Limit My Practice Instead! Thoughts on Reforming Section 382

*By Sam Dimon**

Sam Dimon presents the case that in practice Code Sec. 382 is not working well and suggests practical steps to improve the regime without a major legislative re-write.

Fill in the blank: "The last 18 months have been a time of testing for ____." Your answer says a lot about you: "Those who lost their jobs" shows your compassion; "the economy," your realism; "economic theory," your intellectual bent. If you answered "ownership changes," you may need professional help.

It's true, though. The potentially dire consequences of a Code Sec. 382 "ownership change" tend to preoccupy top managers of economically stressed corporations, and as a consequence, their tax lawyers and accountants. In the last 18 months, there have been more economically stressed corporations than usual, and as a consequence, more focus on testing under Code Sec. 382 to determine the proximity to an ownership change of a company with net operating loss carryforwards or other favorable tax attributes (generically, a "loss corporation" or "loss company," and in examples, "Loss Co.").

This is unfortunate. I am not referring to the economic stress itself, unfortunate as that is. My focus is on the fact that Code Sec. 382 influences corporate decision-making more than it should. Stressed companies too often are inhibited by fear that otherwise rational economic decisions will precipitate an ownership change (or set up conditions where an ownership change could easily occur). As a consequence, stock-for-debt exchanges outside of bankruptcy may be avoided, or pared back, and so may stock offerings to raise needed cash.

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These are not the only costs. Loss companies that can scarcely afford it spend more than they should for advice from outside tax professionals about the intricacies of Code Sec. 382—not to mention the amount of "in-house" time spent by these companies tracking ownership shifts and considering how to avoid the draconian consequences of an ownership change.[1] Relatedly, an increasing number of loss companies that are uncomfortably close to an ownership change have been enacting "tax benefit preservation plans" barring accumulations of five percent of their stock (on pain of triggering a poison pill).[2] These plans—while perfectly reasonable, given the way Code Sec. 382 works—inhibit investments that have nothing to do with objectionable "loss trafficking," which is purportedly what Code Sec. 382 targets.[3] Loss companies emerging from bankruptcy frequently include provisions in their charters that have different mechanics but similar effects.

When counting the costs of Code Sec. 382, we should also remember that the IRS and the Treasury spend a great deal of time dealing with the interpretive challenges posed by Code Sec. 382—most often with a view to mitigating the harshness of the statute and the temporary regulations promulgated in 1988. Unfortunately, in my view, these efforts are circumscribed by the statute and its legislative history, pointing to a need for legislative action if we are to see substantial progress in limiting the counterproductive side effects of the regime. The good news is that there's room for substantial improvement without wholesale redrafting of the statute.

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As things now stand, the Code Sec. 382 regime continues to produce results that are both mystifying and frustrating to most who confront it for the first time.[4] Three years ago I wrote a paper (excerpts of which are attached in edited form as Appendix A) principally devoted to describing why and how the "segregation rules" under Code Sec. 382 could and should be improved by regulatory action. I tucked away in a footnote of that paper some preliminary thoughts about legislative action to more fully address what I perceived (and still perceive) to be the overreach of the statute, concluding with the words "I leave further work on this idea to someone else."[5] Three years later, I am that someone else.[6]

I. Road Map

As detailed in Appendix B, the genealogy of "new" Code Sec. 382 (*i.e.*, the 1986 version) includes several prior legislative efforts that were deemed unsatisfactory and a plethora of "think pieces" by distinguished practitioners, academics and government officials. This article does not offer a new theory. Rather, it begins by presenting the case that *in practice* Code Sec. 382 is not working well, in no small part because of adherence to the "logic" of a model (a calculation mechanic, really) that is not grounded in good theory. It also questions the current method of calculating the Code Sec. 382 limitation on NOL utilization (at least as it applies following mergers and functional equivalents) and suggests what I believe are practical steps to improve the regime without a major legislative re-write.

Part II gives a total of eight examples of transactions that under current Code Sec. 382 get a red light (*i.e.*, trigger an ownership change and a harsh limitation). In my view the first four examples merit a green light (*i.e.*, should not subject Loss Co.'s NOLs to any limitation). The next two examples in Part II involve ownership changes attributable to the acquisition of more than 50 percent of a loss company's stock, by an individual or "entity" that I call the "New Majority Holder (or the "NMH"), in a transaction that leaves the loss company's equity value unchanged or diminished.[7] I submit that these "yellow light" transactions *without more* do not represent what is appropriately termed "trafficking," because the loss company's NOLs are not available to shelter income attributable to capital from the New Majority Holder.[8] The question, which I consider a close one, is whether administrative convenience nonetheless dictates that a limitation on NOL utilization be imposed at the time of such a "yellow light" ownership change.

Part II also includes two "red light" examples where current imposition of a Code Sec. 382 limitation is, in my view, appropriate. One of these "red light" examples involves a merger of Loss Co. into a new entity, less than 50 percent of whose shares are owned by Loss Co. shareholders following the merger. I don't see a readily administrable way to avoid imposing a limitation in this example without creating a loophole—even if there is no "trafficking" intent. Note that in this type of carryover basis "asset" transaction, there may well not be a New Majority Holder (unless we stretch the meaning of that term).[9] Instead, there is what I refer to as a "Changed Loss Corporation": the surviving entity of a merger that brings together the loss corporation's NOLs with capital of new owners who collectively acquire a majority stake.[10] This is a situation where it makes sense to use a "counting mechanism" involving "segregated public groups" in determining whether there has been an "ownership change."[11] Unfortunately, as discussed in Appendix A, the current Code Sec. 382 regulations push the concept of the segregation rules much too far.

The final "red light" example in Part II is an abusive "stuffing" of capital into a shell company possessing no material assets other than NOLs. This transaction fully deserves the harsh treatment it gets under current Code Sec. 382.

Part III discusses how the Code Sec. 382 limitation should be calculated following a nonabusive transaction that results in an ownership change. I believe that the goal should be to permit use of Loss Co.'s NOLs in an amount that reasonably approximates income attributable to the capital of Loss Co. prior to the ownership change (which is in turn a reasonable approximation of the amount of NOLs that Loss Co. could have used had there been no ownership change). As can be seen from a review of Appendix B, which traces the "genealogy" of "new" Code Sec. 382, this is not a new thought. The question is whether the (more or less) "fixed dollar" Code Sec. 382 limitation under current law is the best practical solution. Part III explores as a possible alternative (at least for cases involving a Changed Loss Co.) a "floating" limitation based on the ratio of the equity value of Loss Co. immediately before the ownership change to the equity value, immediately after the ownership change, of Changed Loss Co. Two examples in Part III illustrate that this model is straightforward in some cases but less so in others. The question is whether the

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"fixed dollar" model dictated by the current statute should be left unchanged or whether Congress should give the Treasury the authority to permit an alternative method of calculating the limitation.

Part IV outlines an anti-abuse regime that I believe should serve as a backstop for a more relaxed general rule. Under this approach, if one or more transactions evidence a principal purpose of using a loss company's NOLs to shelter income from new capital, the consequences imposed by the current Code Sec. 382 regime should continue to apply. Part IV suggests objective indicia of both abuse and non-abuse that might be incorporated (with examples) in regulations.

Part V suggests a way forward for improving the operation of the Code Sec. 382 regime. This involves balancing the goal of significantly reducing the regime's over-breadth against the practical reality that a major legislative overhaul is unlikely to occur. My *goal* is that, subject to an anti-abuse rule, the Code Sec. 382 limitation should only apply when there is a New Majority Owner or a Changed Loss Corporation—that is to say, a circumstance where the NOLs of a loss corporation have been brought into "usable proximity" to income attributable to capital of a new "majority." As a corollary, I think that unconnected "non-trafficking" transactions occurring within a three-year period should not be cumulated in deciding whether there has been an ownership change. The question is how close we can come to achieving this goal without substantially rewriting the statute.

The answer, I think, is reasonably close. One legislative change I would suggest is substituting "10-percent shareholder" (or some higher percentage) for "5-percent shareholder." As anyone who has worked closely with Code Sec. 382 knows, much of the "static" produced by the regime relates to transactions involving shareholders who acquire and sell passive investment stakes representing over five percent but less than 10 percent of the outstanding equity value of a loss corporation. I have never seen anything I would call a real trafficking transaction involving such an investment stake, and the only ones I can imagine would be captured by an anti-abuse regulation.

I believe that the best approach for handling the rest of the changes I suggest would be to broaden the Treasury's regulatory authority, allowing but not requiring the changes. The process of proposing regulations and considering public comment would allow the Treasury and the IRS to balance issues of administrability and potential abuse with the goal of reducing the overbreadth of the current regime.

II. Do These Applications of Code Sec. 382 Make Sense?

In each example, "Loss Co." has substantial NOLs and a single class of (common) stock. Please assume, except where the discussion indicates otherwise, that all or substantially all of Loss Co.'s assets are held for use in an active business and that each of the transactions in question has a *bona fide* business purpose. In addition, assume that in each example there has been no prior "owner shift" during the last three years that would count towards an ownership change. The examples are simplified for ease of discussion so that the transaction(s) in each example trigger(s) an ownership change.[12]

The word "Public" refers to holders of less than five percent of Loss Co.'s stock who are treated as a five-percent shareholder for purposes of measuring ownership shifts under the current rules. References to different publics (*e.g.*, "Public A,") refer to groups of "small" holders treated, generally for three years, as different five-percent shareholders pursuant to the "segregation rules."

Example 1. Stock Redemption–No New Majority Holder

Facts

Loss Co. has more than 1,000 shareholders, none owning more than two percent of Loss Co. stock. Loss Co. makes a successful tender offer for 51 percent of its outstanding shares. Following the tender offer, no shareholder of Loss Co. owns five percent or more of Loss Co. stock. Under current law, Loss Co. has an ownership change because of the segregation rules. Specifically, the "public group" that ends up owning 100 percent of Loss Co. stock (Public A) is deemed to have increased its ownership percentage from 49 percent to 100 percent. Since Public A is treated as a five-percent shareholder, the statutory definition of an "ownership change" is met.[13]

Observations

Why would we want to limit Loss Co.'s utilization of its NOLs in this situation? Note that the redemption, by reducing Loss Co.'s equity value, is likely to reduce its earnings going forward (and therefore the rate at which its NOLs are utilized).

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As I read the "legislative history" of Code Sec. 382 (by which I mean not only the committee reports but also some of the articles and testimony that are part of the historical context), if this transaction involves "loss trafficking," it's because the members of Public A indirectly get the benefit of losses generated by capital attributable to the owners of the redeemed shares.[14] To state the obvious, though, there is no direct utilization of Loss Co.'s NOLs by the members of Public A. Rather, Loss Co. is taxed as a separate entity. The legislative history suggests, by way of partial answer, that unless we have Code Sec. 382 to protect the system, there will be market distortions.[15] Undoubtedly, that can happen, and I agree that there should be rules designed to prevent what is reasonably labeled "loss trafficking." But we should be more than a little skeptical, I think, of a strong form of the efficient capital markets hypothesis which assumes that, when it comes to raising capital, the mere fact that a company has NOLs gives it such an advantage over new market entrants that we need a statute as broad and harsh as Code Sec. 382 to neutralize that advantage. I *am* pretty sure that the current Code Sec. 382 regime, designed to remedy perceived "loss trafficking" problems that in many cases seem to me more theoretical than real, significantly distorts economic decision-making by loss companies.

Example 2. Widely Distributed Sale by a Substantial Shareholder

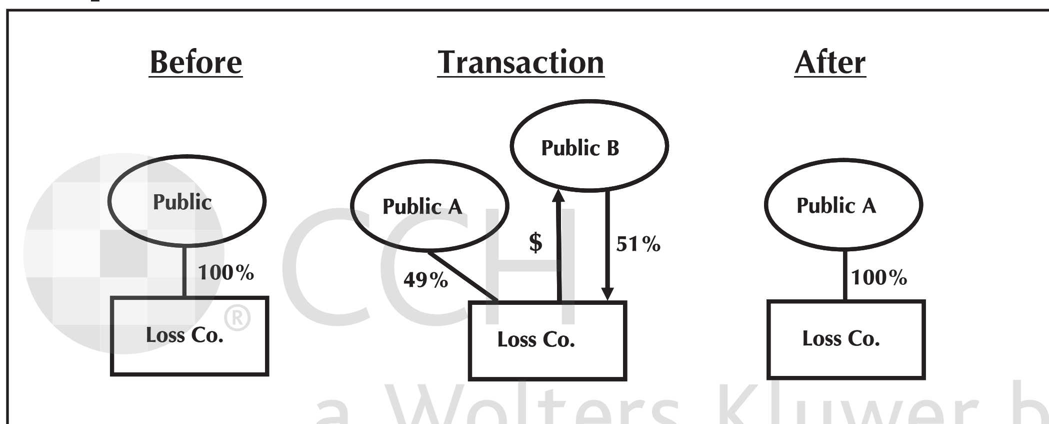
Facts

Loss Co. is owned 51 percent by Entity and 49 percent by Public. Entity sells all of its Loss Co. shares in a widely distributed, registered offering. Following the offering no person owns five percent or more of Loss Co. stock. Under the segregation rules, the "public" buyers of Loss Co. shares from Entity X are treated as a new public group ("Public B"). Public B's ownership percentage increases from zero to 51 percent, resulting in an ownership change.

Observations

Why should the secondary sale by Entity trigger the Code Sec. 382 limitation on Loss Co.'s use of its NOLs? The sale does nothing to enhance utilization of Loss Co.'s NOLs.[16] Of course, it's worth considering whether (on different facts) a sale by a controlling shareholder might be part of an abusive trafficking scheme. Example 8 illustrates the possibility. But Example 8 is a fringe case, appropriately handled by an anti-abuse rule.

Example 1



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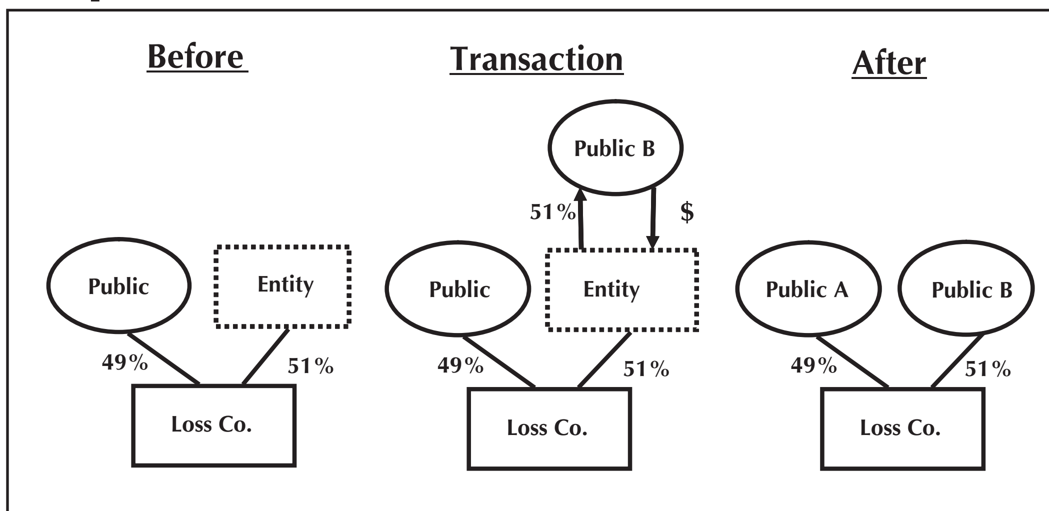
Example 2



Example 3. Stock Issuance Contributes to an Ownership Change; No New Majority Holder

Facts

Thirty shares of Loss Co. are owned by Entity, and 40 shares are owned by Public. Entity sells its shares in a widely distributed secondary offering. Within, say, one year of the sale by Entity, Loss Co. sells 28 shares in a widely distributed primary offering. The result, under the Segregation Rule of Reg. §1.382-2T(j)(3)(iii)(B) and the Segregation Exception of Reg. §1.382-3(j)(3), is that Loss Co. has three public groups:

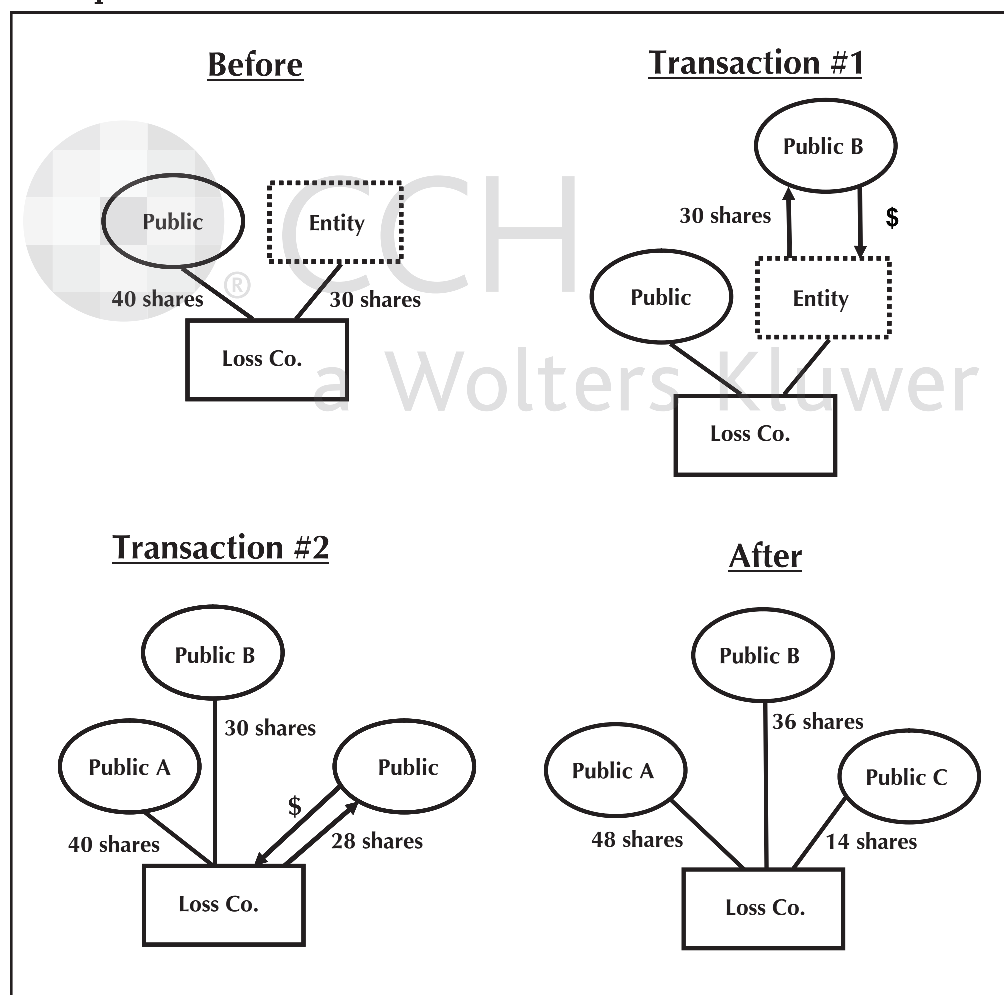
- Public A (the "old and cold" public group), which is treated as owning 48 shares (having been deemed to purchase eight of the shares issued in the primary offering)
- Public B (a "new and counting" public group, treated as owning 30 shares purchased from Entity and six shares purchased in the primary offering)
- Public C (a "new and counting" public group deemed to have acquired 14 of the shares issued in the primary offering)

Since Public B and Public C collectively own more than 50 percent of Loss Co.'s stock, Loss Co. has an ownership change.

