



Dealing with Losses: CARES Act Changes, Debt Restructuring, and Other Strategies for a Strong Future

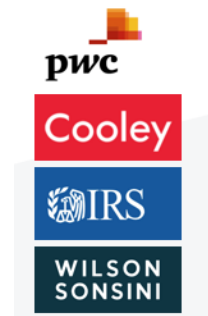
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1

Net Operating Losses – The CARES Act

Changes

Amended section 172 to allow a net operating loss (NOL) from tax years beginning in 2018, 2019, or 2020 to be carried back for five taxable years (see section 172(b)(1)(D)).

Temporarily removes the 80% of taxable income limitation to allow an NOL to fully offset income.

- The 80% limitation is set to apply to taxable years beginning after December 31, 2020.

Net Operating Losses – The CARES Act

Considerations/observations

Losses generated in tax years 2018 – 2020 at a 21% tax rate can be carried back to 2013-2017 at a 35% tax rate.

NOLs carried back to a tax year that includes the section 965 transition tax cannot be applied to offset transition tax liability.

- Alternatively, taxpayers can elect to exclude one or more tax years that are section 965 inclusion years from the five-year carryback period.

NOLs carried back to a tax year that includes a GILTI inclusion may result in a reduction in the amount of the section 250 deduction resulting in only a 10.5% benefit.

NOLs carried back to a tax year in which section 59A (BEAT) is in effect may reduce the tax benefit of the NOL depending on the tax profile.

3

Net Operating Losses – The CARES Act

Technical Corrections to TCJA

Allows NOLs arising in a tax year beginning in 2017 and ending in 2018 to be carried back two taxable years and carried forward 20 years with no 80% taxable income limitation.

Clarifies how to determine the NOL limitation in taxable years that have pre- and post-TCJA NOL carryforwards.

- NOL deduction is equal to the pre-TCJA NOLs plus 80 percent of the remaining taxable income (after reduction by pre-TCJA NOL carryovers).

4

Net Operating Losses – The CARES Act

Reminders

NOLs are carried back to the earliest year of the carryback period and then forward to the year immediately preceding the year in which the NOL was generated.

Taxpayers cannot select how many years to go back – NOLs must be carried back 5 taxable years or 2 taxable years depending on when the NOL was generated.

Short taxable years count for purposes of the carryback period.

Must file election to waive carryback to preserve use of NOLs as carryforwards.

- NOLs deemed utilized in carryback even if taxpayer does not apply for refund claim.

5

Net Operating Losses – The CARES Act

NOL Carrybacks

NOLs Generated in Taxable Years Beginning in 2017, 2018, 2019, and 2020							
2013	2014	2015	2016	2017	2018	2019	2020
35%	35%	35%	35%	35%	21%	21%	21%
		X	X	NOL			
X	X	X	X	X	NOL		
	X	X	X	X	X	NOL	
		X	X	X	X	X	NOL

6

Net Operating Losses – The CARES Act

M&A Considerations/Observations

Taxpayers that have engaged in M&A transactions should review the definitive agreements to determine whether (i) losses may be carried back to years when the target was owned by the seller and (ii) they address which party is entitled to the benefit of the carryback.

Questions to consider:

- What does the specific definitive agreement provide with respect to the target's losses?
- What if the definitive agreement is silent on NOL carrybacks?
- Does the definitive agreement have any provisions on amending the target's prior tax returns?
- Does the definitive agreement address which party is entitled to a refund of pre-closing taxes?
- Does the definitive agreement include a pre-closing indemnity provision?
- What happens if there is no pre-closing indemnity but instead a representations and warranties policy for pre-closing taxes?

7

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M&A Considerations/Observations

If seller is entitled to refund and has a pre-closing indemnity, then consider whether buyer would consider trading the release of seller from its indemnity in exchange for buyer's receipt of refund.

- Even if the agreement allows buyer to obtain any potential refund, if the target was a member of a consolidated group there are a set of rules dealing with carry backs to consolidated return years and these rules can get complicated quickly.

What do the conduct provisions state?

