

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to:

(Large Business & International)

from: Gerald B. Fleming

Senior Technician Reviewer, Branch 2

(Corporate)

subject: Default Substitute Agent for the Consolidated Group under Treas. Reg. § 1.1502-77B

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

LEGEND

Oldco =

Newco =

Newco LLC =

Holdco =

Mid-LLC =

Merger-Sub =

Foreign Sub X =

Debtor's Agreement =

Request for
Competent Authority
Assistance (or
Request) =

Bankruptcy Court =

State A =

Country X =

Country X Taxation Agency =

Year 1 =

Year 2 =

#A =

#B =

Date A =

Date B =

Date C =

Date D =

Date E =

Date F =

Date H =

Date J =

Date K =

PLR#1 =

PLR#2 =

The facts set forth in this memo are those that were provided in connection with your request and have not been verified for accuracy or completeness. All section references are to the Internal Revenue Code of 1986. All references to the regulations under Treas. Reg. § 1.1502-77B are to the regulations in effect for consolidated return years beginning on or after June 28, 2002 and before April 1, 2015.

I. ISSUES

1. Is Holdco the default substitute agent for the Oldco consolidated group for the Year 1 consolidated group's tax year even though it was neither a member of the Oldco group in Year 1 nor a party to the Debtor's Agreement when the Bankruptcy Exchange occurred?
2. Was Holdco the proper party to file the Request for Competent Authority Assistance (the "Request") as agent for the Oldco consolidated group for the Year 1 consolidated return year even though Holdco had not yet filed the required statement pursuant to Rev. Proc. 2002-43 notifying the Commissioner that Holdco was the default substitute agent?

II. CONCLUSIONS

1. Holdco is the default substitute agent for the Oldco consolidated group for the Year 1 year.
2. As the default substitute agent, Holdco was the proper party to file the Request on behalf of the Oldco consolidated group for the Year 1 consolidated return year, notwithstanding that Holdco submitted the required statement pursuant to Rev. Proc. 2002-43 after filing the Request.

III. FACTS

Oldco¹ was the common parent of an affiliated group of corporations that included over #A subsidiaries that were members of the Oldco consolidated group, which filed consolidated federal income tax returns on a calendar year basis for several years, including Year 1. In Year 2, Oldco and certain of its domestic subsidiaries filed for bankruptcy protection under chapter 11 of title 11 of the United States Code in the Bankruptcy Court.

A. The Bankruptcy Exchange

On or about Date A, as part of the initial steps of the Debtor's Agreement in a bankruptcy plan (the "Bankruptcy Exchange"), Oldco transferred substantially all of its assets and liabilities to Newco, in a transaction that qualified as a reorganization under § 368(a)(1)(G). See PLR#1.

It is our understanding of the Debtor's Agreement that Oldco retained certain liabilities and Newco assumed certain other liabilities, including the federal income tax liabilities of the Oldco consolidated group for the Year 1 year.

¹ All entities specifically identified in the facts, other than Foreign Sub X, are State A entities.

B. The F Reorganization Exchange

On or about Date B, Newco and additional parties engaged in the following transaction, consisting of six steps, that qualified as a reorganization under § 368(a)(1)(F) (collectively referred to as “the F Reorganization Exchange”; see PLR#2):

Step 1: Newco formed Holdco, as a wholly owned corporation.

Step 2: Holdco formed Mid-LLC, a wholly owned limited liability company (“LLC”), which is treated as an entity disregarded as an entity separate from its owner for federal income tax purposes (a “disregarded entity”).

Step 3: Mid-LLC formed Merger Sub, a wholly owned corporation.

Step 4: Merger Sub merged with and into Newco, with Newco surviving (the “Reverse Merger”). Pursuant to State A law, the Merger Sub stock held by Mid-LLC in the Reverse Merger was automatically converted into Newco stock.

Step 5: On the day following the completion of the Reverse Merger, Newco converted into an LLC and was renamed Newco LLC. After the conversion, Newco LLC was treated as a disregarded entity.

Step 6: Newco LLC distributed its equity interests in certain businesses and entities to Mid-LLC.

