**BENDING TIME’S ARROW**

Without any mystic appeal to consciousness it is possible to find a direction of time on the four-dimensional map by a study of organization. Let us draw an arrow arbitrarily. If as we follow the arrow we find more and more of the random element in the state of the world, then the arrow is pointing towards the future; if the random element decreases the arrow points towards the past. That is the only distinction known to physics. This follows at once if our fundamental contention is admitted that the introduction of randomness is the only thing which cannot be undone.

I shall use the phrase ‘time’s arrow’ to express this one-way property of time which has no analogue in space. It is a singularly interesting property from a philosophical standpoint.

— Sir Arthur Stanley Eddington, from *The Nature of the Physical World*

1. Introduction
   1. Everybody knows time moves in one direction: past to future, memory to anticipation, cause to effect. Everybody does not include subchapter C practitioners, where something that happens after can be treated, for some or all tax purposes, as something that happened before; and something that happened before can be treated as something that happens after. Indeed, in subchapter C, not even simultaneity is safe.
   2. A fundamental theme is that there is surprisingly little law directly on point law in many of these areas. Common sense is often a reliable guide, but how could the Grand Recasters of Old, with their self-confident (even if at times properly motivated) views of Substance ruling over Form, given such little focus to time?
      1. The importance of many of these questions has only increased with the passage of the TCJA and other recent changes to the tax law
   3. Through examination of various examples, this paper will explore four aspects of how time might be considered in planning and analyzing transactions:
      1. Simultaneity
         1. To what extent are apparently simultaneous events treated as simultaneous for tax purposes?
         2. To what extent are non-simultaneous events treated as simultaneous?
         3. What principles guide the analysis?
      2. Immediacy
         1. What do phrases such as “immediately before” and “immediately after” really mean? What do they permit, or prevent, from a transactional perspective?
      3. Retroactivity, Prospectivity, and Arrowsmithery
         1. What are the circumstances under which events are treated as happening earlier or later than they actually happen?
         2. How different is the strange concept of “retroactivity in part”, also known as Arrowsmithery, from actual retroactivity?
      4. Through Two Doors At Once
         1. When a transaction is completely recast into another transaction—for instance, a stock acquisition treated as an asset acquisition—what guideposts can be discerned in deciding the timing of the events that the tax law cares about?
   4. Before proceeding, an issue arises in many cases where the tax treatment is determined by reference to a day—e.g. close of the day, end of the day, beginning of the day, start of the day. The issue is, whose day? Perhaps surprisingly, this is an issue that practitioners actually consider.
      1. Example: USP owns Dutch BV, which is classified as a corporation. For good business reasons, USP wishes to do an F reorganization of Dutch BV into a UK company. Pursuant to a plan of reorganization that will be completed by Dutch BV electing to be disregarded, USP contributes, on June 30, the stock of Dutch BV to newco UK Ltd. A few weeks later, the tax director populates a draft Form 8832 for Dutch BV, choosing July 1 as the effective date of the election. Several weeks later, Dutch BV legally liquidates. When reviewing the implementation documents and the draft Form 8832, the taxpayer’s advisor notices that the contribution from USP to UK Ltd occurred at 11:59pm UK time. Hmmm, thinks the advisor, the deemed liquidation resulting from an election to be disregarded occurs immediately before the close of the day before the election is effective—which this example will treat as being 11:59pm on June 30 (but see discussion below re “immediately before”). But which “11:59pm on June 30” is relevant—that moment in the UK, or that moment in the Netherlands? If in the Netherlands, that would be ***10***:59pm in the UK, because the Netherlands is an hour ahead. That would mean the deemed liquidation of Dutch BV occurs ***before*** the contribution into UK Ltd—in which case, instead of an F reorganization, the transaction would an inbound upstream C of Dutch BV into the US followed by a Treas. Reg. §1.368-2(k) contribution to UK Ltd that oh by the way is subject to section 367(a).
      2. This concern ought to be able to be remedied by including a description of the intended timing in the Form 8832. The regulations are built on taxpayer flexibility, and even provide a specific rule in the case of tiered elections, providing a default order of top down but allowing the order to be changed to whatever the taxpayer wants. Nonetheless, there is no specific rule that allows time zones to be specified. Such a rule would be welcome, especially if described as a clarification rather than new rule.
      3. In the meanwhile, the paper will employ a simplifying convention of treating all parties as being in the same time zone—and using the Gregorian calendar, for avoidance of doubt.
2. Simultaneity
   1. The tax law is flush with quite ordinary situations where simultaneous events are treated as happening in a certain order within the simultaneous instant
      1. In a merger, the rights and obligations of all the parties are typically affected simultaneously, yet the tax law insists on treating the transaction as a section 361(a) exchange followed by section 361(c) distribution/section 354 exchange
         1. There is no other way a merger can be tax free—it is section 361 and 354 that provide nonrecognition, not section 368(a)(1)(A).
         2. A vertical tier of reorganization targets is presumably handled the same way: If T1 owns T2, and T1 and T2 simultaneously transfer their assets to Acq and then liquidate, then assuming these deemed steps qualify for reorganization treatment at both the T1 and T2 level, presumably the transactions would be analyzed as if the following actually occurred, in order, within the single instant: T2 engages in a section 361(a) exchange with Acq followed by a section 361(c) distribution to/section 354 exchange with T1; and then T1 engages in a section 361(a) exchange with Acq followed by a section 361(c) distribution to/section 354 exchange with T1’s shareholder.
      2. In a conversion of a corporation with two shareholders to an LLC, again the rights and obligations of all the parties are typically affected simultaneously, but the transaction is treated as, first, the corporation distributing all its assets to its shareholders in liquidation, and thereafter the shareholders contributing such assets to a newly formed partnership
         1. This treatment applies the same simultaneity that Treas. Reg. §301.7701-3(g)(1)(ii) applies for an election by a corporation to be classified as a partnership, but not the precise timing—in the check-the-box context, the deemed transactions are described as occurring within a single instant that is immediately before the close of the day before the election is effective. See Rev. Rul. 2004-59, which treats a state law conversion of a limited partnership to a corporation in the same fashion as a check-the-box election of partnership to corporation, except with respect to timing.
         2. Rev. Rul. 2009-15 follows the same general approach, but appears to go further and apply not just the deemed transactions, but also the timing, of the check-the-box regulations to a conversion—at least in context of S corporations.
      3. In a section 304 transaction that is dividend equivalent, again the rights of the parties in the underlying transaction—the exchange of issuing corporation stock for property—typically are determined in an instant, but the transaction is treated as a contribution of the stock of the issuing corporation for stock in the acquiring corporation followed by a redemption of the stock of the acquiring corporation, in order within a single instant
         1. A dividend equivalent section 304 provides the first chance to raise a crucial point, which is discussed in a lengthy example below: “time” in the tax law is relevant not just to *transactions*, but also to *adjustments* and other things like *status* or *relationship*
            1. From the perspective of simultaneity, not only do the contribution in exchange for shares in the acquiring corporation, and the redemption in exchange for property, occur in order within a simultaneous instant, but the ***adjustment*** under Treas. Reg. §§1.358-2 and 1.302-2(d) works its way in between all this: That is, the transferor’s basis in the deemed issued shares of stock in acquiring reflects the transferor’s basis in the issuing corporation, and moreover that basis leaps to other shares, within the same simultaneous instant
      4. *Kniffen* is perhaps a less obvious example on this topic, but still a helpful one to show the normalization in the tax law of the concept of providing an ordering for events that occur within a simultaneous instant. In *Kniffen*, as part of an overall section 351 transaction, the liability accounts that were transferred from the individual shareholder to the corporation included historic amounts owed by the shareholder to the corporation. In holding that section 357(c) applied to these liabilities, the Court stated:
         1. “It is obviously correct, as the [government] contends, that from the standpoint of contractual liability there is a basic difference between an ‘assumption’ of liability and a ‘discharge’ of liability. But here the discharge of the liability results from its assumption. Where, as here, a debtor transfers his debt obligation to his creditor for a valid consideration, the interests of the two parties are merged and the indebtedness immediately is extinguished. \* \* \* The $44,625.79 liability owing by [the taxpayer] to the corporation could not have been discharged had it not been that [the corporation] first ***assumed*** it. Absent the assumption, the interests of the parties would not have merged and the indebtedness would not have been extinguished. [Emphasis in original.]”
         2. In order to get into section 357(c), which the Court obviously thought was the correct result, the Court concluded that the elimination of a debt was a two-step occurrence within a simultaneous event.
            1. There is an open question as to how to treat the second step under the Court’s analysis, i.e., the extinguishment—namely, is such extinguishment a cognizable event for tax purposes that can result in items being recognized
            2. An example similar to *Kniffen*—but looking at it from the other side, in a sense—is where, in a C or D reorganization, the target corporation is a creditor of the acquiring corporation, and thus the debt goes away in the reorganization. Under *Kniffen*, one can presumably treat the acquiring corporation as first “acquiring” the creditor position before such asset goes away, thus allowing the creditor position to be in the numerator for “substantially all” purposes, given that section 368(a)(1)(C) and section 354(b)(1)(A) each refers to an ***acquisition*** of substantially all the assets.
   2. The commonsense principles in the examples above provide guidance in more complex cases, as seen next
      1. Consider an example involving a section 331 liquidation of a CFC: Say US owns 100% of CFC1 and 70% of CFC2; CFC1 owns the remaining 30% of CFC2; and CFC2 converts to a limited partnership, LP, that defaults to be disregarded, and thus is classified as a partnership upon the conversion.