Observations

There's reason for some caution here, because bringing new capital into a loss corporation is a hallmark of objectionable loss trafficking. But it does not follow that every stock issuance by a loss corporation is objectionable. Particularly at this point in our economic history, when the need for balance sheet repair is widespread, we ought to be wary of inhibiting stock issuances (which my experience tells me is one effect of Code Sec. 382). Capital formation is generally a good thing. When a loss corporation (i) issues stock to persons other than a New Majority Holder (ii) in a transaction not resulting in a Changed Loss Co., and (iii) the transaction (or series of transactions, if there is a plan) passes muster under an anti-abuse regime, I see no reason why that transaction (or series) should count in determining whether there is an ownership change.

Example 3



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Example 4. Workout

Facts

Loss Co. is in economic distress. In an out-of-court workout, holders of "old and cold" Loss Co. debt exchange their old debt for shares constituting 80 percent of Loss Co. stock (post-exchange). The value of the shares issued in the

exchange is substantially less than the amount of debt that is retired, and as a consequence Loss Co.'s NOLs are significantly reduced.[17] No exchanging debtholder owns more than five percent of Loss Co. stock following the exchange. The exchanging debtholders did not act in concert in acquiring the debt exchanged for Loss Co. stock and do not act in concert after the exchange, and so should not be viewed collectively as a New Majority Holder.

Observations

Obviously, the workout dramatically increases the equity value of Loss Co., so there is reason for careful thought before giving a "green light." On the other hand, why require Loss Co. to file for bankruptcy protection to get the benefit of the special relief it would be entitled to under Code Sec. 382(l)(5) or Code Sec. 382(l)(6)?

A bit of history is required to understand what these special bankruptcy rules are and how we came to have them. In passing its version of "new" Code Sec. 382 in 1985, the House decided that the general formula for calculating the Code Sec. 382 limitation (*i.e.*, the equity value of the loss corporation *immediately before* the ownership change multiplied by the long-term tax-exempt rate) should be adjusted, in the case of an ownership change resulting from implementation of a bankruptcy plan of reorganization, to equal the equity value of the loss corporation *immediately after* the ownership change multiplied by the long-term tax-exempt rate. This was a conceptual compromise. The House recognized that in the insolvency context the debtholders can be viewed as having been the owners of the loss corporation for an indeterminate period of time (which raises the question why there should be any limitation on NOL utilization). At the same time, the House was concerned that allowing bankrupt companies a blanket exception from the Code Sec. 382 limitation would open the door to potential abuse.[18]

The Senate took a conceptually purer tack in 1986, passing a special bankruptcy provision that would remove the Code Sec. 382 limitation altogether, but only for a select group of bankrupt loss corporations—those at least half of whose equity was owned, following implementation of the bankruptcy plan of reorganization, by a combination of pre-emergence shareholders and creditors whose shares were received in respect of claims that had particular indicia of what might be termed "non-trafficking" ("Qualifying Claims").[19] The holders of Qualifying Claims were implicitly treated as having been the owners of equity of the loss corporation, so that (i) there was no Code Sec. 382 limitation imposed on account of the ownership change occurring at the time of the bankruptcy reorganization, and (ii) the NOLs of the reorganized loss corporation were reduced to "back out" up to four years' worth of interest deductions attributable to the Qualifying Claims.[20] Because of concern about potential abuse, the Senate bill also required that, if the loss corporation had another ownership change within two years of the reorganization, the Code Sec. 382 limitation of the reorganized loss corporation following the second ownership change would be zero.

As enacted, "new" Code Sec. 382 included the Senate's special bankruptcy provision as Code Sec. 382(l)(5), which remains in effect today.[21] Companies emerging from bankruptcy that do not qualify for this relief, or that make an election not to apply Code Sec. 382(l)(5), are subject to Code Sec. 382(l)(6), which codifies the House's special bankruptcy rule.

Treasury regulations initially adopted in 1991 provide guidance regarding the application of Code Secs. 382(l)(5) and 382(l)(6). Most notably, the portion of the regulations governing Code Sec. 382(l)(5) generally treats as a Qualifying Claim any claim the owner of which is not a five-percent shareholder immediately after the bankruptcy reorganization.[22] This represents a welcome relief from a literal reading of the Code Sec. 382(l)(5) requirement, in the case of debt claims that have changed hands, of continuous ownership beginning 18 months prior to the filing of the bankruptcy petition. The policy basis underlying this regulatory relief is straightforward: If Qualifying Claims are implicitly treated as equity, there is no reason to treat transactions in Qualifying Claims that are exchanged for stock any more strictly than the transactions would have been treated if the Qualifying Claims had in fact been equity. In other words, the regulations governing Code Sec. 382(l)(5) use what might be viewed as a "relation-back" approach. There is no evident reason why this "relation-back" approach should not be applied more broadly, subject to an anti-abuse rule. A flexible anti-abuse rule should also render unnecessary the rigid rule under Code Sec. 382(l)(5)(D), which attaches draconian consequences to

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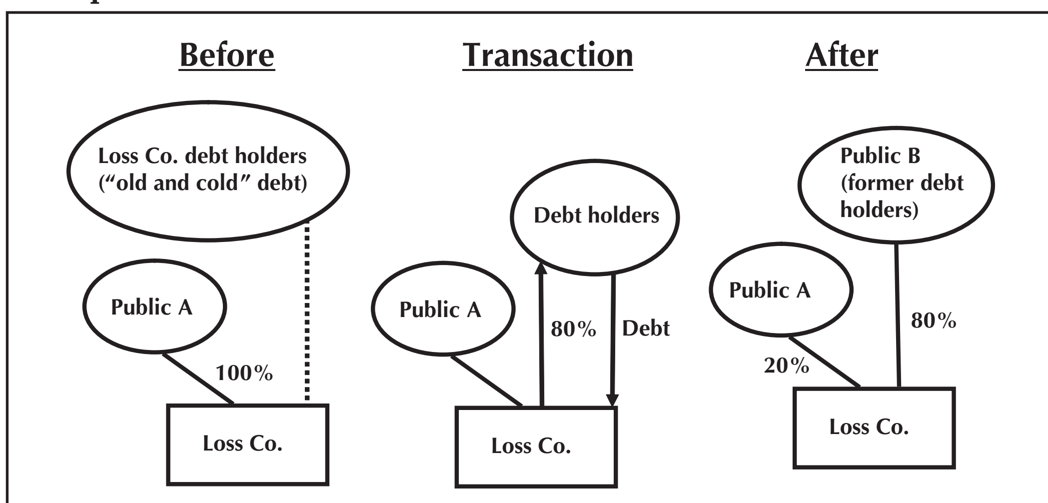
a second ownership change in two years, without regard to whether there has been anything pointing to abuse.

The conference report for the '86 Act noted that, although "[t]he special bankruptcy provisions do not apply to informal workouts, ... the conference agreement directs the Secretary of the Treasury to report informal bankruptcy [*sic*] workouts under sections 108 and 382, and report to the tax-writing committees of Congress before January 1, 1988."[23] No such report was issued, and the requirement for a report was repealed in 1990.[24]

Example 4



The legislative history of the special bankruptcy rules under Code Sec. 382 is sufficiently specific that it seems rather unlikely, in the absence of new authorization by Congress, that the Treasury would exercise its general regulatory authority under Code Sec. 382(m) and Code Sec. 7805 to extend these rules to workouts outside of bankruptcy. But this article is written precisely to make the case for Congressional delegation under Code Sec. 382 of regulatory authority to make such changes, among others.[25]

The facts of this Example 4 do not involve objectionable loss trafficking. The increase in the equity value of Loss Co. as a result of the stock-for-debt exchange is analogous to the increase in equity value attributable to the issuance of Loss Co. stock for cash in Example 3. Of course, the percentage increase in Loss Co.'s equity value in this Example 4 is larger than the percentage increase attributable to the stock issuance for cash in Example 3. On the other hand, Loss Co. is not really raising fresh capital in this Example 4 (as it does in Example 3); rather, it's effecting an exchange that converts debt capital to equity capital, under circumstances that give practical assurance that the debt was not issued in contemplation of the later workout.

Moreover, Loss Co. will incur a tax cost on account of this exchange, through some combination of cancellation of indebtedness income under Code Sec. 61 and reduction of its NOLs under Code Sec. 108(b)(1)(B).[26] On the facts of this Example 4, I see no need to impose the additional burden of a Code Sec. 382 limitation on Loss Co.'s use of its remaining NOLs. Nor do I see the need, in the context of an out-of-court workout, for imposing specific preconditions for relief from the current regime (*e.g.*, requiring that the exchange be effected under an imminent threat of involuntary bankruptcy, or that the company be insolvent at the time of the exchange). There *is* good reason to authorize anti-abuse regulations that would backstop any regulatory relaxation of the current rigidity of the Code Sec. 382 bankruptcy rules. But it is the process of proposing regulations, considering comments and finalizing the regulations—rather than the legislative process—that offers the best way to balance the scope of relaxation of the special bankruptcy rules, the scope of related anti-abuse regulations, and considerations related to administrability of the changes that are made.

Example 5. Stock Acquisition by a New Majority Holder (Nonconsolidated)

Facts

Initially Loss Co. is owned 100 percent by Public. New Majority Holder acquires more than 50 percent of Loss Co. stock from existing public shareholders (*e.g.*, by a tender offer). Following this transaction, Loss Co. is not part of a consolidated return group that includes NMH or any entity related to NMH. The lack of consolidation might be because NMH does not acquire enough Loss Co. stock, or because

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of the rules limiting the type of entity that can be part of a consolidated return group (*e.g.,* NMH might be a non-U.S. corporation, or a partnership).

Observations

This transaction clearly carries with it the potential for "something more" in the future. In particular, because NMH already owns more than 50 percent of Loss Co. stock, it can acquire the rest of Loss Co. stock without triggering a second ownership change under the current regime, and then "stuff" away. But without more, the transaction itself does not change the potential for utilization of Loss Co. NOLs in a way that seems objectionable. A possible alternative to imposition of the Code Sec. 382 limitation at this juncture would be to treat this kind of transaction (*i.e.,* one that does not increase the equity value of the loss company) as a "reporting trigger," but to permit deferral of any limitation unless and until there is an infusion of capital attributable to the New Majority Holder.[27] Whether such a regime would be too burdensome administratively is a question that I would defer to the IRS and the Treasury. The question is whether Congress should authorize the IRS and the Treasury to consider deferring imposition of a limitation under Code Sec. 382 in a situation such as this Example 6. I believe there is considerable upside and little downside in such an authorization.

Example 6. Redemption Resulting in New Majority Holder (Nonconsolidated Group)

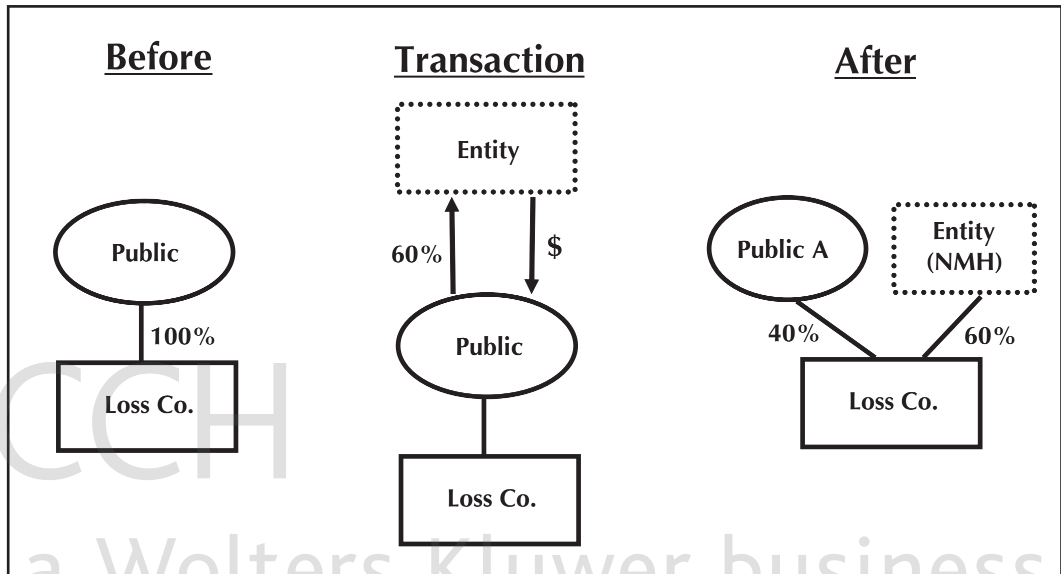
Facts

Loss Co. engages in a leveraged buy-out, pursuant to which more than 50 percent of Loss Co. stock is redeemed, resulting in a New Majority Holder for Loss Co.

Observations

This example raises issues similar to Example 5. It is a somewhat easier case for deferring imposi-

Example 5



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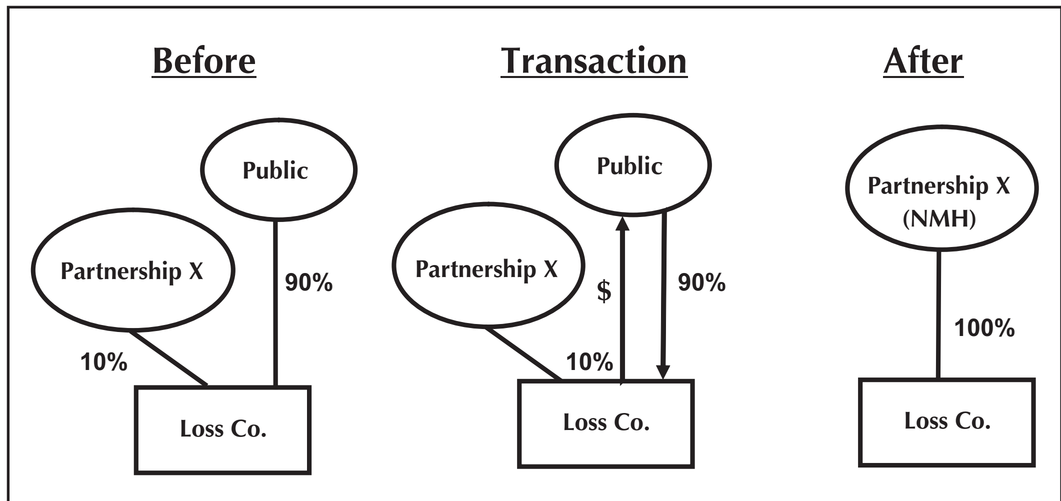
Example 6



tion of the Code Sec. 382 limitation, because the redemption decreases the equity value of Loss Co. But that distinction does not point to a satisfactory dividing line.

Example 7. Tax-Free Merger of Loss Co. into Changed Loss Corporation

Facts

Loss Co. merges into Changed Loss Corporation in a transaction that is tax free under Code Sec. 368(a)(1)(A). Loss Co.'s shareholders receive 20 percent of the stock of NMH in the merger.

Observations

Clearly there has been an ownership change, and failure to impose any form of limitation under Code Sec. 382 might be viewed as creating an attractive nuisance, *i.e.*, incentivizing profitable companies to gobble up loss companies with outsized NOLs (even if those transactions also had what would pass muster as a valid business purpose). The question, which will be considered in Part III, is whether the current method of calculating the 382 limitation is appropriate in this situation.

Example 8. Stuff and Sell

Facts

Entity owns 100 percent of Loss Co., which has assets worth say $5, and no active business. As part of a plan, Entity contributes $90 to Loss Co. that are invested in passive assets and proceeds to sell 80 percent of Loss Co. to Public for, say, $85.