Holdco succeeded to Newco’s section 381 attributes as a result of the F Reorganization Exchange.

C. The Stipulation Order

On Date C, Oldco, Holdco, and Newco LLC entered into a stipulation and order under the authority of the Bankruptcy Court (“the Stipulation Order”). We understand the Stipulation Order to mean that Holdco and Newco LLC agreed, subject to the Debtor’s Agreement, to assume the Federal Tax liabilities of Oldco including the federal income tax liabilities of the Oldco consolidated group for the Year 1 year.²

² The language in the Stipulation Order states that

The copies of the Proofs of Claim provided to CC:CORP indicate that they include claims with respect to the federal income tax liabilities for the Oldco consolidated group for the Year 1 year. Holdco has also provided written statements indicating it is liable for the federal income tax liabilities for the Oldco consolidated group for the Year 1 year.

On Date D, Oldco dissolved under State A law. Oldco, the common parent for the Oldco consolidated group for the Year 1 consolidated tax year, did not designate an agent for the group pursuant to Treas. Reg. § 1.1502-77B(d)(1) for the Year 1 consolidated return year prior to Oldco's dissolution. Furthermore, the Commissioner has not at any time designated an agent for the Oldco consolidated group for the Year 1 consolidated return year pursuant to Treas. Reg. § 1.1502-77B(d)(3).

D. Request for Competent Authority Assistance Under Tax Treaties with Commissioner

Foreign Sub X was a wholly owned Country X subsidiary of Oldco during Oldco's consolidated federal income tax year for Year 1. Foreign Sub X purportedly was acquired by Holdco on Date F during the Bankruptcy Exchange (or, more likely, during the F Reorganization Exchange).³

On Date H, the Country X Taxation Agency issued a letter to Foreign Sub X proposing to increase Foreign Sub X's Country X income for the Year 1 taxable year. In its letter, the Country X Taxation Agency also proposed to assess a withholding tax on the proposed adjustment with respect to the Year 1 taxable year.

On Date E, Holdco, pursuant to Rev. Proc. 2006-54, 2006-49 I.R.B. 1035, filed the Request. In the Request, Holdco requested the U.S. competent authority to assist it with respect to matters covered in the mutual agreement procedure provisions of the U.S./Country X Tax Treaty. Holdco is requesting competent authority assistance under the Treaty to consider proposed actions of Country X regarding Foreign Sub X's income for Year 1. In particular, relief is requested because double taxation could result if an adjustment is not made by the IRS.

E. Notification that Holdco is the Default Substitute Agent

On Date J, Holdco filed a statement pursuant to Rev. Proc. 2002-43, 2002-2 CB 99 (Determination of Substitute Agent for a Consolidated Group When the Common Parent Ceases to Exist), ("Holdco's Rev. Proc. 2002-43 Notice") notifying the Commissioner that Holdco is the default substitute agent for the Oldco consolidated group for consolidated return years beginning on or after Date K and ending on or before Date F under Treas. Reg. § 1.1502-77B(d)(2). Holdco attached a statement in which it agreed to serve as the group's substitute agent; and, because it was not a member of the group during the consolidated return year(s) for which it is the default substitute agent, acknowledged that it is primarily liable as a successor of the former common parent of the group for the consolidated tax liability for such consolidated return year(s).

³ We are not certain as to when Foreign Sub X was acquired by Holdco, but we do not believe this is relevant to the issue before us because we are concerned only about the Year 1 consolidated return year of the Oldco group. For purposes of this memorandum, we assume that Newco, directly or indirectly, acquired Foreign Sub X from Oldco during the Bankruptcy Exchange, and then Holdco acquired, directly or indirectly, Foreign Sub X from Newco in the F Reorganization Exchange on or about Date B.

IV. LAW

Treas. Reg. § 1.1502-77B(a)(1)(i) sets forth the following basic rule:

Except as provided in paragraphs (a)(3) and (6) of this section, the common parent (or a substitute agent described in paragraph (a)(1)(ii) of this section) for a consolidated return year is the sole agent (agent for the group) that is authorized to act in its own name with respect to all matters relating to the tax liability for that consolidated return year, for—

(A) Each member in the group; and

(B) Any successor (see paragraph (a)(1)(iii) of this section) of a member.

