Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **201326013**
Release Date: 6/28/2013

CC:CORP:B01
POSTF-137227-11

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 382.00-00

date: March 19, 2013

to: Senior Counsel
(Large Business & International)

from: Mark S. Jennings
Branch Chief, Branch 1
(Corporate)

---

subject: Whether Notice 2008-83 operates to exclude certain bank loans from the computation of NUBIG/NUBIL for purposes of I.R.C. sections 382(h) and 56(g)(4)(G)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

This Chief Counsel Advice reflects our further consideration of, and our current views on, the issues addressed in the Chief Counsel Advice dated April 18, 2012 and July 24, 2012.

<u>LEGEND</u>

Taxpayer	=
Target	=
Date 1	=
Date 2	=
<u>a</u>	=
<u>b</u>	=

c =

d =

ISSUE

Whether excludes from the computation of net unrealized built-in gains ("NUBIGs") and net unrealized built-in losses ("NUBILs") for purposes of I.R.C. sections 382(h) and 56(g)(4)(G).

CONCLUSION

does not alter the NUBIG/NUBIL computation for purposes of either section, but rather serves only to allow

. With regard to section 382(h), Taxpayer must include the in its NUBIG/NUBIL computation. With regard to section 56(g)(4)(G), Taxpayer must reduce the basis of Target's assets for purposes of the adjusted current earnings computation.

FACTS

Taxpayer is a and the parent of a consolidated group of corporations. Effective after the close of business on Date 1, Taxpayer acquired Target (the "Acquisition"), and Target became a member of Taxpayer's consolidated group beginning with the taxable year ending Date 2.

For purposes of section 382, Taxpayer determined that Target had a NUBIG of approximately $a by comparing the fair market value of Target's assets immediately before the Acquisition with the assets' aggregate adjusted basis at such time (see section 382(h)(3)(A)(i)). As discussed below, however, Taxpayer computed Target's NUBIG based on the assumption that assets giving rise to are to be excluded from the NUBIG/NUBIL computation. If such assets were included in Target's NUBIG/NUBIL computation, Target would have a NUBIL in excess of $b instead.

For the taxable year ending Date 2, Taxpayer determined that it had a tentative minimum tax of $c, which was less than its computed regular tax liability of $d. In determining its adjusted current earnings ("ACE") for purposes of calculating its alternative minimum taxable income ("AMTI"), Taxpayer did not step down the basis of Target's assets pursuant to section 56(g)(4)(G).

LAW AND ANALYSIS

Computation of NUBIG/NUBIL for Purposes of Section 382(h)

Section 382(a) limits the extent to which a loss corporation that has undergone an ownership change may use pre-change losses to offset post-change taxable income. Section 382(h) governs the treatment of certain built-in gains and losses recognized with respect to assets that were held by a loss corporation at the time of an ownership change. Subparagraph (h)(1)(A) provides that if a loss corporation had a NUBIG at the time of the ownership change, the section 382 limitation for any recognition period taxable year will be increased by any recognized built-in gains (“RBIGs”) for such year (to the extent of NUBIG less RBIGs for prior taxable years ending in the recognition period). Conversely, subparagraph (h)(1)(B) provides that if a loss corporation had a NUBIL at the time of the ownership change, the RBILs for any recognition period taxable year will be subject to limitation under section 382 in the same manner as if they were pre-change losses (to the extent of NUBIL less RBILs for prior taxable years ending in the recognition period). For these purposes, the terms “NUBIG” and “NUBIL” mean, with respect to any old loss corporation, the amount by which (i) the fair market value of the assets of such corporation immediately before an ownership change is more or less, respectively, than (ii) the aggregate adjusted basis of such assets at such time. Section 382(h)(3)(A)(i).