         1. This is not a section 381 event, so the rule that treats the tax year as ending with the close of the day of a transaction, discussed at length below, is not relevant here
         2. The transaction is implemented by conversion, so the benefits and burdens of all parties are affected at once
         3. In a section 331 liquidation, the corporation recognizes gain or loss under section 336, and the shareholders recognize gain or loss under section 331. To note, these events are not described in the Code as parts of the same exchange. Instead, the liquidating corporation is described as recognizing gain or loss “on the ***distribution*** of [its] property…***as if*** such property were sold to the distributee at its fair market value” (emphasis added); and each shareholder treats the amounts received in the distribution “***as*** in full payment in exchange for the stock” (emphasis added) of the liquidating corporation. Thus, the language of the Code does not express a requirement, or describe a situation, of simultaneity. In such a case, should the section 336 gain or loss and the section 331 gain or loss be treated as happening at the same time, or should one go “first”? And is there room for anything to happen between them?
      2. In a taxable liquidation of a CFC, assuming there is gain recognized under section 336, the US shareholder would typically expect to have a GILTI inclusion.
         1. When is the GILTI inclusion? Under Treas. Reg. § 1.951A-1(b):
            1. “Each person who is a United States shareholder of any controlled foreign corporation and owns section 958(a) stock of any such controlled foreign corporation includes in gross income in the U.S. shareholder inclusion year the shareholder’s GILTI inclusion amount, if any, for the U.S. shareholder inclusion year.”
         2. The “U.S. shareholder inclusion year” is defined in Treas. Reg. § 1.951A-1(f)(7) as follows:
            1. “The term U.S. shareholder inclusion year means any taxable year of a United States shareholder in which or with which a CFC inclusion year of a controlled foreign corporation ends.”
            2. As relevant here, a CFC inclusion year means any taxable year of a CFC.
         3. Thus, there is a CFC inclusion year in US’s year in which CFC2 converts to an LP—CFC2’s tax year ends when CFC2 ceases to exist as a corporation. Can the section 961(a) adjustment be properly ordered within the series of simultaneous ordered events so that US, in computing its section 331 gain or loss, can take into account any increase to basis?
         4. In a sense it is even easier to move an ***adjustment*** to the right place in ***tax*** time, because it isn’t moored to an event happening in ***real*** time. In the section 304 example discussed above, it is second nature to treat the stock of acquiring as being allocated basis under section 358 and the regulations thereunder, and then as leaping to other shares, all in the same instance as the stock sale. In the case of section 961, second nature is perfectly fine guide, but there are also helpful clues in the regulations: Under the regulations, the basis of a United States shareholder’s stock in a controlled foreign corporation is increased under section 961(a) “as of the last day in the taxable year of such corporation on which it is a controlled foreign corporation”—i.e., not specifying any particular point during the year. It therefore seems the only logical result that the section 961(a) adjustment would apply before the section 331 gain or loss is computed: not just ordering, but properly ordering, specific events and adjustments within a simultaneous moment is fundamental to how the tax law works.
      3. Consider one more example that is conceptually similar, but includes an additional provision to contend with, where the GILTI results from the deemed asset sale in tiered section 338 elections. Assume UST owns CFCT, and P acquires UST in a QSP and a section 338(h)(10) election is made for UST and a section 338(g) election is made for CFCT? The section 338 regs say when there are tiered 338 elections, they go “top down”. Treas. Reg. §1.338-3(b)(4) provides:
         1. **“(i) Stock sold in deemed asset sale.** If an election under section 338 is made for target, old target is deemed to sell target’s assets and new target is deemed to acquire those assets. Under section 338(h)(3)(B), new target's deemed purchase of stock of another corporation is a purchase for purposes of section 338(d)(3) on the acquisition date of target. If new target’s deemed purchase causes a qualified stock purchase of the other corporation and if a section 338 election is made for the other corporation, the acquisition date for the other corporation is the same as the acquisition date of target. However, the deemed sale and purchase of the other corporation’s assets is considered to take place after the deemed sale and purchase of target’s assets.”
            1. See also Treas. Reg. §1.338(h)(10)-1(d)(3)(ii)
            2. It appears the reason for this provision is for properly allocating ADSP and AGUB
         2. Despite this express timing rule, there is no reason to reach a different result from the section 331 transaction—the section 961(a) adjustment is flexible enough to apply to the stock of CFCT “before” UST calculates its gain on such stock in UST’s deemed asset sale
      4. Private letter ruling and GLAM
         1. To make the reader aware, two informal pieces of IRS guidance were recently issued. Each addresses a context related to the above, namely the extent to which section 961(a) adjustments should be taken into account in determining the amount of basis available for determining basis reduction under section 961(b)(1) and gain under section 961(b)(2).
            1. PLR 2023 04 008 (Jan. 27, 2023)
            2. GLAM (Mar. 10, 2023)
   3. Consider next *TBS-Tracinda*, 111 TC 315 (1998). Simplifying somewhat, Tracinda owned 50.1% of MGM; the remaining 49.9% of MGM was publicly traded. MGM owned 100% of United Artists. TBS wished to acquired MGM without United Artists.
      1. The parties engaged in the following steps, which happened simultaneously under the implementing documents:
         1. TBS acquired the stock of MGM from Tracinda and MGM’s public shareholders for cash
         2. Tracinda acquired the stock of United Artists from MGM for cash
         3. Tracinda sold shares of United Artists constituting 21% of its stock to former MGM public shareholder for cash (pursuant to a subscription agreement).
      2. The government attempted to recast the actual steps, and to treat the steps in the recast as occurring in a certain order, which included the following:
         1. Step 1, TBS makes a capital contribution to MGM equal to the value of United Artists
         2. Step 2, MGM redeems out Tracinda with the United Artists stock.
      3. This allowed the government to argue that there would be no loss recognized on the United Artists stock, because any loss realized would not be recognized under section 311(a)
      4. The Tax Court rejected the view, stating, among other things:
         1. “Respondent’s argument in its purest terms is that sale of all the issued shares in MGM to the TBS Group and MGM’s sale of all the issued shares in UA to Tracinda cannot be viewed as occurring simultaneously for tax purposes. Respondent contends the transactions must be assigned a sequential order for tax purposes. Respondent further argues that since simultaneous sale transactions cannot be recognized for tax purposes, it is necessary to recharacterize the transaction to reflect its true substance. We find respondent's argument that the sales could not occur simultaneously for tax purposes to be no more than superficially appealing, unsupported by authority, and without merit in view of the stipulated facts. On brief, respondent cites no authority for the proposition that ‘some kind of [sequential] ordering of the steps of the transaction is necessary for tax purposes to determine the tax consequences.’ Transactions that occur simultaneously or are deemed by law to have occurred concurrently or simultaneously are commonplace.”
            1. Despite the arguably broad language, it seems clear that the Tax Court was saying no more than “Imposing an order for tax purposes on simultaneous steps is not always appropriate—and is decidedly not appropriate in this case.”
   4. As a final example, consider Rev. Rul. 73-16, in which steps that were not simultaneous in real time were treated as simultaneous for tax purposes (in addition, certain steps were disregarded). In this ruling there were three corporation, X, Y, and Z; pursuant to an overall plan, Y acquired all the X stock for Y voting stock, and then Z acquired all the Y stock, including the stock just issued to the former X shareholders, for Z voting stock. The ruling treats the transaction as Z acquiring the stock of Y in a B reorganization of Y and Y acquiring the stock of X in a triangular B reorganization. The interesting feature of the ruling for our purposes is that a triangular B requires, among other things, “the acquisition by one corporation \* \* \* in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation”, but at the time Y acquires the stock of X, Z is ***not*** in control of Y. In short, either Z’s acquisition of Y is treated as occurring before it actually happens, or Y’s acquisition of X is treated as occurring after it actually happens. This, then, becomes an example of retroactivity or prospectivity rather than simultaneity, which topics are discussed below.
3. Immediacy
   1. The notion of something happening ***immediately*** before or ***immediately*** after something else goes against our basic belief that time is continuous—i.e., that for any given moment in time, there exist other moments that are arbitrarily close to the given moment. But in using the word immediately, the tax law is not trying to upend physics, but instead is trying to be pragmatic. The key principle seems to be: You, taxpayer, cannot transact between one event (or adjustment, or status) and another that is described in the tax law as immediately before or after the firs.t
      1. A key exception is mentioned here and discussed in detail further below: In a number of contexts, the word “immediately” should not be taken seriously, to use a phrase. For example, in section 351, the “control immediately after” test has consistently been interpreted as testing for control over a longer period than the moment immediately after the transfer.
   2. Among other things, the discussion will consider what policy is protected by preventing taxpayers from transacting in the interstices? Where should the rules change?
   3. Using section 355 as a case study, section 355 contains several uses of the phrase “immediately after”, of which two are the focus here (the phrase “immediately before” also appears—noted for completeness)
      1. The active conduct requirement—each of D and C must be engaged in the active conduct of a trade or business ***immediately after the distribution***
         1. This is intriguing because, at least on first read, it seems to suggest that the active conduct requirement can be met by having D or C acquire a business after the spinoff, instead of relying on a business that D owned before the spinoff.
            1. How does this square with a view that section 355 is about separating businesses historically owned by D (directly or through C)?
            2. But is this what section 355 is about? Section 355(b)(2)(C) it expressly contemplates meeting the active conduct requirement by relying on a business that is ***not*** historically owned by D or C, even where such business is acquired as late as ***the date of the distribution***, as long as the business is acquired in a transaction in which no gain or loss is recognized.

