

# **CLEANING UP THE ORGANIZATION CHART: TAX OPPORTUNITIES AND PITFALLS**

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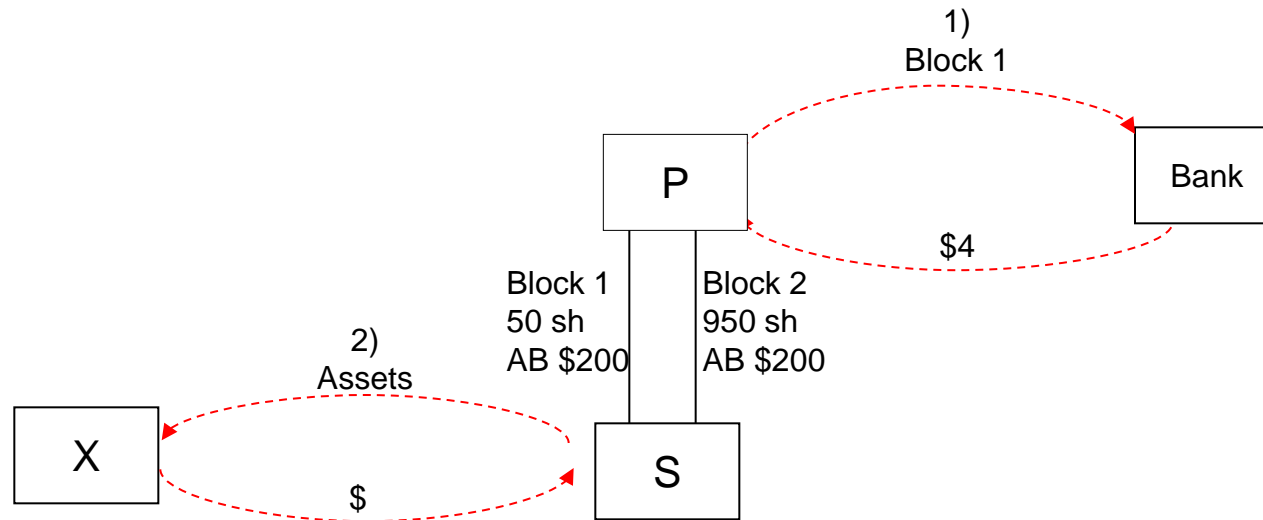
## **SUPPLEMENTAL SLIDES**

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September 25, 2013

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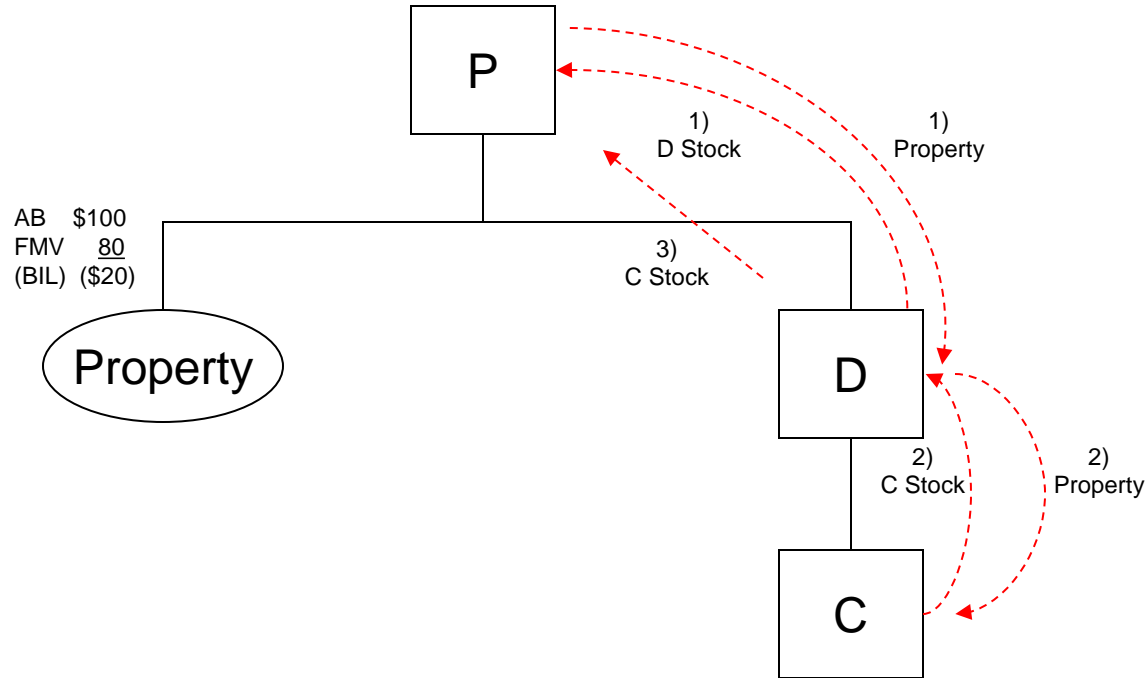
# Duquesne Light Holdings, Inc. v. Commissioner, T.C. Memo. 2013-216