Observations

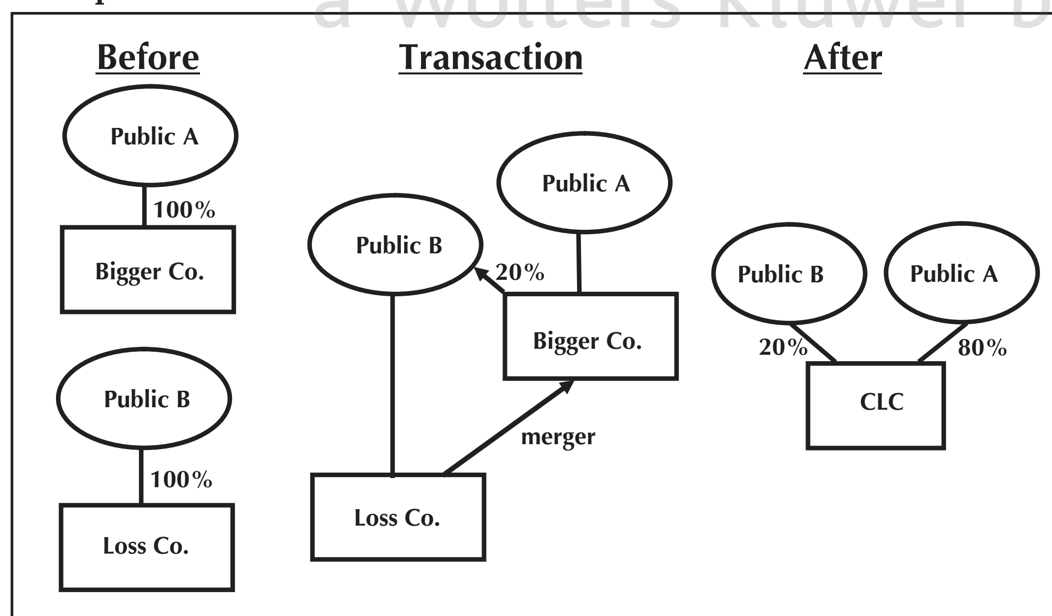
If this isn't loss trafficking, I don't know what is. Under the current regime, Loss Co. would have a Code Sec. 382 limitation of zero, which seems entirely appropriate.[28]

III. Calculating the Code Sec. 382 Limitation in a Nonabusive Case

Example 7 is an example of a tax-free "asset" transaction (a merger) that, for reasons noted above, I think warrants imposition of a limitation on the utilization of the NOLs of Changed Loss Co. that are attributable to "old" Loss Co. Similarly, I think a limitation is appropriate in a stock transaction when Loss Co. is acquired by, and becomes a member of, a consolidated return group, which I would generally view post-acquisition as the functional equivalent of a Changed Loss Corporation. Apart from these Changed Loss Corporation situations, I also support imposing a limitation whenever Loss Co. receives capital from a New Majority Holder in connection with, or following, an ownership change. In all these cases, even though tax planning might have played no role in the transaction, I believe that a "purity of purpose" test would be too difficult to administer.

It does not necessarily follow that the current method of calculating the Code Sec. 382 limitation should apply in situations that pass muster under an anti-abuse regime. As a "quick and dirty" summary, following an ownership change Code Sec. 382 currently imposes an annual limitation on the use of Loss Co.'s pre-

Example 7



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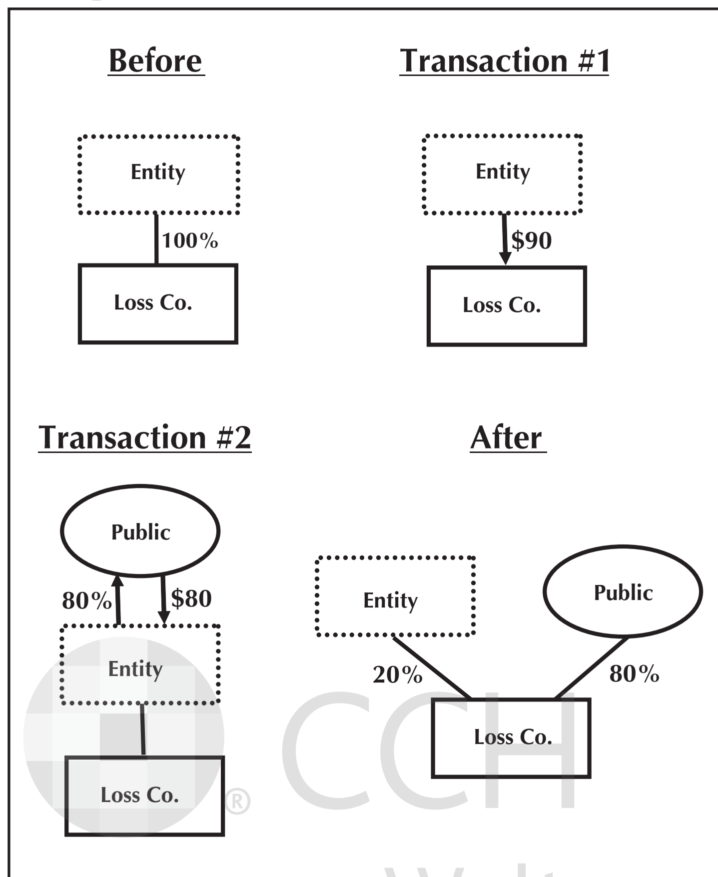
change losses calculated (outside the bankruptcy context) as follows: the equity value of Loss Co., immediately before an ownership change, is multiplied by the "long-term tax-exempt rate."[29] There are, I think, at least two (noncontradictory) explanations for this formula.[30] I've already criticized one of these explanations (protecting against over-allocation of capital to loss corporations) as a manifestation of an efficient capital markets hypothesis that strikes me as too doctrinaire when it comes to "normal" market transactions. It would be different if the threat of the limitation did not itself distort economic decision-making by loss corporations, but it does.

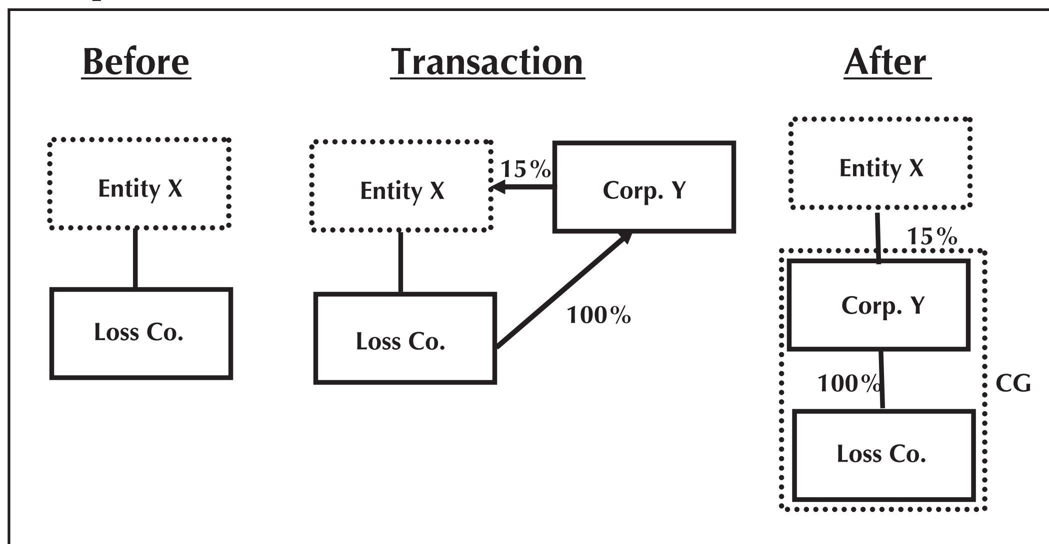
Example 8



Another explanation for the formula for the current Code Sec. 382 limitation is that it is a one-size-fits-all approximation of the income Loss Co. could have earned—and used its NOLs to offset—in the absence of the ownership change. It's worth considering whether we can do better than this.

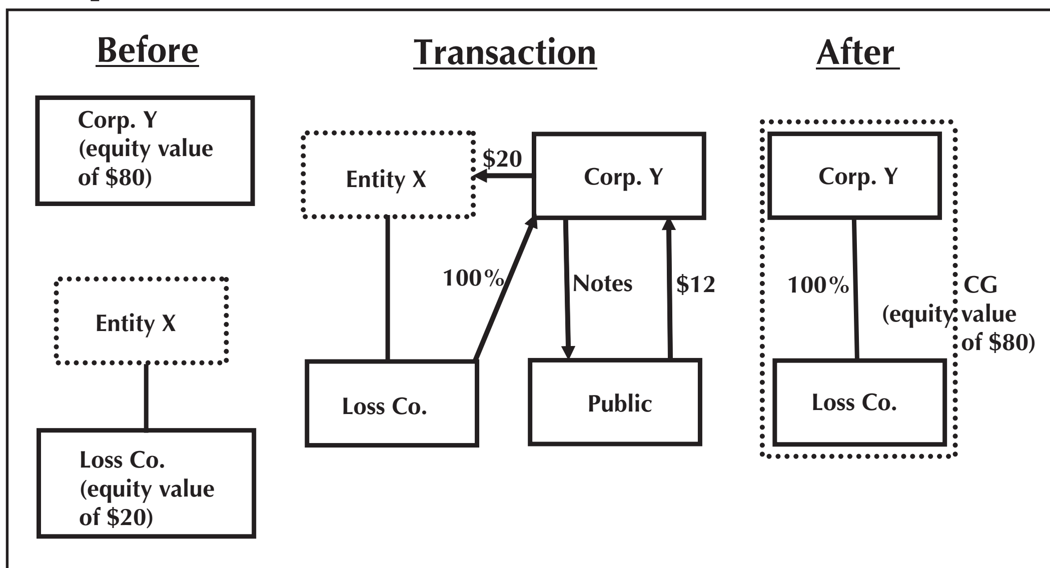
As discussed in Appendix B, the legislative history (broadly defined) of "new" Code Sec. 382 supports the concept of "neutrality," meaning among other things that after an ownership change Loss Co.'s NOL utilization ideally would be approximately the same as it would have been had there been no ownership change.[31] While the legislative history acknowledged this goal, it was concluded that individualized determinations would be too complicated. I believe this conclusion was based in significant part on the unstated assumption that it is important to have a single rule that governs both potentially abusive and non-abusive cases. The problem with this approach is that the rules needed to choke off abuse are too rigid when it comes to normal corporate transactions—with the result that Code Sec. 382 currently does not come close, in my view, to the stated goal of neutrality.

Example 9



The question is whether, assuming adequate protections are crafted against abuse (a topic discussed in Part IV), we can find a better proxy for income attributable to Loss Co.'s pre-change capital (as opposed to income attributable to capital of

Example 10



the New Majority Holder or to the capital of Changed Loss Co. that did not come from "old" Loss Co.). I suggest that the Treasury be given latitude to identify circumstances where the annual utilization of Loss Co.'s NOLs following an ownership change is best expressed not as a fixed dollar amount, but as a *portion* of the post-change income of Loss Co. or Changed Loss Co. That portion would reflect the ratio of the equity value of "old" Loss Co. immediately prior to the Limitation Trigger to the equity value of "new" Loss Co. or Changed Loss Co. immediately following the ownership change.[32] If this approach is adopted, there should be appropriate adjustments to take account of net unrealized built-in gains or losses of "old" Loss Co. and of "new" or Changed Loss Co.

This proposal is straightforward in some cases, less so in others, as illustrated by the following two examples.

Example 9. Unleveraged Stock-for-Stock Acquisition of Loss Co., Resulting in Consolidation

Facts

Loss Co. is acquired in a 100 percent stock-for-stock transaction after which Loss Co. and the acquiring entity both belong to the same consolidated group ("CG").

Observations

This strikes me as sufficiently close to the merger in Example 7 that following the transaction the consolidated group should be treated as Changed Loss Co. The owners of Loss Co. receive 15 percent of the stock of the parent of CG in the transaction. My suggestion is that Loss Co.'s NOLs should be available to offset 15 percent of the income of CG for each post-change tax period.[33]

Example 10. Leveraged Cash Purchase of Loss Co. Stock, Resulting in Consolidation

Facts

All of the stock of Loss Co. is purchased for $20 by Entity Y. Prior to the acquisition Entity Y has an equity value of $80 and its assets include $8 of "excess cash." Entity Y borrows $12 in connection with the purchase. Following the purchase Loss Co. and Entity Y are members of the same consolidated group (CG). Loss Co. guarantees the $12 borrowing by Entity Y. Following the transaction the equity value of CG is $80.

Observations

If we view the transaction as functionally equivalent to a merger (*i.e.,* treat CG as Changed Loss Corporation), the question, in computing the ratio of the equity value of Loss Co. before the transaction to the equity value of CG following the transaction, is how much of the $20 that exits corporate solution (via the stock purchase) should be treated as an adjustment to the value of "old" Loss. Co. As an initial reaction, I'm not sure why the $20 shouldn't be apportioned to (subtracted from) the pre-transaction equity value of Loss Co. based on the ratio of its equity value to the combined equity values of Loss Co. and Entity Y immediately prior to the transaction. Under that approach, we would allow Loss Co.'s NOLs to offset 20 percent of the income of CG for each tax period (or portion thereof) following the acquisition.[34] In other

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words, the borrowing would not affect the Code Sec. 382 limitation.[35]

Example 9 and Example 10 by no means cover the waterfront in terms of issues that could be presented by a proportional limitation approach. It seems likely that, if such an approach is to be explored, it might be best tested through a ruling process rather than being adopted without the benefit of more experience. But the approach will not be available at all unless Code Sec. 382 is amended to permit it to be explored.

One special situation that the Treasury should consider, in this context, is how to calculate the Code Sec. 382 limitation when there is a New Majority Holder or a Changed Loss Corporation following an out-of-court workout (including a merger) in which debt claims against the "old" loss corporation are exchanged for equity of the "new" loss corporation. Here, Code Sec. 382(l)(6) provides a useful model. Specifically, if the Code Sec. 382 limitation is (permitted to be) calculated using a "proportional limitation" approach of the type outlined in Example 9, it makes sense to allow the equity value of the "old" loss corporation to be increased to reflect the value of stock issued, in connection with the ownership change, in exchange for debt claims against the "old" loss corporation.

IV. Abusive Trafficking–No Mercy

I see no reason for modifying the current regime in a way that provides a better result for abusive trafficking. One inevitable question is, "But how do you define 'abusive'?" I take some comfort in the history of the partnership anti-abuse regulation,[36] which I think has worked reasonably well in practice (mine, at least). I also draw some lessons from the history of Code Sec. 269.

Let's start with Code Sec. 269, since it came first, and failed. I doubt we ever would have needed Code Sec. 382 if Code Sec. 269's predecessor had been enacted as originally passed by the House in 1943, in a form that included the words: "one of the principal purposes for which such acquisition was made … is the avoidance of Federal income … tax … ."[37] While the (to my mind, unfortunate) wording change made by the Senate in 1943 is water under the bridge, it's important to note that the target of Code Sec. 269 has always been bad intent. Unfortunately, when the words shifted to "the principal purpose," the courts proved unwilling to second-guess earnest assertions of "good" intent. I'm not sure that courts these days would reach similar conclusions if the language were a matter of first impression today, but it's not. I think we do well, in designing an anti-abuse rule, to avoid the words "the principal purpose."

The consequence of Code Sec. 269's toothlessness is that we now have an almost entirely mechanical Code Sec. 382, which, by largely avoiding inquiry into intent, treats the clearly nonabusive transaction as badly as the clearly abusive one.

"I see where this is going—'A principal purpose'! More than half of the transactions I work on would grind to a halt!"

"No, they wouldn't. None of the transactions you currently work on are subject to a more liberal version of Code Sec. 382."

True, but not, I think, an adequate response. As I said, I take comfort from the history of the partnership anti-abuse regulation. "A principal purpose" hasn't brought life under Subchapter K as we knew it to an end. The development of the regulation was deliberate, and comments on the proposed regulation were met with meaningful response. The regulation provides a reasonable definition of the purpose of Subchapter K and a reasonable set of examples, including examples of what is acceptable. Also, the invocation of the regulation on audit has been controlled from above, and my impression (without having conducted a study) is that its invocation in litigation has been in rather extreme cases. Following this model, I suggest we focus on identifying criteria for separating the sheep from the goats when it comes to loss trafficking.

First, let's consider hallmarks of abusive transactions. Generally, abusive transactions involve a conjunction of "new" capital and "old" NOLs. The "old" NOLs would generally be "assets" of a loss corporation with some or all of the following characteristics:

- High ratio of NOLs to pre-change active business assets
- Low ratio of the value of pre-change active business assets to the amount of "new" capital
- Insignificant gross revenues or gross costs

Following the "stuffing" we might expect to find some or all of the following:

- Lack of meaningful business continuity
- A large percentage of investment assets
- Risk reduction devices for new capital (*e.g.*, tracking stock linked to investment assets)

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What about indicia of nonabuse? These would include raising capital to meet the reasonable needs of an existing active business, including expansion, and issuing equity to debt holders in order to reduce unsustainable leverage.

V. Going Forward

I have already acknowledged that a full-blown legislative rewrite of Code Sec. 382 is unlikely. That's just as well. If the genealogy of Code Sec. 382 set out in Appendix B shows anything, it's that trying to "get it right" through detailed legislative drafting is not a promising way to go. The better course, it seems to me, is to "open up" the existing statutory vise by expanding the Treasury's regulatory authority, so that the defects of the current regime can be remedied in a thoughtful manner over time.

That said, I do believe that the use of five-percent shareholders in testing for ownership changes produces unnecessary complexity without serving a meaningful policy goal. I see much benefit, and no meaningful risk, in changing the relevant "unit" to 10-percent shareholders. A shareholder whose stake is less than 10 percent is highly unlikely to be attempting to shift income to a loss corporation. Of course, shareholders with smaller stakes might act in concert to achieve "trafficking" results, but that possibility is already "caught" by the expansive definition of "entity" in the current regulations.[38]

As indicated in Part I, above, my goal would be to arrive at a regime under which limitations on a company's NOLs would apply only in the case of (i) a true "change of control" in which there is a New Majority Holder or a Changed Loss Corporation (or a functional equivalent), or (ii) an abusive transaction, as defined in regulations that provide indicia of abuse and nonabuse, with illustrative examples, that can serve as a guide for both taxpayers and the IRS.

As a corollary, I would hope we could arrive at a point where there is no need to "count" nonabusive transactions, such as stock issuances to the public or to creditors in a workout, in determining whether the Code Sec. 382 limitation should apply. While I think it better to leave to the regulatory process the question of how (or how close) to get to this type of regime, I do believe it would be helpful if the legislative history of amendments to Code Sec. 382(m) specifically acknowledged such a regime as a permissible outcome of regulatory development.

