# Carryover of Tax Attributes in Acquisitions

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No one wants to be accused of making a corporate acquisition primarily to acquire tax attributes. Yet like so much else in the tax field, the rules governing what you can—and mostly cannot—do are terribly important. With the changing levels of sophistication (and sometimes even artistry) that inevitably roil the field over time, the rules are not static.

And they are not even always about net operating losses. Congress and the IRS have periodically responded with either sweeping changes or tweaks to an already complex system of carryover and disallowance rules.

This time, the IRS has weighed in with proposed regulations that look back at the fundamentals.

## Regulatory Reform

Proposed regulations under Code Sec. 381 look at the definition of an acquiring corporation in certain asset acquisitions. These proposed rules are expressly designed to tie to other proposed regulations under Code Sec. 312. Those rules deal with earnings and profits (E&P).

They confirm that the direct acquiring corporation will succeed to the E&P and other tax attributes governed by Code Sec. 381. That section generally provides that in certain asset acquisitions, the acquiring corporation succeeds to the tax attributes of the target corporation. Notably, among the tax attributes that are carried over is the target's E&P.

The old regulations in Reg. §1.381(a)-1(b)(2), generally define the acquiring corporation as either the corporation that ultimately acquires all of the assets transferred by the target, or the corporation that directly acquires the assets if no single corporation ultimately acquires all of the assets. Yet if the corporation that directly acquires the assets is the acquiring corporation, and it thereafter transfers any acquired assets to a controlled subsidiary, the carryover to the controlled subsidiary isn't governed by Code Sec. 381. (Reg. §1.381(a)-1(b)(3)(ii).)

Proposed regulations issued in 2012 (under Code Sec. 312) say that the E&P goes to the acquiring corporation. Although those proposed regulations cross-reference the proposed Code Sec. 312 regulations, the IRS concluded that more than that was needed. In a sense, this should hardly be a surprise. And the two sets of proposed regulations, now under Code Secs. 312 and 381, are expected to be finalized together, presumably later in 2014.

## Drop-Downs?

In a transaction described in Code Sec. 381(a)(2), the acquiring corporation is the one that directly acquires the assets, even if the transferee corporation ultimately sends them off to subsidiaries, retaining none of the assets itself. (Prop. Reg. §1.381(a)-1(b)(2)(i).)

The idea, says the IRS, is to mirror the current Code Sec. 381 regulations. However, there is a difference when all of the assets are acquired pursuant to a plan of reorganization. In that case, the current regulations treat the subsidiary as the acquiring corporation.

The IRS has complained that this can allow a company to manipulate where the target's attributes will go. After all, it is a simple matter to drop all of the acquired assets down to one or more subsidiaries. The IRS says the proposed rules produce more appropriate results by eliminating the choice.

There are side benefits too, says the IRS. Whether there is a plan of reorganization should not matter to the ultimate destination of the E&P. The not infrequent fumbling to determine whether every single asset is acquired or transferred should also be eased under the new rules. The IRS says the location of the E&P of the target should generally be housed in the corporation that is closest to the transferor corporation's former shareholders, except in triangular reorganizations.