Target was a loss corporation that underwent an ownership change in the Acquisition. Thus, Taxpayer only may utilize Target’s pre-change losses to the extent of the annual limitation calculated under section 382(b). Additionally, if Target had a NUBIL at the time of the Acquisition, then RBILs for any recognition period taxable year are subject to limitation under section 382 in the same manner as if they were pre-change losses. On the other hand, if Target had a NUBIG at the time of the Acquisition, then the section 382 limitation for any recognition period taxable year is increased by any RBIGs for such year.

In computing Target’s NUBIG/NUBIL, Taxpayer wholly excluded certain assets held by Target at the time of the ownership change (hereafter, the “ ”) that were of a type that would give rise to . Taxpayer thus determined that Target had a NUBIG of approximately $a. Had Taxpayer included the in the NUBIG/NUBIL computation, Target would have had a NUBIL of approximately $b instead. Although nothing in section 382 or the regulations thereunder permits the to be excluded from the NUBIG/NUBIL computation, Taxpayer takes the position that requires NUBIG/NUBIL to be computed in this manner.

Section 1 of

In turn, Section 2 of

,

.

Taxpayer makes two primary arguments in support of its position that permits the to be excluded from Target's NUBIG/NUBIL computation. First, Taxpayer contends that its position is supported by the "plain language" of . Taxpayer observes that, by its terms,

.

Taxpayer further notes that is not expressly inapplicable to NUBILs. Taxpayer thus contends that

" requires that not be treated as built-in or pre-change losses for any purpose under section 382(h), including for purposes of computing NUBIG/NUBIL.

Taxpayer's first argument is incorrect. does not concern the application of section 382(h) in general; rather, as reflected in Section 1, the subject of is " ." More specifically, as stated in

" (emphasis added). A NUBIL is not an item of deduction or loss. Moreover, applies to items of " whereas NUBIG and NUBIL are computed based on a hypothetical asset sale immediately *before* an ownership change. On its face, then, has no bearing on the NUBIG/NUBIL computation.

In this vein,

" was not meant to apply to both NUBILs and RBILs. Rather, this phrase was intended to ensure that

.

. Similarly,

.

Taxpayer's argument appears to be predicated on the assumption that losses generally must be treated the same way for purposes of determining RBILs and computing NUBIL. Yet such is not the case. As illustrated by Notice 2003-65, 2003-2 C.B. 747, the RBIL determination and the NUBIL computation are separate and distinct matters.

Notice 2003-65 provides two alternative safe harbors regarding the identification of built-in items under section 382(h)—the 1374 approach and the 338 approach. Loss corporations with a NUBIL usually apply the 1374 approach, for (as indicated below) this approach generally yields fewer RBILs than the 338 approach.

The 1374 approach generally incorporates the rules of section 1374(d) and §§ 1.1374-3, 1.1374-4, and 1.1374-7 in calculating NUBIG/NUBIL and identifying RBIG/RBIL. Section 1.1374-3(a) generally defines NUBIG as the amount that would be the amount realized if, at the beginning of the first day of the recognition period, the corporation had remained a C corporation and had sold all its assets at fair market value to an unrelated party that assumed all its liabilities, subject to certain adjustments. In turn, items of income or deduction generally are treated as RBIGs or RBILs under § 1.1374-4(b) if the item would have been properly included in gross income (or properly allowed as a deduction against gross income) before the beginning of the recognition period by an accrual-method taxpayer. This difference in methods of computing NUBIG/NUBIL and RBIG/RBIL is acknowledged in the preamble to the final regulations under section 1374, where the IRS and the Treasury Department declined to extend the NUBIG/NUBIL hypothetical sale approach to the computation of net recognized built-in gain. The IRS and the Treasury Department reached this conclusion because the NUBIG/NUBIL computation is made in the aggregate, whereas the net recognized built-in gain calculation involves the determination whether (and to what extent) an individual item is an RBIG or RBIL. Thus, with respect to the latter, requiring taxpayers to posit a hypothetical sale in each instance "would be unduly burdensome both for taxpayers and for the IRS." T.D. 8579, 1995-1 C.B. 170.

