

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1**

[REG-141268-11]

RIN 1545-BK73

**Allocation of Earnings and Profits in Tax-Free Transfers From One Corporation to Another****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations under section 312 of the Internal Revenue Code (Code). The proposed regulations clarify the regulations under section 312 regarding the allocation of earnings and profits in tax-free transfers from one corporation to another. The proposed regulations affect corporations involved in these transfers and their shareholders.

**DATES:** Written or electronic comments and requests for a public hearing must be received by July 16, 2012.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-141268-11), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-141268-11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Submissions may also be sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-141268-11).

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, Stephanie D. Floyd at (202) 622-7930 or Isaac W. Zimbalist at (202) 622-7550 (not toll-free numbers); concerning submissions of comments and/or requests for a public hearing, Oluwafunmilayo (Fumni) Taylor, at 202-622-7180.

**SUPPLEMENTARY INFORMATION:****Background and Explanation of Provisions**

This document contains proposed amendments to 26 CFR part 1 concerning the allocation of earnings and profits in tax-free transfers from one corporation to another. The IRS has historically interpreted the regulations under section 312 as providing that the earnings and profits of the transferor corporation do not move to the transferee in whole or in part other than in a transfer described in section 381 or,

to the extent provided under § 1.312-10, in a divisive reorganization. Furthermore, the IRS has interpreted the regulations to provide that in a corporate reorganization described in section 381, the acquiring corporation, as defined in § 1.381(a)-1(b)(2), succeeds to the full earnings and profits account of the transferor corporation. Thus, the earnings and profits account is not divided if the acquiring corporation in an acquisitive asset reorganization subsequently transfers target assets to one or more controlled subsidiaries. Practitioners have suggested that this result may be unclear under current law. See § 1.381(c)(2)-1(d) (providing that where part of the acquired assets is transferred to one or more controlled corporations, or all of the acquired assets are transferred to two or more controlled corporations, the allocation of earnings and profits is made without regard to section 381); § 1.312-11(a) (providing for proper adjustment and allocation of earnings and profits with respect to asset transfers in connection with reorganizations, and cross-referencing the section 381 regulations for specific rules).

Consistent with the longstanding administrative position, the proposed regulations clarify that, except as provided in § 1.312-10, if property is transferred from one corporation to another and no gain or loss is recognized, no allocation of the earnings and profits of the transferor is made to the transferee unless the transfer is described in section 381(a). The proposed regulations further clarify that, in a transfer described in section 381(a), only the acquiring corporation, as defined in § 1.381(a)-1(b)(2), succeeds to the earnings and profits of the distributor or transferor corporation (within the meaning of § 1.381(a)-1(a)).

The IRS and Treasury Department believe the proposed rule is appropriate because earnings and profits measures the capacity of a corporation to pay dividends to its shareholders and the corporation that has an interest, directly or indirectly, in all of the target's assets has the dividend-paying capacity that is most comparable to that of the target. Further, the IRS and Treasury Department believe the rules for the allocation of earnings and profits should conform to the rules for the allocation of other tax attributes under section 381.

**Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It

has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Comments and Requests for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

**Drafting Information**

The principal author of these proposed regulations is Stephanie D. Floyd of the Office of Associate Chief Counsel (Corporate). Other personnel from the IRS and Treasury Department participated in their development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

**PART 1—INCOME TAXES**

**Paragraph 1.** The authority citation for part 1 continues to read, in part, as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

**Par. 2.** Section 1.312-11 is amended by revising paragraph (a) and adding paragraph (e) to read as follows:

**§ 1.312-11 Effect on earnings and profits of certain other tax-free exchanges, tax-free distributions, and tax-free transfers from one corporation to another.**

(a) In a transfer described in section 381(a), the acquiring corporation, as defined in § 1.381(a)-1(b)(2), and only that corporation, succeeds to the earnings and profits of the distributor or transferor corporation (within the

meaning of § 1.381(a)–1(a)). Except as provided in § 1.312–10, in all other cases in which property is transferred from one corporation to another and no gain or loss is recognized (or is recognized only to the extent of the property received other than that permitted to be received without the recognition of gain), no allocation of the earnings and profits of the transferor is made to the transferee.

\* \* \* \* \*

(e) *Effective/Applicability date.*

Paragraph (a) of this section applies to transactions occurring on or after the date of publication of the Treasury decision adopting this rule as a final regulation in the **Federal Register**.