ENDNOTES

* I myself need, receive and am grateful for many kinds of professional help. In particular, I'm grateful for the professionals who helped me prepare this article. I thank "my" panelists Bill Alexander, Jerred Blanchard and Eric Solomon for their many probing questions and thoughtful insights as I prepared the paper that became this article. Jerred's excellent written summaries of, and commentaries on, our conversations and my drafts have been a great help as I prepared this article. My associates Michael Berkovits, Christine Graham, Andrew Hayashi, Devasish Majumdar and Moses Sternstein provided excellent research assistance and participated in many lively discussions with me as I prepared the paper. Andrew and Dev also were at the office with me on quite a few weekends and late nights when it came time to finalize the paper and, later on, to write this article. My partner Kathleen Ferrell is the best I know when it comes to untangling other lawyers' words, and an expert on Code Sec. 382 to boot. Her suggestions have been invaluable. All failures of analysis and peculiarities of expression are mine.

[1] If you are familiar with the Code Sec. 382 regime, you don't need the following overview. If you are uninitiated, the overview won't provide practical help. It may, however, give you an inkling why one thoroughly exasperated practitioner, writing 20 years ago about the burgeoning complexity of the tax law, focused on Code Sec. 382. *See* Gordon Henderson, *Controlling Hyperlexis—The Most Important 'Law and … ,'"* 43 TAX LAW. 177 (1989). As that author memorably put it, "just as P. G. Wodehouse learned that life is but a microcosm of golf, so the rest of the tax is rapidly becoming just a microcosm of Section 382." *Id.*, at 186, note 12.

Pursuant to Code Sec. 382(g)(1), an ownership change occurs:

> ... if, immediately after any owner shift involving a five-percent shareholder or any equity structure shift—(A) the percentage of the stock of the loss corporation owned by one or more five-percent shareholders has increased by more than 50 percentage points, over (B) the lowest percentage of the stock of the loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period.

I don't plan to unpack that sentence here. If you're not familiar with Code Sec. 382, one tip: the least intuitive part of the regime is that all direct and indirect shareholders who don't own five percent of a company's stock are aggregated into one or more "public groups," each of which is, for a time, treated as a separate five-percent shareholder. See Appendix A for further detail.

Generally, the consequence of an ownership change is that the annual utilization of "pre-change losses" is limited to the equity value of the loss corporation immediately before the ownership change multiplied by the "long-term tax-exempt rate" (approximately four percent in February 2010). Code Sec. 382(d)(1) defines "pre-change losses" to mean net operating loss carryovers (NOLs) from pre-change years and the portion of any net operating loss for the year of the ownership change, to the extent attributable to the pre-change portion of the year. In addition, Code Sec. 382(h) limits the deductibility of certain built-in losses (excess of asset basis over value at the time of an ownership change) and certain other built-in deductions if, at the time of an ownership change, the loss company has a "net unrealized built-in loss." Code Sec. 383 provides similar rules applicable to capital loss and credit carryforwards. This article does not separately address the rules of Code Sec. 382(h) and Code Sec. 383, since my observations about utilization of pre-change losses are equally applicable to the limitations under Code Secs. 382(h) and 383. Subsequent references to "pre-change losses" or "NOLs" should be understood as

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shorthand for all of a loss corporation's tax attributes that are subject to limitation under current Code Secs. 382 and 383 following an ownership change. Note also that this article does not discuss Code Sec. 384, which prohibits use of built-in losses of one company to offset built-in gains of another company following certain acquisitions of control and certain tax-free "asset" reorganizations.

[2] Actually, the "trigger" is typically set below five percent, to avoid foot faults.

[3] The legislative history of "new Code Sec. 382" (the result of a far-reaching overhaul in 1986) includes explanations that the statute is needed to prevent "loss trafficking." *See, e.g.*, H.R. Rep. No. 99-426, at 258–59 (1985); S. Rep. No. 99-313, at 233 (1986); Staff of J. Comm. On Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986 at 296-97 (Comm. Print 1987); *see also* The Proposed Subchapter C Revision Act of 1985: Hearing Before the Senate Finance Subcommittee on Taxation and Debt Management (1985) (written testimony of Ronald A. Pearlman, Treasury Assistant Secretary for Tax Policy). My thesis is that the current regime is based on an overly broad concept of loss trafficking. For a more complete review of the rationale of Code Sec. 382, and a summary of how we got where we are, see Appendix B.

[4] The printable versions of responses I get from those who aren't tax lawyers, after I explain the regime, are, "You're kidding, right?" or "Who came up with this?"

[5] Here's the proposal I outlined in 2006, which is fairly close to what I suggest in this paper:

> If you really want to "downsize" Code Sec. 382, think about designing a regime that starts with [an] expansive definition of entity [similar to that set out in Reg. §1.382-3(a)(1)(i)] and provides that an ownership change is triggered if and only if an individual or entity acquires more than a specified percentage of participating stock of a loss corporation within a specified period (50 percent and three years being plausible but not inevitable benchmarks). This would be a legislative proposal, of course, and it would require careful thought so that downsizing the statute did not leave major loopholes. Among the possible benefits I could envision would be getting rid altogether of the … 5-percent shareholder rules and the segregation regime. In this regard, while I see the theoretical basis for concern about allowing a loss corporation to raise unlimited amounts of capital by public offerings … , I honestly don't think that's a real-world concern—except perhaps in cases of shell companies, where Code Sec. 269 might provide a suitable backstop.

[6] "Fare forward, you who think that you are voyaging;/ You are not those who saw the harbour/ Receding, or those who will disembark" (internal quotations omitted). *The Dry Salvages*, No. 3 of *Four Quartets*, T.S. Eliot.

[7] For the technically minded, I'm using "entity" in roughly the same way the term is defined in Reg. §1.382-3(a)(1)—*i.e.*, the term includes a "real" entity such as a corporation or partnership, and a "deemed" entity consisting of "a group of persons who have a formal or informal understanding among themselves to make a coordinated acquisition of [loss corporation] stock." There's one twist: I also use "entity" to mean a group of persons who act in concert, not to acquire Loss Co. stock, but following a redemption that increases their ownership interest in Loss Co.

[8] Transactions that permit use of pre-change losses to shelter income from new capital are sometimes referred to by Code Sec. 382 mavens as "stuffings" or "stuffs." Perhaps I'm being overly fastidious, but "stuffing" sounds unnatural (reminiscent of foie gras). I prefer not to use "stuffing" except in connection with transactions that merit application of the anti-abuse rule I'm going to propose. Some transactions (*e.g.*, mergers) that are caught by Code Sec. 382 have a business purpose quite unconnected to use of pre-change losses. Think, for instance, of a situation where two corporations with substantial NOLs merge (or become members of a single consolidated group) in a transaction that triggers an ownership change for each. It may be appropriate, for reasons of administrative convenience, to apply a Code Sec. 382 limitation in this context, but I can't bring myself to call this a "stuffing." Nor can I bring myself to call a "normal" stock issuance by a loss corporation a "stuffing," even though the NOLs of the loss corporation are available to shelter income attributable to the capital raised by the stock offering.

[9] That's to say, the "new majority" owners may not act in concert as that term is usually understood.

[10] A similar effect can be achieved without a merger if there is a transaction that results in a tax consolidated group that includes the loss corporation and capital attributable to new majority owners.

[11] The segregation rules are the principal focus of Appendix A. The "primary" segregation rules appear at Reg. §1.382-2T(j)(2) (read at your own risk, since it's hard to understand without reading all of -2T, and even then not exactly pellucid). Under these rules, "public groups" are treated as five-percent shareholders, and transactions such as redemptions, sales by five-percent owners and certain stock issuances result in "segregation" of public groups in a way that contributes to ownership changes. These segregation rules are modified by Reg. §1.382-3(j), which are referred to in Appendix A as the Segregation Exceptions.

[12] Some of the examples (*e.g.,* Example 2) would be more realistic if the transaction in question was not of a size to trigger an ownership change all by itself. It would be more common for such a transaction to merely "count" towards an ownership change. I believe that, absent indicia of abuse, the transactions in at least half of these examples should not count at all.

[13] *See* note 2, *supra*.

[14] Staff of J. Comm. On Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986 (Comm. Print 1987), at 295 ("[T]he special limitations generally apply when shareholders who bore the economic burden of a corporation's NOLs no longer hold a controlling interest in the corporation"); S. Rep. No. 99-313, at 231–32 (1986); The Proposed Subchapter C Revision Act of 1985: Hearing Before the Senate Finance Subcommittee on Taxation and Debt Management (1985) (written testimony of Ronald A. Pearlman, Treasury Assistant Secretary for Tax Policy).

[15] Staff of J. Comm. On Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986 (Comm. Print 1987), at 295 ("[T]he ability to use acquired losses against such unrelated income creates a tax bias in favor of acquisitions"); *Full Text: Treasury Assistant Secretary Pearlman's Testimony Before the Senate Finance Subcommittee on Taxation and Debt Management on the Subchapter Revision Act of 1985*, 85 TNT 194-8 (1985); H.R. Rep. No. 99-426, at 250 (1985); S. Rep. No. 99-313, at 225 (1986). *See also, e.g.*, Samuel C. Thompson, Jr., *Planning for the Loss Corporation: The Interaction Among Code Secs. 269, 381, Old and New 382 and the Consolidated Return Regulations*, 1979 U.S.C. Major Tax Planning 223 (1979) ("Acquirers of NOLs are effectively buying a tax shelter for their expected future profits, whereas if the same persons had used their capital to start a new business on their own, no such loss offsets would be available").

[16] As discussed in Appendix A, it is anomalous that the Segregation Exceptions in Reg. §1.382-3(j) treat stock issuances by Loss Co. (which one might expect to marginally increase utilization of Loss Co.'s NOLs) more favorably than the Segregation Rules treat secondary sales by five-percent owners.

[17] When a solvent company exchanges its stock for its debt, it has cancellation of debt (COD) income if the value of the exchanged stock is less than the adjusted issue price of the debt that is retired. *See generally* Code Sec. 108(e)(8), Reg. §1.61-12(c)(2)(ii). If a company that is insolvent exchanges its stock for its debt outside of bankruptcy, the amount that would otherwise have been COD income is excluded from income, but only to the extent of the company's insolvency. *See* Code

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Sec. 108(b)(1)(B), (b)(3). The benefit of this exclusion under Code Sec. 108 comes at a price: The company's tax attributes such as NOLs are subject to reduction in an amount determined by reference to the amount of COD excluded from income. *See* Code Sec. 108(b). To oversimplify for ease of discussion, in Example 4 the cumulative effect of Code Sec. 108 and Code Sec. 61 typically would be to reduce Loss Co.'s NOLs by an amount equal to the COD attributable to the exchange (including the COD excluded from income under Code Sec. 108).

[18] H.R. Rep. No. 99-426, at 261–62 (1985).

[19] S. Rep. No. 99-313, at 245–46 (1986). Under the Senate bill, Qualifying Claims included (i) any claim acquired more than eighteen months prior to the filing of the bankruptcy petition by the creditor that continued to hold this claim at the time of the bankruptcy reorganization, and (ii) any "ordinary course" claim whose original holder continued to hold this claim at the time of the bankruptcy reorganization.

[20] If Qualifying Claims are treated like "old and cold" equity for purposes of concluding that there has been no "ownership change" and thus no Code Sec. 382 limitation, the conceptually pure approach is to treat interest payments with respect to Qualifying Claims as non-deductible distributions on equity. Under the Senate's approach, this adjustment is made with respect to interest paid or accrued on the Qualifying Claims for the three tax years preceding the date of the bankruptcy reorganization and the portion of the "change" tax year that precedes the "change" date. This adjustment period roughly corresponds to the three-year period generally used in testing whether there has been an ownership change. *See* Code Sec. 382(i).

[21] There have been some clarifying amendments and one significant change to Code Sec. 382(l)(5), reflecting a more general change in the tax rules applicable to bankrupt corporations. Under the 1986 version of Code Sec. 382(l)(5), there was a required reduction of the loss corporation's NOLs equal to 50 percent of any amount excluded from income under the then-applicable "stock-for-debt exception." This reduction in NOLs was related to the fact that, where the "stock-for-debt" exception was available, there was not a reduction of tax attributes of the loss corporation for what was, economically speaking, COD attributable to the exchange of Qualifying Claims for stock in the bankruptcy reorganization. The stock-for-debt exception was repealed by the Omnibus Revenue Reconciliation Act of 1993 (generally effective for stock transferred after December 31, 1994), and Code Sec. 382 was amended to delete the related adjustment to the NOLs of a company whose bankruptcy reorganization is subject to the (l)(5) rule.

[22] Reg. §1.382-9(d)(3). This "continuous ownership" presumption does not apply to Qualifying Claims exchanged for stock by an entity through which a five-percent shareholder (immediately after the consummation of the bankruptcy plan of reorganization) holds an indirect interest in the reorganized loss corporation. The "continuous ownership" presumption also does not apply to otherwise Qualifying Claims held by "a person whose participation in formulating a plan of reorganization makes evident to the loss corporation (whether or not the loss corporation had previous knowledge) that the person has not owned the indebtedness for the requisite period." *Id.* The policy rationale behind the latter limitation is not readily apparent.

[23] Act Sec. 621(d) of the Tax Reform Act of 1986 (P.L. 99-514).

[24] Act Sec. 11832(3) of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508), reprinted at 1991 CB 481, 554.

[25] Appendix A focuses on changes I believe the Treasury can and should make under its existing regulatory authority, without the need for new legislative action.

[26] *See* note 18, *supra*.

[27] Caveat: There are transactions, short of capital infusions by NMH, that need to be considered. For instance, if NMH acquired most or all of the stock of Loss Co., it might artificially steer new income-generating opportunities to Loss Co.

[28] Code Sec. 382(l)(4) requires that the equity value of a loss corporation that has substantial investment assets be reduced by the value of the investment assets. Thus, in this example the equity value of Loss Co. immediately prior to the ownership change is deemed to equal zero. *Cf.* Code Sec. 382(c) (if the new loss corporation does not continue the business enterprise of the old loss corporation during the two-year period beginning on the change date, the Code Sec. 382 limitation is reduced to zero).

[29] If you are not familiar with the current method and want a bit more detail, see the third paragraph of note 2, *supra*. The rationale for using the long-term, tax-exempt rate is examined in endnotes 85 and 88 of Appendix B.

[30] In fact, the explanations can be seen as two sides of the same theoretical coin, "neutrality," meaning generally that tax considerations should have as little influence as possible on (nontax) economic decision-making.

[31] *See* Appendix B, at Section B.X.

[32] This idea is not new. *See, e.g.*, Appendix B, at Parts B.V and B.IX.

[33] This may require a "closing of the books" for both Loss Co. and CG on the change date.

[34] Under this approach, the portion of the $20 allocable to (subtracted from) Loss Co.'s equity value prior to the transaction is $20 x ($20/$100) = $4. Thus, Loss Co.'s "adjusted equity value" is $16. The ration of $16 to the combined equity value of CG following the transaction ($80) is 20 percent.

[35] Compare Code Sec. 382(e) (requiring that determination of the value of the old loss corporation be adjusted to take account of any redemption or other corporate contraction).

[36] Reg. §1.701-2.

[37] H.R. 3687 (as passed by the House, Nov. 24, 1943). *See* Appendix B, Section B.II for further detail.

[38] *See* Reg. §1.382-3(a)(1).

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Appendix A.
What the Treasury Can Do Now to Improve Code Sec. 382

This Appendix focuses on the mother of all Code Sec. 382–related problems: the so-called segregation rules elaborated in excruciating detail in Reg. §1.382-2T(j) ("the -2T Segregation Rules").[1] As discussed in further detail below, I believe that the Treasury could rely on the numerous grants of regulatory authority under Code Sec. 382 to improve these rules. I hope that those at the Treasury and the IRS responsible for the regulations under Code Sec. 382 will agree and act.

Since the promulgation in 1987 of Reg. §1.382-2T, there have been a number of regulatory improvements in the 1990's, including a couple of exceptions to the -2T Segregation Rules. As

Appendix A. ***cont'd***

discussed below, these improvements don't go far enough.

A.I. Background

The biggest problem with the Code Sec. 382 regime is that it is hideously complicated. A comprehensive description of the law and related guidance would defeat my purpose of using this Appendix A to focus attention on the -2T Segregation Rules. Accordingly, this section provides only a sketch of portions of current law.

A. The Statute and Legislative History

As detailed in Appendix B, the origin of Code Sec. 382 lies in the failure of Code Sec. 269 (which employs a subjective and narrow "the principle purpose" test) to deter trafficking in NOLs. Not surprisingly, then, Code Sec. 382 is designed to identify potential trafficking and limit utilization of NOLs based on objective standards.[2] The statute becomes operative when, immediately after any "owner shift," the percentage of stock of a "loss corporation" owned by one or more "5-percent shareholders" has increased by more than 50 percentage points over the lowest percentage of stock owned by such shareholders during the preceding three years.[3] Generally (and quite imprecisely), the result of such an "ownership change" is that the corporation's use of its NOLs is thereafter subject to an annual limitation equal to the product of the equity value of the corporation immediately prior to the ownership change multiplied by a statutory rate based on the yield of long-term tax-exempt obligations (the dreaded "Code Sec. 382 limitation").[4]

It is worth pausing to ask why a change in ownership merits a limitation on the use of a company's NOLs. The answer is that, without a rule resembling Code Sec. 382 (or an "invigorated" Code Sec. 269, or both), the opportunities following an ownership change for use of a loss corporation's NOLs to shelter unrelated income of the company's new owners would be an attractive nuisance.[5]

The best argument, from a policy perspective, for the broad, mechanical scope of Code Sec. 382 is that a regime built on subjective tests and the necessarily complex assessment of facts and circumstances would prove too difficult to administer, and that "rough justice" is all we can hope for. Accepting the point *arguendo*, there's still no reason that justice has to be any rougher than is reasonably necessary to accomplish the underlying policy goal: preventing trafficking in tax attributes. Which brings us to the subject of the segregation rules.