Under Notice 2003-65, both the 1374 approach and the 338 approach utilize the hypothetical sale approach to calculating NUBIG or NUBIL—this figure is the net amount of gain or loss that would be recognized in a hypothetical sale of the loss corporation's assets to a third party for fair market value immediately before the ownership change. But these two approaches handle RBIG/RBIL determinations differently. The 338 approach generally identifies RBIG or RBIL by comparing the loss corporation's actual items of income, gain, deduction, and loss with those items that would result if a section 338 election had been made for the hypothetical purchase. In contrast, in cases other than sales and exchanges, the 1374 approach generally relies on the accrual method of accounting to identify income or deduction items as RBIGs or RBILs, respectively (in other words, an item properly included in income or allowed as a deduction during the recognition period generally is considered "attributable to periods before the change date" under section 382(h)(6), and thus is treated as an RBIG or RBIL, respectively, if an accrual-method taxpayer would have included the item in income or been allowed a deduction for the item before the change date). The fact that NUBIG and NUBIL are computed in the same manner under both approaches, but that RBIGs and RBILs are identified using different methodologies, reveals that these determinations are separate and distinct.

In applying the accrual method, the 1374 approach generally does not treat income from a built-in gain asset during the recognition period as RBIG because such income did not accrue before the change date. For example, say that LossCo has a $300,000 NUBIG that is attributable in part to a patent with a fair market value of $170,000 and an adjusted basis of $20,000. In Year 1 of the recognition period, LossCo has $20,000 of gross income attributable to royalties collected in connection with the license of the patent. This income item is not treated as an RBIG because the income would not have been properly taken into account before the change date by an accrual-method taxpayer. See Notice 2003-65, *Example 6*. As this example demonstrates, an asset may be included in the NUBIG/NUBIL computation even if income therefrom is not treated as an RBIG.

The 1374 approach also deviates from the accrual method in certain respects. For example, the 1374 approach generally treats cancellation-of-indebtedness income ("COD income") as an RBIG if the income arises from a debt owed by the loss corporation at the beginning of the recognition period, but only if such item of income is properly taken into account during the first 12 months of the recognition period. Notice 2003-65 treats any reduction of tax basis (under sections 108(b)(5) and 1017(a)) that occurs as a result of COD income realized within this 12-month period as having occurred immediately before the ownership change for purposes of the section 382(h)(2) RBIG/RBIL determination, but any such basis reduction does not affect the loss corporation's NUBIG or NUBIL under section 382(h)(3). The RBIG/RBIL determination and the NUBIG/NUGIL computation are thus separate; an item of income or deduction may be included in or excluded from the former without affecting the latter.

Similarly, the 1374 approach under Notice 2003-65 generally treats a bad debt deduction under section 166 as an RBIL if the deduction arises from a debt owed to the loss corporation at the beginning of the recognition period, but only if such deduction is properly taken into account during the first 12 months of the recognition period. Consequently, a debt instrument may be treated as an asset for NUBIG/NUBIL purposes even though a bad debt deduction with respect thereto will not be treated as an RBIL if it properly arises after the first year of the recognition period.

If Taxpayer were to apply the 1374 approach to calculate Target's RBILs, then Target's bad debt deductions taken into account under section 166 more than 12 months after the Acquisition would not be treated as RBILs under Notice 2003-65. effectively extends this "not RBIL" treatment to Target's bad debt deductions taken into account within 12 months after the Acquisition and to all sales or exchanges of Target's . As noted above, the loans' value and basis would continue to be included in Target's NUBIG/NUBIL computation under the 1374 approach.

Second, Taxpayer argues that the purpose of was to , and that excluding from the NUBIG/NUBIL computation furthers that purpose. As support for its argument, Taxpayer cites

.

Based upon such language, Taxpayer concludes that should be excluded from the application of section 382(h) (including for purposes of the NUBIG/NUBIL computation) because were not readily ascertainable at the time of the Acquisition.

