Philadelphia Tax Conference

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Agenda

- Guidance Update
- Section 355
- Corporate Alternative Minimum Tax
- Stock Buyback Excise Tax
- Section 1202: Qualified Small Business Stock
- Notice 2025-45 Regarding Section 368(a)(1)(F) Reorganizations
- One Big Beautiful Bill Act
- Section 269
- Economic Substance Doctrine, including the *Liberty Global* Case

Guidance Update

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Treasury/IRS Guidance Priorities

- The 2025-2026 Treasury/IRS Priority Guidance Plan (PGP) was released on September 30, 2025.
- The Biden Administration guidance priorities were directed to implementing the 2022 Inflation Reduction Act (IRA), including the energy provisions, the 1% excise tax on stock repurchases, and the 15% corporate alternative minimum tax.
- In contrast, the Trump Administration guidance priorities are implementing the One Big Beautiful Bill Act (OB3) and eliminating or modifying Biden-era guidance.

Notice 2025-19

- Executive Order 14219 (Feb. 19, 2025) states that the policy of the second Trump Administration is to focus the executive branch's limited resources on regulations squarely authorized by constitutional federal statutes.
- As stated in Executive Order 14219, Treasury and the IRS are focused on addressing (i) unconstitutional regulations; (ii) regulations based on unlawful delegations of legislative power; (iii) regulations not based on the best reading of the statute; (iv) regulations that implicate matters of significance that are not authorized by clear statutory authority; (v) regulations that impose significant costs on private parties that are not outweighed by public benefits; (vi) regulations that harm the national interest; and (vii) regulations that impose undue burdens on small business and impede private enterprise.
- Executive Order 14192 (Jan. 31, 2025) states that for each new regulation issued, at least 10 prior regulations must be identified for elimination.

Corporate Tax Items on 2025-2026 PGP

- Guidance under section 263 and related Code sections regarding the treatment of capitalized costs for section 355 distributions and reorganizations.
- Regulations under sections 355 and 361 regarding matters addressed in Rev. Proc. 2024-24. (Proposed regulations were issued on January 13, 2025, and withdrawn on September 29, 2025.)
- Not included on the 2025-2026 PGP are regulations relating to the device and active trade or business requirements.
  - Proposed regulations regarding active trade or business were issued in May 2007.
  - Proposed regulations regarding device and active trade or business were issued in July 2016.
  - September 2018 IRS Statement, Rev. Rul. 2019-09, and May 2019 request for information regarding the need for collection of income for purposes of active trade or business.
  - Project to repropose 2007 and 2016 proposed regulations is now dormant?

Corporate Tax Items on 2025-2026 PGP (cont'd)

- Proposed regulations under section 382(h)(6).
  - Proposed regulations were issued in September 2019 and in January 2020. Both were withdrawn on July 2, 2025.
  - Notice 2003-65 remains in effect.
- Regulations under section 1502 regarding life-nonlife consolidated groups.
- Final regulations regarding computation of the excise tax under section 4501 on the repurchase of corporate stock. (Discussed below.)

Corporate Tax Items on 2025-2026 PGP (cont'd)

- Other Tax Issues
  - Corporate Alternative Minimum Tax (Discussed below.)
  - Section 163(j)
- Note that all of the corporate tax items on the 2025-2026 PGP mentioned on these slides (except section 163(j)) are listed under the topic Deregulation and Burden Reduction.

Rev. Proc. 2023-26: Fast-Track Processing of Corporate PLRs

- Rev. Proc. 2022-10, which was issued in January 2022, initiated an 18-month pilot program to provide fast-track processing of private letter rulings (PLRs) solely or primarily within the jurisdiction of the IRS Chief Counsel corporate division. In July 2023, Rev. Proc. 2023-26 made the program permanent.
- If a taxpayer requests fast-track processing and the request is granted, the IRS will endeavor to issue the PLR within 12 weeks. The normal time period to receive a PLR is four to six months.
- In order to obtain fast-track processing, the taxpayer must request a pre-submission conference, must provide a statement setting forth the reasons for requesting fast-track processing, must agree to provide any additional information requested by the IRS within seven business days, and must submit a draft letter ruling.

Rev. Procs. 2025-1 and 2025-3

- The IRS has changed its procedures for PLRs within the jurisdiction of the corporate division.
- Before 2024 the corporate division ruled only on significant subissues in liquidations, incorporations and reorganizations. In contrast, for spinoffs, the corporate division would give full transactional or subissue rulings, as requested.
- Now the corporate division will give full transactional rulings in liquidations, incorporations and reorganizations, as well as spinoffs. For example, in PLR 202531001 (May 7, 2025), the IRS gave full rulings on a section 368(a)(1)(B) reorganization.
- The IRS will need to develop standard representations for the new areas in which it will give full transactional rulings. (See ABA Tax Section Comments of March 5, 2024.)
- In addition, for spinoffs, the corporate division will now rule on device and section 355(e), but not business purpose.
- There will be no more PLRs on significant subissues, even if the taxpayer does not want a full transactional ruling.

Section 385 Regulations – A Reminder

- In November 2019, Treasury/IRS revoked the Reg. § 1.385-2 documentation rule.
- Also in November 2019, Treasury/IRS announced they will retain the Reg. § 1.385-3 recharacterization rules in order to address U.S. base erosion concerns, despite requests to revoke the rules as unnecessary after enactment of section 163(j) and BEAT in the Tax Cuts and Jobs Act ("TCJA").
- In addition, Treasury/IRS announced they will issue proposed regulations to modify the Reg. § 1.385-3 recharacterization rules to make them more streamlined and targeted.
- The project to modify the recharacterization rules is dormant, so the recharacterization rules remain in place. Will the second Trump administration consider revoking the recharacterization rules?

Section 355

Spinoff Ruling Guidelines: Rev. Proc. 2024-24 and Notice 2024-38

- On May 1, 2024, Treasury and IRS issued Rev. Proc. 2024-24, which revised the standards for issuing private letter rulings (PLRs) under section 355.
- Rev. Proc. 2024-24 replaced prior ruling standards in Rev. Proc. 2018-53 and modified the ruling standards in Rev. Proc. 2017-52.
- The guidelines in Rev. Proc. 2024-24 were more restrictive than prior ruling standards in several significant ways.
- Rev. Proc. 2024-24 was accompanied by Notice 2024-38, which provided Treasury and IRS views and concerns relating to matters contained in Rev. Proc. 2024-24.