Treas. Reg. § 1.1502-77B(a)(1)(ii) explains the status of a substitute agent as follows:

For purposes of this section, any corporation designated as a substitute agent pursuant to paragraph (d) of this section to replace the common parent or a previously designated substitute agent acts as agent for the group to the same extent and subject to the same limitations as are applicable to the common parent, and any reference in this section to the common parent includes any such substitute agent.

Treas. Reg. § 1.1502-77B(a)(1)(iii) defines the term “successor” in the following manner:

For purposes of this section only, the term successor means an individual or entity (including a disregarded entity) that is primarily liable, pursuant to applicable law (including, for example, by operation of a state or Federal merger statute), for the tax liability of a member of the group. Such determination is made without regard to § 1.1502-1(f)(4) or 1.1502-6(a). (For inclusion of a successor in references to a subsidiary or member, see paragraph (c)(2) of this section.)

Treas. Reg. § 1.1502-77B(a)(1)(iv) provides that if a subsidiary of a group becomes, or its successor is or becomes, a disregarded entity for Federal tax purposes, the common parent continues to serve as the agent with respect to that subsidiary’s tax liability under § 1.1502-6 for consolidated return years during which it was included in the group, even though the entity generally is not treated as a person separate from its owner for Federal tax purposes.

Treas. Reg. § 1.1502-77B(a)(4)(i) specifies the term of the common parent’s agency as follows:

Except as provided in paragraph (a)(4)(iii) of this section, the common parent for the consolidated return year remains the agent for the group with respect to that

year until the common parent's existence terminates, regardless of whether one or more subsidiaries in that year cease to be members of the group, whether the group files a consolidated return for any subsequent year, whether the common parent ceases to be the common parent or a member of the group in any subsequent year, or whether the group continues pursuant to § 1.1502-75(d) with a new common parent in any subsequent year.

Treas. Reg. § 1.1502-77B(d)(1)(i) authorizes the common parent to designate a substitute agent for the group as follows:

(i) If the common parent's existence terminates, it may designate a substitute agent for the group and notify the Commissioner, as provided in this paragraph (d)(1).

(A) Subject to the Commissioner's approval under paragraph (d)(1)(ii) of this section, before the common parent's existence terminates, the common parent may designate, for each consolidated return year for which it is the common parent and for which the period of limitations either for assessment, for collection after assessment, or for claiming a credit or refund has not expired, one of the following to act as substitute agent in its place—

- (1) Any corporation that was a member of the group during any part of the consolidated return year and, except as provided in paragraph (e)(3)(ii) of this section, has not subsequently been disregarded as an entity separate from its owner or reclassified as a partnership for Federal tax purposes; or
- (2) Any successor (as defined in paragraph (a)(1)(iii) of this section) of such a corporation or of the common parent that is a domestic corporation (and, except as provided in paragraph (e)(3)(ii) of this section, is not disregarded as an entity separate from its owner or classified as a partnership for Federal tax purposes), including a corporation that will become a successor at the time that the common parent's existence terminates.

(B) The common parent must notify the Commissioner in writing (under procedures prescribed by the Commissioner) of the designation and provide the following—

- (1) An agreement executed by the designated corporation agreeing to serve as the group's substitute agent; and
- (2) If the designated corporation was not itself a member of the group during the consolidated return year (because the designated corporation is a

successor of a member of the group for the consolidated return year), a statement by the designated corporation acknowledging that it is or will be primarily liable for the consolidated tax as a successor of a member.

Treas. Reg. § 1.1502-77B(d)(1)(ii) provides that a designation under paragraph § 1.1502-77B(d)(1)(i)(A) does not apply unless and until it is approved by the Commissioner. The Commissioner's approval of such a designation is not effective before the existence of the common parent terminates.

