

**MEMO# 3667**

April 3, 1992

## **FINAL REGULATIONS UNDER SECTION 382 DEFINE "ENTITY" FOR PURPOSES OF DETERMINING OWNERSHIP CHANGES**

April 3, 1992 TO: TAX MEMBERS NO. 22-92 ACCOUNTING/TREASURERS MEMBERS NO. 19-92  
RE: FINAL REGULATIONS UNDER SECTION 382 DEFINE "ENTITY" FOR PURPOSES OF DETERMINING OWNERSHIP CHANGES

As you know, the rules under Internal Revenue Code sections 382 and 383 provide certain limitations on the ability of corporations to utilize certain tax attributes, such as capital loss carryforwards, following "ownership changes." (See, e.g., Institute Memorandum to Tax Members No. 46-91 and Accounting/ Treasurers Members No. 30-91, dated November 4, 1991.) To trigger an ownership change, the percentage of stock owned by "5- percent shareholders" must increase by more than 50 percentage points over the lowest percentage of stock of such corporation owned by such stockholders at any time during the prior three- year period. The regulations under sections 382 and 383 provide detailed rules for determining when certain groups of shareholders (known as "public groups") are to be treated as 5- percent shareholders. The attached final regulations define the term "entity" (which can be the basis for treating a group of shareholders as a separate 5-percent shareholder) to include "a group of persons who have a formal or informal understanding among themselves to make a coordinated acquisition of stock." In determining whether such an understanding exists, a "principal element" is whether "the investment decision of each member of a group is based upon the investment decision of one or more other members." One instance in which this determination could be relevant is where different funds in a fund complex acquire shares of a particular corporation at approximately the same time. Several examples in the regulation provide guidance on whether an "understanding" exists to make a coordinated acquisition of stock. In example 3, an investment adviser advised its clients that it believed a company's stock was undervalued and recommended that the company's shares be acquired. The 20 unrelated individuals who purchased stock based upon the investment adviser's recommendation are not treated as an entity because each investor's decision was not based upon the investment decisions made by one or more other clients. The - 1 - example further indicates that the same "no entity" conclusion would be reached if a trustee of several qualified trusts sponsored by unrelated corporations caused each trust to purchase the company's stock, so long as the investment decision made on behalf of each trust was not based on the investment decision made on behalf of one or more of the other trusts. The regulation generally applies to testing dates on or after November 20, 1990. In the case of a group of regulated investment companies ("RICs") that enter a formal or informal understanding to acquire shares of a company's stock before November 20,

1990, the regulation shall apply to testing dates on or after November 20, 1990 only if the group increases its ownership investment in the company relative to its percentage ownership investment at the close of November 19, 1990 by five percentage points or more on or after November 20, 1990. We will keep you informed of developments. Keith D. Lawson Associate Counsel - Tax Attachments

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