Once one accepts the statutory premise that limitation should be imposed on use of a company's NOLs following an ownership change, the need for segregation rules follows inevitably, as a few examples will show. Say that L is a publicly traded loss corporation with substantial NOLs and no "real" five-percent shareholders. Assume that L merges into unrelated corporation A, another publicly traded company with no "real" five-percent shareholders, in a tax-free reorganization under Code Sec. 368(a)(1)(A) pursuant to which the former shareholders of L receive 10 percent of the stock of A. Under Code Sec. 381, A succeeds to L's NOLs. If the Code Sec. 382 limitation didn't apply in this case, there would be a glaring loophole. L's NOLs are combined with the income-earning assets of A, which is the paradigm situation to which the statute is meant to apply. But without a rule for both aggregating and segregating public shareholders, the limitation wouldn't apply—after the merger, there is one company (A) that has no five-percent shareholders and that itself (as an entity) has not had an ownership change.

If on similar facts A had acquired ownership of L in a triangular merger, it would be clear that the interest of a five-percent shareholder (however defined) had increased by more than 50 percentage points. Indeed, at first blush one might say that A's interest had increased by 100 percentage points. But it's pretty obvious that this overstates the amount of the change that should "count" by 10 percentage points.

Suppose, under alternative facts, that in a tax-free reorganization L merges into A (or a subsidiary of A), with L's shareholders receiving shares representing 60 percent of A's stock following the merger. It's relatively intuitive that this transaction, without more, should not be treated as an ownership change. Similarly, a merger of A into L should not constitute an ownership change if L's shareholders end up owning 60 percent of L stock. On the other hand, a merger of A into

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Appendix A. *cont'd*

L *should* constitute an ownership change if L's shareholders end up owning only 10 percent of the company. We see, then, that segregation rules are needed to avoid "overcounting" just as much as "undercounting." The key is to make sure that the rules don't take on a life of their own that is divorced from policy considerations.

The principal statutory basis for the segregation rules is found in the following language of Code Sec. 382(g)(4):

> (4) SPECIAL RULES FOR APPLICATION OF SUBSECTION [G, WHICH DEFINES "OWNERSHIP CHANGE"].—
>
> (A) TREATMENT OF LESS THAN 5-PERCENT SHAREHOLDERS. Except as provided in subparagraphs (B)(i) and (C), in determining whether an ownership change has occurred, all stock owned by shareholders of a corporation who are not 5-percent shareholders of such corporation shall be treated as stock owned by 1 [one] 5-percent shareholder of such corporation.
>
> (B) COORDINATION WITH EQUITY STRUCTURE SHIFTS. For purposes of determining whether an equity structure shift (or subsequent transaction) is an ownership change—
>
> (I) LESS THAN 5-PERCENT SHAREHOLDERS. Subparagraph (A) shall be applied separately with respect to each group of shareholders (immediately before such equity structure shift) of each corporation which was a party to the reorganization involved in such equity structure shift.
>
> (II) ACQUISITIONS OF STOCK. Unless a different proportion is established, acquisitions of stock after such equity structure shift shall be treated as being made proportionately from all shareholders immediately before such acquisition.
>
> (C) COORDINATION WITH OTHER OWNER SHIFTS. Except as provided in regulations, rules similar to the rules of subparagraph (B) shall apply in determining whether there has been an owner shift involving a fi5ve-percent shareholder and whether such shift (or subsequent transaction) results in an ownership change.

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These rules are supplemented by Code Sec. 382(m), which provides that the Secretary "shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section and Code Sec. 383, including (but not limited to) regulations … (4) providing for the application of subsection (g)(4) where there is only one corporation involved … ."

One other rule is relevant here, in describing how "counting" is done with respect to "public groups": generally, the rules of Code Sec. 318 apply in determining ownership of loss corporation stock for purposes of Code Sec. 382, but attribution of ownership (of loss corporation stock) to the shareholders of a corporation (that owns loss corporation stock) is determined without regard to the 50 percent limitation found at Code Sec. 318(a)(2)(C), and, except as provided in regulations, shares attributed under this expanded "look through" rule are no longer treated as owned by the entity from which there is attribution (*e.g.*, the corporation that owns shares of the loss corporation's stock).[6]

Congratulations if you got through the last three paragraphs in one reading! So what does the statute contemplate? It provides, quite generally—and with a grant of wide regulatory latitude to elaborate on or contract the rules—that (i) all stock held by "public shareholders" must be aggregated and treated as owned by one five-percent shareholder (hereafter the "residual public group"), (ii) public shareholder groups of different corporation must be segregated following an "equity structure shift,"[7] (iii) except as provided in regulations, similar rules shall apply in determining whether there has been an owner shift "involving a 5-percent shareholder" and whether such owner shift or a subsequent transaction results in an ownership change, (iv) under regulations, similar rules shall apply "where

Appendix A. ***cont'd***

there is only 1 corporation involved …" and (v) "real" five-percent shareholders that are entities ("first-tier entities," to use the regulatory jargon) also have their own "public groups" (because of the expansion of Code Sec. 318 attribution).

Depending on your ease with abstract constructs, that is probably somewhere between completely confusing and relatively intuitive, albeit vague and repetitive. Either way, one might want to go to the legislative history to learn find out more about what Congress "had in mind." A "blue book" isn't technically legislative history, but as usual the '86 BLUE BOOK is the best single place to get an overview of what went on.[8] Read its 40 pages devoted to new Code Sec. 382,[9] complete with 26 examples, and sooner or later you may get that "So it's a bit complicated—no problem, I'm a tax lawyer!" feeling. Which would be okay, more or less, if *each* of the 26 examples in the legislative history *really* made sense.

The 26 examples *do* all make *logical* sense, but they don't *all* make policy sense. The drafters of the statutory language and the legislative history seem to have fallen in love with a model, to the point of sometimes forgetting what it was they were properly targeting. Code Sec. 382 is properly about keeping the NOLs of a loss corporation from being combined with sources of income that the loss corporation wouldn't have had if the transactions giving rise to the ownership change hadn't occurred. Otherwise, the statute is just an ill-conceived "restraint on alienation" (in the legal, not philosophical, sense). That's why trading among public shareholders is properly ignored. To generalize, the more one is able to target the application of Code Sec. 382 to cases where an "ownership change" results in a concentrated holding of loss corporation stock, the better, since that's where 99 percent of the real trafficking opportunities would arise.[10]

There is, however, one additional circumstance, aside from concentrated shareholding, where Code Sec. 382 principles are implicated, at least arguably. The *issuance* of loss corporation stock in a public offering brings in cash, presumably generating additional income that can be sheltered by the loss corporation's NOLs. One can make a good argument that this concern is misplaced, except for cases of abuse, but I accept the point, for the sake of this limited discussion of changes to the Segregation Rules that the Treasury could make under its existing grant of regulatory authority. To my considerable surprise, in Example 10 from the Blue Book, a loss corporation that has a value of $1 million and no five-percent shareholders effects a $2 million public offering that results in no five-percent shareholders and … there's no ownership change, because the "public group" continues to own 100 percent of the company. The Blue Book authors point out, however, that there's regulatory authority under what's now Code Sec. 382(m)(4) to write segregation rules that make this transaction an ownership change.[11] For better or worse, that's been done.

Unless I'm missing something, though, the drafters of the examples were mesmerized by the model into finding ownership changes in two instances where they shouldn't have. First, in example 5 of the BLUE BOOK discussion,[12] once sales by the sole individual owner result in a public group that owns more than 50 percent of the loss company's stock, there's an ownership change. Why? As a policy matter, the ownership of the loss corporation has been *dispersed,* and the formerly sole shareholder can no longer freely contribute income-producing assets, as he once could. It is unsatisfactory to defend imposition of the Code Sec. 382 limitation in this case on the basis that "It's hard to make the model perfect" and "Trying to fix it causes even more complexity" unless one has at least *tried* to limit the rules appropriately—which is what this Appendix is about.

The second instance where the BLUE BOOK gets it wrong, in my view, has to do with corporate redemptions. Of course, once you accept the basic statutory model—and I'm not arguing against it in this Appendix—there's an appropriate role for applying the Code Sec. 382 "counting" rules when a redemption increases the ownership of a "real" five-percent shareholder. But Example 9 in the BLUE BOOK equates a redemption-like transaction involving only "small" public shareholders to a transaction involving "real" five-percent shareholders.[13] Think about that for a minute. It would have been absolutely fine for the public shareholders who end up with 100 percent of the common stock to have purchased it from the shareholders whose interests

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Appendix A. ***cont'd***

are redeemed. It will *not* do to say that this latter result (ignoring public trading) is a rule of convenience, and that once there's a clearly identifiable event such as a redemption the rule of convenience must fall away. This is, unfortunately, exactly what the BLUE BOOK says.[14] That is exalting the model and forgetting the policy. There is no more risk after such a redemption than there was before of income-stuffing or otherwise using the loss corporation's NOLs to shelter "unrelated" income. Indeed, one would expect less income-earning power in a loss corporation following a redemption.

B. The -2T Segregation Rules

Not surprisingly, given the legislative history, the drafters of Reg. §1.382-2T came up with a remarkably elaborate set of segregation rules. Under -2T(j)(2)(iii)(B), there's a segregation event upon virtually any issuance of stock by the loss corporation, as well as any issuance of "nonstock stock" (don't ask). The same goes for redemption-type transactions and deemed issuances of stock associated with the issuance of stock options or warrants.[15] There are also segregation rules for sales of loss corporation stock by "real" five-percent shareholders, and the same "principles" apply to *issuances* of stock of "higher-tier entities" (again, don't ask)[16]—and, of course, redemptions of stock of higher-tier entities.[17] If all of this seems incomplete, note that I haven't tried to detail the rules for keeping track of public groups of upper-tier entities or the presumptions used when there are multiple segregation events (*e.g.*, a public offering followed by a redemption within the testing period).[18]

C. The Segregation Exceptions

Partly in response to a number of comments from tax practitioners and their clients, the Segregation Exceptions were adopted. Basically, there are two rules, one that turns off the -2T Segregation Rules entirely ("the small issuance exception"), and one that turns them off in part ("the 50-percent rule").

The small issuance exception allows a loss corporation to issue new shares during a tax year equal to 10 percent of the number of shares that were outstanding at the beginning of the year without creating a new public group.[19] That covers, among other things, stock grants to employees and similar events that previously were making tax directors of loss corporations crazy.

The 50-percent rule allows a company that issues stock solely for cash (in a transaction not covered by the small issuance exception) to treat its public groups as acquiring an amount of that stock equal to one-half of the interest they owned before the issuance.[20] That's a fair (some would say generous) reflection of the fact that public owners often purchase additional shares when there's a new issuance.[21]

A.II. Suggested Changes to the Segregation Rules

A. The Current Segregation Rules

The principles of the Segregation Exceptions apply to "*issuances* of stock by a first tier or a higher tier entity that owns five percent or more of the loss corporation's stock. ..."[22] That rule clearly applies when such an entity issues its own stock (here we're in the dizzying realm of public groups of upper-tier entities). I am not certain, however, whether it is meant to apply to a *sale* of loss corporation stock by such an entity, for the simple reason that the stock in question is not *issued* by the selling entity. If I'm being an overly finicky reader, I'd really like to know it.[23] If I'm not, then I'm hoping that the failure to apply the same principles to sales of stock of the loss corporation by a "real" five-percent shareholder can be remedied. I certainly can't see any policy justification for it. Please don't say "avoiding complexity."

B. The Case for Broader Segregation Exceptions Using a "Relation-Back" Approach

As discussed above, I see the segregation rules as embodying, not a principle, but a mechanic that should be made subservient to the statutory principle of deterring trafficking in tax attributes (and not given a life of its own). I will make the case in Part A-III that the Treasury and the IRS have the regulatory authority to do that.

So, what could be done without legislative action? I think there's a viable model in the existing regulations that can and should be applied more broadly.

Reg. §1.382-10 ("the Plan Distribution Rule") arose out of a crisis faced by a particular company,

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UAL. An employee stock ownership plan (ESOP) owned more than 50 percent of UAL stock. After UAL filed for bankruptcy, the ESOP trustee wanted to sell the stock in order to capture what little share value was left for the benefit of the employees. UAL had obtained an order from the bankruptcy court, however, forbidding a sale of UAL stock by a five-percent shareholder unless UAL consented to the sale, so as to prevent a premature ownership change that would have destroyed UAL's NOLs.[24] UAL agreed with the ESOP trustee to ask for a ruling that a sale of stock by the ESOP wouldn't result in an ownership change. The IRS was apparently unwilling to issue the ruling under the existing regulatory regime, but was willing to write a regulation providing that an ownership change would not result if the ESOP distributed the UAL shares it owned to the plan beneficiaries.

The Plan Distribution Rule provides as follows:

> For purposes of § 1.382-2T, if a qualified trust described in section 401(a) … distributes an ownership interest in an entity [*e.g.*, stock of the loss corporation], then for testing dates on or after the date of the distribution, the distributed ownership interest is treated as having been acquired by the distributee on the date and in the manner acquired by the trust and not as having been acquired or disposed of by the trust. The distribution does not cause the day of the distribution to be a testing date.[25]

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Thus, if the qualified trust (*e.g.*, UAL's ESOP) has held the loss corporation stock for more than three years (it had) and none of the distributees are "real" five-percent shareholders (they weren't), the distributees are treated as part of the loss corporation's residual public group. That solved UAL's problem, for the most part.[26]

I submit that a similar rule should apply to any sale by a "real" five-percent shareholder that would otherwise result in a segregation event under the -2T Segregation Rules. If you happen to be on the bandwagon at this point, you may be wondering why I don't just suggest ignoring (*i.e.*, not "counting" for purposes of determining whether an ownership change has occurred) increases in the ownership percentages of "direct" public groups that arise out of transactions other than reorganizations or other business combinations. In the "main body" of this article I do in fact propose a legislative change permitting such a result, under regulations to be promulgated by the Treasury, which would include appropriate anti-abuse rules. This discussion of the Segregation Rules relates to changes that I think the Treasury can make under current law.

Accepting, then, that *issuances* for cash of corporate stock beyond the small issuance exception result in a segregation event (albeit with the benefit of the 50-percent rule), *all* sales by "real" five-percent shareholders cannot be exempted from the segregation rules without creating a potential "loophole" (if the statute isn't amended to provide for anti-abuse regulations): namely, issuances of loss corporation stock to "real" five-percent shareholders who subsequently sell the stock to non–five-percent shareholders (*e.g.,* private placements followed by registered secondary sales). That concern is addressed, however, by the "relation-back" principle embodied by the Plan Distribution Rule.

Under the relation-back rule I am proposing, a sale of loss corporation stock by a five-percent shareholder would not automatically result in a segregation event. Instead, the "non–five-percent" investors who acquire the shares in question would be deemed to have acquired them in the manner in which the selling five-percent shareholder had earlier acquired them. Thus, if an individual or entity became a five-percent shareholder by purchasing shares from the public and subsequently resold these shares to the public, the consequence under the broader relation-back I am suggesting would be to ignore all of this activity as trading among small holders. Similarly, if a five-percent shareholder or five-percent owner (*e.g.,* an ESOP) sold to the public shares it had acquired from the loss company more than three years before the sale to the public, the public purchasers would be treated as part of the "general" public group.

C. Modifying the Segregation Rules in the Case of Redemptions

As discussed above, I do not see a policy justification for treating a redemption of stock of the loss corporation as a segregation event. As discussed below in Part A-III, I believe that the Treasury has

Appendix A. ***cont'd***

ample authority under the existing statute not to treat a redemption as giving rise to a segregation event. If there is no segregation event, then the only ownership increases attributable to a redemption that would "count" towards an ownership change would be increases in the ownership interests of "real" five-percent shareholders.

A.III. The Case for Regulatory Action

The only questions I see are, first, whether the Treasury and the IRS have the regulatory authority under current law to make the changes to the Segregation Rules that I've proposed, and second, assuming they have the authority, whether there's any good reason for them to refrain from exercising it.

Let's briefly revisit the convoluted language of Code Sec. 382(g)(4) and Code Sec. 382(m)(4) quoted above (at 15–16). Subparagraph (g)(4)(A) provides a general rule establishing a "residual public group" of non–five-percent shareholders that is treated as a single five-percent shareholder "except as provided in subparagraphs (B)(i) and (C)." Subparagraph B(i) provides for segregation in cases of a reorganization. Subparagraph (C) provides that, "[e]xcept as provided in regulations, rules similar to the rules of subparagraph (B) shall apply in determining whether there has been an owner shift involving a five-percent shareholder and whether such shift (or subsequent transaction) results in an ownership change." Finally, Code Sec. 382(m)(4) authorizes all "necessary or appropriate" regulations "providing for the application of subsection (g)(4) where there is only 1 corporation involved … ."

While that language certainly *authorized* the -2T Segregation Rules, it did not *require* them to be written as they were written. The fact that we now have the Segregation Exceptions illustrates the agreement of the Treasury and the IRS on this score. In addition, the "except as provided in regulations" language of subparagraph 382(g)(4)(C), along with the authority under Code Sec. 382(m)(4), seems to me to provide ample authority for Treasury regulations that specify (i) when to create separate public groups (outside the reorganization context, in any event, and even then in the case of reorganizations under Code Sec. 368(a)(1)(E)) and (ii) how changes in the ownership percentage of public groups arising out of the types of transactions I have been discussing "count" (or not) towards an ownership change.

Would the drafters of the legislative history have agreed with my suggestions (setting aside the stock for debt question)? I would like to think they were as reasonable as the current personnel at the Treasury and the IRS responsible for changing the regulations under Code Sec. 382. So, to those persons currently in charge of the regulations I would say, "If you think I'm right as a policy matter, don't let a couple of examples in the legislative history that were written before the statute had ever become effective, and thus without the benefit of reasoned discussion based on experience, stop you from doing the right thing."

I would add, in passing, that in recent years, the personnel at the Treasury and the IRS have shown admirable boldness and imagination in using their regulatory authority to make Code Sec. 382 work better. I think, for example, of Reg. §1.382-9, which makes perfect sense as a policy matter but takes what I consider completely appropriate liberties with the statutory definition of "qualified creditor." Similarly, Notice 2003-65, 2003-2 CB 747, is admirable as a policy matter in the way it liberally interprets (in the "338 approach") the rules of Code Sec. 382(h) so that "built-in gain" companies aren't forced to resort to measures like sale-leasebacks in order to "free up" NOLs associated with depreciable property with built-in gains.

