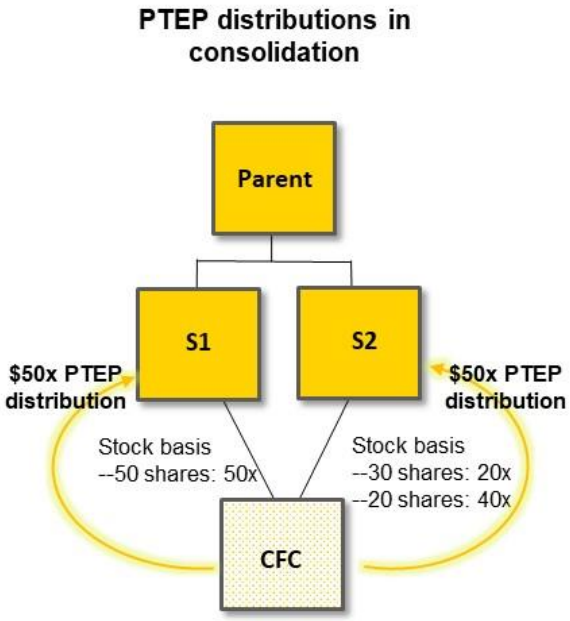
Technical Developments and Musings

Consolidated groups, lumpy basis and proposed PTEP regulations. Treasury and the IRS released a comprehensive set of proposed regulations addressing previously taxed earnings and profits (PTEP) of foreign corporations, typically CFCs. Broadly, the package addresses (i) income exclusion rules under §959, (ii) basis rules that apply to US shareholders, CFCs and certain partnerships that own CFC stock, and (iii) certain foreign currency consequences, among other things. With respect to foreign corporation stock basis, one theme underscored by the regulations is the primacy of each share of stock. This often re-results in original basis disparity in blocks of stock within the same class being perpetuated by per-share adjustments, with associated tax consequences. See, e.g., *Johnson v. US,* 35 F.2d 1257 (4th Cir. 1971). What's more, in consolidation, the prospect of "lumpy" stock basis applies to each consolidated group member that is a "covered shareholder," representing separate-member §961 treatment. For PTEP purposes, however, the entire group would be treated as a single covered shareholder; i.e., unlike stock basis, PTEP would be a single-entity attribute, shared by group members. Further, the proposed regulations do not address the treatment of untaxed earnings. This hybrid approach could lead to unanticipated results for distributions of PTEP to consolidated group members, including §961(b)(2) gain recognition. For example, as depicted here, each member treats its share of the $100x distribution by CFC as sourced from PTEP. But as to S2, even though there is adequate aggregate stock basis (both collectively as to the group and more particularly, as to S2), it would recognize gain of $10x on its low basis block. For further info, see Tax Alert 2024-2229.



***Loper Bright* and tax regulations.** The US Supreme Court's *Loper Bright* decision—broadly, minimizing deference to agency regulations—continues to have consequences in tax cases. Most recently, the US Court of Appeals for the Fifth Circuit affirmed the Tax Court's denial of tax exemption under §501(c)(4) for an accountable care organization, stating that the organization was not operated with the exclusive purpose of promoting social welfare. In *Memorial Hermann Accountable Care Org. v. Comm'r,* the appellate court noted that "we no longer are required to provide '*Chevron* deference' to Treasury's interpretation …" Instead, it looked primarily to a 1945 Supreme Court case addressing the use of the same phrase in an adjacent statutory paragraph, §501(c)(3). The court also rejected taxpayer arguments based on Internal Revenue Manual interpretations: "[a]s noted above, the IRS's embrace of a legal standard cannot supplant our independent interpretation of the statutory text." For further info, see Tax Alert 2024-2146.

No substantial compliance for NOL carryback waiver. In a memorandum opinion, the Tax Court agreed with the IRS that a corporate taxpayer failed to waive net operating loss carryback when it filed its return. In *IQ Holdings v. Comm'r,* T.C. Memo. 2024-104, the court rejected a taxpayer assertion that it substantially complied with waiver carryback requirements by informing its accountant of such desire, even though this was not correctly reflected on the return.

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