Spinoff Ruling Guidelines: Rev. Proc. 2024-24 and Notice 2024-38 (cont'd)

- Concerns reflected in Rev. Proc. 2024-24 and Notice 2024-38, as well as in the January 2025 proposed regulations, included (but were not limited to):
  - Debt allocation between the distributing corporation and the controlled corporation, including the use of direct issuances of debt by the distributing corporation that are exchanged for controlled corporation stock or securities;
  - Delayed distributions of controlled corporation stock;
  - Solvency and viability of the distributing corporation and the controlled corporation; and
  - Sufficiency of information reporting to the IRS.

Proposed Regulations Regarding Spinoffs

- Treasury and the IRS issued proposed regulations on January 13, 2025, implementing the positions in Rev. Proc. 2024-24 and Notice 2024-38.
- The IRS announced that it would follow the proposed regulations in administering PLR requests.

Proposed Regulations Regarding Incorporations and Reorganizations

- The proposed regulations issued on January 13, 2025, included provisions addressing corporate incorporations and acquisitive reorganizations (in addition to the spinoff rules discussed above).
- Proposed regulations under section 357 included:
  - Revised rules for determining when a liability is treated as assumed and in what amount;
  - A presumption that the assumption of a liability has a principal purpose of tax avoidance (or non-business purpose) if not incurred in the ordinary course of business; and
  - Provisions addressing the determination of gain when liabilities are assumed in excess of basis under section 357(c) (in divisive reorganizations and section 351 exchanges).

Proposed Regulations Regarding Incorporations and Reorganizations (cont'd)

- Proposed regulations under section 368 included:
  - Revisions to the definitions of "party to a reorganization";
  - New record-keeping requirements; and
  - Detailed rules regarding the determination of a "plan of reorganization" (Prop. Reg. § 1.368-4).

Elimination of Rev. Proc. 2024-24, Notice 2024-38, and the Proposed Regulations

- On September 29, 2025, Treasury and the IRS withdrew the proposed regulations issued on January 13, 2025, regarding spinoffs, incorporations, and reorganizations.
- Also on September 29, 2025, in Notice 2025-30, Treasury and the IRS superseded Rev. Proc. 2024-24 and revoked Notice 2024-38.
- In doing so, prior PLR ruling standards in Rev. Proc. 2017-52 (before modification by Rev. Proc. 2024-24) were restored, as well as the prior PLR ruling standards in Rev. Proc. 2018-53 (which was temporarily superseded by Rev. Proc. 2024-24).

Some Open Questions

- In this new environment, what positions will the IRS take in the PLR process regarding particular section 355 issues?
- What positions will tax advisors rendering opinions take regarding particular section 355 issues?
- Will the 2024-2025 events affect IRS and taxpayer behavior?
- Presumably the IRS will no longer follow the January 2025 proposed regulations in the PLR process. But will those proposed regulations, Rev. Proc. 2024-24, and Notice 2024-38 have a lingering effect on the PLR process?
- Will the IRS once again issue rulings on significant subissues?

Corporate Alternative Minimum Tax

Corporate Alternative Minimum Tax (CAMT)

- Enacted in the IRA, CAMT imposes a 15% minimum tax on the "adjusted financial statement income" (AFSI) of "applicable corporations."
- The CAMT is effective for taxable years beginning in 2023 and thereafter.
  - However, many aspects will require the projection of CAMT rules back into prior years to determine applicability and the tax base.

CAMT: Two Part Analysis

If there is an
Applicable Corporation
(uses >$1 billion threshold)

then

Potential CAMT liability
= (15% AFSI – CAMT foreign tax credits) – (regular tax + the base erosion anti-abuse tax)

Scope Determination

- CAMT applies to corporations if aggregate average annual adjusted financial statement income (AFSI) over a three-year period exceeds $1 billion.
- Average annual AFSI is determined without regard to section 56A(d) (financial statement NOL carryovers).
- Excludes S corporations, RICs, and REITs.
- Tax aggregation rules apply.
- For foreign-parented multinational groups (FPMG): (1) average AFSI of all members must exceed $1 billion, and (2) average AFSI of U.S. members (and U.S. trades or businesses of foreign subsidiaries) must exceed $100 million.
- In-scope status, once attained, is hard to shed.

Liability Determination

- General business credits are allowed to offset up to approximately 75% of combined regular tax and CAMT.
- Not every applicable corporation will pay CAMT. It is an alternative minimum tax, and the regular tax system has a rate that is six percentage points higher.
- Similar to the AMT tax credit under pre-2018 corporate AMT, corporations can claim a tax credit for CAMT paid in prior years against regular income tax, to the extent regular tax exceeds the tentative minimum tax for such taxable year.

Recent CAMT Notices

- Notice 2025-27 (June 2, 2025):
  - Interim simplified method for determining applicable corporation status;
  - Waiver of estimated tax penalties for any tax year beginning after Dec. 31, 2024, and before Jan. 1, 2026; and
  - Statement of intention to issue additional interim guidance, including AFSI adjustments for certain corporate transactions.
- Notice 2025-28 (July 29, 2025):
  - Interim guidance simplifying application of CAMT to partnerships.

Additional Recent CAMT Notices

- Notice 2025-46 (September 30, 2025):
  - Interim guidance regarding domestic corporate transactions, financially troubled corporations, and consolidated groups.
- Notice 2025-49 (September 30, 2025):
  - Interim guidance on a variety of issues, including for example certain depreciation deductions that previously gave rise to a net operating loss carryover for regular tax purposes, and section 197 amortization attributable to tax goodwill acquired in certain transactions.

Stock Buyback Excise Tax

Stock Buyback Excise Tax

- Redemptions of stock are taxable under section 302. Many redemptions result in sale or exchange treatment for the redeemed shareholders (and not dividend treatment). Section 1059 applies to certain non-pro-rata redemptions treated as dividends. Section 162(k) denies a deduction to the redeeming corporation.
- Enacted in the IRA, section 4501 imposes a 1% excise tax on a publicly traded U.S. corporation for the value of its stock that is repurchased by the corporation during the taxable year and not offset by the "netting rule" described below.
- The term repurchase means a redemption within the meaning of section 317(b) with regard to the stock of such corporation, and any other economically similar transaction as determined by the Secretary of Treasury.

Stock Buyback Excise Tax (cont'd)

- The stock buyback excise tax applies to repurchases in 2023 and thereafter.
- On December 27, 2022, Treasury and IRS issued Notice 2023-2 regarding the excise tax.
- On April 12, 2024, the Treasury and IRS issued two sets of proposed regulations, proposed procedural regulations and proposed computational regulations.
- Many of the rules in the proposed regulations are consistent with Notice 2023-2, in some instances notwithstanding critical commentary about the comparable provisions in the Notice.
- On June 28, 2024, the Treasury and IRS issued final procedural regulations. The computational regulations were not finalized.

