

Pub. L. 94-455, §806(f)(2), which substituted, in sections 383 as related to section 382(a) and (b) of this title, provisions that the net operating loss limitations in section 382 shall apply to unused investment credits under section 46(b), to unused work incentive program credits under section 50A(b), to excess foreign taxes under section 904(d) and to net capital losses under section 1212 for provisions that the net operating loss carryover limitations in section 382 shall apply, in the case of ownership changes described in section 382(a)(1) or reorganizations specified in section 381(a)(2) resulting in ownership changes described in section 382(b)(1)(B), to unused investment credits under section 46(b), to unused work incentive program credits under section 50A(B), to excess foreign taxes under section 904(c), and to net capital losses under section 1212, was repealed by Pub. L. 99-514, §621(e)(1). See Effective Date of 1986 and 1976 Amendment notes below.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 621(b) of Pub. L. 99-514 applicable to any ownership change after Dec. 31, 1986, except as otherwise provided, see section 621(f) of Pub. L. 99-514, as amended, set out as a note under section 382 of this title.

Repeal of amendment by section 806(f)(1) of Pub. L. 94-455 effective Jan. 1, 1986, with certain exceptions, see section 621(f)(2) of Pub. L. 99-514, set out as a note under section 382 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 applicable to taxable years beginning after Dec. 31, 1983, and to carrybacks from such years, see section 475(a) of Pub. L. 98-369, set out as a note under section 21 of this title.

EFFECTIVE DATE OF 1981 AMENDMENT

Amendment by section 221(b)(1)(C), (D) of Pub. L. 97-34 applicable to amounts paid or incurred after June 30, 1981, see section 221(d) of Pub. L. 97-34, as amended, set out as an Effective Date note under section 41 of this title.

Amendment by section 331(d)(1)(C), (D) of Pub. L. 97-34 applicable to taxable years beginning after Dec. 31, 1981, see section 339 of Pub. L. 97-34, set out as a note under section 401 of this title.

EFFECTIVE DATE OF 1980 AMENDMENTS

Amendment by Pub. L. 96-223 applicable to sales or uses after Sept. 30, 1980, in taxable years ending after such date, see section 232(h)(1) of Pub. L. 96-223, set out as an Effective Date note under section 40 of this title.

Amendment by Pub. L. 96-222 effective, except as otherwise provided, as if it had been included in the provisions of the Revenue Act of 1978, Pub. L. 95-600, Nov. 6, 1978, 92 Stat. 2763, to which such amendment relates, see section 201 of Pub. L. 96-222, set out as a note under section 32 of this title.

EFFECTIVE DATE OF 1976 AMENDMENT

For effective date of amendment by section 1031(b)(5) of Pub. L. 94-455, see section 1031(c) of Pub. L. 94-455, set out as a note under section 904 of this title.

For purposes of applying this section (as it relates to section 382(a) of this title) as amended by section 806(e), (f) of Pub. L. 94-455, the amendments made by section 806(e), (f) of Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1985, with specified provisions for determining the beginning of the taxable years specified in section 382(a)(1)(B)(ii) of this title, and this section (as it relates to section 382(b) of this title) as amended by section 806(e), (f) of Pub. L. 94-455 to apply (and such sections as in effect prior to such amendment not to apply) to reorganizations pursuant to a plan of reorganization adopted by one or more of the parties thereto on or after Jan. 1, 1986, see section 806(g)(2), (3) of Pub. L. 94-455, as amended, formerly set out as a note under section 382 of this title.

EFFECTIVE DATE

Pub. L. 92-178, title III, §302(c), Dec. 10, 1971, 85 Stat. 521, provided that: "The amendments made by this section [enacting this section] shall be applicable only with respect to reorganizations and other changes in ownership occurring after the date of enactment of this Act [Dec. 10, 1971] pursuant to a plan of reorganization or contract entered into on or after September 29, 1971."

DELAY IN EFFECTIVE DATE OF 1976 AMENDMENT

For election by taxpayer for application of prior law with respect to any acquisition or reorganization occurring before the end of the taxpayer's first taxable year beginning after June 30, 1978, see section 368 of Pub. L. 95-600, set out as a Delay in Effective Date of 1976 Amendment note under section 382 of this title.

§ 384. Limitation on use of preacquisition losses to offset built-in gains

(a) General rule

If—

(1)(A) a corporation acquires directly (or through 1 or more other corporations) control of another corporation, or

(B) the assets of a corporation are acquired by another corporation in a reorganization described in subparagraph (A), (C), or (D) of section 368(a)(1), and

(2) either of such corporations is a gain corporation,

income for any recognition period taxable year (to the extent attributable to recognized built-in gains) shall not be offset by any preacquisition loss (other than a preacquisition loss of the gain corporation).

(b) Exception where corporations under common control

(1) In general

Subsection (a) shall not apply to the preacquisition loss of any corporation if such corporation and the gain corporation were members of the same controlled group at all times during the 5-year period ending on the acquisition date.

(2) Controlled group

For purposes of this subsection, the term "controlled group" means a controlled group of corporations (as defined in section 1563(a)); except that—

(A) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears,

(B) the ownership requirements of section 1563(a) must be met both with respect to voting power and value, and

(C) the determination shall be made without regard to subsection (a)(4) of section 1563.

(3) Shorter period where corporations not in existence for 5 years

If either of the corporations referred to in paragraph (1) was not in existence throughout the 5-year period referred to in paragraph (1), the period during which such corporation was in existence (or if both, the shorter of such periods) shall be substituted for such 5-year period.

(c) Definitions

For purposes of this section—

(1) Recognized built-in gain**(A) In general**

The term “recognized built-in gain” means any gain recognized during the recognition period on the disposition of any asset except to the extent the gain corporation (or, in any case described in subsection (a)(1)(B), the acquiring corporation) establishes that—

- (i) such asset was not held by the gain corporation on the acquisition date, or
- (ii) such gain exceeds the excess (if any) of—

(I) the fair market value of such asset on the acquisition date, over

(II) the adjusted basis of such asset on such date.

(B) Treatment of certain income items

Any item of income which is properly taken into account for any recognition period taxable year but which is attributable to periods before the acquisition date shall be treated as a recognized built-in gain for the taxable year in which it is properly taken into account and shall be taken into account in determining the amount of the net unrealized built-in gain.

(C) Limitation

The amount of the recognized built-in gains for any recognition period taxable year shall not exceed—

- (i) the net unrealized built-in gain, reduced by
- (ii) the recognized built-in gains for prior years ending in the recognition period which (but for this section) would have been offset by preacquisition losses.

(2) Acquisition date

The term “acquisition date” means—

(A) in any case described in subsection (a)(1)(A), the date on which the acquisition of control occurs, or

(B) in any case described in subsection (a)(1)(B), the date of the transfer in the reorganization.

(3) Preacquisition loss**(A) In general**

The term “preacquisition loss” means—

(i) any net operating loss carryforward to the taxable year in which the acquisition date occurs, and

(ii) any net operating loss for the taxable year in which the acquisition date occurs to the extent such loss is allocable to the period in such year on or before the acquisition date.

Except as provided in regulations, the net operating loss shall, for purposes of clause (ii), be allocated ratably to each day in the year.

(B) Treatment of recognized built-in loss

In the case of a corporation with a net unrealized built-in loss, the term “preacquisition loss” includes any recognized built-in loss.

(4) Gain corporation

The term “gain corporation” means any corporation with a net unrealized built-in gain.

(5) Control

The term “control” means ownership of stock in a corporation which meets the requirements of section 1504(a)(2).

(6) Treatment of members of same group

Except as provided in regulations and except for purposes of subsection (b), all corporations which are members of the same affiliated group immediately before the acquisition date shall be treated as 1 corporation. To the extent provided in regulations, section 1504 shall be applied without regard to subsection (b) thereof for purposes of the preceding sentence.

(7) Treatment of predecessors and successors

Any reference in this section to a corporation shall include a reference to any predecessor or successor thereof.

(8) Other definitions

Except as provided in regulations, the terms “net unrealized built-in gain”, “net unrealized built-in loss”, “recognized built-in loss”, “recognition period”, and “recognition period taxable year”, have the same respective meanings as when used in section 382(h), except that the acquisition date shall be taken into account in lieu of the change date.

(d) Limitation also to apply to excess credits or net capital losses

Rules similar to the rules of subsection (a) shall also apply in the case of any excess credit (as defined in section 383(a)(2)) or net capital loss.

(e) Ordering rules for net operating losses, etc.**(1) Carryover rules**

If any preacquisition loss may not offset a recognized built-in gain by reason of this section, such gain shall not be taken into account in determining under section 172(b)(2) the amount of such loss which may be carried to other taxable years. A similar rule shall apply in the case of any excess credit or net capital loss limited by reason of subsection (d).

(2) Ordering rule for losses carried from same taxable year

In any case in which—

(A) a preacquisition loss for any taxable year is subject to limitation under subsection (a), and

(B) a net operating loss from such taxable year is not subject to such limitation,

taxable income shall be treated as having been offset 1st by the loss subject to such limitation.

(f) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including regulations to ensure that the purposes of this section may not be circumvented through—

(1) the use of any provision of law or regulations (including subchapter K of this chapter), or

(2) contributions of property to a corporation.

(Added Pub. L. 100-203, title X, §10226(a), Dec. 22, 1987, 101 Stat. 1330-414; amended Pub. L. 100-647,

title II, §2004(m)(1)–(4), Nov. 10, 1988, 102 Stat. 3606, 3607; Pub. L. 101–239, title VII, §7812(c)(1), Dec. 19, 1989, 103 Stat. 2412.)

AMENDMENTS

1989—Subsec. (e)(1). Pub. L. 101–239 substituted “built-in gain” for “build-in gain”.

1988—Subsec. (a). Pub. L. 100–647, §2004(m)(1)(A), amended subsec. (a) generally, making changes in substance and structure.

Subsec. (b). Pub. L. 100–647, §2004(m)(3), substituted “corporations under common control” for “50 percent of gain corporation held” in heading and amended text generally. Prior to amendment, text read as follows: “Subsection (a) shall not apply if more than 50 percent of the stock (by vote and value) of the gain corporation was held throughout the 5-year period ending on the acquisition date—

“(1) in any case described in subsection (a)(1), by members of the affiliated group referred to in subsection (a)(1), or

“(2) in any case described in subsection (a)(2), by the acquiring corporation or members of such acquiring corporation’s affiliated group.

For purposes of the preceding sentence, stock described in section 1504(a)(4) shall not be taken into account.”

Subsec. (c)(1)(A). Pub. L. 100–647, §2004(m)(1)(D), substituted “subsection (a)(1)(B)” for “subsection (a)(2)”.

Subsec. (c)(2). Pub. L. 100–647, §2004(m)(1)(C), amended par. (2) generally. Prior to amendment, par. (2) read as follows: “The term ‘acquisition date’ means the date on which the gain corporation becomes a member of the affiliated group or, in any case described in subsection (a)(2), the date of the distribution or transfer in the liquidation or reorganization.”

Subsec. (c)(4) to (8). Pub. L. 100–647, §2004(m)(1)(B), redesignated par. (4) as (8) and added pars. (4) to (7).

Subsecs. (e), (f). Pub. L. 100–647, §2004(m)(2), (4), substituted “a corporation” for “the gain corporation” in subsec. (e)(2), redesignated subsec. (e) as (f), and added subsec. (e).

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101–239 effective, except as otherwise provided, as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100–647, to which such amendment relates, see section 7817 of Pub. L. 101–239, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100–647 effective, except as otherwise provided, as if included in the provisions of the Revenue Act of 1987, Pub. L. 100–203, title X, to which such amendment relates, see section 2004(u) of Pub. L. 100–647, set out as a note under section 56 of this title.

EFFECTIVE DATE

Pub. L. 100–203, title X, §10226(c), Dec. 22, 1987, 101 Stat. 1330–416, provided that: “The amendments made by this section [enacting this section] shall apply in cases where the acquisition date (as defined in section 384(c)(2) of the Internal Revenue Code of 1986 as added by this section) is after December 15, 1987; except that such amendments shall not apply in the case of any transaction pursuant to—

“(1) a binding written contract in effect on or before December 15, 1987, or

“(2) a letter of intent or agreement of merger signed on or before December 15, 1987.”

ELECTION TO HAVE AMENDMENTS BY PUB. L. 100–647 NOT APPLY

Pub. L. 100–647, title II, §2004(m)(5), Nov. 10, 1988, 102 Stat. 3607, provided that: “In any case where the acquisition date (as defined in section 384(c)(2) of the 1986 Code as amended by this subsection) is before March 31,

1988, the acquiring corporation may elect to have the amendments made by this subsection not apply. Such an election shall be made in such manner as the Secretary of the Treasury or his delegate shall prescribe and shall be made not later than the later of the due date (including extensions) for filing the return for the taxable year of the acquiring corporation in which the acquisition date occurs or the date 120 days after the date of the enactment of this Act [Nov. 10, 1989]. Such an election, once made, shall be irrevocable.”

PART VI—TREATMENT OF CERTAIN CORPORATE INTERESTS AS STOCK OR INDEBTEDNESS

Sec.

385. Treatment of certain interests in corporations as stock or indebtedness.

AMENDMENTS

1969—Pub. L. 91–172, title IV, §415(a), Dec. 30, 1969, 83 Stat. 613, added part heading and analysis of sections.

§ 385. Treatment of certain interests in corporations as stock or indebtedness

(a) Authority to prescribe regulations

The Secretary is authorized to prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated for purposes of this title as stock or indebtedness (or as in part stock and in part indebtedness).

(b) Factors

The regulations prescribed under this section shall set forth factors which are to be taken into account in determining with respect to a particular factual situation whether a debtor-creditor relationship exists or a corporation-shareholder relationship exists. The factors so set forth in the regulations may include among other factors:

(1) whether there is a written unconditional promise to pay on demand or on a specified date a sum certain in money in return for an adequate consideration in money or money’s worth, and to pay a fixed rate of interest,

(2) whether there is subordination to or preference over any indebtedness of the corporation,

(3) the ratio of debt to equity of the corporation,

(4) whether there is convertibility into the stock of the corporation, and

(5) the relationship between holdings of stock in the corporation and holdings of the interest in question.

(c) Effect of classification by issuer

(1) In general

The characterization (as of the time of issuance) by the issuer as to whether an interest in a corporation is stock or indebtedness shall be binding on such issuer and on all holders of such interest (but shall not be binding on the Secretary).

(2) Notification of inconsistent treatment

Except as provided in regulations, paragraph (1) shall not apply to any holder of an interest if such holder on his return discloses that he is treating such interest in a manner inconsistent with the characterization referred to in paragraph (1).