If the common parent does not designate a substitute agent before its existence terminates, Treas. Reg. § 1.1502-77B(d)(2) provides for a default substitute agent under certain circumstances:

If the common parent fails to designate a substitute agent for the group before its existence terminates and if the common parent has a single successor that is a domestic corporation, such successor becomes the substitute agent for the group upon termination of the common parent's existence. However, see paragraph (d)(4) of this section regarding the consequences of the successor's failure to notify the Commissioner of its status as default substitute agent in accordance with procedures established by the Commissioner.

If the common parent fails to designate an agent before its existence terminates and there is no default substitute agent, Treas. Reg. § 1.1502-77B(d)(3)(i) provides that the Commissioner may designate an agent:

In the event the common parent's existence terminates and no designation is made and approved under paragraph (d)(1) of this section and the Commissioner believes or has reason to believe that there is no successor of the common parent that satisfies the requirements of paragraph (d)(2) of this section (or the Commissioner believes or has reason to believe there is such a successor but has no last known address on file for such successor), the Commissioner may, at any time, with or without a request from any member of the group, designate a corporation described in paragraph (d)(1)(i)(A) of this section to act as the substitute agent. The Commissioner will notify the designated substitute agent in writing of its designation, and the designation is effective upon receipt by the designated substitute agent of such notice. The designated substitute agent must give notice of the designation to each corporation that was a member of the group during any part of the consolidated return year, but a failure by the designated substitute agent to notify any such member of the group does not invalidate the designation.

Treas. Reg. § 1.1502-77B(d)(4) adds the following additional rule:

Until a designation of a substitute agent for the group under paragraph (d)(1) of this section has become effective, the Commissioner has received notification in

accordance with procedures established by the Commissioner that a successor qualifying under paragraph (d)(2) of this section has become the substitute agent by default, or the Commissioner has designated a substitute agent under paragraph (d)(3) of this section—

- (i) Any notice of deficiency or other communication mailed to the common parent, even if no longer in existence, is considered as having been properly mailed to the agent for the group; and
- (ii) The Commissioner is not required to act on any communication (including, for example, a claim for refund) submitted on behalf of the group by any person other than the common parent (including a successor of the common parent qualifying as a default substitute agent under paragraph (d)(2) of this section).

Treas. Reg. § 1.1502-77B(e)(1) specifies when a corporation's existence is deemed to terminate, as follows:

For purposes of paragraphs (a)(1)(v), (a)(4)(i), (d), and (j) of this section, the existence of a corporation is deemed to terminate if—

- (i) Its existence terminates under applicable law; or
- (ii) Except as provided in paragraph (e)(3) of this section, it becomes, for Federal tax purposes, either—
 - (A) An entity that is disregarded as an entity separate from its owner; or
 - (B) An entity that is reclassified as a partnership.

Rev. Proc. 2002-43, 2002-2 C.B. 99 (Determination of Substitute Agent for a Consolidated Group When the Common Parent Ceases to Exist) provides instructions with regard to communicating with the Commissioner with respect to determining the agent for the group for consolidated return years beginning on or after June 28, 2002 and before April 1, 2015.

Rev. Proc. 2002-43, Section 9, provides instructions with respect to notification by the default substitute agent under Treas. Reg. § 1.1502-77B(d)(2).

Rev. Proc. 2002-43, Section 9.01, states that:

.01 In general. If a terminating common parent that does not designate a substitute agent pursuant to § 1.1502-77B(d)(1) has a qualifying successor (as

defined in section 6.02 of this revenue procedure), such qualifying successor is the default substitute agent under § 1.1502-77B(d)(2) for consolidated return years beginning on or after June 28, 2002. Such default substitute agent must provide notification to the IRS pursuant to the filing requirements set forth in this section 9 to insure that it will receive communications from the IRS to the group and to insure that the IRS will act on its communications to the IRS on behalf of the group.

Rev. Proc. 2002-43, Section 9.03(8), requires a default substitute agent to attach a statement in which the default substitute agent:

- (a) Agrees to serve as the group's substitute agent; and
- (b) If it was not a member of the group during the consolidated return year(s) for which it is the default substitute agent, acknowledges that it is primarily liable as a successor of the former common parent of the group for the consolidated tax liability for such consolidated return year(s).