## Consolidated Return Double Deduction



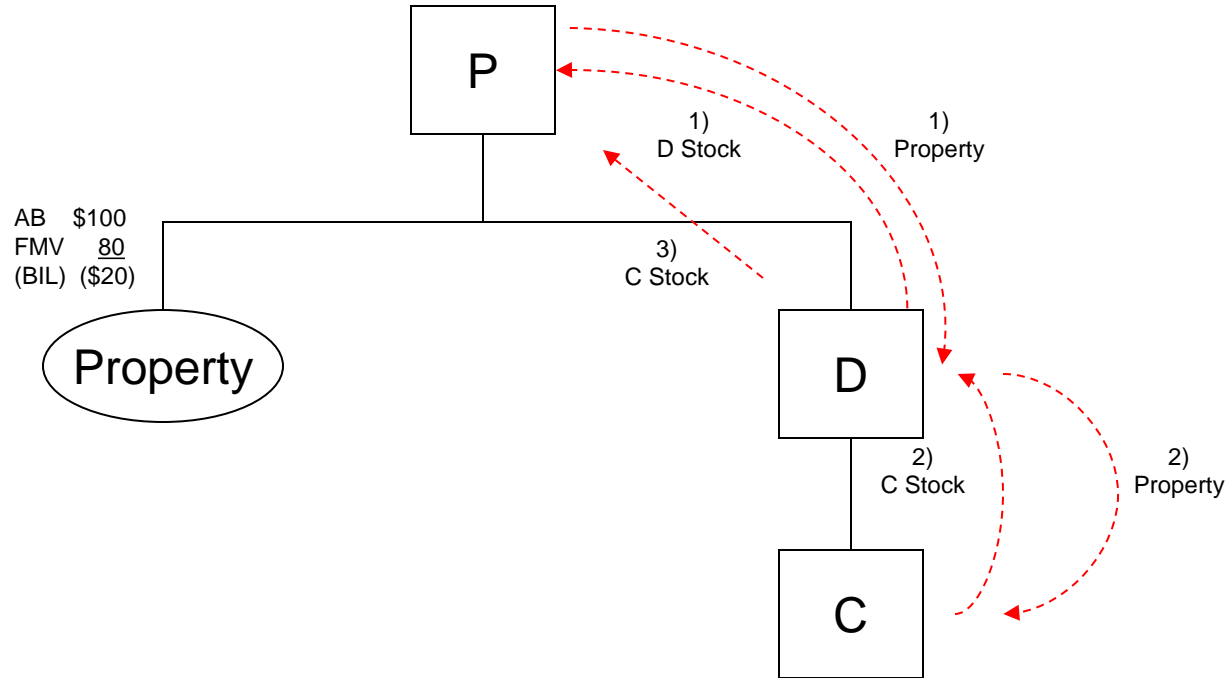
- P and S are members of P's consolidated group.
- 1) In 2001, P sells Block 1 of (50 of its 1,000 shares of S stock) to Bank for \$4 (\$196 loss). S continues as a P group member.
- 2) In 2002-2003, S sells all its assets to X at a loss.
- Court disallows loss on asset sale, to the extent the same economic loss was reflected in the loss on the sale of Block 1. *Charles Iffeld Co. v. Hernandez*, 292 U.S. 62 (1934);
  - Court applies the same analysis used in a contingent liability tax shelter case (*Thrifty Oil Co. v. Commissioner*, 139 T.C. 198 (2012)).
  - Court does not address the validity of the disproportionately large basis in Block 1 to evaluate the loss on the sale of Block 1.