Yet does not constitute official guidance upon which taxpayers are entitled to rely. Furthermore, does not broadly state that should be excluded from the NUBIG/NUBIL computation under the Notice. Instead, it describes as providing, on a temporary basis, that " " (emphasis added).

reference to makes clear that . Nothing in addresses the NUBIG/NUBIL computation or suggests that altered the operation thereof. Thus, even if excluding from the NUBIG/NUBIL computation would further the goal of , nothing in suggests that was intended to go that far.

Moreover, whether or not were readily ascertainable at the time of the Acquisition is irrelevant to Target's NUBIG/NUBIL calculation, for the Acquisition is governed by section 382(h)(8). Section 382(h)(8) provides that

> [i]f 80 percent or more in value of the stock of a corporation is acquired in 1 transaction (or in a series of related transactions during any 12-month period), for purposes of determining the net unrealized built-in loss, the fair market value of the assets of such corporation shall not exceed the grossed up amount paid for such stock properly adjusted for indebtedness of the corporation and other relevant items.

In other words, for purposes of the pertinent NUBIL calculation, Taxpayer simply needed to use the stock price for Target (subject to certain adjustments). Nothing in suggests that was intended to trump or alter the application of section 382(h)(8).

Finally, Taxpayer's approach would affect the tax treatment of items of gain and loss other than . In other words, if a taxpayer were able to exclude from the NUBIG/NUBIL computation, then the taxpayer could end up with a NUBIG rather than a NUBIL. Such a result would be very likely in the case of financially distressed banks undergoing ownership changes. As a consequence, *none* of the taxpayer's built-in losses—whether losses on or otherwise—would be subject to the section 382 limitation. Moreover, the taxpayer's RBIGs would increase the section 382 limitation. Such results go well beyond .

In sum, has no impact on the NUBIG/NUBIL computation for purposes of section 382(h), but rather

. This result is consistent with the 1374 approach as applied to bad debt deductions taken into account more than 12 months after an ownership change.

Computation of NUBIG/NUBIL for Purposes of Section 56(g)

For purposes of determining a corporation's alternative minimum tax ("AMT"), the corporation's alternative minimum taxable income ("AMTI") is increased by 75 percent of the excess (if any) of the corporation's adjusted current earnings ("ACE") over the corporation's AMTI (determined without the ACE adjustment and without regard to the alternative tax NOL deduction). Section 56(g)(1). A corporation's ACE is equal to its AMTI with certain adjustments. Under one such adjustment, a loss corporation with a NUBIL that undergoes an ownership change must reduce the basis of the corporation's assets to their fair market values as of the date of the ownership change. More specifically, section 56(g)(4)(G) provides that if

> (i) there is an ownership change (within the meaning of section 382) in a taxable year beginning after 1989 with respect to any corporation, and (ii) there is a net unrealized built-in loss (within the meaning of section 382(h)) with respect to such corporation, then the adjusted basis of each asset of such corporation (immediately after the ownership change) shall be its proportionate share (determined on the basis of respective fair market values) of the fair market value of the assets of such corporation (determined under section 382(h)) immediately before the ownership change.

In calculating its ACE for the taxable year ending Date 2, Taxpayer did not reduce the basis of Target's assets pursuant to section 56(g)(4)(G) because Taxpayer treated Target as having a NUBIG rather than a NUBIL at the time of the ownership change. For reasons discussed above, Target's should have been included in its NUBIG/NUBIL computation for regular tax purposes, and Target should have been treated as having a NUBIL rather than a NUBIG on the date of the Acquisition. According to § 1.56(g)-1(a)(5)(i), "[e]xcept as otherwise provided by regulations or other guidance issued by the Internal Revenue Service, all Internal Revenue Code provisions that apply in determining the regular taxable income of a taxpayer also apply in determining adjusted current earnings." Moreover, section 56(g)(4)(G) (quoted above) explicitly follows section 382(h) for purposes of determining whether there is a NUBIL. Consequently, pursuant to section 56(g)(4)(G), the basis of Target's assets should have been reduced for purposes of the ACE computation.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

[redacted]

Please call if you have any further questions.