V. ANALYSIS

A. Issue 1

1. Holdco is the Default Substitute Agent

At the outset, we note that Oldco could have designated a substitute agent for the Oldco consolidated group for the Year 1 consolidated return year pursuant to Treas. Reg. § 1.1502-77B(d)(1). However, Oldco did not designate a substitute agent for any of the group's consolidated return years before it dissolved on Date D. Accordingly, the inquiry turns to whether Holdco or another entity is the default substitute agent under Treas. Reg. § 1.1502-77B(d)(2).

In order to be the default substitute agent for the Oldco group for the Year 1 year, Holdco must be the single corporate domestic successor to Oldco for Oldco's federal income tax liabilities for the Year 1 year. The threshold question is whether the Holdco is a "successor" to Oldco for the Year 1 consolidated return year within the meaning of Treas. Reg. § 1.1502-77B(a)(1)(iii).

Pursuant to Treas. Reg. § 1.1502-77B(a)(1)(iii), "the term successor means an individual or entity (including a disregarded entity) that is primarily liable, pursuant to applicable law (including, for example, by operation of a state or Federal merger statute), for the tax liability of a member of the group."

As the parenthetical in that definition indicates, the language "primarily liable, pursuant to applicable law" means, for example, a liability arising "by operation of a state or Federal merger statute". This is not an exclusive meaning and thus, "primarily liable,

pursuant to applicable law” is not limited to transactions consummated under a “state or Federal merger statute”. The term “primarily liable, pursuant to applicable law” could also result, for instance, as a consequence of a practical merger that is not pursuant to a state or Federal merger statute, or an agreement in a Federal Bankruptcy Court order. Accordingly, in light of Holdco’s agreement in the Stipulation Order to assume the federal income tax liabilities of the Oldco group for the year in question, Holdco is primarily liable for Oldco’s Year 1 tax liability and is a successor to Oldco for the Year 1 year. In addition, Holdco’s Rev. Proc. 2002-43 Notice affirmatively acknowledges, under penalties of perjury, that Holdco is the successor to Oldco under Treas. Reg. § 1.1502-77B(a)(1)(iii).

We note that Newco LLC also agreed in the Stipulation Order to be liable for Oldco’s Year 1 tax liabilities and thus is also a successor to Oldco within the meaning of Treas. Reg. § 1.1502-77B(a)(1)(iii). However, as a disregarded entity, Newco LLC is not a corporation and is not eligible to be the agent for the Oldco group’s Year 1 year. See Treas. Reg. § 1.1502-77B(d)(1)(i)(A)(2) and (2). Therefore, Holdco, as the only single successor to Oldco that is a domestic corporation, qualifies as the default substitute agent for the Oldco consolidated group for the Year 1 consolidated return year.

2. No Designation by the Commissioner

According to the available facts, the Commissioner has not designated a substitute agent for the Oldco group for the Year 1 year pursuant to Treas. Reg. § 1.1502-77B(d)(3). Although substantial time elapsed after Oldco dissolved before Holdco notified the Commissioner of its status as the default substitute agent, the Commissioner apparently had no occasion in the interim to deal with the agent for the Oldco group with respect to its Year 1 year. Accordingly, the issue of identifying or designating the agent for the Oldco group did not arise until Holdco filed the Request on Date E. Less than #B weeks after filing the Request, Holdco submitted its notification under Rev. Proc. 2002-43 and attached the required statements.

Even if Holdco had not submitted the required notification that it was the default substitute agent, the Commissioner, to the extent Holdco was the default substitute agent, would be required to recognize it as the substitute agent rather than designate a member of the Oldco group for the Year 1 year as the substitute agent pursuant to Treas. Reg. § 1.1502-77B(d)(3). According to Treas. Reg. § 1.1502-77B(d)(3), the Commissioner can designate an agent if the Commissioner believes or has reason to believe that there is no successor of the common parent that satisfies the requirements of paragraph (d)(2) (or the Commissioner believes or has reason to believe there is such a successor but has no last known address on file for such successor).