# Sections 336(e), 355 and 362(e)(2): Facts



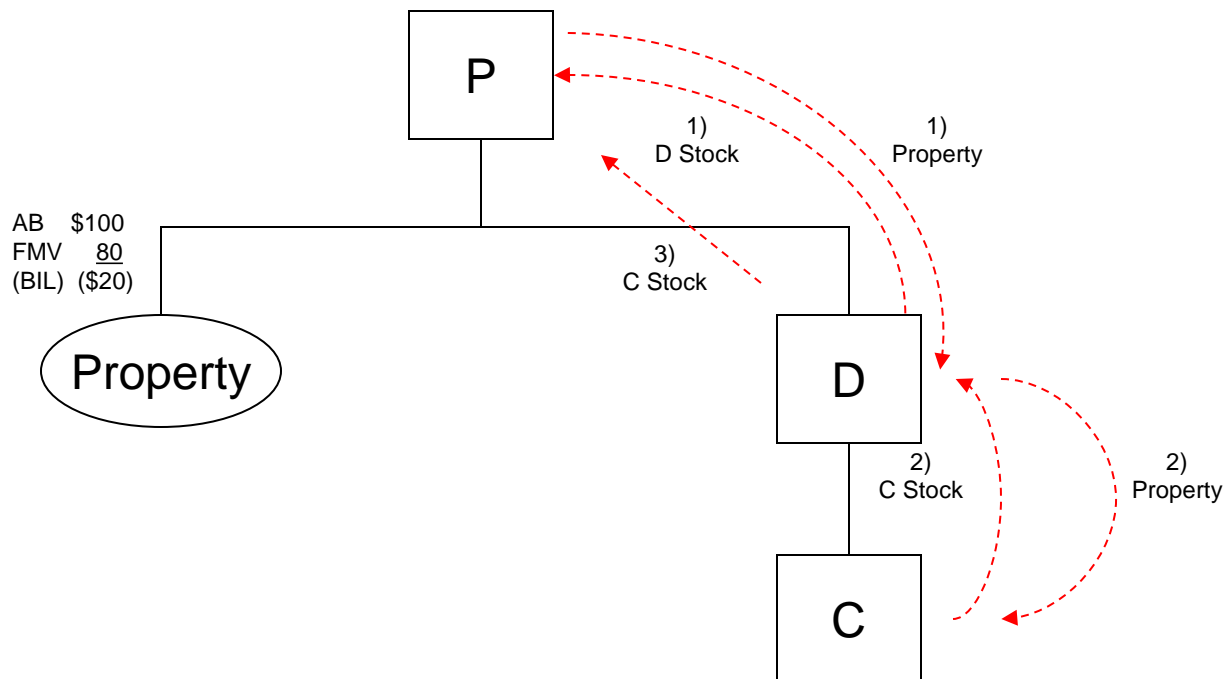
- 1) P transfers Property to D in exchange for D stock.
- 2) D transfers Property to C in exchange for C stock.
- 3) D distributes the C stock to P.

# Sections 355, 336(e) and 362(e)(2): Step I Analysis



- Step I is likely a §351 exchange. If so, §362(e)(2) APPLIES.
  - D's basis in Property is reduced from \$100 to \$80.
  - Or, P may elect to reduce its basis in the D stock by \$20 and allow D its full \$100 basis in Property. §362(e)(2)(C).