Calculating the Stock Buyback Excise Tax

- Step 1: Determine the FMV of all repurchases of the covered corporation's stock during the taxable year.
  - If the total amount of such repurchases does not exceed $1 million, no stock buyback excise tax is due.
- Step 2: The amount of repurchases is reduced by the FMV of:
  - Any stock issued during the tax year, including the FMV of stock issued or provided to employees of the covered corporation and its specified affiliates (the "netting rule"), and
  - Any excluded repurchases (next slide).
- Step 3: The stock buyback excise tax liability = 1% of the stock buyback excise tax base, i.e., total repurchases in Step 1 minus reductions in Step 2.

Statutory Exceptions

- The excise tax does not apply to certain repurchases to the extent:
  1. the repurchase is part of a fully tax-free reorganization;
  2. the repurchased stock or its value is contributed to an employee pension plan, ESOP, or similar plan;
  3. the total amount of stock repurchases within the year is less than $1 million (the “de minimis exception”);
  4. the purchase is by a dealer in securities in the ordinary course of business;
  5. the repurchase is treated as a dividend; or
  6. the repurchase is by a RIC or REIT.

Statutory Exceptions (cont'd)

- Under the proposed regulations:
  - Buybacks covered by the statutory exceptions count as "repurchases" toward the de minimis exception threshold; and
  - The statutory exceptions do not relieve reporting requirements under the excise tax.

Repurchase

- A repurchase means:
  - A redemption within the meaning of section 317(b) with regard to the stock of a covered corporation; and
  - Any transaction determined by the Secretary to be economically similar.
- A repurchase includes a partial liquidation that is not in form a redemption.
- The proposed regulations provide (among other rules):
  - An exclusive list of transactions that ARE redemptions under section 317(b) but are NOT repurchases:
    - A deemed redemption of covered corporation stock under section 304(a)(1), and
    - Payment of cash in lieu of fractional shares.

Repurchase (cont'd)

- The proposed regulations provide an exclusive list of transactions that are "economically similar" to redemptions; and
- A non-exclusive list of transaction that are NOT "economically similar" to redemptions:
  - A distribution in complete liquidation of a covered corporation or a covered surrogate foreign corporation (as appropriate) to which either section 331 or section 332(a) applies in full; and
  - A spinoff under section 355, but the retirement of Distributing stock with SpinCo debt securities is a repurchase subject to the excise tax.
  - Dividends not in the form of redemptions governed by section 301(c)(2) or (3).

Repurchase (cont'd)

- There is no special relief for preferred stock except for bank "additional tier 1 preferred stock,"
  - But preferred stock is also stock for purposes of the netting rule.
- The repurchase of options and debt are not repurchases subject to the excise tax unless those instruments are treated as stock on issuance under general tax principles.
- However, there is a special rule for instruments treated as stock for tax purposes but not issued in the legal form of stock: they don't get issuance credit under the netting rule until repurchased and then at the lesser of issuance value or redemption value.
  - This is meant to be an anti-abuse rule.
  - But the rule is potentially broader: e.g., penny warrants?

Economically Similar Transactions

- Acquisitive reorganizations - the exchange by target shareholders of their covered corporation stock as part of an acquisitive reorganization is a repurchase by the target corporation, even reverse triangular mergers under section 368(a)(2)(E).
- Reorganizations under section 368(a)(1)(E) - the exchange by the recapitalizing corporation shareholders of their covered corporation stock as part of an E reorganization is a repurchase by the recapitalizing corporation.
- Reorganizations under section 368(a)(1)(F) - the exchange by the transferor corporation shareholders of their covered corporation stock as part of an F reorganization is a repurchase by the transferor corporation.
- Splitoffs - the exchange by the distributing shareholders of their covered corporation stock for controlled corporation stock and, if applicable, other property, is a repurchase by the distributing corporation.

Economically Similar Transactions (cont'd)

- Complete liquidations to which both sections 331 and 332 apply - in the case of a complete liquidation of a covered corporation to which both sections 331 and 332(a) respectively apply:
  - each distribution to which section 331 applies is a repurchase by the covered corporation, and
  - the distribution to which section 332(a) applies is not a repurchase.
- There are also rules for forfeitures/clawbacks of restricted/earn-out stock.

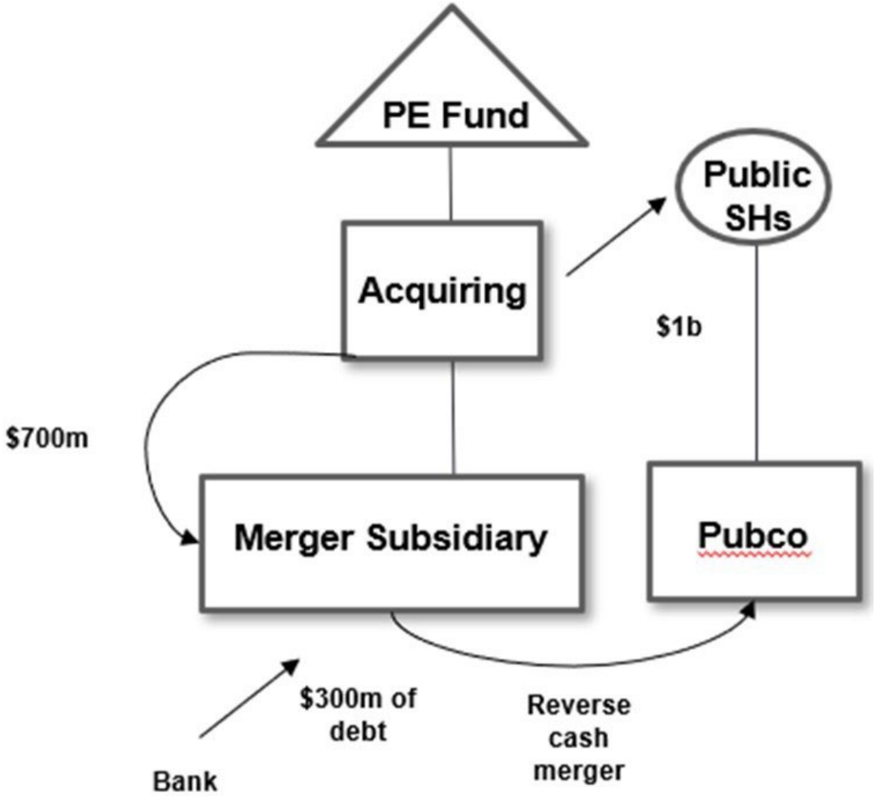
Qualifying Property Exception

- The FMV of stock repurchased by a covered corporation in the transactions described below reduces the covered corporation's stock buyback excise tax base to the extent such repurchase is for property permitted to be received without the recognition of gain or loss by section 354 or section 355:
  - A repurchase by a target corporation as part of an acquisitive reorganization;
  - A repurchase by a covered corporation as part of an E reorganization;
  - A repurchase by a transferor corporation as part of an F reorganization; and
  - A repurchase by a distributing corporation as part of a splitoff (whether or not part of a section 368(a)(1)(D) reorganization).

Qualifying Property Exception (cont'd)

- The net effect of treating the stock component of reorganizations as being a repurchase and then excepted is to treat only the boot as a part of the excise tax base.
- In an acquisitive reorganization, that includes boot sourced from the acquiror as well as the target.
- The acquiror does not get issuance credit under the netting rule for shares issued in the reorganization (the "double benefit rule"). The same rule applies for Spinco in a divisive D spinoff.
- In all reorganizations, including section 368(a)(1)(E) and section 368(a)(1)(F) reorganizations, the stock component erodes qualification for the de minimis exception.

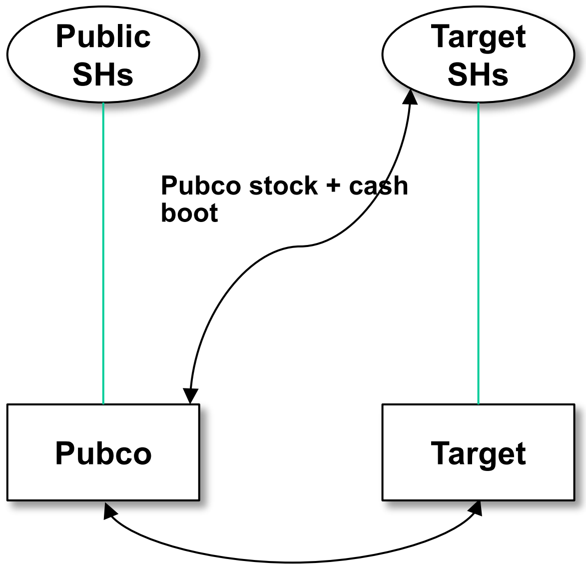
Example 1: “Going Private” Leveraged Buyout



In May 2025, Pubco is acquired by a corporation in a “going private” merger transaction in which Pubco’s public shareholders collectively receive $1 billion for their Pubco shares, funded in part with $300 million of newly issued debt inherited by Pubco in the merger.

- Pubco’s redemption of 30% of its outstanding stock is a section 317(b) redemption, which is not excluded under any exception.
- Therefore, as a result of the transaction, Pubco’s stock buyback excise tax base for its 2025 taxable year is increased by $300 million.
- Same result if the $300 million is funded directly by PubCo.

Example 2: Section 368(a) Reorganization with Boot



In October 2025, Pubco acquires the assets of a publicly traded target corporation in a statutory merger described in section 368(a). The Target shareholders collectively receive $40x of cash and $60x of Pubco stock.

- The exchange by the Target shareholders of their Target stock for the consideration received in the Target merger is a repurchase by Target (as an economically similar transaction) in the amount of $100x.
- Under the qualifying property exception, the FMV of the Target stock exchanged by the Target shareholders for Pubco stock (*i.e.*, $60x of Target stock) is a qualifying property repurchase that reduces Target's stock buyback excise tax base to $40x.
- Under the "double benefit rule," Pubco does NOT get credit for the $60x of Pubco stock issued to the Target shareholders under the netting rule.

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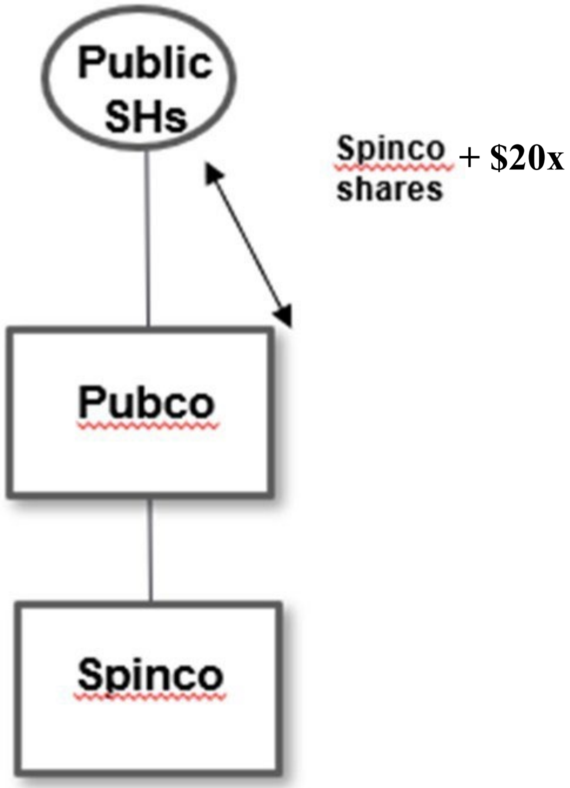
Example 3: Section 355 Splitoff



In December 2025, Pubco shareholders exchange $100x of Pubco stock for $80x Spinco stock and $20x cash pursuant to a splitoff under section 355.

- The exchange by the Pubco shareholders of their Pubco stock for the $80x of Spinco stock and $20x of cash is a repurchase by Pubco (as an economically similar transaction) in the amount of $100x.
- Under the qualifying property exception, the fair market value of the Pubco stock exchanged (*i.e.*, $80x of Pubco stock) is a qualifying property repurchase that reduces Pubco's stock buyback excise tax base to $20x.

The same result applies if the splitoff is part of a transaction qualifying as a section 368(a)(1)(D) reorganization. In that case:

- Under the "double benefit rule", Spinco does NOT get credit for the $80x of Spinco stock issued to Pubco under the netting rule.

Funding Rule for Foreign-Parented Groups

- A U.S. subsidiary of a foreign corporation that buys back its parent's stock is subject to the excise tax.
- Notice 2023-2 provided that a U.S. affiliate is treated as acquiring its foreign parent's stock if the subsidiary "funds by any means" the parent's acquisition or repurchase of the parent's stock and the funding is undertaken for a principal purpose of avoiding the excise tax.
- The proposed regulations retain a similar rule.
- If a principal purpose of a funding is to fund a direct or indirect covered purchase, then, with respect to that funding, there is a principal purpose to avoid the excise tax.
- Funding includes "distributions, debt, or capital contributions."
- Does it include purchases of goods or services from a foreign affiliate? There is no specific carve-out.
- Under this rule, the first dollars of the foreign parent's repurchases are funded from the United States.

Funding Rule for Foreign-Parented Groups (cont'd)

- Notice 2023-2 had a per se rule under which a principal purpose was deemed to exist if there is a funding, other than through distributions, and the funded entity acquires or repurchases stock within two years of the funding.
- The proposed regulations carve this back to a rebuttable presumption only applicable to "downstream" fundings.

Specified Affiliate Acquisitions

- The proposed regulations would extend the scope of the excise tax to constructive repurchases effected through acquisitions of stock or partnership interests in certain entities that hold more than one percent of their assets as acquiror stock (if the entity acquired the stock after 2022).
  - This rule is somewhat analogous to the regulations under section 108(e)(4) for cancellation of indebtedness income but this rule is not intent or time-based.

Final Procedural Guidance

- On June 28, 2024, Treasury and the IRS released final regulations (T.D. 10002) on the reporting and payment of the excise tax on repurchases of corporate stock after December 31, 2022 (the "final regulations").
- The final regulations adopted the proposed procedural regulations issued April 12, 2024, without significant modification. The proposed computational regulations issued April 12, 2024, were not finalized.
- The final regulations make an adjustment to the effective date proposed in the proposed regulations. The final regulations apply to stock repurchase excise tax returns required to be filed after June 28, 2024, the date the final regulations were filed for publication. The proposed regulations had proposed that the regulations would apply to excise tax returns required to be filed after the date the final regulations were published.
- As contemplated by the proposed regulations, covered corporations and persons treated as covered corporations will be required to keep complete and detailed records to establish any amount of stock repurchases and to retain the records as long as they may be material.

Final Procedural Guidance (cont'd)

- Other variations from the proposed regulations:
  - In response to comments to the proposed regulations, the final regulations provide that RICs and REITs are exempt from the excise tax return filing requirements since repurchases by RICs and REITs are exempt from the excise tax under the statute. RICs and REITs remain subject to the recordkeeping requirements.
  - Final regulations clarify that an excise tax return must be filed for any taxable year in which the covered corporation or person treated as a covered corporation makes a repurchase or engages in a transaction treated as a repurchase.
  - Final regulations reserve Prop. Reg. § 58.6011-1(c), applicable to surrogate foreign corporations (pending the issuance of final regulations under Reg. § 58.4501-7(d)(2)).

Section 1202:
Qualified Small Business Stock

Overview of Section 1202: In General

- Ability to exclude gain from gross income by a non-corporate taxpayer on a sale of "qualified small business stock" (QSBS).
- Exclusion calculated at the shareholder level.
- Certain holding period requirements and different exclusion percentages may apply.
- In the case of a partnership:
  - The partners may exclude their share of the gain (subject to the limitations above on a per partner level);
  - The partner recognizing the gain must have held the interest in the partnership on the date the stock was acquired by the partnership;
  - Limited by the share of the gain equal to the ownership interest at the time of acquisition of the stock; and
  - Partner's basis in the partnership increased by the excluded gain.

Corporate-Level Requirements

- For stock to qualify as QSBS, the underlying entity must satisfy the following requirements:
  - The entity must be classified as a domestic C corporation for U.S. federal income tax purposes; and
  - The adjusted tax basis of the assets of the corporation must have been less than $50 million at all times before the issuance of the stock. OB3 increased this ceiling to $75 million.

Corporate-Level Requirements (cont'd)

- The entity must be engaged in one or more qualifying trades or businesses and use at least 80% of its assets in the conduct of such trade(s) or business(es).
- Section 1202 does not provide a list of qualifying trades or businesses but rather provides a list of trades or businesses that do *not* qualify. These include:
  - Any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees;
  - Any banking, insurance, financing, leasing, investing, or similar business;
  - Any farming business (including the business of raising or harvesting trees);
  - Any business involving the production or extraction of minerals; and
  - Any business of operating a hotel, motel, restaurant, or similar business.

Shareholder-Level Requirements

- If stock of an entity satisfies the corporate-level requirements, there are also several shareholder-specific requirements that must be satisfied for a taxpayer to claim the section 1202 exclusion:
  - The shareholder must not be a C corporation;
  - The shareholder must have received the stock directly from the corporation;
  - The shareholder must have received the stock in exchange for cash, property (other than corporate stock) or services;
  - For issuances before July 4, 2025, the shareholder must have held the stock for at least five calendar years (OB3 changed this rule for issuances after such date); and
  - The stock must have constituted QSBS for substantially all of the shareholder's holding period, typically between 85% and 95% of the total holding period of the stock.

Section 1202 – OB3 changes

- No changes to who can claim a Section 1202 exclusion.
- Exclusion up to the greater of $15 million per taxpayer (up from $10 million) or 10 times the taxpayer's basis in the stock sold, so long as such stock was issued after July 4, 2025. This amount will be indexed for inflation beginning in 2026.
- Tiered exclusion regime dependent on the holding period of the stock:
  - 3 Years – 50% - Remainder subject to 28% rate
  - 4 Years – 75% - Remainder subject to 28% rate
  - 5 Years – 100%
- Aggregate gross tax basis in assets (or FMV in case of a contribution) must be less than $75 million after July 4, 2025, anytime prior to the original issue, and immediately after the original issue.

History of Section 1202 Changes

1993

Enactment of Section 1202

- 50% Exclusion
- AMT addback for excluded capital gains

2009

Temporary 75% and 100% Exclusion

- 75% exclusion in 2009
- 100% Exclusion in 2010, extended again in 2012 and 2014
- AMT addback for excluded capital gains

2016

100% Exclusion Made Permanent

- 100% exclusion made permanent in 2016
- AMT addback for excluded capital gains

2017

Capital Gains Excluded from AMT Addback

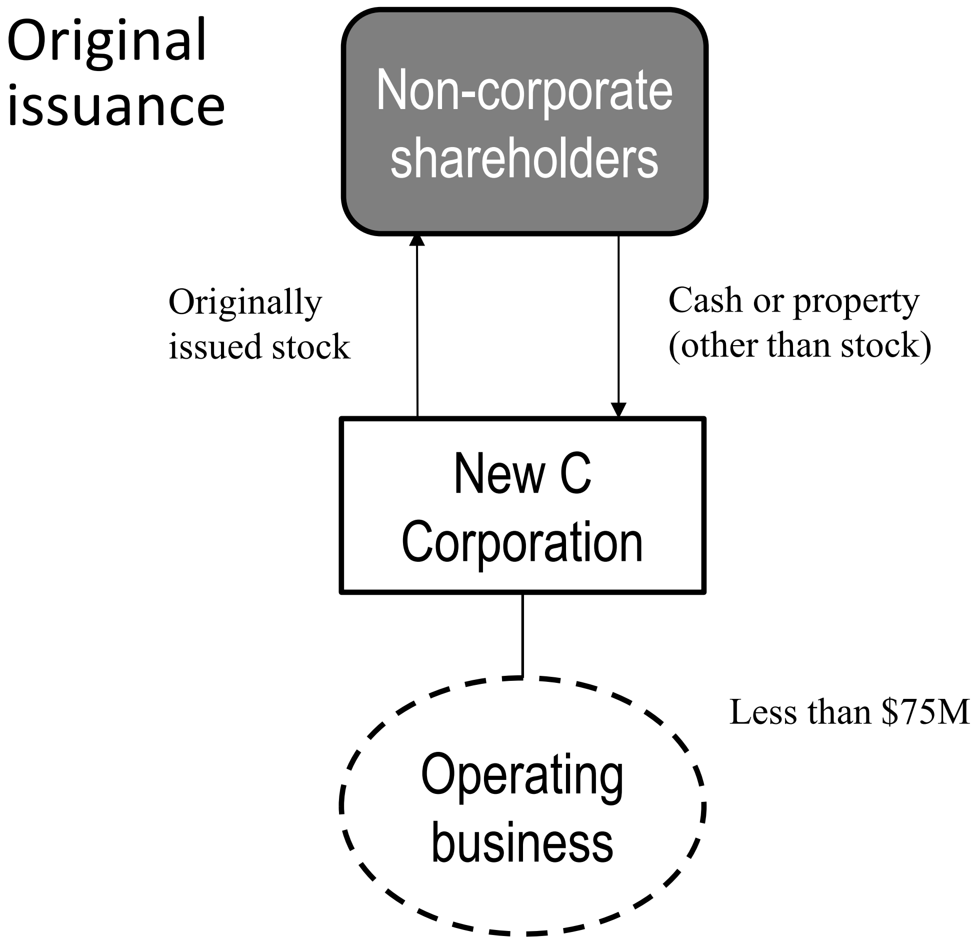
- 100% exclusion,
- No AMT addback

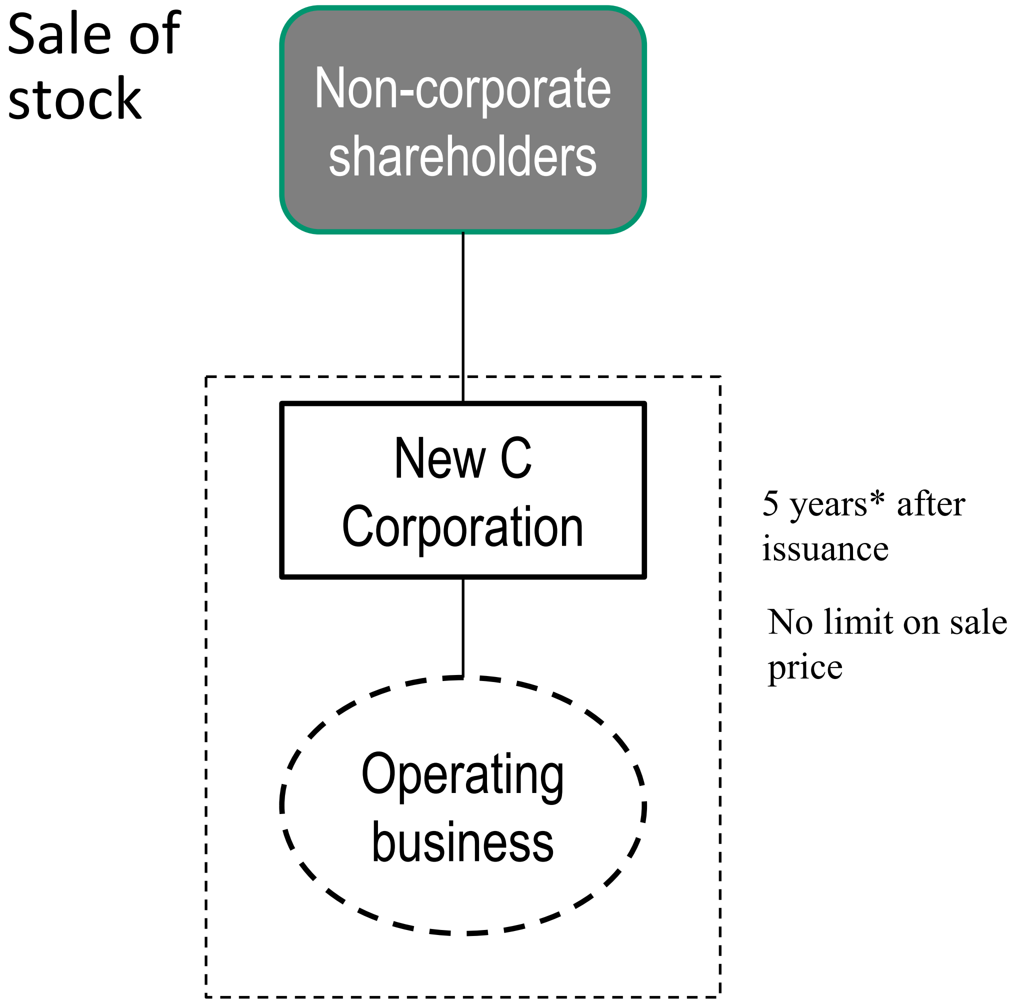
2025

Tiered Exclusion Regime Increased Limitations

- Tiered exclusion regime for shorter holding period.
- Increased asset basis test from \$50m to \$75m
- Inflation adjusted exclusion amount

Illustration





Illustrative Example

Illustrative example:

- Company A has 4 shareholders who are the original founders and each put in $5 million at the time of the original stock issuance.
- The shareholders sell the stock of Company A for $180 million.
- Each shareholder can claim up to $50 million of exclusion (*i.e.*, greater of $15 million or 10 times the investment of $5 million).

With section 1202	Without section 1202
Total gain: $160M	Total gain: $160M
Total exclusion: $160M	Total exclusion: $0
Tax due at 25%: $0	Tax due at 25%: $40M

- **Total cash tax savings to individual shareholders: $40 million.**

Further Insights

- PE Platform Acquisitions under $75 million should be analyzed for eligibility.
    - PE are considering blocked structures instead of flow-through to take advantage of section 1202.
    - Benefit depends on make-up of investors (i.e., individual LPs vs. tax exempt or foreign investors who may not need the benefit and would prefer tax distributions).
- LLC conversions: check-the-box election may be treated as an original issuance.
    - Existing closely held partnerships are considering converting to C corporations.
    - Must be under $75 million in gross asset value (including goodwill) at the time of the conversion.
- S corporation conversions: termination of an S election does not qualify as an original issuance. However, additional structuring may be considered.
- Common qualified businesses: technology companies and manufacturing companies are most common, but various other service companies may qualify.

Initial Structuring

- Consideration of tax implications of setting up a C corporation structure as opposed to a flow-through entity. Modeling the potential tax benefit of the potential section 1202 exclusion.
- Assessment of converting an existing flow-through entity into a C corporation to potentially set up a future section 1202 exclusion.
- The benefit of the exclusion is only available at the time of the exit.
- Practitioner note: any modeling is based on current law but could be affected by future changes in the tax law.

Notice 2025-45 Regarding Section 368(a)(1)(F) Reorganizations

Section 368(a)(1)(F) Reorganization

- Section 368(a)(1)(F) includes as a reorganization “a mere change in identity, form, or place of organization of one corporation, however effected” (F reorganization).
- An example of an F reorganization is the reincorporation of a corporation in another jurisdiction.
- In many ways the resulting corporation is treated as a continuation of the transferor corporation for federal income tax purposes.
- An F reorganization can occur through several steps, for example (i) formation of the resulting corporation, (ii) transfer of the assets and liabilities of the transferor corporation to the resulting corporation, and (iii) liquidation of the transferor corporation.

Identity of Shareholders Requirement

- As indicated above, to qualify as an F reorganization, there must be a mere change in identity, form, or place of organization of one corporation, however effected.
- Accordingly, an F reorganization requires an identity of stock ownership immediately before and immediately after the F reorganization.
- Reg. § 1.368-2(m)(1)(ii) states: “The same person or persons must own all of the stock of the transferor corporation, determined immediately before the potential F reorganization, and of the resulting corporation, in identical proportions.”

Identity of Shareholders Requirement (cont'd)

- What is the effect of trading in the corporation's stock between the first step in the potential F reorganization and the final step in the potential F reorganization? Does the change in shareholders violate the identity of shareholders requirement and prevent qualification as an F reorganization?
- In Notice 2025-45, Treasury and the IRS announced that they will issue proposed regulations to amend Reg. § 1.368-2(m)(1)(ii) to add the following sentence: "Satisfaction of the identity of stock ownership requirement … would not be affected by a disposition of stock in either the transferor corporation or the resulting corporation if that disposition is not included in the plan of reorganization."

Identity of Shareholders Requirement (cont'd)

- Notice 2025-45 also states that the proposed regulations will include a new example in which trading in the stock of a corporation in the middle of a potential F reorganization, where the sale of the corporation's stock is not part of the plan of reorganization, will not affect qualification as an F reorganization.
- See also PLR 202339009 (Oct. 17, 2022) (sales of stock in the middle of a potential F reorganization did not disqualify it).

OB3

Corporate Tax Changes in OB3

- Section 163(j) interest limitation
- Section 168(k) bonus depreciation
- Section 174 research expenses
- Section 1202 small business stock

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Section 269

Section 269

- Under section 269(a), the IRS may disallow a "deduction, credit, or other allowance" if:
  - A person or persons acquire, directly or indirectly, control of a corporation (or a corporation acquires, directly or indirectly, carryover basis property from a corporation not directly or indirectly under its control); and
  - The principal purpose of the acquisition is the evasion or avoidance of federal income tax by securing the benefit of a deduction, credit, or other allowance which the person or corporation would not otherwise enjoy.
- "Control" is 50% by vote or value.

Section 269 (cont'd)

- As an anti-abuse provision, section 269 is subject to significant limitations because:
  - It requires an acquisition of control, and therefore does not apply to situations involving related parties where control preexists;
  - The acquisition of control must be germane to the tax benefit;
  - The tax benefit must be one the parties would not otherwise enjoy; and
  - "The principal purpose" is a hard standard to establish in many cases.
- As a result, section 269 has been invoked infrequently.
- But recently the IRS has been raising section 269 more frequently in audits.

CCA 202501008

- CCA 202501008 describes a situation where the taxpayer attempted to benefit from the effective date discontinuities of the cross-border provisions of the TCJA.
- US Corp owned CFC Y which owned disregarded foreign Company Z.
- Company Z makes products, sells them to CFC Y, which sells them to third parties.
- US Corp and CFC Y are on a calendar tax year.
- Company Z made a check-the-box (CTB) election to be treated as a corporation effective December 30, 2017, and elected a November 30 tax year.
- The effect would be to avoid GILTI tax on Company Z's income for the period ended November 30, 2018.
- In 2020 Company Z changed its tax year to a calendar year.

CCA 202501008 (cont'd)

- Company Z was a new corporation by virtue of the CTB election, so there was an acquisition of control.
- Per the CCA, the choice of taxable year, which has the effect of reducing the tax liability, is an "allowance" subject to disallowance under section 269.
- Per the CCA, Congress did not clearly express its intention to provide this tax benefit.
- The taxpayer did not provide a business purpose for making the CTB and taxable year elections, and they are just tax elections, evidence of "the principal purpose" of tax avoidance.
- The fact that Company Z went back a calendar year in 2020 "reinforces the artificial nature of" the original transaction.

Economic Substance Doctrine, including the *Liberty Global* case

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Codification of the Economic Substance Doctrine

- In 2010 Congress codified the economic substance doctrine.
- Section 7701(o)(1) provides that, in the case of any transaction to which the economic substance doctrine is relevant, the taxpayer must satisfy both prongs of a two-prong test. The taxpayer must demonstrate that:
  1) the transaction changes in a meaningful way (apart from federal income tax effects) the taxpayer's economic position (an objective test), and
  2) the taxpayer has a substantial purpose (apart from federal income tax effects) for entering into such transaction (a subjective test).
- Under section 7701(o)(5)(C), whether the economic substance doctrine is relevant is to be determined in the same manner as if the doctrine had not been codified.

Legislative History of Section 7701(o)

- A House Budget Committee Report (H.R. Rep. No. 111-443) and a technical explanation by the Staff of the Joint Committee on Taxation (JCX-18-10) provide useful background and explanation regarding section 7701(o).
- The codified provision clarifies and enhances application of the economic substance doctrine.

Legislative History of Section 7701(o) (cont'd)

- The provision does not alter a court's ability to aggregate, disaggregate, or otherwise recharacterize a transaction when applying the doctrine. For example, the provision reiterates the present-law ability to bifurcate a transaction in which independent activities with non-tax objectives are combined with an unrelated item having only tax-avoidance objectives.
- If the tax benefits are clearly consistent with all applicable Code provisions and the purposes of such provisions, it is not intended that such tax benefits be disallowed if the only reason for such disallowance is that the transaction fails the economic substance doctrine.

Legislative History of Section 7701(o) (cont'd)

- The provision is not intended to alter the tax treatment of certain basic business transactions that, under longstanding judicial and administrative practice are respected, merely because the choice between meaningful economic alternatives is largely or entirely based on comparative tax advantages.
- Non-exclusive examples of these basic transactions are (1) the choice between capitalizing a business enterprise with debt or equity; (2) a U.S. person's choice between utilizing a foreign corporation or a U.S. corporation; (3) the choice to enter a transaction or series of transactions that constitute a corporate organization or reorganization under subchapter C; and (4) the choice to utilize a related-party entity in a transaction, provided that the arm's length standard of section 482 and other applicable concepts are satisfied.

Strict Liability Penalty

- A taxpayer is subject to a strict liability penalty if its transaction lacks economic substance or fails to meet the requirements of any similar rule of law.
- There is no reasonable cause exception.
- The penalty is 40% of the underpayment if the transaction is undisclosed, and 20% if it is disclosed.
- What is a “similar rule of law?”
  - Notice 2014-58 states that a “similar rule of law” means a rule or doctrine that applies the same factors and analysis that is required under section 7701(o) for an economic substance analysis, even if a different term is used.

Key Issues Raised in any Economic Substance Analysis

- What is the “transaction” to be analyzed?
- Is the economic substance doctrine relevant to that transaction?
- Are the tax benefits allowed because they are clearly consistent with all applicable Code provisions and the purposes of such provisions? Or is the taxpayer’s treatment respected under longstanding judicial and administrative practice?
- Does the transaction change in a meaningful way (apart from federal income tax effects) the taxpayer’s economic position?
- Does the transaction have a substantial purpose (apart from federal income tax effects)?
- Could any other judicial doctrine or anti-avoidance rule apply?

Application of Section 7701(o): Liberty Global

- Liberty Global (D. Colo. 2023) raises several of the key issues listed in the previous slide.
- The federal district court held that the first three steps in a four-step transaction lacked economic substance and consequently disregarded their intended U.S. tax effect.

Application of Section 7701(o): Liberty Global

- The first three steps were designed to generate earnings and profits (E&P) in an indirect foreign subsidiary (Target) of Liberty Global, Inc. (LG US).
- In the fourth step Target was sold out from under LG US to the group's foreign parent corporation (LG plc).
- The creation of the E&P was intended to make the sale of Target to LG plc result in a dividend to LG US under section 964(e) that was eligible for the section 245A 100% dividends received deduction, so that LG US avoided tax on the transfer of Target to LG plc.
- The transfer of Target out from under LG US to LG plc removed Target from the U.S. tax regime.

Application of Section 7701(o): Liberty Global (cont'd)

- E&P was generated in Target in the first three steps of the transaction by the creation of intercompany debt and nonqualified preferred stock combined with a check-the-box election that converted a subsidiary of Target (Target Sub) from a disregarded entity into a corporation for U.S. tax purposes.
- The election resulted in a deemed incorporation of Target Sub, resulting in boot to Target under section 351(b), creating the E&P in Target.

Application of Section 7701(o): Liberty Global (cont'd)

- In the fourth step of the transaction, Target's foreign owner (FZ) sold the stock of Target to LG plc.
- The U.S. taxpayer (LG US, which owned FZ) took the position that FZ's sale of Target stock to LG plc was treated as a dividend to LG US (FZ's owner) under section 964(e).
- LG US took the position that the deemed dividend to LG US was offset by the section 245A 100% dividends received deduction, resulting in no tax to LG US.

Application of Section 7701(o): Liberty Global (cont'd)

- In June 2019, the Treasury Department issued retroactive temporary regulations to deny the 100% dividends received deduction in a situation like LG US's.
- In April 2022, a federal District Court in Colorado invalidated the temporary regulations. The court found that the process for promulgating the regulations failed to satisfy the requirements of the Administrative Procedure Act.

Application of Section 7701(o): Liberty Global (cont'd)

- In October 2023, the same judge on the federal District Court in Colorado held that nevertheless the dividends received deduction was not allowed.
- The court held that the section 7701(o) language applying the statutory test "in any transaction to which the economic substance doctrine is relevant" is not a separate test and is subsumed in the two-prong section 7701(o) analysis whether the transaction has economic significance and a substantial purpose.
- The court held that the first three steps of the transaction, which created E&P, lacked economic substance and therefore E&P was not created.
- The court found that the first three steps of the transaction had neither a meaningful non-tax economic effect nor a substantial non-tax business purpose.

Application of Section 7701(o) (Liberty Global) (cont'd)

- To have a dividend that can qualify for a dividends received deduction, there must be E&P to support the dividend.
- Without E&P there wasn't a dividend that could qualify for the 100% dividends received deduction. That would make FZ's sale of the Target stock result in subpart F income to LG US not eligible for a section 245A deduction.
- The taxpayer has appealed the case to the 10th Circuit.
  - The taxpayer is arguing that the statute requires a threshold analysis whether the economic substance doctrine is relevant.
  - The government is arguing that the relevance test is not a separate test and is subsumed in the two-prong analysis.

Partnership Basis Shifting

- The government is concerned about basis shifting in partnership transactions among related parties, in particular where basis is shifted from nondepreciable property to depreciable property using section 743(b), 734(b) or 732(b).
- On June 17, 2024, the government issued Rev. Rul. 2024-14, which takes the position that the economic substance doctrine applies to disallow tax benefits associated with a series of transactions involving related-party partnerships.

Partnership Basis Shifting (cont'd)

- The government's position in Rev. Rul. 2024-14 is being litigated in the Tax Court in the Otay case, where the taxpayer created an inside/outside basis disparity and later triggered a section 743 adjustment.
- Consistent with the government's position in Liberty Global, Rev. Rul. 2024-14 does not perform a threshold analysis of whether the economic substance doctrine is relevant.
- The question of whether there is a threshold test to determine if the economic substance is relevant is also being litigated in the Patel case in the Tax Court.

Thank you

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