DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR: Associate Area Counsel -

FROM: Associate Chief Counsel (CORP) CC:CORP:B05

SUBJECT: Section 382 Transaction

Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This Chief Counsel Advice should not be cited as precedent.

LEGEND

Company =

X =

Y =

Z =

a =

b =

c =

d =

e =

Date 1 =

Year 1 =

Year 2 =

ISSUES

Whether the purchase of Company stock by Y in Year 2 resulted in an ownership change within the meaning of § 382(g) of the Internal Revenue Code ("Code"), and if so, whether Company's net operating loss ("NOL") deduction is limited under § 382.

CONCLUSIONS

The purchase of Company stock by Y in Year 2 resulted in an ownership change as defined in the § 382(g) of the Code. Consequently, Company's NOL deduction will be limited under § 382.

FACTS

Background:

Our understanding of the facts is as follows:

Company has at all pertinent times been owned and controlled by members of the Z family. At the beginning of Year 1, Company's principal shareholders, X and Y, owned approximately a% and b%, respectively, of Company's issued and outstanding stock. Other family members owned the remaining shares of Company.

X and Y are brothers. Their parents were deceased more than 3 years prior to Date 1. Neither of the parents of X or Y, nor the parents' estates, ever owned, directly or indirectly, any stock in Company or its subsidiaries.

During Year 1, Company underwent a reorganization described in § 368(a)(1)(D) due to the requirements of certain lenders and government agencies. Following the reorganization, X and Y remained Company's principal shareholders. However, X now owned c% and Y owned d%. X's ownership interest decreased from a% to c% and Y's ownership increased from b% to d%, including stock owned by Y through a trust for his children. The remaining shares of company stock continued to be owned by the same family members who owned stock at the beginning of Year 1.

On Date 1, Y sold all of his Company stock to X. As a result, X increased his ownership interest in company from c% to e%, an increase of more than 50% during Year 2.

Company claimed a NOL deduction on its Year 2 return as originally filed. The NOL was incurred and carried forward from prior tax years, and a carryover remained for use in subsequent tax years.

Field's Position

The field takes the position that Company's ability to offset its taxable income in post-change years with the NOL carryover is subject to the limitation imposed by § 382 because, it is contended, an ownership change, as defined in § 382(g)(1), occurred during Year 2 when Y sold his stock in Company to X.

Taxpayer's Position

Company asserts that the NOL carryover is only limited by its taxable income in subsequent years and not subject to § 382 because, it is contended, the sale of Company stock from Y to X did not trigger an ownership change or owner shift under § 382(g). Although Company does not dispute that the sale of Y's Company stock to X in Year 2 increased X's stock ownership interest in Company by more than 50 percentage points, Company contends that under § 382(l)(3)(A)(i), X and Y should be treated as 1 individual for purposes of applying § 382. Company claims that X and Y are individuals described in § 318(a)(1), namely the children of their deceased parents, and thus § 382(l)(3)(A)(i) prevents transactions between the two brothers from triggering a § 382(g) ownership change.

LAW AND ANALYSIS

Under § 382(a), after a loss corporation undergoes an ownership change, the amount of the loss corporation's prechange NOLs available to offset taxable income for any postchange year shall not exceed the 382 limitation for that year. Section 382(b) generally provides that the 382 limitation equals the fair market value ("FMV") of the corporation's stock as of the change date multiplied by the long term tax-exempt rate provided in § 382(f). Section 382(k)(1) provides generally that a "loss corporation" is a corporation entitled to use a NOL carryover, or one that has a NOL, in the taxable year in which an ownership change occurs. Under § 382(k)(2) an "old loss corporation" is a corporation that is a loss corporation before an ownership change, and § 382(k)(3) generally defines a "new loss corporation" as a corporation that is a loss corporation after an ownership change. Section 382(d) provides generally that a prechange loss is any NOL carryforward or NOL of the old loss corporation for the taxable year in which an ownership exchange occurs.

Under § 382(g)(1), an ownership change occurs when one or more 5-percent shareholders of a loss corporation increase their stock ownership by more than 50 percentage points over the lowest percentage of stock owned by the 5-percent shareholders at any time during the testing period. Section 382(i) provides generally that the testing period for determining whether an ownership change has occurred is the 3 -year period ending on the day of any owner shift involving a 5-percent shareholder.

Section 382(l)(3)(A)(i) and § 1.382-2T(h)(6)(ii) provide that paragraphs (1) and (5)(B) of § 318(a) do not apply for purposes of applying § 382(a), but "an individual and all members of his family" described in paragraph (1) of § 318(a) shall be treated as 1 individual. The family members described in § 318(a)(1) include children, grandchildren and parents, though not grandparents or siblings. Thus, there is no attribution of stock between or among spouses, children, grandchildren or parents for purposes of applying § 382. Moreover, these family members are treated as a single shareholder for purposes of § 382, with the result that § 382(g) is applied to the aggregate stock ownership of the family members.

In the Conference Report to the Tax Reform Act of 1986, Congress reiterated this interpretation of the language of § 382(l)(3)(A)(i) when it noted that:

> The family attribution rules of sections 318(a)(1) and 318(a)(5)(B) do not apply, but an individual, his spouse, his parents, his children and his grandparents are treated as a single shareholder.

See H. R. Rep. No. 841, 99th Cong., 2d Sess., Sept. 18, 1986, II-182. This indicates that Congress intended that only certain members of a family be treated as a single shareholder for purposes of applying § 382. Although § 382(l)(3) does not specifically designate who is a member of an individual's family, it does incorporate by reference those individuals listed in § 318(a)(1)(A). Thus, an individual and only his or her spouse, parents, children and grandparents, but not his or her siblings,[1] are to be treated as a single shareholder under § 382(l)(3)(A)(i).

In the present case, Company argues that X and Y are family members described in § 318(a)(1)(A) and should therefore be treated as a single shareholder pursuant to § 382(l)(3)(A)(i). As noted above, siblings or brothers are not mentioned in § 318(a)(1), and thus two brothers should not be treated as a single shareholder under § 382(l)(3)(A)(i) for purposes of applying § 382.

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[1] It is important to note that Congress has amended § 318 several times since 1954 and chosen not to bring the family attribution rules of § 318(a) in line with those under §§ 267 and 707, both of which include siblings as members of a family.

Although an individual and his or her children would be treated as a single shareholder under § 382(l)(3)(A)(i), in the instant case, X an Y are not the children of any living “individual”, as both of their parents died prior to, and did not own Company stock during, the testing period set forth in § 382(i). The Supreme Court has indicated that "the words of statutes -- including revenue acts -- should be interpreted where possible in their ordinary, everyday senses." See Malat v. Riddell, 383 U.S. 569, 571 (1966)(citing Crane v. C.I.R., 331 U.S. 1, 6 (1947)). Because the commonly used meaning of the term “individual” does not include a deceased or non-existent parent, allowing X and Y to be treated as a single shareholder under § 382(l)(3)(A)(i) would contradict the intent of Congress. See supra, H. R. Rep. No. 841, at II-182.

In addition, the fact that Congress has chosen to use the term “decedent” when referring to a deceased individual supports the view of the Service that Congress intended that the plain meaning of “individual” be used, which does not include a deceased parent or other ancestor. A contrary interpretation of “individual” would frustrate the clearly expressed intent of Congress to limit the scope of § 382(l)(3)(A)(i) to only certain family members. See supra, H. R. Rep. No. 841, at II-182.

Furthermore, both § 318(a) and § 382(l)(3)(A) provide constructive ownership rules for attributing stock from a decedent’s estate to its beneficiaries that are different from the constructive ownership rules for families. Because a “decedent” can not own, directly or indirectly, any property, but only his or her estate can own property, Congress could not have intended for the term “individual”, when used in the context of determining members of a family, to include a “decedent”. Moreover, the fact that § 6012 provides different rules for the making of tax returns for individuals and decedents creates a strong implication that Congress does not view a deceased individual as an “individual” after his or her death.

Thus, X and Y cannot claim that they constitute a single shareholder for purposes of § 382, because there is no individual with which either of them has a family relationship that is described in § 318(a)(1). Without such a family relationship, neither X nor Y can avail themselves of the single shareholder treatment provided by § 382(l)(3)(A)(i). Therefore, the sale of Company stock by Y to X will trigger an ownership change under § 382(g) because X’s interest in company stock increased by more than 50 percentage points.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[redacted]

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Please call Krishna Vallabhaneni at (202) 622-7550 for further assistance.

By:_____
Assistant to the Branch Chief, Branch 5