# Sections 355, 336(e) and 362(e)(2): Steps 2 and 3 Analysis



- Step 2 is a §351 exchange and also may qualify under §361.

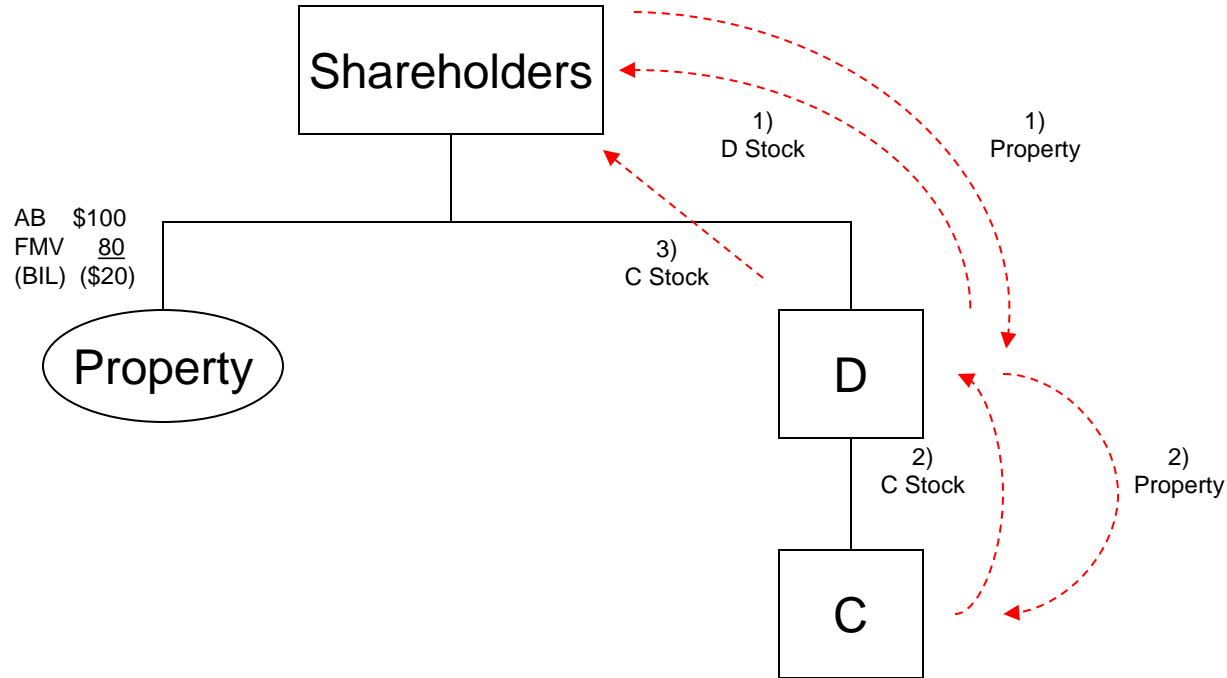
○ If—

- In Step 1 P elects to reduce its basis in the D stock, and
- Step 3 is tax-free under §355,  
§362(e)(2) DOES NOT APPLY to Step 2. C's basis in Property remains \$100. Reg. §1.362-4(c)(1).

If Step 3 is not tax-free under §355 or is subject to §355(d) or (e), §362(e)(2) DOES APPLY to Step 2.