In fact, the active business can be acquired at any time during the 5-year period ***ending on the date of the distribution***, if acquired in a nonrecognition transaction. This, if it existed in isolation, would suggest that the business could be acquired ***after*** the distribution as long as it is not acquired later than the date of the distribution.

This suggests that from a policy perspective, “immediately after” may be too strict

* + - * 1. However, if a section 355(b)(2)C) acquisition could be implemented ***simultaneously*** with the distribution, based on *Tracinda*, it seems the active conduct requirement would be met.
        2. Finally, most people read the immediately after test as a necessary, not sufficient, condition for satisfying the active conduct requirement: the test is not met merely by conducting the business during the instant that is immediately after the distribution, rather the active conduct of the business must continue for the foreseeable future after the distribution.
    1. In another subsection in section 355, namely section 355(d), it can be advantageous to believe that “immediately after” cannot be preempted transactionally. Section 355(d) looks to the quantity of disqualified stock—stock acquired by “purchase” within the 5-year period ending on the date of the distribution, using the term “purchase” as defined in the regulations—as of “immediately after” the distribution in determining whether the transaction is a disqualified distribution:
       1. The first point to make here is that, as with simultaneity, immediacy is relevant to adjustments as well as transactions: Here, “immediately after” seems to refer to the adjustments that happen automatically under the tax law, in particular under section 358 and Treas. Reg. § 1.358-2; and applying a “no room to transact” theory, no taxpayer can insert a transaction between the distribution and these adjustments. This would mean that a contribution of cash into D or C a second after the distribution, even where such cash creates disqualified stock constituting a 50-percent or greater interest in the corporation, does not, itself, cause the distribution to be a disqualified distribution because the threshold of disqualified stock was not met immediately after the distribution.
  1. As noted above, there are cases where the word “immediately” should not be taken seriously
     1. Section 351(a) is a good example.
        1. In section 351(a), the question of immediacy goes to a status or relationship rather than a transaction. But it raises the same question—can a taxpayer transact between the event, i.e., the exchange, and the status or relationship, i.e., being in control, which must exist immediately after the exchange.
        2. However, section 351(c) provides a clue that that phrase “immediately after” should not be taken seriously. If “immediately after” in section 351(a) meant “no room to transact”, there would be no need for section 351(c)—true immediacy would mean that a later event, such as a distribution by a corporate transferor to its shareholders, could ***never*** occur fast enough after the transfer to arrive before the moment that is immediately after the transfer. The courts have consistently interpreted “immediately after” in section 351(a) to ***not*** mean “the instant after”. in just this way. See, e.g., *Intermountain Lumber*, 65 TC 1025 (1966).
           1. Section 351(c) seems to reflect an additional principle, providing “step into the shoes” treatment for the distributee in a section 351(c) distribution—i.e., the immediately after test, however it applies, would continue to apply to the distributee. See, e.g., Rev. Rul. 62-138, 1962 CB 95.
        3. Another example is embodied by section 368(a)(2)(H)(ii). Although the general language of section 368(a)(1)(D) refers to control “immediately after the transfer”, with “transfer” referring to the section 361(a) exchange, section 368(a)(2)(H)(ii) provides that in the case of a D/355 reorganization, the fact that the shareholders of the distributing corporation dispose of part or all of the controlled corporation’s stock, or the fact that the controlled corporation issues additional stock, is not taken into account. Because section 368(a)(2)(H)(ii) is looking to actions of the shareholders of the distributing corporation, it seems that Congress did not intend for the “control” inquiry to stop immediately after the distributing corporation’s transfer of assets to the controlled corporation.
           1. This is interesting because the “immediately after” test in section 368(a)(1)(D) is neutral as to whether it is describing an acquisitive or a divisive D reorganization. Thus, the fact that section 368(a)(2)(H)(ii) doesn’t take the phrase “immediately after” seriously in the divisive context suggests that it may not need to be taken seriously in the acquisitive context either—i.e., that in determining control in an acquisitive D reorganization, control is tested as the end of the series of related transactions.
  2. The definition of intercompany transaction in Treas. Reg. §1.1502-13(b)(1) is an interesting case. The rule itself tests the status of the parties to a transaction immediately after the transaction to determine if the transaction is an intercompany transaction—if the parties are member of the same consolidated group immediately after, the transaction qualifies as an intercompany transaction. Thus, for example, if P, the common parent of a consolidated group, transfers assets to a previously unrelated includible corporation, X, in exchange for 80% of X’s sole class of stock in a transaction described in section 351, this would appear to be an intercompany transaction under the general rule of Treas. Reg. §1.1502-13(b)(1). However, there are rules in Treas. Reg. §1.1502-76—i.e., the end of the day rule and the next day rule—that are worth analyzing before concluding on the treatment of this simple section 351 transaction. These rules are discussed in the next section.

1. Retroactivity, Prospectivity, and Arrowsmithery
   1. Sometimes events—including transactions, adjustments, or changes in status or relationship—are deemed to happen before they actually happen, and not merely in the sense of being ordered within a moment of simultaneity as discussed above, but with hours or days or weeks between them. This will be referred to as ***retroactivity***. On the other hand, sometimes events are deemed to happen after they actually happen. For lack of a better term, this will be referred to as ***prospectivity***. Finally, sometimes events are not actually deemed to happen before they actually happen, but the tax treatment is determined by imagining the treatment as if a similar event had happened before the event under consideration, and treating the event under consideration consistently (in some fashion) with the imagined earlier event. This will be referred to as ***Arrowsmithery***. Sometimes it is quite easy to distinguish Arrowsmithery from retroactivity, but sometimes it is not.

* 1. As to retroactivity, the focus of the discussion will be on check-the-box elections.
     1. Rescission, along with transactions that are determined to be void ab initio, are types of retroactivity, but are not addressed here, in part because they involve a complete undoing of a transaction—which is not the focus of the discussion below—and in part because they have been thoughtfully addressed in prior articles. See Banoff, *Unwinding or Rescinding a Transaction: Good Planning or Tax Fraud*, 62 Taxes 942; Schnabel, *Revisionist History: Retroactive Federal Tax Planning*, 60 Tax Law. 685.
     2. As a simple example of check-the-box retroactivity, Assume US1 owns CFC1, which owns DRE1. On April 1, DRE1 sells one of its assets, Asset X, to an unrelated person for cash. On June 1, DRE1 validly elects to be classified as a corporation for US tax purposes with an effective date of April 1. This means, at least initially, that CFC1 is treated as contributing all the assets of DRE1, including Asset X, to “CFC Newco” immediately before the end of March 31, and CFC Newco is treated as selling Asset X to the unrelated person for cash. Stated differently, after the election takes effect, the correct view of ***historical fact*** is that CFC1 contributed all of the former DRE1 assets, including Asset X, to CFC Newco on March 31, and CFC Newco sold Asset X on April 1.
        1. The fact that this becomes the correct view of historical fact begins, rather than ends, the analysis.
           1. Does it matter whether US1 intended for DRE1 to elect to be classified as a corporation at the time of either the negotiation of the sale of Asset X or of the sale itself? Or is the principal inquiry clear reflection of income—i.e., whether, on clear reflection grounds, CFC Newco, rather than CFC1, should be treated as recognizing the income associated with the sale of Asset X? Consider *Central Cuba Sugar*, 198 F.2d 214 (2d Cir. 1952); *National Securities Corporation*, 137 F.2d 600 (3d Cir. 1943).
     3. Intent—and in particular “plan”—is arguably more important in the context of a reorganization than in the context of the section 482 authorities referenced above. With that in mind, consider the following two reorganization fact patterns involving check-the-box elections:
        1. *Example where effective time of check-the-box occurs after relevant events.* P owns CFC1 and CFC2, and for good business purposes contributes the stock of CFC1 into CFC2. Later, P’s advisor says it would be better if these steps constituted a reorganization (for example, it might obviate the need for a GRA), so the advisor suggests checking the box on CFC2 to be disregarded with an effective date of the day after the stock contribution.
        2. *Example where effective time of check-the-box occurs before relevant events.* P owns LLC, and P and LLC together own LP-CFC, which is a non-US LP classified as a corporation for US tax purposes. LP-CFC has no liabilities, and its sole asset is DRE, a non-US company that is an eligible entity that is disregarded a separate from LP-CFC for US tax purposes. DRE has assets and operations. Without consulting Tax, Legal causes LLC to merge into P with P surviving. This causes LP-CFC to legally liquidate. Assume this occurs at noon on Day 1. Tax doesn’t like this result, so P’s tax advisor suggests checking the box on DRE to be classified as a corporation, referred to as Newco CFC, with an effective date of Day 1. This would result in the transaction being treated as LP-CFC contributing the assets and liabilities of DRE, which constitute all of LP-CFC’s assets and liabilities for tax purposes, to Newco CFC immediately before the close of Day 0, and Newco CFC beginning to exist as a corporation at the start of Day 1, with LP-CFC liquidating and distributing the stock of Newco CFC to P at noon on Day 1. P’s tax advisor believes this causes what would otherwise be an inbound liquidation of LP-CFC to be characterized into a downstream F of LP-CFC.
        3. The difference between the two examples is obviously that in the first, the deemed transactions resulting from the check-the-box election complete the purported reorganization, whereas in the second, the actual transactions complete the purported reorganization.
           1. In the first example, it seems difficult to find the “plan of reorganization” requirement to be met. Although the parties to a reorganization do not necessarily need to believe all the intended steps will qualify as a reorganization under section 368 (see, e.g., *James Armour Inc. v. Commissioner*, 43 TC 295 (1964)), the parties must plan to do ***something***—at the least to implement all the steps that ultimately will be adjudged to be a reorganization. In the first example, at the time of the contribution, no one planned the liquidation.
           2. In the second example, does the switching of the order of the deemed transactions make a difference?

Consider Treas. Reg. §301.7701-3(f)(4), Example 1, quoted here in full:

“A, a U.S. person, owns a domestic eligible entity that is disregarded as an entity separate from its owner. On January 1, 1998, B, a U.S. person, buys a 50 percent interest in the entity from A. Under this paragraph (f), the entity is classified as a partnership when B acquires an interest in the entity. However, A and B elect to have the entity classified as an association effective on January 1, 1998. Thus, B is treated as buying shares of stock on January 1, 1998. (Under paragraph (c)(1)(iv) of this section, this election is treated as a change in classification so that the entity generally cannot change its classification by election again during the sixty months succeeding the effective date of the election.) Under paragraph (g)(1) of this section, A is treated as contributing the assets and liabilities of the entity to the newly formed association immediately before the close of December 31, 1997. Because A does not retain control of the association as required by section 351, A’s contribution will be a taxable event. Therefore, under section 1012, the association will take a fair market value basis in the assets contributed by A, and A will have a fair market value basis in the stock received. A will have no additional gain upon the sale of stock to B, and B will have a cost basis in the stock purchased from A.”

This example does not contain any facts suggesting that A alone, or A and B together, planned at the time of sale of the equity interest to cause the entity to elect to be classified as a corporation. Instead, the example seems to be relying on ***inevitability***: The deemed exchange of assets for stock in the new corporation occurs before the sale of the equity interests, and thus, looking at things by reference to the moment in time of the deemed exchange, it is inevitable that the sale of the stock will happen. Stated differently, this is better than a binding commitment, which after all could be breached—from the time of reference of the deemed contribution in exchange for stock, it’s a ***certainty*** that the stock sale will happen after the exchange, because it has obviously already happened.

Under this interpretation, the second reorganization example above would meet the plan requirement for the same reason—the liquidation of LP-CFC that is needed to complete the reorganization would be inevitable from the reference point of the contribution that starts the reorganization.

* 1. Prospectivity arises most commonly with “end [sometimes “close”] of the day” and “next day” provisions. The discussion below will address both section 381 and Treas. Reg. §1.1502-76. Treas. Reg. §1.1502-76 is, in a sense, more sophisticated than section 381 when it comes to issues of timing—it contains a workable rule that answers questions that, in the section 381 context, seem untethered.
     1. In section 381 transactions, both the movement of attributes (section 381(a), flush language) and the end of the tax year (Treas. Reg. §1.381(b)-1(a)(1)) occur at the close of the day of the distribution or transfer of the corporation undergoing the section 381 transaction.
        1. Assume Target and Acquiring are unrelated; Target has E&P while Acquiring has no E&P; Target mergers into Acquiring at noon; and, finally, Acquiring redeems a portion of a significant historic Acquiring shareholder’s stock in a dividend equivalent redemption at 1pm. Is the dividend equivalent redemption out of E&P—i.e., is Target’s E&P “there” in Acquiring at 1pm on the day of the merger?
           1. This transaction does not involve boot in a reorganization, so it is not clear whether *Commissioner v. Clark*, 489 US 726 (1989) has any relevance; but one could still ask whether the *Clark* fiction could be applied to determine “when” the E&P moves.

See Treas. Reg. §1.1502-13(f)(7) Example 3, where S merges into B and there is boot that is treated as a redemption after the reorg; the example contains the following statement: “Because B is treated under section 381(c)(2) as receiving S's earnings and profits and the redemption is treated as occurring after the merger, $100 [which was the *combined* E&P of S and B] of the distribution is treated as a dividend under section 301”.

* + - * 1. See also 1995 FSA LEXIS 380, where, in a reorganization with boot, a field attorney attempted to take section 381’s timing statement seriously, arguing, that, under *Clark*, only the acquiring’s corporation’s E&P should be taken into account because the target corporation’s E&P wouldn’t arrive until the end of the day, after the *Clark* fictions applied. The National Office essentially said No, treat the target corporation’s E&P as arriving at the time of the reorganization, i.e., before the end of the day.
      1. How broadly can the example in Treas. Reg. §1.1502-13, and the reasoning in the FSA, be applied? In a merger between 3rd parties, where transactions occur on the day of the reorganization that give rise to items of income or deduction, is the moment of the merger relevant to determining the tax return on which the items are reported? Section 381 does not have rules like the end of the day rule and the next day rule discussed next.
    1. Treas. Reg. §1.1502-76(b)(1) begins with a general rule that provides that A consolidated return must include the common parent’s items of income, gain, deduction, loss, and credit for the entire consolidated return year, and each subsidiary’s items for the portion of the year for which it is a member. This is followed by the “end of the day rule”, which provides, as relevant here, that if a corporation becomes or ceases to be a member during a consolidated return year, it becomes or ceases to be a member at the end of the day on which its status as a member changes, and its tax year ends for all Federal income tax purposes at the end of that day.
    2. There is debate about whether the general rule and the end of the day rule merely allocate items between the separate and consolidate returns of a corporation, or in fact actually determine the moment at which a corporation joins or leaves the group.
       1. Returning to the example above, where P, the common parent of a consolidated group, transfers assets to a previously unrelated includible corporation, X, in exchange for 80% of X’s sole class of stock in a transaction described in section 351: Is this an intercompany transaction?
          1. If one believes the end of the day rule actually determines the moment of consolidation, this would not be an intercompany transaction. In that case, for example, section 357(c) could apply. See Treas. Reg. §1.1502-80(d) (generally turning off section 357(c) for intercompany section 351 exchanges). But there is another rule relevant to this analysis, namely the next day rule, discussed next.
    3. Interestingly, for many purposes, it doesn’t really matter whether a corporation actually becomes or ceases to be a member at the end of the day; this is because of the next day rule.
       1. If there were no next day rule, and no other authorities one could rely on to soften the effect of end of the day rule, the results would be easier to determine but would not necessarily clearly reflect income: on the day of a status change, all the items of a joining member would go on the separate return, and all the items of a departing member would go on the consolidated return, without regard to the precise time during the day the status-changing event happened, and without any qualitative analysis of the items or of clear reflection
       2. But there is a next day rule, and the next day rule properly allocates transactions that happen during the day of the status-changing event between the separate return and the consolidated return
          1. As a quick aside, what constitutes a proper allocation, and the amount of flexibility taxpayers have to agree to a proper allocation, is beyond the scope of this paper. For background, consider GLAM 2012-010.
          2. The next day rule frequently has the same consequence as treating the member as joining or leaving ***at the time of the status-changing event*** rather than at the end of the day—i.e., a transaction that is allocated under the end of the day rule is like a transaction that arises before the change in status, and a transaction that gets allocated to the next day is like a transaction that arises after the change in status.

As relevant to the section 351 example above, the next day rule applies if an item is from a transaction with respect to member stock, as illustrated by the following example: if a member transfers encumbered land to nonmember S in exchange for additional S stock in a transaction to which section 351 applies and the exchange results in S becoming a member of the consolidated group, the applicability of section 357(c) to the exchange must be determined under Treas. Reg. §1.1502–80(d) by treating the exchange as occurring after the event.

* + - * 1. There can be no doubt that the next day rule practices prospectivity, at least as to the group and everyone related to the group, who must treat any transaction properly allocable to the next day as though it happened at the beginning of the next day
      1. Fact patterns arise, however, where even the sophisticated rules of Treas. Reg. §1.1502-76(b) feel some pressure. In each of the two examples below, FP owns USP1, which is the parent of a consolidated group; USP1 owns (in addition to one or more affiliated members) CFC; and CFC owns USP2, the parent of a second consolidated group.
         1. Example 1: The following steps occur in order between noon and 1pm on a particular day:

CFC distributes all the stock of USP2 to USP1 in a good section 355(c) distribution

USP2 distributes some appreciated assets to USP1 in a section 311(b)/section 301 distribution

* + - * 1. Example 2: Steps i and ii are the same as Example 1; after Step ii, and within the same noon-1pm time period, Step iii: USP1 on-distributes all the stock of USP2 to FP in a good section 355(c) distribution

Even if the end of the day rule should be read literally as to the timing of joining and leaving the group, given the discussion of simultaneity above, nothing would prevent USP2 from becoming and then ceasing to be a member of the USP1 group in order in an instant at the end of the day

This could impact things like liability under Treas. Reg. §1.1502-6 and ability to reconsolidate under section 1504(a)(3).

But how does the next day rule apply where the purported member, USP2 in the example, is not a member at all during the next day?

* 1. As for *Arrowsmith*, everybody knows *Arrowsmith* doesn’t move the tax consequences of an event to a prior tax year; rather, when it applies, it causes the tax consequences of the event to be analyzed based on relationships that existed previously. Another way to say this is that Arrowsmithery is “retroactivity for some purpose, but not all purposes”
     1. Consider Rev. Rul. 83-73, 1983-1 CB 84, which itself cites *Arrowsmith* and is often cited alongside *Arrowsmith*. In this ruling, simplifying somewhat, in 1979, A and B were the shareholders of Z; Z merged into X, and A and B got X stock. However, as a condition to the merger, A and B agreed to indemnify X for a certain contingent liability. In 1981, the contingency crystalized, X paid the claim, and A and B reimbursed X.
        1. The discussion section of the ruling contains the following: “Under the principle of relation-back to the time of the initial exchange, the indemnity payments should be treated as if they had been contributions to the capital of the transferor corporation, ***made by its shareholders immediately before the merger***. *See* *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952), 1952-2 C.B. 136.” (Emphasis added.)
        2. It seems this sentence should be understood to mean “made by its shareholders immediately before the merger solely for purposes of determining today what are the consequences to A and B”, or something along these lines. Actually treating the capital contribution as happening before the merger enervate *Arrowsmith*. For example, say the contingency was resolved in 1991 rather than 1981, but A had sold some of the shares of X stock in 1981. The correct answer under *Arrowsmith* would seem to be to give A capital loss in 1991; see Treas. Reg. §1.338-7(e), Example 1, discussed below; but if A is instead treated as making a capital contribution in 1979 and selling the X stock with a higher basis in 1981, A’s 1981 tax year would be closed, denying A the benefit of *Arrowsmith*.
     2. Arrowsmith frequently arises in the context of spinoff transactions, about which more below; but to make the reader aware, private letter rulings have used different formulations in applying *Arrowsmith*, with three examples quoted here.
        1. From PLR 2023 40 015, Ruling 13: Payments made between Distributing and Controlled and their respective affiliates under any of the Continuing Arrangements regarding liabilities, indemnities or other obligations that (i) have arisen or will arise for a taxable period ending on or before the Proposed Transaction or for a taxable period beginning before and ending after the Proposed Transaction and (ii) will not become fixed and ascertainable until after the Proposed Transaction, ***will be viewed as occurring immediately before the Proposed Transaction***. *Cf*. *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952); Rev. Rul. 83-73, 1983-1 C.B. 84.
        2. From PLR 2023 39 007, Ruling 17: Except for purposes of section 355(g), any post-Internal Spin 2 payments (i.e., any Post-Distribution Payments) made between Distributing 2 and Controlled 1, if any, that: (i) have arisen or will arise for a taxable period ending on or before Internal Spin 2 or for a taxable year beginning before and ending after Internal Spin 2; and (ii) will not become fixed and ascertainable until after Internal Spin 2, ***will be treated as occurring immediately before Internal Spin 2***. *See* *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952); Rev. Rul. 83-73, 1983-1 C.B. 84.
        3. From PLR 2023 30 002, Ruling 16: Any payments made between any of Distributing and Controlled and their respective affiliates under any of the Continuing Arrangements regarding liabilities, indemnities, or other obligations that (i) have arisen or will arise for a taxable period ending on or before the Initial Distribution or for a taxable year beginning before and ending after the Initial Distribution, and (ii) will not become fixed and ascertainable until after the Initial Distribution ***will be characterized in a manner consistent with the proper treatment if such payments or transfers had occurred immediately before the Initial Distribution pursuant to the Spin-Off***. *See* *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952) and Revenue Ruling 83-73, 1983-1 C.B. 84.
     3. Example involving a spin-off: As part of the packaging up needed for a public spin, there is an internal spin where certain assets owned by D do not get transferred to C at the time of D’s spin of C. After the spin to the public, the assets are transferred between the two public companies
        1. Assume the later transfer is from D in the Remainco public company to C in the Spinco public company.
           1. Scope of *Arrowsmith*. On first blush, it seems D would recognize no gain on the later transfer to C, and C would have no income

Does it matter why the assets weren’t transferred at the time of the internal spin—e.g., mistake (the assets just weren’t identified as “belonging to C” at the time of the spin), vs. regulatory approval (or similar) that needs to occur before the transfer?

Does it matter if the later transfer is pursuant to a binding commitment to transfer the assets once the contingencies are resolved? If D had contributed to C an obligation that constituted ***debt*** for tax purposes, and later retired the debt with the assets, presumably D would recognize gain; what’s the difference between a debt and a binding commitment that is not debt?

* + - * 1. How to apply *Arrowsmith*.

What if the later transfer includes enough liabilities that there would have been section 357(c) gain if they had been included in the first transfer? This seems like classic Arrowsmithery: D would have gain in the year of the transfer, not gain in the year of the spinoff.

If holding period is relevant to determining character, what holding period should D use—as of the spinoff or as of the later transfer?

If some of the gain could be treated as a dividend under section 1248 amount, what section 1248 E&P should D use—as of the spinoff or as of the later transfer?

What if the assets are transferred directly to an entity in the Spinco public company that is C’s parent? Is *Arrowsmith* turned off and thus D has gain (under section 1001) in the year of the transfer, or does *Arrowsmith* apply and thus C has gain (under section 311(b)) in the year of the transfer?

How is E&P determined? Assume at the time of the spinoff the assets subject to the contingency are worth $100 and the contingency is 70% likely to be resolved in a way that permits the later transfer to occur. Do we apply Treas. Reg. §1.312-10 at the time of the spinoff by including $70 of value for these assets, thus allocating additional E&P based on the contingent value? (But if so, what basis does this value have at the time of the spinoff?) Or do we include no value for purposes of allocating E&P, and let future distributions be resolved by applying *Arrowsmith*?

Assume you take latter position of including no value for purposes of Treas. Reg. §1.312-10. Consider what happens if C distributes cash under section 301 ***before*** the later asset transfer, and based on C’s E&P at the time, C’s shareholder has section 301(c)(3) gain.

Does *Arrowsmith* apply to C’s shareholder?

If so, does the shareholder get a loss in the year the asset is transferred to C, to the extent needed to offset the gain that would not have been recognized if the E&P had moved at the time of the spinoff? See Treas. Reg. §1.338-7(e), Example 1, where, upon the resolution of a contingent liability, additional AGUB is allocable to an asset that had been sold before the contingency is resolved. The example concludes that, under Arrowsmith, the corporation gets an immediate loss.

On the other hand, what if C distributes cash under section 301 ***after*** the later asset transfer, and such distribution would all be out of E&P if E&P the value of the later transferred assets had been taken into account in the Treas. Reg. §1.312-10 allocation? Applying *Arrowsmith*, the proper character of this later distribution would appear to be as a section 301(c)***(1)*** distribution, exactly the same as treating the transaction as happening retroactively.

* + - 1. Thus, in a number of cases, applying *Arrowsmith* reaches a result identical to retroactivity. And as the example from the section 338 regulations shows, Arrowsmith goes beyond characterizing items that would otherwise be recognized without regard to Arrowsmith, but in fact can cause an item to arise in a particular. Taxpayers, know your attributes!

1. Through Two Doors at Once
   1. Deemed transactions present a unique set of issues when it comes to timing. Sometimes these transactions are referred to as reordering transactions, but they can only be described as reorderings in a general sense—and the general sense misses some key points. For example, in Rev. Rul. 70-140, discussed in more detail below, one can speak generally and say that the ruling reorders the asset contribution and the stock acquisition. But in fact, “the asset contribution” is not reordered, but is changed—i.e., from a contribution from A to X into a contribution from Y to X; and similarly the stock acquisition is changed from Y’s acquisition of X stock from A to Y’s acquisition of less valuable X stock and some assets from A. This is a crucial principle when assessing time’s role—the deemed transactions are different transactions from the actual transactions, and it seems a tragic falling off of analysis to treat them as the same transactions that happen in a different order and to analyze the timing elements on this basis. Stated differently, it doesn’t seem sufficient to say “I’m not going to ‘time-travel’, I’m just going to treat the asset transfer as happening when it happens”, because there is no “***the*** asset transfer”—truth’s an indefinite article, and in fact the deemed transaction is a different transaction from the actual transaction.
   2. With this principle in mind, consider Rev. Rul. 70-140, with some additional facts to flesh out the transaction.
      1. As an aside, the discussion reserves on whether Rev. Rul. 70-140 is a correct statement of the law. To note, Treas. Reg. §1.338(h)(10)-1(e) Example 4 seems to think that the recast is appropriate in some circumstances.
      2. As additional facts to Rev. Rul. 70-140, assume the signed business deal between A and Y is that at close, A will deliver the stock of X in exchange for Y voting stock, and at that time X will already own the assets of A’s sole proprietorship—i.e., it is A’s responsibility to contribute the sole proprietorship to X before Y acquires the X stock. Assume further that there will be a lengthy delay between sign and close that is beyond the parties’ control. Finally, assume A is not willing to challenge Rev. Rul. 70-140 and treat the transaction as a tax-free section 351 exchange followed by a B reorganization—and Y certainly doesn’t mind taking a stepped-up basis in the assets. However, A realizes that if the sole proprietorship was contributed soon after signing, and if the income generated by the business between sign and close were ***X’s*** income rather than A’s, A’s overall US tax burden would be less (because of losses in X or whatever). Assume Y is indifferent to when the sole proprietorship is contributed, as long as it is before close. With this as background, A contributes the sole proprietorship to X the day after signing, and reports the income as X’s income during the period from signing to closing, citing *WAGE* and *Snively*.
         1. In *WAGE*, two related corporations (there was significant, but not 100%, overlap among the shareholders), WAGE and Sentinel, were combined in a transaction where Sentinel was contributed into WAGE for newly issued shares on August 31, and Sentinel merged upstream into WAGE on December 31, of 1943. The Court concluded the combination was a reorganization (under section 112(b)(4) of the 1939 Code). *WAGE Inc. v. Commissioner*, 19 TC 249 (1952).
            1. The Court agreed with the government that WAGE was not entitled to a credit for “invested equity capital”, which was only available if the transaction was treated as ***WAGE acquiring the stock in Sentinel from the shareholders***; but agreed with WAGE that WAGE’s income ***did not include Sentinel’s items of income*** from September 1 through December 31, 1943.
         2. *Snively* was ***literally*** a “fruits from the tree” case: The taxpayer, one Snively, owned and operated a citrus orchard as a sole proprietorship, and wished to acquire a second orchard from an unrelated closely held corporation, Meloso. After discussing with their tax advisors, the parties agreed to and implemented a transaction in which Snively purchased the Meloso stock on July 15, and Snively caused Meloso to liquidate on December 31, of 1943. The fruit in the Meloso orchard ripened and was sold between July and December, generating income. *Snively v. Commission*, 19 TC 850 (1953), affd 219 F2d 66 (5th Cir 1955).
            1. The Court agreed with Snively that he ***realized no gain on the stock*** of Meloso upon the liquidation, because the transaction was properly treated as a direct asset acquisition; but agreed with the government that the profits from the Meloso orchard in 1943 ***was income of Meloso, not Snively***.
      3. Is this how it works—A and Y can agree that the Rev. Rul. 70-140 recast is correct, but yet A can take a position that is fundamentally inconsistent with that recast, based on 70-year-old cases from the dawn of the *Kimbell-Diamond* era? An understandable reaction to this—paraphrasing Eric the Clown (*Seinfeld*, Season 5, “The Fire”)—might be “You’re livin’ in the past, man! You’re hung up on some cases from the ***fifties***, man!”
   3. In *WAGE* and *Snively*, treatment as an asset acquisition was obviously dependent on a condition subsequent—i.e., the later liquidation. It is worth noting that this did not concern the Courts at all. Along these lines, consider a transaction like the transaction in Rev. Rul. 83-142, where a spinoff is accomplished through circular consideration: Shareholder owns Distributing and Distributing owns Controlled, and for good business reasons Shareholder acquires Controlled in exchange for a note or cash, and, pursuant to the plan, Distributing distributes the note or cash back to Shareholder. If the later legal distribution of the note or cash is a month later, or in the following tax year, when is the section 355 distribution deemed to happen? It would seem to happen when it happens; the fact that completing the circle of the cash is a condition subsequent to the transaction being described in section 355 is irrelevant as to the timing of the section 355 distribution. This principle is relevant to the reorganization fact pattern considered next.
   4. Consider next a C reorganization, implement under the following facts: USP owns 100% of CFC Acquiring, and unrelated FP owns 100% of CFC Target, which is a CFC because FP owns a US subsidiary (i.e., because of the changes to section 958(b)(4)), but CFC Target has no “US shareholder”. Every entity is calendar year for US tax purposes. Pursuant to a plan of reorganization and a binding commitment entered into by all relevant parties, two steps occur: **Step 1:** At noon on June 30, 2024, CFC Acquiring acquires 100% of the stock of CFC Target in exchange for CFC Acquiring stock. This is referred to as the “**Stock Acquisition**”. **Step 2:** At noon on April 30, 2025, CFC Target liquidates. This is referred to as the “**Liquidation**”. The Stock Acquisition and Liquidation, if recast under Rev. Rul. 67-274, meet all the requirements of a C reorganization, and all parties to the transaction will consistently report it as such. Moreover, after the transaction USP continues to own at least 10% of the stock of CFC Acquiring.
      1. Thequestion that drives the lengthy discussion to follow is: When are the “**section 381 events**” for this C reorganization—i.e., when do CFC Target’s attributes move and CFC Target’s tax year: June 30, 2024, or April 30, 2025?
      2. The discussion below considers four options, which derive principally from two things:
         1. How strongly does one believe that, in a Rev. Rul. 67-274-style recast, the actual steps of the transaction are ignored, and the transaction is treated as though the subchapter C fictions—i.e., section 361(a) exchange, section 361(c) distribution/section 354 exchange—actually occur?
            1. The author believes it is well established that the actual steps of the transaction are ignored and the subchapter C fictions are treated as actually occurring. The recent case *TBL Licensing v. Commissioner*, 2023 U.S. App. LEXIS 23898 (1st Cir 2023) affirms this long-standing principle.

While the parties in *TBL Licensing* stipulated, rather than the Tax Court and the Court of Appeals concluding, that the subchapter C fictions applied, it is hard to believe both Courts wrote eloquently about the fictions, ***and*** reached an ultimate conclusion on the basis of them being correct, if the Courts thought they were incorrect.  Moreover, the Courts did expressly conclude that once you accept the subchapter C fictions, you apply the tax law ***to those fictions***, not to the actual transactions.

Assuming *Snively* (a taxable sale) and *WAGE* (a reorg) are still good law, even ***they*** don’t go so far as to say the acquiring corporation is treated as acquiring the stock of the target corporation—i.e., even they respect the fictional transfers as occurring. In fact, they expressly confirm that the acquiring corporation is ***not*** treated as acquiring or holding the stock of the target corporation. These cases do no more than treat certain items of income and deduction as items taxable to a corporation rather than an individual

Mover, the IRS has consistently stated that the acquiring corporation in a stock-acquisition-and-liquidation-style transaction is treated as acquiring assets, with some of the more highly regarded vintages being 1967, 2001, 2004, and 2008.

See Rev. Rul. 67-274, 1967-2 C.B. 141; Rev. Rul. 2001-46, 2001-2 C.B. 321; Rev. Rul. 2004-83, 2004-2 C.B. 157; Rev. Rul. 2008-25, 2008-1 C.B. 986.

* + - 1. What do section 381 and the regulations thereunder require as to the timing of the section 381 events?
         1. As discussed above in the section about prospectivity, but addressed here with a slightly different emphasis: In a reorganization the section 381 events occur at the end of ***the day*** ***of the transfer of the assets in the reorganization***. Treas. Reg. §1.381(b)-1(b)(1).

For this purpose, in general the day of the transfer is the day on which all of the properties to be transferred in the reorganization are transferred. But if the transfer of all such properties is not made on one day, the day of the transfer is the day on which the transfer of all such properties are transferred. Treas. Reg. §1.381(b)-1(b)(1).

There is an election, not further discussed, where parties can treat the transfer of substantially all, rather than all, the properties to be transferred as the day of transfer, where certain other conditions are met. Treas. Reg. §1.381(b)-1(b)(1).

* + 1. And now…the options
       1. Option 1. Apply simultaneity, i.e., treat the subchapter C fictions as applying in the simultaneous instant that is the stock acquisition. This view has great explanatory power: It explains why FP owns stock in CFC Acquiring—i.e., because CFC Target has already liquidated and distributed the CFC Acquiring stock to FP; and it explains the economics, i.e., that FP and USP now jointly own the operations of CFC Acquiring and CFC Target. Finally, the fact that it relies on a condition subsequent—i.e., the legal liquidation of CFC Target into CFC Acquiring—to complete the reorganization should not be problematic for the reasons discussed above.
          1. Under Option 1, CFC Target’s attributes would move, and CFC Target’s tax year would end, on June 30, 2024.
          2. Also, to be clear, Option 1, by itself, does not determine which of the following two alternative views, x) or y), is correct: treat CFC Acquiring as contributing the former CFC Target assets to “New CFC Target”, with **x)** New CFC Target being respected as a subsidiary that later liquidates on April 30, 2025, or **y)** New CFC Target being disregarded as transitory. This question can be analyzed under authorities such as Rev. Rul. 68-602 (1968-2 C.B. 135), as well as under *WAGE* and *Snively* themselves—in particular, one might feel that *WAGE*’s and *Snively*’s apparent insistence on allocating items of income to a subsidiary corporation might override Rev. Rul. 68-602 in this context.
       2. Option 2. Apply simultaneity for all federal tax purposes ***other than section 381***.  It is not clear what authority supports this option. While *TBL Licensing* doesn’t address section 381, it seems country to the view that only particular portions of the tax law apply to the subchapter C fictions. And our old friends *WAGE* and *Snively* don’t address section 381; rather, these cases focus only on taxing particular items to a particular tax person (i.e., a subsidiary corporation).  But if one accepts this option, one could take the position that CFC Target’s attributes move and CFC Target’s tax year ends on April 30, 2025.  In other words, under this view, one can “turn off” section 381’s normal application—which would be to apply on the day of the asset transfer that occurs under the subchapter C fictions, namely June 30, 2024—and instead choose to apply section 381 on April 30, 2025.  For completeness, under this view, presumably CFC Target would have a natural tax-year-end on December 31, 2024.
       3. Option 3. Start from the opposite end: Start by assuming the section 381 events for CFC Target occur on April 30, 2025, i.e., the date of the legal liquidation, and see what the subchapter C fictions would have to look like to explain this approach. As with Option 2, it is not clear what authority supports this option. Moreover, the subchapter C fictions get a little complicated under this approach: If CFC Target’s attributes move and CFC Target’s tax year ends on April 30, 2025, it ***must*** be the case that April 30, 2025, is the day of the transfer of assets from CFC Target to CFC Acquiring.  This is because section 381 governs the movement of attributes and the ending of tax years in reorganizations, and, as noted above, section 381 is absolutely clear that the attributes move and the tax year ends on the day of the asset transfer.  What fictions would be needed to describe a transaction where FP receives CFC Acquiring stock equal to the value of the CFC Target assets on June 30, 2024, but CFC Target doesn’t actually transfer those assets to CFC Acquiring until April 30, 2025? Perhaps the following fictions would do it: **a)** CFC Acquiring “prepays” for the CFC Target assets with CFC Acquiring stock on June 30, 2024; **b)** on April 30, 2025, CFC Target transfers the assets to CFC Acquiring, which causes CFC Target’s attributes to move and CFC Target’s tax year to end; **c)** CFC Target does something else on June 30, 2024, namely it distributes the CFC Acquiring stock to FP, which explains why FP owns CFC Acquiring stock; and, finally, **d)** CFC Target also does something else on April 30, 2025, namely it liquidates into FP, completing the reorganization.
       4. Option 4. Treat CFC Target as historic CFC Target until April 30, 2025, at which time it liquidates. That is, treat the transaction exactly as a B reorganization followed by a section 332 liquidation. But a C reorganization that is taxed exactly like a B reorganization followed by a section 332 liquidation is not a C reorganization, it is a B reorganization followed by a section 332 liquidation.
    2. Private letter rulings. To make the reader aware, there are a number of private letter rulings that address this type of fact pattern. Only one of these seems to apply Option 1. It is not clear whether the others are applying one of the other options above, or a different theory. It is worth a reminder of the obvious point that private letter rulings are requested by taxpayers, and taxpayers invariably withdraw if the IRS decides not to provide the requested ruling.
       1. PLR 89 25 087 appears to apply Option 1. It includes a statement that “for purposes of §1.381(b)-1, the date of the proposed transaction shall be the date on which Parent acquires the stock of the Target”. However, it is worth noting that the upstream transaction happened on the same day as the stock acquisition.
       2. The following PLRs are silent on the timing of the section 381 events, and in fact do not cite section 381 at all; but respect the target as a separate entity before the upstream transaction (presumably under some application of *WAGE* and/or *Snively*): PLR 98 36 032, PLR 98 40 004, PLR 1999 10 038, PLR 1999 15 013, PLR 1999 24 038, PLR 1999 24 042, and PLR 1999 51 012.
       3. PLR 2010 02 027 is silent on the timing of the section 381 event, but seems to cite section 381 as ***support*** for respecting the target as a separate entity before the upstream transaction.
       4. PLR 201213019 expressly rules that the section 381 events occur at the time of the upstream transaction.
  1. Ramifications for the C reorganization example
     1. If one believes in the subchapter C fictions apply, CFC Acquiring never becomes a shareholder of CFC Target. This means ***USP*** never becomes a ***US shareholder*** of CFC Target. Thus, USP has no GILTI inclusion resulting from CFC Target’s items of income up to and including the day of the Stock Acquisition.
        1. This is because the GILTI inclusion for a US shareholder’s tax year is based on the US shareholder’s “net CFC tested income”, which is determined for each tax year of a CFC that ends in or with the tax year of the US shareholder.
           1. For this purpose, it doesn’t matter whether CFC Target’s tax year ends June 30, 2024, or April 30, 2025—if CFC Acquiring never becomes a shareholder of CFC Target, and thus USP never becomes a US shareholder of CFC Target, USP cannot have a GILTI inclusion with respect to CFC Target’s items.
           2. It also doesn’t matter whether it is proper to treat CFC Acquiring as owning the stock of “New CFC Target” from July 1, 2024, through April 30, 2025, as discussed as a possibility above, because New CFC Target would, at most, be a new corporation that only starts generating items of income on July 1, 2024.
     2. Selected additional ramifications
        1. In Option 1, CFC Acquiring succeeds to and takes into account CFC Target’s E&P (as accumulated E&P), and CFC Target’s tax year ends, with the close of June 30, 2024
           1. Moreover, net CFC tested income that arises from activity of CFC Target from July 1, 2024, through December 31, 2024, and from January 1, 2025, through April 30, 2025—i.e., during the period following the Stock Acquisition in which CFC Target is legally still in existence—will be included in determining USP’s GILTI inclusions in USP’s 2024 and 2025, tax years, respectively. This is true regardless of whether or not the legal entity “CFC Target” is respected as “New CFC Target” during the interim period, although the exact computation of GILTI could differ depending on whether CFC Target is respected as New CFC Target.
        2. In Option 2, where the subchapter C fictions apply for all purposes other than section 381, starting with the easy question, items of net tested income that result from activity of the legal entity CFC Target starting July 1, 2024, would be taken into account in determining USP’s GILTI—because under this option, the assets of CFC Target are treated as transferred to CFC Acquiring on June 30, 2024, for all purposes other than section 381.
           1. The hard question: What is the proper treatment for items of net CFC tested income that arise from January 1 through June 30, 2024? The GILTI inclusion hinges on a tax-year end; but under this option, CFC Target doesn’t have a tax-year-end on June 30, 2024. Does CFC Target’s final tax year run from January 1, 2024, through April 30, 2025?
        3. In Option 3, CFC Target would have a tax-year-end on December 31, 2024, as well as April 30, 2025.
           1. Contrary to Option 1, this would cause CFC Target’s items of net CFC tested income for the entire 2024 year—not just from January 1 through June 30, 2024—to avoid being taken into account as GILTI. This is because CFC Target would be treated as continuing to own its assets throughout 2024, during which time FP, rather than USP, would be the shareholder of CFC Acquiring (the view that there would no GILTI is based on the further assumption that FP itself has no US shareholder). For the same reason, CFC Target’s net CFC tested income from January 1 through April 30, 2025, also would not be taken into account as GILTI—CFC Target would retain its assets, and remain wholly owned by FP, until April 30, 2025, and thus there would be no US shareholder. From May 1, 2025, onward, the items from CFC Target’s operations would be included in GILTI.
        4. In Option 4, all of CFC Target’s items of net CFC tested income for the 2024 year—i.e., from January 1 through December 31—would be included in USP’s GILTI for 2024, and, similarly, all of CFC Target’s items of net CFC tested income for 2025 would be included in USP’s GILTI (for the period through April 30, in CFC Target as a separate CFC; for the period starting May 1, with the CFC Target operations including in CFC Acquiring’s items). This is because USP would become a US shareholder of CFC Target on June 30, 2024, in the middle of CFC Target’s tax year; and CFC Target would have a tax-year-end on December 31, 2024, and again on April 30, 2025.
  2. A different timing concern arises in the context of public company F reorganizations
     1. In PLR 2023 39 009, simplifying somewhat, publicly traded Parent formed a corporation, Resulting, with nominal consideration, and then the Parent public shareholders exchanged their Parent shares for Resulting shares, with Parent’s nominal shares in Resulting being canceled
     2. Some days later, Parent converted to an entity that was an eligible entity for purposes of the check-the-box regulations, and thereafter Parent elected to be disregarded.
     3. The taxpayer represented that “No planned purchase or sale of stock of Resulting during the period of time between the Resulting Exchange and the Election will be included as part of the Plan of Reorganization”
     4. The IRS ruled as follows
        1. “The period of time between the Resulting Exchange and the Election will not prevent the Proposed Transaction from qualifying as a reorganization under section 368(a)(1)(F).”
        2. “Sales or exchanges of Resulting stock during the period of time between the Resulting Exchange and the Election will not prevent the Proposed Transaction from qualifying as a reorganization under section 368(a)(1)(F). Treas. Reg. §1.368-2(m)(1)(ii).”
     5. It is not clear whether the ruling is applying Option 1 or is instead concluding that the F reorg does not happen simultaneously with the stock acquisition but nonetheless the taxpayer can ignore any changes in shareholders that occur “in the middle of the F”