- Is seller required to cooperate with buyer to facilitate the claim and refund?
- How can the buyer gain access to information about the target during the pre-acquisition period that pre-dates diligence?

These questions get more complicated if the target was acquired out of a consolidated group.

If buyer and seller cannot negotiate the ability to carryback an NOL of target, buyer may want to waive the carryback period so the selling consolidated group cannot amend its return to obtain the benefit of target's loss.

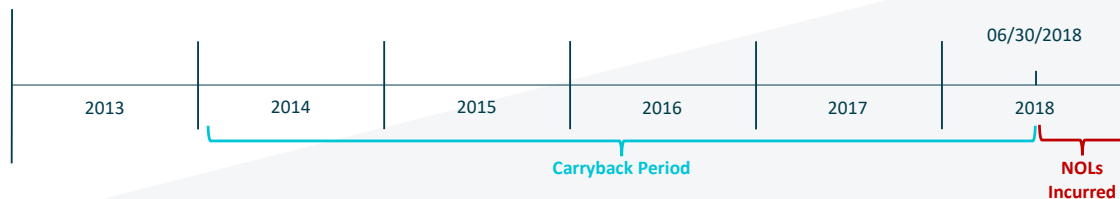
8

Net Operating Losses – The CARES Act

Example – Post-acquisition NOL

Target, a calendar year taxpayer, was acquired in a taxable stock acquisition on 06/30/2018 that ended its tax year.

Target incurred significant NOLs in the period from 07/01/2018 to 12/31/2018.



9

Net Operating Losses – The CARES Act

Considerations – Post-acquisition NOL

Acquisition raises contractual and technical considerations discussed above.

If seller is entitled to refund and has a pre-closing indemnity, then buyer may consider trading the release of seller from its indemnity in exchange for buyer's receipt of refund (or a portion of the refund if carried back to a 35% tax rate year).

What happens if there is no pre-closing indemnity but instead a representations and warranties policy for pre-closing taxes?

Given the deal mechanics, buyer may consider waiving the carryback period (under section 172(b)(3)) and carryforward the NOL.

- Generally, election to waive the carryback period is made by the due date (including extensions) for filing the return for the year of the NOL.
- However, election to waive the carryback period for NOL generated in 2018 or 2019 tax year must be made by the due date (including extensions) for filing the 2020 tax return (see Rev. Proc. 2020-24).

10

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Considerations – Post-acquisition CNOL

Same facts but the buyer is a member of a consolidated group and the buyer consolidated group generates a post-acquisition CNOL, which is partly attributable to the target.

Acquisition raises same contractual and technical considerations discussed above.

Given the deal mechanics, buyer may consider waiving the carryback period and carryforward the NOL.

- However, mechanism for waiving the carryback period is different.
 - A group may make an irrevocable election under section 172(b)(3) to relinquish the entire carryback period with respect to a CNOL for any consolidated return year (see Treas. Reg. Sec. 1.1502-21(b)(3)(i)).
 - The annual election must be filed with the group's tax return for the year of the CNOL and is applicable to the entire group and can't be made separately for any member.
 - As a result of this election, none of the consolidated group's CNOL may be carried back, including any portion of the loss attributable to existing members of the group.

11

Net Operating Losses – The CARES Act

Considerations – Post-acquisition CNOL

- Alternatively, the buyer consolidated group may make an irrevocable election to waive all CNOLs attributable to the target corporation for the portion of the carryback period during which it was a member of another consolidated group (otherwise known as a "split-waiver election.") (see Treas. Reg. Sec. 1.1502-21(b)(3)(ii)(B)).
 - The split-waiver election must be filed with the buyer consolidated group's original income tax return for the year in which the corporation became a member.
 - Because many companies didn't contemplate NOL carrybacks post-TCJA, they likely didn't make the split-waiver election.
 - To provide relief to buyer consolidated group's, IRS and Treasury released temporary regulations allowing the buyer consolidated group to effectively file a late split waiver election resulting from the amendment to the NOL rules (otherwise known as the "amended statute split-waiver election") (see Treas. Reg. Sec. 1.1502-21T(b)(3)(i)(C)).
 - The amended statute split-waiver election must be attached to an amended return that must be filed no later than November 30, 2020.