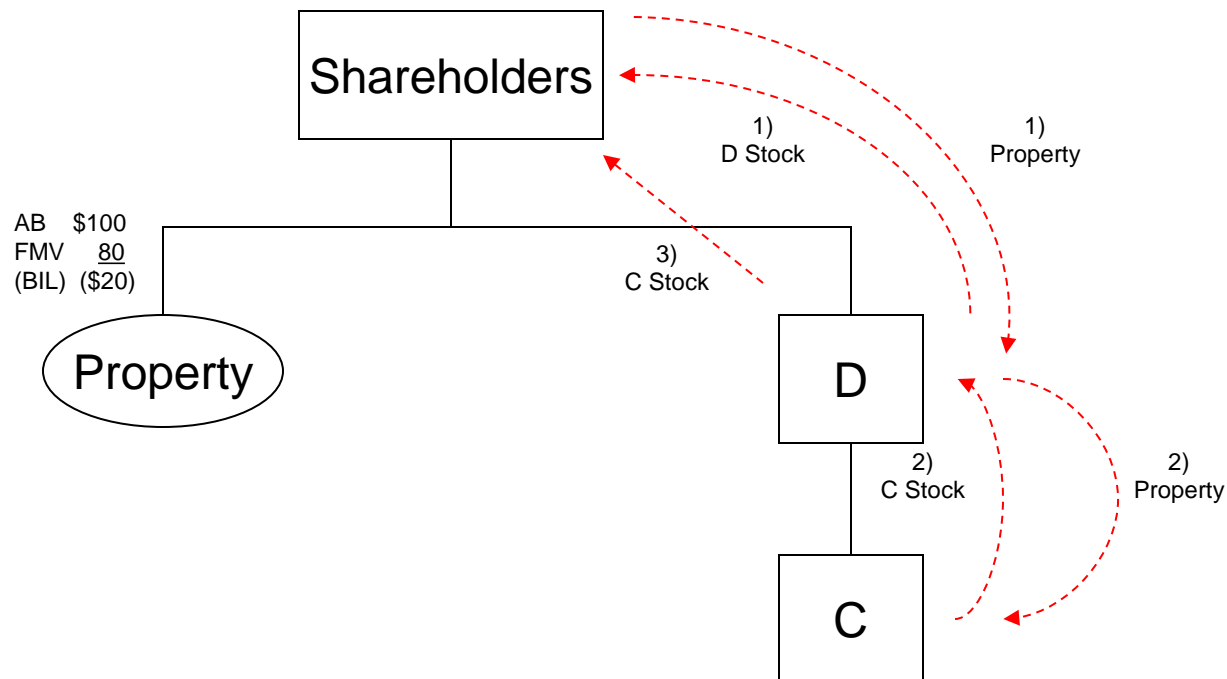
- C's basis in Property is reduced from \$100 to \$80.
- Or, D may elect under §362(e)(2)(C) to reduce its basis in the C stock by \$20 and so increase its gain, or reduce its (disallowed) loss on the distribution of the C stock, by \$20.
- Because P and D are “related persons,” D may not make a §336(e) election for Step 3.

# Sections 355, 336(e) and 362(e)(2) Variation: Facts



- Several unrelated persons hold the D stock (instead of P), with no  $\geq 50\%$  shareholder.
- In Step 1, Shareholders elect, under §362(e)(2)(C), to reduce their basis in the D stock, instead of D reducing its basis in Property.
- Step 3 is not tax-free under §355, or it is subject to §355(d) or (e).

## Sections 355, 336(e) and 362(e)(2) Variation: Steps 2 and 3 Analysis



D may make a §336(e) election for Step 3. There are four possible outcomes:

- **§362(e)(2)(C) election in Step 2 / §336(e) election in Step 3.** Deemed sale by C of its assets, including Property. C's net gain or (disallowed) loss reflects historic \$100 basis in Property. Basis in C stock is eliminated, so that reduction in stock basis under §362(e)(2)(C) has no effect.
- **§362(e)(2)(C) election in Step 2 / No §336(e) election in Step 3.** Gain on C stock is recognized to D. Any such gain is increased by the \$20 reduction in D's basis in the C stock.
- **No §362(e)(2)(C) election in Step 2 / §336(e) election in Step 3.** Deemed sale by C of its assets, including Property. C's net gain or (disallowed) loss reflects reduced basis in Property (\$80). Full basis of C stock (increased by \$100 in Step 2) is eliminated with no effect.
- **No §362(e)(2)(C) election in Step 2 / No §336(e) election in Step 3.** Gain on C stock is recognized to D. Any such gain reflects \$100 increase to D's basis in the C stock, in Step 2. C's basis in Property is \$80 instead of \$100.