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Endnotes

[1] It is more accurate to describe the rules of Reg. §1.382-2T(j) as providing for the aggregation of shareholders owning less than five-percent of a company's stock into "public groups" and the segregation of public groups. For ease of expression, I will generally refer to rules dealing with aggregation and segregation of less-than-five-percent shareholders as "segregation rules."

[2] Which is not to say that the Code Sec. 382 regime successfully breaks free of inquiries into purpose. For instance, Code Sec. 382(l)(1)(A) provides for disregarding "[a]ny capital contribution received by an old loss corporation as part of a plan a principal purpose of which is to avoid or increase any limitation under this section … ." More significantly, the regulations under Code Sec. 382 resort to subjective inquiries in numerous instances. *See, e.g.*, Reg. §1.382-2T(k)(4) (modifying the operation of the regulation in cases of ownership interests structured to avoid treating a person as a five-percent shareholder); Reg. §1.382-4 (using "a principle [bad] purpose" to determine when an

Appendix A. *cont'd*

option should be deemed exercised); Reg. §1.382-9(d)(5)(iii) (modifying operation of the regulation in the case of an acquisition of indebtedness "for a principal purpose of benefiting from the losses of the loss corporation"). This calls to mind the warning, issued by Bayless Manning and taken up by Gordon Henderson, about the futility of trying to eliminate ambiguity by means of more elaborate drafting. *See* Manning, *Hyperlexis: Our National Disease,* 71 N.W.U. L. REV. 767 (1977); Henderson, *Controlling Hyperlexis—The Most Important 'Law and … ,'* 43 TAX LAW. 177, 184–85 (1989).

3 Code Sec. 382(g)(1).

4 Code Sec. 382(b).

5 Prior to the enactment of new Code Sec. 382 in 1986, there was substantial discussion of whether trafficking in losses should in fact be allowed, explicitly or implicitly, rather than made the subject of anti-trafficking legislation. *See* Nicholls, *Net Operating Loss Carryovers and Code Sec. 382,* 22 TAX NOTES 609, 611 (Feb. 13, 1984) (concluding, correctly in my view, that "[p]robably it is sufficient answer to all of the above arguments that 'we are just not going to do it'").

6 Code Sec. 382(l)(3)(A)(ii).

7 Code Sec. 382(g)(3)(A)(i) defines "equity structure shift" to mean any reorganization (within the meaning of Code Sec. 368) except for a divisive "D" or "G" reorganization or an "F" reorganization. "To the extent provided in regulations, the term 'equity structure shift' [also] includes taxable reorganization-type transactions, public offerings, and similar transactions." Code Sec. 382(g)(3)(B).

8 Staff of Joint Comm. on Taxation, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986 (Comm. Print 1987). The Blue Book repeats what was in the relevant portions of the "real" legislative history and adds a few glosses.

9 *Id.*, at 288–327.

10 That doesn't mean that it's possible to craft an "objective" statute like Code Sec. 382 that isn't overbroad in some, perhaps very significant, respects, but this overbreadth should be understood as a by-product of a decision about administrability.

11 *Id.*, at 305–06.

12 *Id.*, at 303.

13 *Id.*, at 305. Technically, the example involves a recapitalization in which the owner(s) of 60 percent of the common stock exchange it for "vanilla" preferred stock. Notwithstanding what the Blue Book says, this is not a "redemption," see Code Sec. 317, but that's a quibble.

14 *Id.*, at 304.

15 Reg. §1.382-2T(j)(2)(iii)(C), (D).

16 Reg. §1.382-2T(j)(3)(i).

17 Reg. §1.382-2T(j)(3)(iii).

18 Think of what you've just read as something like the New Yorker's map of the United States. All you really need to know is that between New Jersey and the Golden Gate bridge there lie the Rocky Mountains.

19 Reg. §1.382-3(j)(2). If you're wondering if the rule is really that simple, the answer is no. But the detail is beside the point for my purposes.

20 Reg. §1.382-3(j)(3).

21 The preamble to the proposed regulations containing the Segregation Exceptions states, "The Service and the Treasury believe that, on average, there is considerable overlapping ownership between existing less-than-5-percent shareholders and less-than-5-percent shareholders purchasing stock in a stock offering." 57 FR 52738, 52739 (Nov. 5, 1992).

22 Reg. §1.382-3(j)(11).

23 I suspect I'm not, though. I find it a bit hard to imagine that the drafter(s) of the Segregation Exceptions, who spelled things out very carefully, wouldn't have put in a "coordinating" rule to address the situation where a loss corporation engages in small issuances and a "real" five-percent shareholder engages in "small sales" that would have qualified for the small issuance exception if the seller/issuer had been the loss corporation itself. Also, the preamble to the proposed regulations states that "rules similar to the above rules apply to issuances of ownership interests by a first tier or higher tier entity." 57 FR 52738, 52740 (Nov. 5, 1992) (emphasis added). That appears to summarize both the rule quoted in the text above accompanying footnote 22 and the rule now appearing as Reg. §1.382-3(j)(12) ("As the context may require, a non-stock ownership interest in an entity other than a corporation is treated as stock for purposes of this paragraph (j)"). Sounds like the drafter(s) really did mean to refer only to ownership interests in entities other than the loss corporation.

24 The special bankruptcy rules found at Code Secs. 382(l)(5) and (6) only apply to ownership changes resulting from a transaction that is "ordered by the court or is pursuant to a plan approved by the court." Reg. §1.382-9(a).

25 Reg. §1.382-10(a)(1).

26 In subsequent litigation, the ESOP trustee sought damages from UAL for the decline in the value of the stock during the period the trustee was blocked by the court order from disposing of the stock.

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Appendix B: A Genealogy of Code Sec. 382

> The rule is arbitrary, like the cutting of the Gordian knot. But no other solution than an arbitrary one seems possible. … [U]nanimity of view along theoretical lines is unattainable.[1]

B.I. Introduction

In 1986, Congress enacted a "new" version of Section 382, the principal provision of the Code directed at "loss trafficking," a practice easier to denounce than to define. This was by no means the first attempt to stamp out loss trafficking—Congress had passed the predecessor to current Code Sec. 269 in 1943. Over time, the legislative focus moved from an intent-based test to objective standards that many view as clumsily overbroad. The evolution of the legislative responses to loss trafficking from 1943 to 1986 evidences the lack

Appendix B. ***cont'd***

of a fully satisfactory solution, and a trend towards what some would describe as rough justice and others as quite rough and not particularly just.

B.II. Code Sec. 269: An Intent-Based Test

World War II led to a surge in corporate tax rates and a surtax, which in turn spurred an increase in tax avoidance transactions. A merger involving a profitable corporation and a shell corporation with attractive tax attributes was one (but by no means the only) strategy for shielding the profitable company's income.[2] In 1943, in an effort to stem tax avoidance activity, Congress began a legislative process that resulted in the enactment of Section 129 of the Internal Revenue Code of 1939, as amended ("1939 Code"), the predecessor to current Code Sec. 269.[3]

In the initial phase of the 1943 legislative process, the House Ways and Means Committee noted that tax avoidance transactions could involve acquisitions of shares or assets, that the transactions could take a variety of forms, and that "the tax benefits sought may be one or more of several deductions or credits... ."[4] Consequently, the House decided not to target:

> ... any particular methods for carrying out such tax avoidance schemes but [to include] within [the proposed section's] scope these devices in whatever form they may appear. ... [T]he scope of the terms used in the section is to be found in the objective of the section, namely, to prevent the tax liability from being reduced through the distortion or perversion effected through tax avoidance devices.[5]

The bill that passed by the House would have cast a wide net, disallowing deductions or credits where one or more persons directly or indirectly acquired "an interest in, or control of, a corporation, or property" if the IRS determined that "one of the principal purposes" for the acquisition was the avoidance of federal income (or excess profits) tax by "securing the benefit of a deduction, credit, or other allowance ..."[6]

Practitioners and taxpayers worried that the language of the House bill was too broad.[7] In particular, it was feared that the phrase "one of the principal purposes" might allow the government to challenge transactions with business purpose. During hearings before the Senate Finance Committee, a test requiring that tax avoidance be "the principal purpose" rather than "one of the principal purposes" of the transaction was proposed. One practitioner presciently predicted that this formulation would gut the statute, stating that "it would be utterly impossible to say the tax benefit was the sole purpose, or the primary purpose" of a transaction.[8]

The Senate passed an amended version of the House provision that narrowed the focus to acquisitions of a *controlling* interest in a corporation or acquisitions by a corporation of assets with a carryover basis from a corporation that prior to acquisition was not controlled by, or controlling, or under common control with, the acquiring corporation. In addition, the "one of the principal purposes" formulation was changed to "the principal purpose" despite the criticism of this formulation in the Senate hearings.[9] In conference, the Senate version of the provision was accepted, and Section 129 was added to the 1939 Code by the Revenue Act of 1943.

With Section 129 at its disposal, the IRS litigated various transactions, arguing that each had tax avoidance as its principal purpose.[10] It appears that from 1943 to 1954 the IRS did not prevail in any of these cases. [11] Taxpayers parried the IRS's attacks by arguing that there was a nontax business purpose for the transaction.

In 1954, Congress enacted a significantly revised Internal Revenue Code. Confronted with the IRS's dismal record in litigating Section 129 cases, Congress modified Code Sec. 129 by adding subsection (c), which provided that "substantially disproportionate consideration" paid for the acquisition of a corporation or assets with carryover basis would constitute *prima facie* evidence in favor of the IRS.[12]

In 1976, subsection (c) was removed from Section 269 on the grounds that (1) tax-motivated transactions are likely to include the tax benefit as part of a company's fair market value so that a test based on the consideration paid is ineffective[13] and (2) the burden of proof is already on the taxpayer.[14] Congress also made clear that Section 269 worked in tandem with Section 382, rather than being in-

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Appendix B. ***cont'd***

applicable in certain instances where Section 382 governed.[15] Section 269 remains a part of the Code today but continues to be relatively ineffective.

B.III. Old Section 382 (1954 Version)

By 1954, it was clear that Section 269 alone was inadequate to police loss trafficking.[16] Congress responded by enacting a second provision aimed at loss trafficking, based on objective standards: Section 382 of the 1954 Code.[17] Because a common element of many problematic transactions that had occurred since 1943 was a transfer of ownership of a loss corporation, Congress adopted ownership changes as an objective indicium of loss trafficking.

Under the House's version of Section 382, a reduction in a company's NOLs would be triggered if, at the end of a tax year, any subset of its 10 largest shareholders had increased their ownership percentage by at least 50 percentage points relative to their ownership percentage at the beginning of that, or the prior, tax year. The bill measured only ownership obtained through purchase or redemption and contained exceptions for public corporations and stock acquired in a tax-free exchange or by inheritance or bequest.[18]

The Senate made several major changes to the House version of Section 382. In the case of ownership changes resulting from a purchase or redemption, the changes included (1) removing the public company exception, (2) adding a business continuity exception pursuant to which a company's NOL usage was unaffected if it continued its historic business, and (3) disallowing *all* NOL carryovers if the loss corporation engaged in a different business after the 50-percent ownership change test was met.[19]

The Senate also added a separate test for tax-free reorganizations. If a corporation's original shareholders made up 20 percent or more of the shareholders after the reorganization, Section 382 did not apply. For each percentage point that the continuing ownership interest of the original shareholders fell below 20 percent, the NOL carryovers were decreased by five percent. The legislative history of the Senate provision suggests that legislators agreed with the view that tax-free reorganizations could be done for the purpose of loss trafficking when there is no "substantial continuing interest" by the original shareholders.[20]

In enacting Section 382, Congress rejected suggestions that the objective standards imposed by the statute would affect "good faith" transactions.[21] While clearly preferring objective criteria, Congress acknowledged that ambiguities remained. In particular, because the metric for an ownership change was based on fair market value but increases were only included if they were "attributable to" a purchase or redemption, there was uncertainty how changes in the relative value of different classes of shares would be captured.[22]

B.IV. *Libson Shops*

In 1957, the Supreme Court weighed in on the issue of loss utilization following a merger. In *Libson Shops*,[23] 17 separate corporations, owned by the same interests, that either sold or were permitted to sell women's apparel were merged into a single corporation in 1949. Three of the separate corporations had incurred NOLs prior to the merger, and the surviving entity sought to carry forward those NOLs and offset them against the post-merger income of the other merged corporations. [24] Under the 1939 Code, which was applicable to the case, "If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years."[25] The issue in the case was whether the surviving corporation was the same "taxpayer" as the corporations that had merged into it.

The Court upheld the IRS's position that no loss carryforwards should be allowed in this case, noting that there was "no indication in their legislative history that these [loss carryforward] provisions were designed to permit the averaging of the pre-merger losses of one business with the post-merger income of some other business which had been operated and taxed separately before the merger." [*Libson Shops,* 353 US, at 386–87.] The Court distinguished a case where a corporation underwent a merger to change its state of incorporation. The Court noted that in the latter case, "But for the merger, the old corporation itself would have been entitled to a carry-back.

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In the present case, the 16 sales corporations, prior to the merger, chose to file separate income tax returns rather than to pool their income and losses by filing a consolidated return." [*Id.,* at 388.] The Court also noted that in several other cases, the merits of which it did not address, there was a carryforward of NOLs after a change of business by a single corporation.[26] In holding that the petitioner was not entitled to the NOLs of the old loss corporations, the Court noted the absence of a finding of a tax-motivated purpose, but was not swayed, stating that the result was necessary in order to prevent a "windfall" usage of tax attributes that would not have offset income absent the merger.

In *Libson Shops*, the Court focused on the difference between the corporation that incurred the losses and the corporation attempting to utilize the losses. The analysis was not based on ownership at the shareholder level; instead, the Court considered whether the post-merger corporation was appropriately viewed as a successor to the pre-merger component corporations. One important difference between the post-merger corporation and the pre-merger component corporations was that the post-merger corporation pooled the income and losses of the component corporations.[27] There was some uncertainty about whether *Libson Shops* was superseded by the enactment of Section 382 of the 1954 Code.[28]

B.V. A Pool of Capital Approach

In 1959, Professor E. J. Brown of Harvard University proposed a limitation on net operating loss carryforwards based on what was later termed the "pool of capital" of a loss corporation.[29] Rather than disallowing loss carryforwards completely when pools of corporate capital were merged, Brown suggested the limitation should operate in a more discriminating manner. He considered two cases, *Newmarket Mfg. Co.* and *F.C. Donovan, Inc.*[30] In each case, "The court's decision was that the loss carryover should not be denied where it was demonstrable that the loss-producing enterprise had profits in the other years and the loss could have been used to offset those profits had there been no reorganization."[31] Brown suggested adapting this approach to a statutory rule:

> [T]he operating hypothesis, very simply converted into a statutory rule, would be that after the reorganization the subsequent income should be attributed to the component corporations (for loss carryover purposes) in the ratio of their contribution of assets to the reorganized corporation at the time of the reorganization. This would not turn on value—always subject to dispute and difficult to prove—but upon the relative amounts of the net basis of the assets contributed. ... The rule would be that the loss carryover from a constituent corporation after a reorganization could be used to offset no more than a fraction of the resulting corporation's subsequent income. The fraction of income subject to offset would be the fraction that was formed with the net basis of the loss corporation's assets as the numerator, and the net basis of the combined corporations' assets as the denominator, the figures being taken as of the time of the reorganization.[32]

B.VI. The Subchapter C Advisory Group Report (1958)

A few years after the 1954 enactment of Section 382, a Congressional subcommittee focusing on Subchapter C wrote (and revised) a report with a section devoted to Section 382 ("the Subchapter C Advisory Group Report").[33] One of the report's major criticisms of Section 382 was that there was no well-articulated reason why there were different consequences for taxable transfers and tax-free reorganizations.[34] In addition, the report noted that Section 382(b) arguably prevented application of Section 269.[35] As a consequence, parties entering into a tax-motivated reorganization might trigger 382(b) and argue that, as a consequence, the full disallowance of losses imposed by Section 269 was precluded.[36] The report also noted several other open questions about the 1954 Code provision.[37]

Turning to potential solutions to the loss trafficking problem, the report rejected *Libson Shops* "on the ground that it would result in too narrow a rule, not in harmony with the general carryover scheme of the statute, and that it would be very difficult to draft and apply."[38] The revised version of the report also

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considered a proposal made by the ALI (discussed below) to "preserve a corporation's carryovers in all case unless as much as 66 2/3 percent of its stock changes hands within a 2-year period and to cut off carryovers completely in every case where such a change in ownership does take place, regardless of relative values, continuity of business, or any other factor."[39] The report rejected this approach because:

> [I]t appears to the group not to give sufficient weight to the fact that the Federal corporate income tax system is based upon the principle of treating the corporation as an entity separate and apart from its shareholders and taxing the income of the corporation separate and apart from that of the shareholders. Thus the group believes that in the absence of some extraordinary event indicating that a loss corporation is primarily the subject of tax maneuvers, the loss carryover should not be affected by a change in ownership of its stock.[40]

The report proceeded to tackle the issue of identifying problematic transactions, asserting that the problem is "one of differentiating between acquisition of a going business, the tax attributes of which would be incidental, and mere acquisition of the tax attributes themselves."[41] The report stated that the solution for such a problem "can be accomplished by relating the availability of carryovers to the price paid for the business or stock of the loss corporation so as to eliminate any profit from the acquisition of loss carryovers except as incident to the acquisition of a substantial going business."[42]

The advisory group recommended a provision in which "the available carryovers of an acquired business would be limited to 50 percent of the consideration paid for that business."[43] A trigger was set at a 50 percentage–point ownership shift to determine if an acquisition had occurred. In the event that only a portion of the business was purchased, the fair market value of this portion was used to calculate the total value of the corporation.[44] The report acknowledged that the rule was somewhat crude and not well-suited for all situations, but concluded that "no other solution than an arbitrary one seems possible."[45]