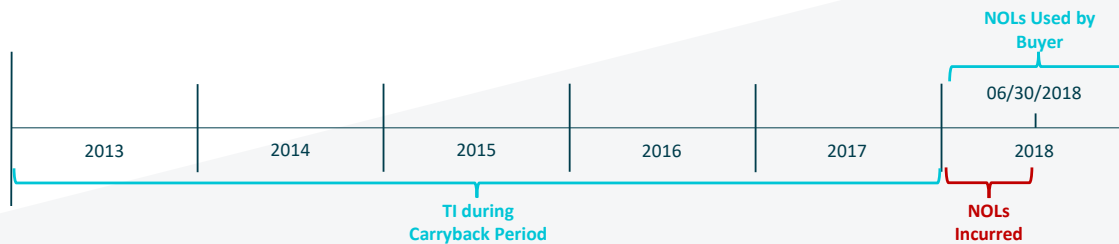
12

Net Operating Losses – The CARES Act

Example – Pre-acquisition NOL

Target, a calendar year taxpayer, was acquired in a taxable stock acquisition on 06/30/2018 that ended its tax year.

Target incurred significant NOLs in the period from 01/01/2018 to 06/30/2018 and buyer has taxable income in the post-acquisition periods.



13

Net Operating Losses – The CARES Act

Considerations – Pre-acquisition NOL

Seller could carry back the pre-acquisition NOL to offset pre-acquisition income during the carryback period, but will the definitive agreement allow seller to carry back the NOL?

If the definitive agreement allows the seller to carry back the NOL, what happens if buyer already utilized the NOL to offset post-acquisition income? Is buyer required to amend its tax return for the benefit of seller?

If buyer must compensate seller for the utilization of such loss (because the losses are attributable to transaction expenses), buyer may be willing to allow seller to carry back that loss to a pre-acquisition tax year because buyer isn't entitled to the benefit of the loss.

If seller contractually cannot carry back the NOL and buyer does not have to compensate seller for use of the NOL, then buyer may (i) negotiate to allow seller to carry back and share in the benefit of the carryback, especially if the refund is in a 35% tax year or (ii) elect to waive the carryback period and carry forward the NOL.

14

Section 382(h)

- Basic limitation after an ownership change: long-term tax exempt rate times fair market value of the LossCo
- If a LossCo has “net unrealized built-in again” (NUBIG) at time of an ownership change, the annual 382 limitation during first 5 years is increased by “recognized built-in again” (RBIG)
- NUBIG: fair market value of LossCo’s assets at time of ownership change minus LossCo’s basis in its assets
- RBIG: gain recognized by LossCo on assets held at time held at time of ownership change, to the extent it does not exceed fair market value at time of ownership change minus basis in assets
- Similar limitation for NUBILs/RBILs

15

Notice 2003-65

- Two different approaches to calculating NUBIG/NUBIL and identifying RBIG/RBIL
 - 1374 Approach:
 - Based on Section 1374(d) and applicable regulations
 - NUBIG/NUBIL: amount of net gain or loss that would have been recognized on a hypothetical sale of LossCo’s assets immediately before ownership change
 - RBIG/RBIL: Amount of gain or loss recognized on sale of asset during recognition period
 - 338 Approach:
 - Based on a hypothetical Section 338 election on the date of ownership change, assuming an acquisition of LossCo occurred on such date (“Hypothetical Sale”)
 - NUBIG/NUBIL: same as under 1374 Approach
 - RBIG/RBIL: Identified by comparing LossCo’s items of income, gain, deduction and losses with those that would have resulted from a Hypothetical Sale
 - Hypothetical amortization of IP treated as RBIG

16

Notice 2003-65 - Example

- LossCo has one asset, IP, and \$25mil of NOLs. On date of ownership change, LossCo is worth \$100mil
 - Base 382 limitation:
 - \$890,000 per year in losses
 - \$186,900 in cash tax benefit
 - 1374 Approach:
 - No increase in 382 limitation unless IP is sold
 - 338 Approach:
 - Amortization deduction in Hypothetical Sale: \$6,666,666 per year
 - Annual limitation in first 5 years is increased by \$6,666,666 per year
 - Cash tax benefit: \$1.4mil per year

17

2019 Proposed Regulations

- September 2019 Proposed Regulations
 - Eliminates 338 Approach altogether and rely on the 1374 Approach
 - Rationale: 1374 Approach is more consistent with text and purpose of Section 382 and simplifies tax administration
 - Increases items treated as RBIL – e.g., payments of contingent liabilities, deferred deductions
 - Introduces more complex rules around COD income, which depend in part on whether debt is recourse or non-recourse
 - TCJA conformity, including dividends and GILTI and Section 163(j)

18

Treatment of Deferred Revenue

- Proposed Regulations provide:
 - Prepaid income received prior to the ownership change but attributable to post-ownership change performance is not RBIG
 - RBIL includes deferred deductions
- Example
 - LossCo with \$100 of prepaid income and \$90 liability for deferred revenue
 - NUBIG: \$0
 - NUBIL: \$190
 - When services are performed:
 - \$90 income
 - \$90 deduction is RBIL, may not be fully available to offset income

19

2020 Proposed Regulations

- January 2020 Proposed Regulations introduced a much-welcomed transition period
 - Regulations are effective 30 days after finalized (the “effective date”)
 - Regulations do not apply to ownerships changes that occur after the effective date but that are pursuant to:
 - A binding agreement in effect on or before the effective date
 - A transaction that has been publicly announced or appeared in an SEC filing on or before the effective date
 - Bankruptcy court order on or before the effective date or
 - PLR describing the transaction is submitted to the IRS on or before the effective date

20

NOL Poison Pills - Basic

- NOL carryforward is a valuable asset
 - Less valuable after TCJA
- Example:
 - Assume: \$10 mil in NOLs, 21% tax rate, 80% Limitation, 5% discount rate

Year	Taxable Income	NOL Utilized	Tax Savings	PV
1	\$2 mil	\$1.6 mil	\$336,000	\$320,000
2	\$2 mil	\$1.6 mil	\$336,000	\$304,762
3	\$2 mil	\$1.6 mil	\$336,000	\$290,249
4	\$2 mil	\$1.6 mil	\$336,000	\$276,428
5	\$2 mil	\$1.6 mil	\$336,000	\$263,265
6	\$2 mil	\$1.6 mil	\$336,000	\$250,728

21

NOL Poison Pills – Key Terms

- NOL Poison Pill disincentivizes acquisitions of significant blocks of stock (e.g., 5% or more)
- Rights are issued to stockholders via dividend
 - Each stockholder is granted a right to purchase shares of company stock at a discount in the event of (1) the acquisition by a third party of 4.99% or more of company stock without Board approval, or (2) an announcement of a tender or exchange offer that would result in a third party acquiring 4.99% or more of company stock
- When a “triggering event” occurs, all stockholders other than the one who triggered the rights may exercise their rights and purchase common stock at a discount
- Results in significant dilution (economic and voting) to the third party acquirer
- Delaware Supreme Court upheld an NOL Poison Pill in *Versata Enterprises Inc. v. Selectica, Inc.*, but noted that whether an NOL Poison Pill is reasonable depends on the specific facts and circumstances of the case.

22

NOL Poison Pills – Key Terms

Rights are designed to give the Board maximum flexibility to consider and respond to any acquisition of shares by a third party that may jeopardize the Company's future use of its NOLs

The Board generally has authority to amend or repeal the plan at any time, subject to its fiduciary duties

Prior to a triggering event, rights will not have any impact on the Company's capital structure and will have no economic impact for the Company or its stockholders

Historically, a rights plan is a deterrent device designed to give the board appropriate leverage and opportunity to consider issues in accordance with its fiduciary duty; rights plans are generally not "triggered" because the economic impact to the triggering party is too severe

23

NOL Poison Pills – Pros and Cons

Pros

- Deters acquisitions that could impair or destroy the value of the NOLs
- Encourages third parties interested in acquiring the Company to negotiate with the Board
- Creates time to evaluate proposals and develop alternative strategies

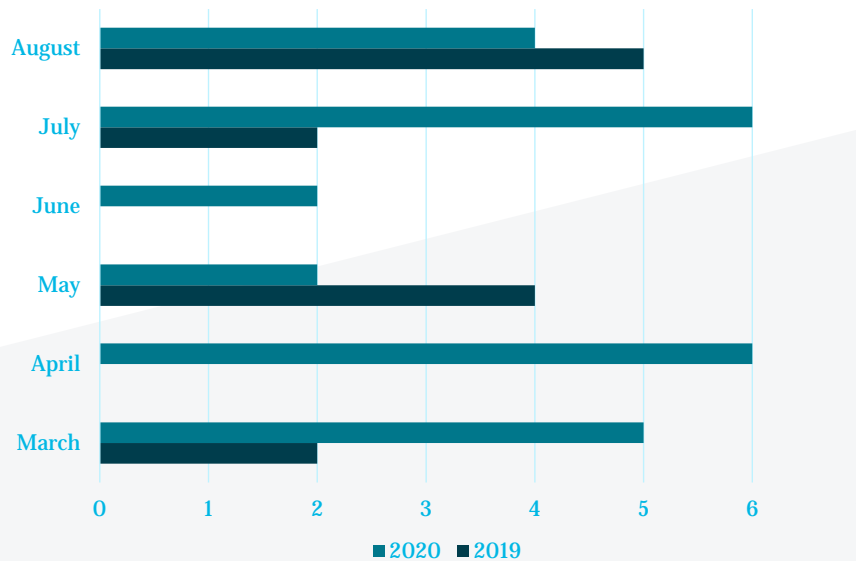
Cons

- Do not prevent stock acquisitions that could impair or destroy the value of the NOLs
- Disfavors all acquisitions of more than 5% of the Company's stock (whether hostile or friendly)
- May increase the threat of proxy fights and shareholder lawsuits
- Could result in adverse investor reaction (especially if not put up for shareholder approval)

24

Summary of NOL Poison Pills

- 132 companies have implemented NOL Poison Pills in past ten years
- 72 still in effect



25

Section 163(j) Limitation on Business Interest Expense

§163(j) under TCJA generally limits deductibility of business interest expense (BIE) for any taxable year beginning after 12/31/17 to:

- 30% of adjusted taxable income (ATI), plus
- business interest income (BII), plus
- floor plan financing interest (car dealerships) for the taxable year.

EXAMPLE:

- Facts: For TY2021, TP has ATI of \$100x, BIE of \$50x (which includes \$10x of floor plan financing interest expense) and BII of \$20x. §1.163(j)-2(h), Ex. 1
- §163(j) limitation=\$60x
Sum of BII (\$20x), plus 30% of ATI (\$100x x 30%=\$30x), plus floor plan financing interest expense (\$10x)
- TP's BIE (\$50x) does not exceed §163(j) limitation (\$60x), so TP can deduct all \$50x of BIE for TY2021.
- If TP's BIE were \$80x, \$20x of BIE would not be deductible in TY2021, but would be carried forward as BIE in next TY (and afterward).

26

Limitation on Business Interest Expense cont'd

- Any amount disallowed under §163(j) is carried forward indefinitely as BIE paid or accrued in the succeeding taxable year.
- §163(j) generally applies to all taxpayers, and applies at the entity level, with special rules for partnership or S corporation level debt.
- “Small businesses” with average gross receipts over preceding three-year period of less than \$25 million are excluded.
- Certain businesses are exempt, including electing real property businesses, electing farming businesses and certain regulated utilities.
- ATI includes only income from a trade or business, which excludes performing services as an employee.
- §163(j) generally applies after application of provisions that subject interest expense to disallowance, deferral, capitalization, or other limitation. §1.163(j)-3(b).

27

Limitation on Business Interest Expense, cont'd

Limitation increased to 50% of ATI for taxable years beginning in 2019 and 2020 under CARES Act. §163(j)(10)(A)(i).

50% limitation not available in 2019 to partnerships, §163(j)(10)(A)(ii), but:

- Partners treat 50% of their allocable share of partnership's EBIE for 2019 as BIE in partner's first taxable year beginning in 2020 without limitation under §163(j);
- Remaining 50% continues to be subject to §163(j) limitation applicable to EBIE carried forward at the partner level. Proposed §1.163(j)-6(g)(4).

TPs can elect not to apply 50% limitation. §1.163(j)-2(b)(2)(ii), (b)(4); Rev. Proc. 2020-22, 2020-18 I.R.B. 745.

28

Limitation on Business Interest Expense cont'd

TPs can elect to use ATI for last TY beginning in 2019 to determine §163(j) limitation for TY beginning in 2020. §163(j)(10)(B). §1.163(j)-2(b)(3).

- If acquirer in §381 transaction makes this election, target's 2019 ATI is not included. Proposed §1.163(j)-2(b)(3)(iii).
- Consolidated group making this election uses its 2019 ATI, even if membership in group changed during 2020 taxable year. Proposed §1.163(j)-2(b)(3)(iv).

29

Definition of Interest

4 categories, including an anti-avoidance rule. §1.163(j)-1(b)(22).

Category 1—Amounts paid, received, or accrued as compensation for use or forbearance of money under debt instrument, or treated as interest under other provisions of Code or regs.

Category 2—Swaps with significant nonperiodic payments treated as two separate transactions:

- On-market, level payment swap and
- A loan, which must be accounted for separately, with time value component under §1.446-3(f)(2)(iii)(A) recognized as interest expense by payor and interest income by recipient.
- Exceptions for cleared swaps and swaps required to meet margin or collateral requirements of federal regulator.
- Delayed applicability date to September 14, 2021, although TPs can opt in, and anti-avoidance rule will apply. §1.163(j)-1(c)(3)(i).

30

Definition of Interest, cont'd

Category 3—Other amounts treated as interest, including:

- Bond issuance premium, ordinary income or loss on CPDIs, substitute interest payments on repos or securities lending transactions not entered into in the ordinary course of TP's business, ordinary gain under §1258 (conversion transactions), income on factored receivables.
- Category 3 was narrowed significantly by deleting: Items from derivatives that alter TP's effective cost of borrowing or yield, loan commitment fees, debt issuance costs and guaranteed payments for the use of capital under §707(c).
- However, several of the deleted items may be swept into the anti-avoidance rule.

31

Definition of Interest, cont'd

Category 4 anti-avoidance rule: Any expense or loss **economically equivalent** to interest is treated as interest expense if **a principal purpose** of structuring is to reduce amounts that otherwise would have been treated as interest under Categories 1 through 3.

- Facts and circumstances test.
- But a business purpose for obtaining the use of funds or the ability to obtain funds at a lower pre-tax cost based on structure do not affect determination of whether TP has a principal purpose of reducing interest expense.
- Equivalent anti-abuse rule for artificially increasing interest income.
- Corresponding amounts treated as BII if counterparty TP “knows” that expense is treated as interest by payor under anti-abuse rule and TP's income with respect to transaction is substantially earned in consideration of time value of money.
- Five examples, not all of which appear to be abusive. Are the examples supposed to be examples of abusive transactions?

32

Definition of ATI

Starts with TTI, which is taxable income under §63, but without regard to §163(j) limitation or disallowed BIE carryforwards. §1.163(j)-1(b)(1), (b)(43).

Additions for BIE (other than disallowed BIE carryforwards); NOL deduction; §199A deduction; deduction for depreciation, amortization and depletion (for taxable years beginning before 1/1/22); deduction for capital loss carryback or carryover; and deductions or loss not properly allocated to non-excepted trade or business.

Subtractions for BII; floor plan financing interest expense; anti-double counting adjustment; income or gain not properly allocated to non-excepted trade or business; and deemed inclusions of subpart F income and GILTI properly allocated to non-excepted trade or business, net of §250 deduction.

33

Anti-Double Counting Adjustment

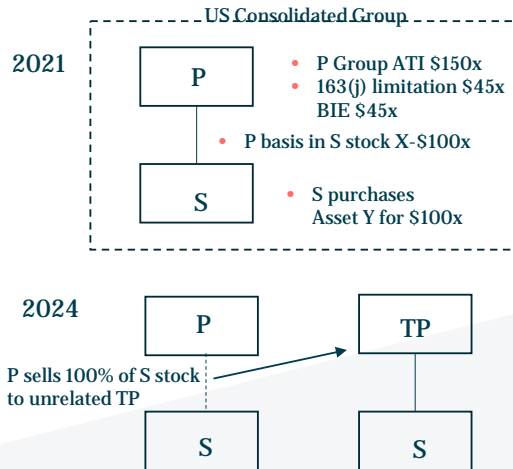
- Intended to prevent addition of depreciation, amortization, and depletion in tax years beginning after 12/31/17 and before 1/1/22 from being double counted when asset is later sold or disposed of, including through sale of stock of consolidated group member. 1.163(j)-1(b)(1)(ii)(C)-(E)
- Sale or disposition generally does not include §381 transactions or intercompany transactions, but does include deconsolidations and §351 transactions.

EXAMPLE: §1.163(j)-1(b)(1)(viii), Ex. 1

- **Facts:** In 2021, A purchases a depreciable asset (Asset X) for \$100x and fully depreciates Asset X under §168(k). For 2021, A's ATI (after adding back A's depreciation deductions with respect to Asset X) is \$150x. A incurs \$45x of BIE in 2021. In 2024, A sells Asset X to an unrelated third party.
- A's §163(j) limitation for 2021 is \$45x ($\$150x \times 30\%$), so all \$45x of A's BIE incurred in 2021 is deductible in that year. However, A must subtract \$100x from TTI in computing ATI for 2024. A would be required to do so even if A's ATI in 2021 was \$150x before adding back A's depreciation deductions with respect to Asset X.

34

Anti-Double Counting Adjustment, cont'd



- In 2021, S purchases a depreciable asset (Asset Y) for \$100x and fully depreciates it under §168(k).
- P reduces its basis in its S stock by \$100x under §1.1502-32 to reflect S's depreciation deductions.
- For the 2021 taxable year, the P group's ATI (after adding back S's depreciation deductions with respect to Asset Y) is \$150x.
- P group incurs \$45x of BIE in 2021.
- In 2024, P sells all of its S stock to an unrelated third party.
- Same results as prior example.
- If P's gain on sale of S stock is less than investment adjustments for S's depreciation deductions, P could elect to add "lesser of" to TTI in 2024 under 2020 proposed regs.

§1.163(j)-1(b)(1)(viii), Ex. 2

35

C Corporations

- Basic framework of 2018 proposed rules was maintained.
- All interest expense and interest income of C corporation is per se BII and BIE allocable to C corporation's trade or business. §1.163(j)-4(b)(1).
- Disallowance and carryforward of deduction for BIE does not affect whether or when BIE reduces TP's earnings and profits. §1.163(j)-4(c).
- Current year BIE is deducted in the current taxable year before any disallowed BIE carryforwards from prior taxable year are deducted in that year.
- Disallowed BIE carryforwards are deducted in the order they arose, beginning with the earliest taxable year, subject to certain limitations (e.g., under §382). §1.163(j)-5(b)(2).
- Disallowed BIE carryforwards are "inheritable" tax attributes under §381 (subject to §382 and/or SRLY limitations). §1.381(c)(20)-1.
- Acquirer's ability to use transferor's disallowed BIE carryforwards in first tax year ending after a §381(a) acquisition is limited, based on similar rule as for acquired NOLs. §1.381(c)(1)-1 and 1.381(c)(1)-2.

36

C Corporations, cont'd

Interaction with §250 Deduction

- §163(j) limitation is based in part on TP's ATI. §250 generally provides a deduction based on amount of FDII and GILTI of domestic corporation, subject to a limitation based on taxable income (the greater TP's taxable income for purposes of §250, the greater the allowable deduction).
- Prior proposed regs provided that ATI was determined without regard to the limitation on the §250 deduction (resulting in lower ATI).
- Service determined that further study is required to determine the appropriate rule for coordinating Code provisions that limit the availability of deductions based, directly or indirectly, upon TP's taxable income.
- Until additional guidance is effective, TPs may choose any reasonable approach (which could include an ordering rule or simultaneous equations) as long as approach is applied consistently for all relevant taxable years.