**§ 1.381(c)(2)–1(d) [Removed]**

**Par. 3.** Section 1.381(c)(2)–1(d) is removed.

**Steven T. Miller,**

*Deputy Commissioner for Services and Enforcement.*

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[REG–139991–08]

**RIN 1545–B184**

**Certain Transfers of Property to Regulated Investment Companies [RICs] and Real Estate Investment Trusts [REITs]**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed amendments to regulations under section 337(d) of the Internal Revenue Code. The proposed regulations provide guidance concerning certain transfers of property from a C corporation to a Regulated Investment Company (RIC) or a Real Estate Investment Trust (REIT) and will affect the parties to such transactions. This document also invites comments from the public regarding these proposed regulations.

**DATES:** Written or electronic comments and requests for a public hearing must be received by July 16, 2012.

**ADDRESSES:** Send submissions to: CC:PA:LDP:PR (REG–139991–08), room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions

may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LDP:PR (REG–139991–08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG–139991–08).

**FOR FURTHER INFORMATION CONTACT:**

Concerning the proposed regulations, Grid Glycer (202) 622–7930 or Maury Passman (202) 622–7750 with respect to the corporate issues, and David H. Kirk (202) 622–3060 with respect to the partnership issues; concerning submissions of comments, Oluwafunmilayo Taylor (202) 622–7180 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

**Background**

Congress repealed the *General Utilities* doctrine in the Tax Reform Act of 1986 (Pub. L. 99–514, 100 Stat. 2085), as amended by the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100–647, 102 Stat. 3342), when sections 336 and 337 of the Internal Revenue Code were amended to require corporations to recognize gain or loss on the distribution of property in connection with complete liquidations other than certain subsidiary liquidations. Section 337(d)(1) directs the Secretary to prescribe regulations as may be necessary to carry out the purposes of *General Utilities* repeal, including rules to “ensure that such purposes may not be circumvented \* \* \* through the use of a regulated investment company, a real estate investment trust, or tax-exempt entity \* \* \*.”

On March 18, 2003, regulations under § 1.337(d)–7 (the regulations) were published in the **Federal Register** (TD 9047, 68 FR 12817). The regulations generally provide (in paragraphs (a) and (b)(1)) that if property of a C corporation (the C corporation transferor) becomes the property of a RIC or REIT by the qualification of that C corporation as a RIC or REIT or by the transfer of assets of that C corporation to a RIC or REIT (a conversion transaction), then the RIC or REIT will be subject to tax on the net built-in gain in the converted property under the rules of section 1374 and the underlying regulations. This treatment, however, does not apply if the C corporation transferor elects to recognize gain and loss as if it sold the converted property to an unrelated party at fair market value (deemed sale treatment).

**Explanation and Summary of Comments**

This preamble first discusses the proposal as it relates to net built-in gain property acquired by a RIC or REIT either in a like-kind exchange (where the C corporation transferor's gain is not recognized by reason of section 1031) or in an involuntary conversion (where such gain is not recognized by reason of section 1033). This preamble then discusses a proposed revision to the definition of a C corporation in the regulations, which provides that a transfer of property by a tax-exempt entity to a RIC or REIT is not treated as a conversion transaction unless the tax-exempt entity would have been subject to tax if a deemed sale election had been made.

In addition, the proposed regulations also add definitions for the terms RIC, REIT, and S corporation. While these terms are not explicitly defined in the regulations, their meanings are both self-evident and unambiguous in that context. Nonetheless, for clarification and ease of use, the proposed regulations add explicit definitions.

*A. Like-Kind Exchanges and Involuntary Conversions*

The current regulations generally provide that if property of a C corporation becomes the property of a RIC or REIT in a conversion transaction, then, absent a deemed sale election, the RIC or REIT will be subject to tax on the net built-in gain in the converted property under the rules of section 1374 and the underlying regulations (as modified in paragraph (b) of the regulations), as if the RIC or REIT were an S corporation.

Commentators have expressed concern that the general rule may inappropriately expose property transferred in certain exchanged basis transactions—specifically, like-kind exchanges and involuntary conversions—to this treatment. In these transactions, the C corporation transferor replaces property it transferred to a RIC or REIT with property that has an equivalent basis and built-in gain, and as a result, the built-in gain remains subject to corporate tax in the hands of the transferor. Therefore, there would not be any circumvention of the purposes of *General Utilities* repeal. Section 1.337(d)–4(b)(3) provides an exception in an analogous context (where a C corporation transfers all or substantially all of its assets to a tax-exempt entity) to the extent the transaction qualifies for nonrecognition treatment under section 1031 or section 1033.