Although the report noted the lack of unanimity regarding what constitutes loss trafficking, it identified several situations that fit in this category:

> [A] loss corporation may have assets (perhaps the proceeds of sale of its trade or business), though it no longer is engaged in trade or business. Such a corporation is really a shell in a business sense and must not be permitted to pass its carryover on to new owners. Similarly a going business might be acquired with no idea of continuing it, but merely for the purpose of utilizing its carryovers.[46]

To address such cases, the report suggested that its proposal with respect to Section 382 be supplemented by an amendment to Section 269.[47]

B.VII. The 1958 ALI Report

Soon after the decision in *Libson Shops* and the publication of the initial version of the Subchapter C Advisory Group Report, the American Law Institute produced a report on Subchapter C of the 1954 Code that included a section devoted to NOL carryforwards ("the 1958 ALI Report").[48] The report rejected the free transferability of losses, stating that this idea "does appear to many as partaking of tax immorality."[49] It also criticized the recommendation made by the Subchapter C Advisory Group Report as "designed to strike only at sham transactions and to prevent the acquisition of corporate shells for the purpose of utilizing their loss carryovers.[50] According to the report:

> It is questionable whether an approach which is aimed at abuse meets the basic problems in this area. It may be argued that limitations which only operate on acquisitions of shell corporations do not meet the fundamental question of whether outsiders should in any situation be able to purchase tax losses and secure a tax umbrella for their other operations.[51]

In addition, "Since losses will presumably be sold at a discount, it appears that buyers would be put in a position to obtain tax windfalls."[52] The report suggested that this potential for windfalls may be at odds with the "averaging concept"

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that is "the underlying basis of the net loss carryover provisions."[53]

The report also criticized NOL carryover limitations based solely on a "same business" approach as inadequate, stating that "there is no warrant for giving the loss benefits to the new interests just because the corporation might have been able to utilize the losses had the former stockholders retained ownership of the corporation."[54] The report went on to assert that "just as in the case of the approach based only on prevention of abuse, an approach which requires the continuation of the same business does not go to the basic question whether as a general rule losses should be available to outsiders."[55] The report also noted that while one might want to include a "same trade-or-business" requirement as part of the test, such a requirement could be difficult to administer.[56]

In lieu of a test focused solely on abuse or business continuity, the report endorsed an approach based on continuity of ownership.[57] An ownership-based approach was expected to:

> [G]o beyond cases of "tax avoidance". It would attempt directly to limit the benefits of loss carryovers to those who were the owners of the business at the time the losses were incurred. A limitation in terms of continuity of ownership would appear to be simpler and more certain than limitations based on other approaches.[58]

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B.VIII. The 1976 Tax Reform Act

The next major legislative action related to loss trafficking was the enactment of the Tax Reform Act of 1976 ("the 1976 Act"),[59] which included prospective amendments to Section 382. In addition to criticizing "old" Section 382 for providing for different treatment of taxable purchases and tax-free reorganizations,[60] the legislative history of the 1976 Act included anecdotal evidence that the statute had proven ineffective in preventing loss trafficking.[61]

The legislative history also indicated a concern for the problem of windfalls suggested by the earlier 1958 ALI Report. The Senate Finance Committee Report stated:

> [A] free traffic in loss carryovers could result in large windfalls for buyers of stock or assets, who could take advantage of the weak bargaining position of the existing owners of a loss business and acquire large carryovers for only a few cents on the dollar. Such buyers are effectively buying a tax shelter for their expected future profits, whereas if the same person had used their capital to start a new business on their own, no such loss offsets would be available.[62]

The Committee also noted that there was an unintended exception for "B" reorganizations that needed to be fixed.[63]

The 1976 version of Section 382 was designed to ensure that the consequences of the taxable and tax-free subsections were substantially identical. This was accomplished by removing the business continuity exception and providing for partial disallowance of NOL carryovers in Section 382(a). In addition, for both 382(a) and 382(b), the threshold for reducing loss carryovers was changed to a 60-percent ownership shift. Also, rather than have a five percent decrease for each percent change above 80 percent, the new provision had a 3.5-percent loss limitation for each percentage change in ownership above 60 percent up to 80 percent and a 1.5-percent loss limitation for each additional percentage change up to 100 percent. Finally, rather than measuring ownership shifts by reference to the percentage point increase of the 10 largest shareholders over the preceding two years, the new provision looked at the 15 largest shareholders and looked back three years to measure ownership increases.[64]

The 1976 amendments to Section 382 were widely criticized by commentators.[65] For example, the Tax Section of the New York State Bar Association wrote a report (the "1978 NYSBA Report") questioning the underlying premise of the changes, stating:

> The fundamental premise underlying new section 382 is that a change in the statutory machinery is necessary to restrict undue trafficking in net operating loss carryovers and other tax benefits. Yet none of the committee reports adduces any facts to demonstrate that there is significant "trafficking" in carryovers

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> under present law. Moreover, the committee reports state that the revenue effects of these amendments are 'uncertain'—which certainly suggests that trafficking, to the extent it exists, may have no great revenue effects.[66]

The 1978 NYSBA Report also found the nonlinear disallowance mechanism to be an unjustified complication and suggested that a test based on ownership change alone was too broad. Companies should be allowed to be excepted from Section 382 if "there is adequate assurance that the carryover will only be used against tax liabilities generated by the business that gave rise to the carryovers."[67] The report went on to consider free transferability of NOLs as an alternative regime.[68]

Another commentator tackled this issue of intent versus shareholder identity head on, stating:

> Maybe Congress is no longer concerned with "trafficking" at all, but with restricting the use of tax losses after a change in ownership of the loss corporation on the theory that only the group of stockholders who were stockholders when the loss was sustained should benefit from the net operating loss carryover. Such a theory, of course, ignores the facts of corporate life. It overlooks the fact that we do have a separate tax system for corporations and their stockholders; that corporations do pay taxes on their separate taxable incomes; and that, except for reorganizations and liquidations, transactions in shares of stock generally affect the tax liabilities of the stockholder and not the corporation.[69]

This commentator also noted that the change of ownership rule helps companies who can raise debt financing at the expense of companies who must issue stock to raise capital.[70]

Yet another commentator, noting the lack of "clearly identified governing principles" for Section 382, concluded that the only justification for the regime is political and criticized the 1976 version of Section 382 as unnecessary because there is no major public demand for change.[71] This commentator argued that NOLs should be viewed as prepaid expenses and should be freely transferable. Facing the argument that transferability cuts against the averaging principle underlying NOL carryovers, he argued that traditional notions of averaging should not apply to a corporate level tax because the incidence of the tax is unknown.[72]

Perhaps as a result of some or all of this criticism, the effective date of the 1976 amendments was delayed several times. After 10 years, Congress passed the 1986 Tax Reform Act and retroactively repealed the 1976 provision, which had, finally and fleetingly, become effective in the beginning of 1986.[73]

B.IX. The 1982 ALI Report

In 1982, as the third postponement of the effective date of the 1976 version of Section 382 was being considered, the American Law Institute published a report on subchapter C that included a section devoted to NOL carryovers ("the 1982 ALI Report").[74]

The report noted that although there is an "absence of any clear and coherent articulation of purpose for the limitation on net operating loss carryovers ..., [i]t is nevertheless possible to identify and consider certain stated purposes for the special limitations."[75] The report identified five purposes for Sections 269 and 382: (1) prevention of trafficking in loss corporations, (2) prevention of windfalls, (3) preventing the offsetting of losses incurred in one business against profits of an unrelated business, (4) avoiding economic inefficiencies likely to be inherent in net-loss corporations, and (5) preventing distortion of business transactions. In light of these purposes, the 1982 ALI Report proposed not to limit the total amount of NOL carryovers, but instead to limit the use of the losses to the amount that would have been earned by the old business.

The report took a two-prong approach. One prong dealt with mergers and similar combinations, which combine the loss corporation's NOLs with new capital.[76] In such cases, NOL carryovers would be limited to a fraction of the new corporation's earnings based on the relative value of the loss corporation to the corporation surviving the merger.[77]

The report observed that, in contrast to a merger that increased the capital of a loss corporation, in theory a purchase of shares should not, in itself, limit the use of NOLs. Observing, however, that it

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may be difficult to police injections of capital into a loss corporation following an ownership change, the report concluded that the limitation should be imposed at the last time the new shareholders engage in a reliably arm's-length transaction involving the loss corporation. This occurs when the new shareholders purchase the loss corporation's stock.[78]

The report proposed that an ownership change resulting from a purchase of shares should result in a loss limitation based on a fixed rate serving as a proxy for the return on the original pool of capital. For example, if a two-thirds interest in a loss corporation were purchased, then the loss corporation's NOLs could be freely deducted in an amount equal to one third of the corporation's subsequent earnings, while the use of NOLs to offset the remaining two-thirds of earnings would be limited to a fixed rate multiplied by two-thirds of the market capitalization of the loss corporation at the time of transfer.[79]

B.X. The Subchapter C Revision Act of 1985

In 1985, the staff of the Senate Finance Committee finalized a report ("Staff Report") analyzing several potential reforms to the Code, including changes to Section 382.[80] The report included a model statute entitled the Subchapter C Revision Act of 1985 ("Model Act"). This report was replete with detailed discussion not found in earlier legislative history of Section 382. Written testimony of Assistant Secretary of the Treasury (Tax Policy) Ronald Pearlman in support of the Model Act was submitted to the Senate Finance Subcommittee on Taxation and Debt Management ("the Pearlman Testimony").[81] The analysis in the Staff Report and Pearlman's testimony is philosophically similar to that provided by the 1982 ALI Report, but put more emphasis on the concept of tax neutrality. [82]

In evaluating the best method of limiting NOL carryforward utilization in the event that Section 382 is triggered,[83] the Staff Report concluded that a two-prong approach to loss limitation, such as the approach suggested by the 1982 ALI Report, was too complex,[84] and that a single limitation based on a specified rate was appropriate.[85] Pearlman agreed, noting that while the ideal rate of return for determining NOL usage would be specific to each loss corporation, "a rule that would in each case require the identification of the earnings attributable to the loss corporation's assets would not be administrable."[86] The Staff Report chose the long-term federal rate.[87]

B.XI. The 1986 Tax Reform Act and New Code Sec. 382

The revisions made to Section 382 by the 1986 Act drew heavily from recommendations made by the Senate Finance Committee staff in its 1985 final report on the Subchapter C Revision Act of 1985. The approach of new Code Sec. 382, to limit the rate at which pre-change NOLs could be utilized rather than the amount of NOLs that could be carried forward, is a significant departure from how old Section 382 had operated.[88] Congress generally followed the suggestion of the Staff Report regarding calculation of the limitation, but chose the long-term tax-exempt rate.[89]

New Code Sec. 382 keyed imposition of the limitation to stock ownership changes, as recommended by both the Staff Report and Pearlman.[90] It should be noted, however, that while an ownership change is the necessary pre-condition to the imposition of the limitation under new Code Sec. 382, other factors, such as continuity of business enterprise,[91] the presence of "excess" investment assets,[92] and pre-change contributions to capital[93] all are relevant in determining the *amount* of the limitation.

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ENDNOTES

1 The Subchapter C Advisory Group, describing in 1958 its proposed solutions to the problems targeted by Code Sec. 382.

2 During the war there were advertisements in the WALL STREET JOURNAL for the purchase and sale of these shell corporations. A seller advertised in the NEW YORK TIMES in 1943: "For sale. Stock of corporation having 1943 tax loss deduction $120,000. Sole assets are $80,000 in cash and equivalent." A buyer advertised in the WALL STREET JOURNAL that he wanted "to acquire all the outstanding stock of a corporation with original invested capital of several hundred thousand dollars with present assets at nominal values." BORIS BITTKER & JAMES EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS & SHAREHOLDERS, ¶14.41 (7th ed. 2000).

3 26 USCA §129 (1944). The legislative history of the 1943 legislation includes H.R. REP. NO. 78-871 (1943), *reprinted in* J.S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAWS 1953–1939 (1954), and S. REP.

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No. 78-627 (1943), *reprinted in* J.S. Seidman, Seidman's Legislative History of Federal Income and Excess Profits Tax Laws 1953–1939 (1954).

[4] H.R. Rep. No. 78-871, reprinted in J.S. Seidman, Seidman's Legislative History of Federal Income and Excess Profits Tax Laws 1953–1939, at 1970.

[5] *Id.*, at 1970.

[6] H.R. 3687 (as passed by the House, Nov. 24, 1943).

[7] *Hearings before the Committee on Finance United States Senate Seventy-Eight Congress First Session on H. R. 3687 An Act to Provide Revenue, and for Other Purposes*, 78th Cong. (1943) (statements of Hugh Satterlee, representing Satterlee, Green & Sher and Chairman of the Committee on Taxation of the New York County Lawyers' Association, Harry J. Rudick, Chairman, Taxation Committee, Association of the Bar of the City of New York, Harold V. Bozell, representing United States Independent Telephone Association, Ellsworth C. Alvord, Chairman, Committee on Federal Finance, Chamber of Commerce of the United States, John W. Hooper, on behalf of Brooklyn Chamber of Commerce and Granger Hansell, Georgia Marble Co.) [hereinafter "1943 Hearings"]. Satterlee argued that "this provision is directed primarily at the practice of acquiring corporations with a large invested capital, but small present assets. But the provision goes much further than that and would furnish a fertile field for litigation and arbitrary exactions by the Treasury Department." 1943 Hearings, at 220.

[8] Statement of Ellsworth C. Alvord, 1943 Hearings, at 594–95.

[9] H.R. 3687 (as passed by the Senate, Jan. 21, 1944). It is of course water under the bridge, but the thought occurs that if the House version of Section 129 had passed in 1943, the tax law might be considerably less complicated today.

[10] *See, e.g., Commodores Point Terminal,* 11 TC 411 (1948); *Alcorn Wholesale Company*, 16 TC 182 (1951); *Berland's Inc. of South Bend*, 16 TC 182 (1951); *Chelsea Products, Inc.*, 16 TC 840 (1951), *aff'd*, CA-3, 52-2 ustc ¶9370, 197 F2d 620 (1952); *WAGE, Inc.*, 19 TC 249 (1952); *Great American Industries, Inc.*, 25 TC 1160 (1956).

[11] *See generally* Thomas N. Tarleau, *Acquisition of Loss Companies*, 31 Taxes 1050, 1054 (Dec. 1953); Peter Miller, *Capital Gains Taxation of the Fruits of Personal Effort: Before and Under the 1954 Code*, 64 Yale L. J. 1, 64 (1954).

[12] The House of Representatives had sought to mitigate the limiting effects of the "principle purpose" test by requiring the taxpayer to negate bad intent under a "clear preponderance of the evidence" standard in instances "where the tax basis of the property acquired for depreciation and other purposes, together with the tax value of other tax benefits, such as operating loss carryovers, is substantially greater than the amount paid for the property." H.R. Rep. No. 83-1337, at 32 (1954).

The Senate Committee on Finance agreed in principle with the approach reflected in the House's language, but was concerned that taxpayers would not be able to meet the burden of "a clear preponderance of the evidence." S. Rep. No. 83-1622, at 39 (1954). The Senate's solution, which was ultimately enacted, was to provide that "substantially disproportionate consideration" paid for the acquisition of a corporation or assets with carryover basis would constitute *prima facie* evidence in favor of the IRS. 26 USCA §269(c) (1955).

[13] H.R. Rep. No. 94-658, at 377 (1976); S. Rep. No. 94-938, at 497–98 (1976). The House report stated:

> This amendment repeals the presumption of a tax avoidance purpose in certain cases where the consideration paid for stock or assets of a corporation is disproportionate to the total of the adjusted basis of the assets of the acquired corporation plus the amount of tax benefits obtained through the acquisition (sec. 269(c)). This presumption seems to be contrary to the purpose of the provision; *i.e.*, usually tax avoidance motives would be more apt to be present where the value of "tax benefits" was paid for, than they would be where the "tax benefits" were not given weight.

H.R. Rep. No. 94-658, at 377 (1976).

[14] The House Report states, "[U]nder general tax litigation principles, the Commissioner's determination of a tax avoidance motive is presumptively correct and the burden of proof is already on the taxpayer." H.R. Rep. No. 94-658, at 377 (1976).

[15] The 1954 legislative history had indicated that Section 269 was not meant to apply if Section 382(b) applied. S. Rep. No. 83-1622, at 284 (1954). ("If a limitation in this section [382(b)] applies to a net operating loss carryover, section 269, relating to acquisitions made to evade or avoid income tax, shall not also be applied to such net operating loss carryover.")

[16] S. Rep. No. 83-1622, at 39 (1954).

[17] *See, e.g.,* H.R. Rep. No. 83-1337, at 42 (1954). ("This special limitation on net operating loss carryovers provides an objective standard governing the availability of a major tax benefit which has been abused through trafficking in corporations with operating loss carryovers, the tax benefits of which are exploited by persons other than those who incurred the loss. It treats a business which experiences a substantial change in its ownership, to the extent of such change, as a new entity for such tax purposes.")

[18] Under the House's proposal, triggering a Section 382 limitation would have caused a percentage reduction in the loss corporation's NOLs. This percentage would have been equal to the sum of the increase, if any, in the percentage of stock held by each of the 10 largest shareholder at the end of the year over the percentage of stock held by such shareholders at the beginning of that tax year or the prior tax year (using whichever percentage amount is lower), but only to the extent that such increase was attributable to a stock purchase or redemption. H.R. Rep. No. 83-1337, at A143–44 (1954).

[19] H.R. 8300 (as passed by the Senate); Amendments to the Bill (H.R. 8300) to Revise the Internal Revenue Laws of the United States [hereinafter 1954 Senate Amendments]; Staff of the Joint Committee on Internal Revenue Taxation, Summary of the Senate Amendments to H.R. 8300 (Comm. Print 1954) [hereinafter JCT Summary of Senate Amendments], at 16–17 (summarizing Senate changes).