37

§382

- Disallowed BIE carryovers are subject to §382 ownership change rules in a manner similar to pre-change losses.
- For BIE arising in a change year, default rule is daily proration, unless §1.1502-76 applies because the loss corporation is joining or leaving a consolidated group.
- Final regs permit election to close the books. §1.382-6(b)(4).
- Disallowed BIE carryforwards are not treated as RBILs, so there is no double detriment under §382. §1.163(j)-5(e)(5); 1.382-7(d)(5).
- Application of 382 to CFCs requires further study.
 - §382(e)(3) provides that, except as otherwise provided in regulations, only items treated as ECI are taken into account in determining the value of foreign loss corporation if an ownership change occurs.
 - If foreign corporation with no U.S. trade or business undergoes a §382 ownership change, §382(e)(3) appears to limit the foreign Corporation's disallowed BIE carryforwards to \$0.

38

Consolidated Groups

- Single §163(j) limitation applies at consolidated group level, consistent with §163(j), Notice 2018-28 and 2018 proposed regs. §1.163(j)-4(d)(2).
- Consolidated group's ATI is group's taxable income, and is determined generally disregarding intercompany transactions with offsetting items.
- Intercompany obligations generally are disregarded for purposes of computing ATI, BII and BIE. Result is that consolidated group's BIE subject to limitation is determined by reference to external BIE, rather than with respect to member that ultimately bears cost of borrowing (through on-loans, internal financing).
- Exception for repurchase premium deductible under §1.163-7(c) from deemed satisfaction of obligations that become intercompany obligations. §1.163(j)-4(d)(2)(v)(B). Service determined that it should not matter which member of consolidated group repurchases external debt.

39

Consolidated Groups, cont'd

- Current year or disallowed BIE of departing member treated consistently with consolidated NOLs under §1.1502-21(b).
- Retained and carried forward to departing member's first separate return year to extent not used by consolidated group for taxable year including departure date or otherwise reduced.
- Under unified loss rule of §1.1502-36, disallowed BIE is treated as a deferred deduction subject to reduction or reattribution in connection with transfer of loss share.
- Anti-avoidance rule provides that arrangements entered into with a **principal purpose** of avoiding §163(j) or the regs, including the use of multiple entities to avoid the \$25M gross receipts test of §448(c), may be disregarded or recharacterized. Treas. Reg. §1.163(j)-2(j)(1).

40

CFCs

Why does it matter if §163(j) applies to CFCs?

- Potential to increase subpart F income, and GILTI tested income.
- Can limit subpart F income, and GILTI tested income included in determination of US shareholders' §163(j) limitation.
- Reduces tax efficiency of locating debt offshore to maximize value of interest deductions.
- Final regs continue to exclude from ATI of US shareholders subpart F income inclusions, GILTI inclusions and §78 gross-up on deemed paid taxes; proposed regs include adjustment to ATI for portion of subpart F income and GILTI inclusions for CFC group member that is attributable to CFC's ETI.
- Anti-abuse rule applies to certain intra-group interest payments made with a principal purpose of reducing US shareholders' tax liability when CFC group election is not in effect.
- Final regs continue to apply to CFCs on separate company basis absent CFC group election or safe harbor election.

41

CFCs cont'd

Proposed regs include quasi-consolidated group concept with single §163(j) limitation (with each CFC allocated its share of limitation).

- Limitation computed for CFC group by determining ATI, BIE and BII on separate company basis and then aggregating.
- Transactions between members of CFC group and items of income and expense arising from indebtedness between CFC group members are taken into account in determining ATI of CFC group.
- ATI computations take foreign taxes into account.

Modified requirements for group election:

- 80% (direct or indirect) value test, but group parent can be applicable CFC or US person.
- CFCs with ECI can be included (non-ECI items).
- CFC financial services subgroup eliminated.

CFC group election revocable after 60 months and then can't be made for again for another 60 months.

42

Thank you!

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