If the Commissioner believed there was no default substitute agent, the Commissioner could generally designate a remaining member of the group or a successor to a member as the substitute agent. If, on the other hand upon further inquiry, the Commissioner determined the existence of a successor that satisfies the requirements

of Treas. Reg. § 1.1502-77B(d)(2), the Commissioner would have no choice but to recognize that successor as the default substitute agent.

Thus, if the Commissioner were to designate an agent pursuant to Treas. Reg. § 1.1502-77B(d)(3) in the instant case, the Commissioner would have to designate Holdco as the agent because it is a successor to Oldco that satisfies the requirements of Treas. Reg. § 1.1502-77B(d)(2).⁴ If the Commissioner did not consider Holdco to be the default substitute agent, the Commissioner could designate another substitute agent. However, Holdco, as the only single domestic corporate successor to Oldco, qualifies as the default substitute agent, and the Commissioner does not need to designate another agent.

In summary, based on our understanding of the available information, Holdco has been properly identified as the default substitute agent for the Oldco consolidated group for the Oldco Year 1 consolidated return year after Oldco dissolved without designating a substitute agent before its existence terminated.

B. Issue 2

Holdco, as the default substitute agent for the Oldco group, was the proper party to file the Request for the Oldco consolidated group for the Year 1 consolidated return year, notwithstanding that Holdco had not yet filed the notification required by Rev. Proc. 2002-43.

Pursuant to Treas. Reg. § 1.1502-77B(d)(4)(ii), the Commissioner is not required to act on any communication (including, for example, a claim for refund) submitted on behalf of the group by any person other than the common parent (including a successor of the common parent qualifying as a default substitute agent under paragraph (d)(2)) until the notification required by Rev. Proc. 2002-43 is submitted. Thus, when Holdco filed its Request without having previously submitted the required notification, that filing prompted an inquiry to determine whether Holdco was the appropriate party to file the request.

Section 9.02 of Rev. Proc. 2002-43 provides that the default substitute agent's notification "should be filed promptly after the existence of the common parent terminates." However, neither the regulation nor the revenue procedure imposes a deadline for filing or a penalty for not filing the notification promptly, other than the predictable inconvenience described in Treas. Reg. § 1.1502-77B(d)(4)(ii) of not receiving communications from the Commissioner or not being recognized by the Commissioner as the substitute agent for the consolidated group. The purpose of the notification requirement is to assure that the Commissioner is not prejudiced by any

⁴ As a practical matter, rather than designate the default substitute agent as the substitute agent, the Commissioner would ordinarily contact the default substitute agent and remind it to submit the required notification pursuant to Section 9 of Rev. Proc. 2002-43.

failure to provide the notification and accompanying statements. If the records do not reflect the existence of a default substitute agent, the Commissioner has no reason to accept or act on a communication purportedly submitted on behalf of the consolidated group by such an agent.

Although it would have been preferable for Holdco to file the required notification promptly after Oldco's dissolution, or at least before it filed the Request, Holdco's lack of promptness does not negate the priority accorded by Treas. Reg. § 1.1502-77B(d)(2) to Holdco as the default substitute agent. In any event, Holdco did submit the required notification within a reasonably short period after filing the Request, and there was no prejudice to the Commissioner or conflicting designation by the Commissioner pursuant to Treas. Reg. § 1.1502-77B(d)(3).

Furthermore, as discussed above, if the Commissioner were to designate an agent pursuant to Treas. Reg. § 1.1502-77B(d)(3), the Commissioner would be required to designate Holdco, a successor that satisfies the requirements of Treas. Reg. § 1.1502-77B(d)(2).

Under the circumstances we discern no prejudice to the Commissioner that Holdco filed the Request as the default substitute agent for the Oldco group. Here, it makes no difference whether Holdco's Rev. Proc. 2002-43 Notice should have instead been filed on or before Date E (the date the Request was filed), or anytime afterwards, such as on Date J (when Holdco filed the proper statement pursuant to Rev. Proc. 2002-43 notifying the Commissioner that Holdco was the default substitute agent for the Year 1 Oldco consolidated group).

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

If you have any questions, please call Gerald B. Fleming at 202-317-6975 or Richard M. Heinecke at 202-317-5363.

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cc: