

MEMO# 22938

September 30, 2008

Notice 2008-78 Addresses Capital Contributions to Loss Corporations Under Code Section 382(l); Comments Requested

[22938]

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TO: TAX COMMITTEE No. 32-08 RE: NOTICE 2008-78 ADDRESSES CAPITAL CONTRIBUTIONS TO LOSS CORPORATIONS UNDER CODE SECTION 382(L); COMMENTS REQUESTED

The Internal Revenue Service ("IRS") has released attached Notice 2008-78 (the "Notice"), which addresses capital contributions to loss corporations under Code section 382(l). The Notice provides that, notwithstanding section 382(l)(1)(B), a capital contribution will not be presumed to be part of a plan a principal purpose of which is to avoid or increase a section 382 limitation (a "Plan") solely as a result of having been made during the two-year period ending on the change date (as defined in section 382(j)). A capital contribution is determined to be part of a Plan based on (1) whether the contribution is described in one of four safe harbors or (2) consideration of all facts and circumstances.

Safe Harbors

The Notice provides safe harbors similar to those provided in Reg. §1.355-7. A contribution will not be considered part of a Plan if the contribution is:

1. made by a person who is neither a controlling shareholder (determined immediately

before the contribution) nor a related party, no more than 20% of the total value of the loss corporation's outstanding stock is issued in connection with the contribution, there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change, and the ownership change occurs more than six months after the contribution;

2. made by a related party but no more than 10% of the total value of the loss corporation's stock is issued in connection with the contribution, or the contribution is made by a person other than a related party, and in either case there was no agreement, understanding, arrangement, or substantial negotiations at the time of the contribution regarding a transaction that would result in an ownership change, and the ownership change occurs more than one year after the contribution;
3. made in exchange for stock issued in connection with the performance of services, or stock acquired by a retirement plan, under the terms and conditions of Reg. § 1.355-7(d)(8) or (9), respectively; or
4. received on the formation of a loss corporation (not accompanied by the incorporation of assets with a net unrealized built in loss) or received before the first year from which there is a carryforward of a net operating loss, capital loss, excess credit, or excess foreign taxes (or in which a net unrealized built-in loss arose).

“Principal Purpose” Test

The fact that a contribution is not described in one of the safe harbors does not constitute evidence that the contribution is part of a Plan. If, based on all facts and circumstances, a contribution is not part of a Plan (the principal purpose of the contribution is not to avoid or increase a section 382 limitation), then the contribution to an old loss corporation will be taken into account and not reduce the loss corporation's value.

No Duplication of Reductions in Value

The Notice permits appropriate adjustments if the value of the old loss corporation is subject to reduction under both sections 382(l)(1) and 382(l)(4) (reduction because new loss corporation has substantial non-business assets immediately following an ownership change) to avoid duplicating reductions in value.

Reliance on Notice

The Treasury Department and the IRS intend to issue regulations regarding the issues addressed in the Notice. Taxpayers may rely on the Notice for ownership changes that occur in any taxable year ending on or after September 26, 2008. The Notice's rules will continue to apply until the IRS issues additional guidance.

Comments Requested

The IRS requests comments regarding:

1. the appropriate scope and application of section 382(l)(1);
2. the appropriate factors that may tend to show that a capital contribution is or is not made as part of a Plan, including standards for contributions made by related parties;
3. the desirability of applying standards similar to those in Reg. §1.355-7 as safe harbors for purposes of section 382(l)(1), and whether additional safe harbors are needed; and
4. the appropriate treatment under section 382(l)(1) of options and conversion rights in general, and whether coordinating rules should be issued under §1.382-4(d).

The due date for submitting comments is December 22, 2008. Please provide any comments to Keith Lawson (202-326-5832 or lawson@ici.org), Karen Lau Gibian (202-371-5432 or kgibian@ici.org) or Lisa Robinson (202-326-5835 or lrobinson@ici.org) by November 28, 2008.

Lisa Robinson
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[Attachment](#)

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