[20] "The Senate Finance Committee limits the allowance of net operating loss carryovers resulting from a tax-free reorganization. … These carryovers are appropriately allowed in full only when the shareholders of the predecessor corporation have a substantial continuing interest in the successor corporation." JCT Summary of Senate Amendments, at 16.

[21] The use of an objective standard had brought the criticism that, "This section is arbitrary and should be amended by adding a provision permitting discretionary authority on the part of the Secretary or his delegate as is done in section 269 in case of mergers with loss corporations." Digest of Materials Presented to Committee of Finance at Hearings on HR 8300 (Comm. Print 1954), at 46.

[22] "[T]he concept of percentage of stock requires clarification, particularly if there are two or more classes of participating stock outstanding." *Id.* This issue is currently governed by Section 386(l)(3)(C), the application of which remains subject to uncertainty. *See generally*, *NYSBA Members*

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Submit Report on Ownership Changes in Loss Corporations, 2009 TNT 245-16 (Dec. 24, 2009); *Practitioners Probe for Details on Anticipated Interim Guidance on Fluctuations in Value*, 2009 TNT 9-11 (Jan. 15, 2009); *Owner Shifts and Fluctuations in Value: A Theory of Relativity*, 2005 TNT 54-29 (Mar. 22, 2005).

[23] *Libson Shops v. Koehler*, SCt, 57-1 USTC ¶9691, 353 US 382 [hereinafter *Libson Shops*].

[24] The Court noted that the operations that had generated the pre-merger losses continued to lose money after the merger. *Libson Shops, id.*, at 383–84.

[25] 26 USCA §122(b)(2)(C) (1939).

[26] *Libson Shops,* 353 US, at 390, note 9, *citing Northway Securities Co.,* BTA, Dec. 7003, 23 BTA 532 A. X-2 CB 52 (1931) (withdrawn); NA. 1960-2 CB 8; *Alprosa Watch Corp.*, 11 TC 240 (1948); *A. B. & Container Corp.*, 14 TC 842 (1950); *WAGE Inc.*, 19 TC 249.

[27] In the legislative history of "new" Section 382, *Libson Shops* is generally referred to as requiring continuity of business enterprise in order to justify continued use of NOLs. This seems like something of a simplification—in *Libson Shops*, the assets of the loss companies continued to be used in the same line of business by the successor corporation. *Libson Shops* might equally well be viewed as a harbinger of a "pool of capital" approach. One version of a pool of capital approach is discussed in Section V below.

[28] *Compare* Rev. Rul. 63-40, 1963-1 CB 46 *with Adkins-Phelps*, CA-8, 68-2 USTC ¶9609, 400 F2d 737; *Maxwell Hardware*, CA-9, 65-1 USTC ¶9332, 343 F2d 713; S. REP. NO. 94-938, at 206 (1976).

[29] E.J. Brown, *An Approach to Subchapter C*, 3 TAX REVISION COMPENDIUM—COMPENDIUM OF PAPERS ON BROADENING THE TAX BASE 1619, 1628–30, SUBMITTED TO THE HOUSE COMMITTEE ON WAYS AND MEANS, 86th Cong., 1st Sess. (Comm. Print 1959). The phrase "pool of capital" seems to have been introduced in the 1980s. *See, e.g.*, ALI FEDERAL INCOME TAX PROJECT SUBCHAPTER C PROPOSALS OF THE AMERICAN LAW INSTITUTE (1982), at 240; STAFF OF THE COMMITTEE ON FINANCE, THE SUBCHAPTER C REVISION ACT OF 1985 (S. Prt. 99-47, 1985), at 70.

[30] *Newmarket Mfg. Co.,* CA-1, 56-1 USTC ¶9540, 233 F2d 493*; F.C. Donovan, Inc.,* CA-5, 261 F2d 460 (1968).

[31] Brown, *supra* note 29, at 1629.

[32] *Id.* Brown stated that the statutory rule did not need to be precise. "Like other acceptable operating hypotheses, this need not guarantee minutely accurate correlation with facts which happen to be unascertainable so long as it produces results of a generally acceptable nature." *Id.*

[33] REVISED REPORT ON CORPORATE DISTRIBUTIONS AND ADJUSTMENTS TO ACCOMPANY SUBCHAPTER C ADVISORY GROUP PROPOSED AMENDMENTS, AS REVISED RECEIVED BY THE SUBCOMMITTEE ON INTERNAL REVENUE TAXATION (1958).

[34] The report stated, "Generally speaking, section 382 (a) covers stock acquisitions and section 382 (b) covers asset acquisition cases. They are separately compartmented, and it is difficult to find any common thread of policy running through the section as a whole." It proceeded to list some of the differences between the two provisions. Subchapter C Advisory Group Report, at 89.

[35] *Id.*

[36] In the words of the report:

> Taxpayers have made much of the statement in the committee report on the 1954 Code that applicability of section 382 (b) to any extent prevents application of section 269 regardless of result. The technique (as to the effectiveness of which the advisory group expresses no opinion and which, it is understood, the Internal Revenue Service is certain to challenge) is to give the loss corporation's shareholders, say, a 19-percent interest, thereby accepting a five-percent reduction in carryovers to insure against a much greater, perhaps even a total, disallowance under section 269.

Id., at 89.

[37] The report asked:

> Can taxpayers avoid both subsections of section 382 by acquiring the stock of the loss company in a section 368(a)(1)(B) reorganization and then liquidating the company under section 332, where acquisition of the assets directly in a section 368(a)(1)(C) reorganization would bring section 382(b) into play? Can the shareholders of the acquiring company purchase the stock of the loss company and then merge it into the acquiring company, relying on the common-ownership provision of section 382(b)(3) to escape the limitations of the section?

Id., at 90.

[38] *Id.*

[39] *Id.* The Subchapter C Advisory Group Report was originally written prior to the publication of the ALI report, but the revised version was written after the ALI report was published. Consequently, the Subchapter C Advisory Group Report and the ALI report comment on each other.

[40] *Id.*

[41] *Id.*

[42] *Id.,* at 91.

[43] *Id.,* at 91. For example, in the case of a corporation with $200,000 of NOLs, at least $400,000 would need to be paid for the corporation in order to fully utilize the NOLs. *Id.*

[44] *Id.*

[45] *Id.*

[46] *Id.,* at 95.

[47] *Id.*

[48] ALI FEDERAL INCOME TAX PROJECT SUBCHAPTER C PROPOSALS OF THE AMERICAN LAW INSTITUTE (1958).

[49] *Id.,* at 341.

[50] *Id.,* at 343.

[51] *Id.,* at 344. The report went on to note that the approach of the Subchapter C Advisory Group Report ties the use of net operating loss carryovers to the size of the business and only analyzes ownership change to the extent of its use as a triggering mechanism. According to the 1958 ALI Report, this approach:

> would ... work in the direction of greater freedom to acquire loss corporations as long as the same corporate entity continues. But the 'entity' argument does require analysis as to what is meant by 'the same' corporation continuing where there are changes in the corporate activity after a change in ownership. Furthermore, if this view is pushed to its logical conclusion, the survival of carryovers would turn on formalistic differences depending upon the legal existence of the old corporation, since losses could not survive reorganizations in which the loss corporation disappeared.

Id., at 344. The report also noted that the Advisory Group proposal "would probably increase pressure by creditors to force an early sale of a loss corporation in order to avoid any further decreases in asset values and corresponding decreases in the size of the available loss carryovers." *Id.,* at 345.

[52] *Id., at* 344–45.

[53] *Id., at* 345.

[54] *Id., at* 346.

[55] *Id., at* 347.

[56] *Id., at* 346.

[57] Generally, the report's proposal was similar to Section 382 of the 1954 Code, except that the ownership cutoff was set at 67 percent for both taxable transfers and reorganizations. A 67-percent limitation

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Appendix B. *cont'd*

trigger was chosen because a 50-percent cutoff was perceived to be unfair to substantial minority shareholders.

[58] *Id., at* 347.

[59] Tax Reform Act of 1976 (P.L. 94-455) (as enacted).

[60] S. REP. NO. 94-938 (1976). ("Generally speaking, section 382(a) covers stock acquisitions and section 382(b) covers asset acquisitions. These rules of existing law are not coordinated, however. ... where enough stock of a loss corporation is purchased for cash, carryovers are lost if the corporation does not continue to carry on the same trade or business. However, losses can still be carried over after a tax free reorganization whether or not the same trade or business is continued. Conversely, after a purchase of stock, losses can be carried over in full if the former business is continued; but after a reorganization, the loss carryover may be reduced even if the old business is continued.") *Id.,* at 202. *See also* STAFF OF J. COMM. ON TAXATION, 94th Cong., *General Explanation of the Tax Reform Act of 1976,* 192 (Comm. Print 1976), *reprinted in* 1976-3 CB 1, 192 (Vol. 2) [hereinafter General Explanation] ("The former purchase rules required no continuity of interest by the former owners of a loss company, since a 100 percent change in stock ownership could preserve all the carryovers if at least the same kind of business was continued. By contrast, the reorganization rules required at least 20 percent continuity by former owners if carryovers were to survive in full. Where the purchase limitations applied, the loss carryovers were completely disallowed. Where the reorganization rules applied, loss carryovers were merely reduced in proportion to the change in stock ownership.")

[61] Tax Reform: Public Hearings Before the H. Comm. on Ways and Means, 94th Cong., 1st Sess., 3587, 3589 (1975) (testimony of Michael Waris, Jr.). Waris presented an exhibit showing that in 1974, 224 ads were put in the WALL STREET JOURNAL relating to sale or purchase of loss carryover corporations. The total amount of loss carryovers stated in the ads with dollar figures was $250 million. The value was thought likely to be substantially higher if it included ads with dollar amounts and loss carryovers not being advertised.

[62] S. REP. NO. 94-938, at 201–02 (1976).

[63] *Id*. The report states, "The reorganization limitation does not apply to a 'B'-type reorganization (stock for stock). This means that a profitable company can acquire the stock of a loss company in exchange for the profit company's stock, liquidate the loss company after a reasonable interval, and use its loss carryovers without limit against the profit company's future income." *Id.,* at 202.

[64] H.R. 10612 (as enacted); S. REP. NO. 94-938, at 204 (1976).

[65] *See, e.g.,* Aidinoff, *Utilization of Acquired Net Operating Loss Carryovers and The Tax Reform Act of 1976—A Face-Lift for Section 382*, 55 TAXES 874 (1977); Fleming, *Reflections on Section 382: Searching for a Rationale*, 1979 B.Y.U. L. REV. 213 (1979); New York State Bar Association Tax Section Committee on Corporations, *Report on Section 382 of the Internal Revenue Code as Amended by the Tax Reform Act of 1976*, 31 TAX LAW. 283 (1978). Also, note that Section 382 was referred to as "universally loathed" at the 1985 Senate Finance Subcommittee hearings. SENATE FINANCE SUBCOMMITTEE CONSIDERS SUBCHAPTER C REFORM, 85 TNT 194-3 (1985).

[66] 1978 NYSBA Report at 283.

[67] The report says, "In the committee's view, a change in the ownership of a corporation should not result in a disallowance of its carryovers under either section 382(a) or section 382(b) if there is adequate assurance that the carryover will only be used against tax liabilities generated by the business that gave rise to the carryovers. This rule would be an exception to the general rule that disallows carryovers when there has been the requisite change in ownership." *Id., at* 287.

[68] 1978 NYSBA Report. The report stated:

> [E]ntrepreneurs who offset losses from one line of business against another existing line of business or against other sources of income in effect receive a government subsidy for an unprofitable enterprise which is not available to others who cannot so offset their losses. Allowing free transferability of loss carryovers would make the subsidy to all entrepreneurs essentially the same. It would also be a dramatic help for those trying to raise capital for new venture capital businesses.

The report went on to say, "Free trade in net operating loss carryover corporations would substantially reduce the possibility of 'windfalls' for buyers which the General Explanation suggests as the basic reason for the present prohibitions or limitations on transfers of interests in loss corporations." *Id.,* at 286.

[69] Aidinoff, *supra* note 65, at 887.

[70] "Section 382(a) burdens smaller and weaker corporations, and favors stockholders of public corporations in relation to stockholders of private companies. A corporation with substantial net assets which sustains a net operating loss is more likely to have the borrowing power to acquire a profitable business whose profits can be utilized against such net operating loss than a small corporation. A weaker corporation may be able to acquire the necessary cash only by the receipt of additional equity capital, which in many instances can be obtained only from new investors. Thus, the weaker corporation is more likely to experience a change in ownership that will trigger Section 382(a)." Aidinoff, *supra* note 65, at 888.

[71] Fleming, *supra* note 65, at 214, 224–25.

[72] *Id., at* 216.

[73] For a list of the postponing amendments, *see* Michael L. Schultz, *Section 382 and the Pursuit of Neutrality in the Treatment of Net Operating Loss Carryovers*, 39 U. KAN. L. REV. 59 (1990–1991), at 71, quoting footnote 67.

[74] ALI FEDERAL INCOME TAX PROJECT SUBCHAPTER C PROPOSALS OF THE AMERICAN LAW INSTITUTE (1982).

[75] *Id.,* at 207.

[76] *Id.,* at 225, 237.

[77] The report provides several values for this fraction with a maximum value being the proportion based solely on fair market value.

[78] *Id., at* 269–70. In the 1980s, others also proposed mechanisms to prevent loss trafficking. *See, e.g.,* Bacon and Tomasulo, *Net Operating Loss and Credit Carryovers: The Search for Corporate Identity,* 20 TAX NOTES 835, 843–46 (1983); *see generally* STAFF OF THE JOINT COMMITTEE ON TAXATION, *Special Limitations on the Use of Net Operating Loss Carryovers and Other Tax Attributes of Corporations,* JCS-16-85 (Comm. Print 1985).

[79] *Id.,* at 273–74.

[80] STAFF OF THE COMMITTEE ON FINANCE, THE SUBCHAPTER C REVISION ACT OF 1985 (S. Print 99-47, 1985). Note that many of the changes in the Tax Reform Act of 1986 were based on proposals in this report.

[81] *Carryover of Net Operating Losses and Other Tax Attributes of Corporations, Hearing before the Subcommittee on Select Revenue Measures of the House Ways and Means Committee,* 99th Cong. 10 (1985) (written testimony of Ronald Pearlman). Pearlman had also testified about loss trafficking more generally in 1983. *See Carryover of Net Operating Losses and Other Tax Attributes of Corporations, Hearing before the Subcommittee on Select Revenue Measures of the House Ways and Means Committee,*

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98th Cong. 5 (1983) (statement of Ronald Pearlman).

[82] Pearlman identified "tax and economic policy considerations" similar to those identified by the 1982 ALI Report. He also emphasized the importance of tax neutrality in his testimony, noting that any limitation regime "should not distort investment decisions and should not create undue bias between diversified and nondiversified entities between old and new businesses" and "should prevent 'trafficking' in loss corporations." Pearlman Testimony. *Id.,* at 8–9.

[83] Staff Report, at 71.

[84] *Id.,* at 69–70.

[85] *Id.,* at 71.

[86] Pearlman Testimony, at 13.

[87] The Staff Report noted:

> [T]he loss corporation could simply liquidate its assets and purchase taxable securities, yielding a steady, risk-free flow of taxable income which could be offset by any available losses. This would at least maximize the use of carryovers by the loss corporation, although it might not maximize the after-tax rate of return of the corporation.
>
> It was decided, therefore, that the "neutrality" principle should be implemented by assuming that the loss corporation, in all cases, would maximize the use of its carryovers, had there been no control change. ... The long-term Federal rate was selected because it is based on an average of long-term Treasury bond rates, the maximum risk-free rate of return the loss corporation could have obtained.
>
> *Id.,* at 71–72.

The Staff Report also observed that the tax-exempt rate was higher than the average rate at which loss corporations actually absorbed NOLs. *Id.,* at 71.

[88] The report stated, "This 'limitation on earnings' approach is intended to permit the survival of NOL carryforwards after an acquisition, while limiting the ability to utilize the carryforwards against another taxpayer's income." H.R. REP. NO. 99-426, at 257 (1985).

[89] H.R. REP. NO. 99-841, at 188 (1986) (Conf. Rep.) stating:

> The long-term tax exempt rate will be computed as the yield on a diversified pool of prime, general obligation tax-exempt bonds with remaining periods to maturity of more than nine years. The use of a rate lower than the long-term Federal rate is necessary to ensure that the value of the NOL carryforwards to the buying corporation is not more than their value to the loss corporation. Otherwise there would be a tax incentive for acquiring loss corporations. If the loss corporation were to sell its assets and invest in long-term Treasury obligations, it could absorb its NOL carryforwards at a rate equal to the yield on long-term government obligations. Since the price paid by the buyer is larger than the value of the loss company's assets (because of the value of NOL carryforwards are taken into account), applying the long-term Treasury rate to the purchase price would result in faster utilization of NOL carryforwards by the buying corporation.

The Senate Finance committee report also mentioned the Staff Report's observation that the chosen rate was higher than the average rate at which loss corporations actually absorbed NOLs. S. REP. NO. 99-313, at 233 (1986).

[90] New 382 tracks ownership changes involving five-percent shareholders. One might wonder whether the five-percent threshold represents a decision that transfers by less than five-percent shareholders do not present potentially abusive situations, or whether it is a rule of administrative convenience. The legislative history indicates that the latter is the case:

> A purpose of the provision that considers only owner shifts involving a 5-percent shareholder is to relieve widely held companies from the burden of keeping track of trades among such shareholders ... The conferees believe, however, that there are situations involving transfers of stock involving less-than-5-percent shareholders, other than tax-free reorganizations (for example, public offerings), in which it will be feasible to identify changes in ownership involving such shareholders, because, unlike public trading, the changes occur as part of a single, integrated transaction. Where identification is reasonably feasible or a reasonable presumption can be applied, the conferees intend that the Treasury will treat such transactions under the rules applicable to equity structure shifts.
>
> H.R. REP. NO. 99-841, at 176 (1986) (Conf. Rep.)

[91] 26 USCA §382(c).

[92] 26 USCA §382(l)(4).

[93] 26 USCA §382(l)(1).

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