Corporate and M&A

INTRODUCTION

In 2024, FustCharles continued our commitment to talent development, innovation, and teamwork to provide our clients with a best-in-class service experience. As we turn the page on 2024, there is plenty of uncertainty in the tax landscape. Many TCJA provisions are set to expire at the end of 2025, however as Republicans hold the White House, and have a slim majority in both chambers of Congress, there is an increased likelihood that 2025 will have some level of tax legislation through the budget reconciliation process.

FustCharles tax professionals grasp the intricate connections between evolving laws, economic dynamics, and the tax implications of various business decisions, and are well-positioned to serve as strategic advisors, steering companies toward success. Tax planning remains a vital aspect for businesses seeking to optimize cash flow by managing their long-term tax obligations.

Our 2024 Year-End Tax Planning Guide delves into effective tax strategies, considering recent administrative guidance and potential legislative changes that are currently under review. For further information and assistance, please reach out to a member of our expert tax team.

Unless explicitly stated otherwise, the information provided in this guide is based on existing tax laws and policies as of the publication date, and it may be subject to adjustments in response to future legislative or tax policy changes.

During 2024, the U.S. Department of the Treasury and the IRS issued important tax guidance for U.S. corporations — including long-awaited proposed regulations on the corporate alternative minimum tax and final procedural regulations on the stock repurchase excise tax. These and other key tax developments corporate taxpayers should consider when planning for 2024 and beyond include:

- Corporate Alternative Minimum Tax Guidance Includes Detailed Proposed Regulations
- IRS, Treasury Issue Final Procedural Regulations on Stock Repurchase Excise Tax
- Tax Court Rules for Taxpayer on Related Party Advances
- IRS Rules Stock Contributions Will Not Result in Deemed Dividends or Application of Gift Tax
- Uncertainties Surround Treatment of S Corporation State Law Conversions
- IRS Rules Professional Corporation Arrangement Requires Consolidation

Corporate Alternative Minimum Tax Guidance Includes Detailed Proposed Regulations

The Inflation Reduction Act of 2022 (IRA) created a new corporate alternative minimum tax (CAMT) for taxable years beginning after December 31, 2022. Since being signed into law, the U.S. Department of the Treasury and the Internal Revenue Service have released multiple pieces of guidance culminating in proposed regulations.

Prior Guidance

Prior to issuing proposed regulations, the following notices addressed the application of the CAMT:

- **Notice 2023-7** announced the intent to issue proposed regulations on the CAMT treatment of consolidated groups, depreciation of property under Section 168, troubled corporations, and the determination of applicable corporation status. Importantly, this Notice contained a first-year safe harbor that allowed taxpayers to use a simplified method to determine applicable corporation status.
- **Notice 2023-20** provided interim guidance on the CAMT treatment of variable contracts, certain reinsurance and coinsurance agreements, and adjustments for fresh start accounting.
- **Notice 2023-42** provided penalty relief for underpayments of estimated taxes relating to a taxpayer's CAMT liability for any tax year that begins after December 31, 2022, and before January 1, 2024.
- **Notice 2023-64** provided interim guidance on the determination of a taxpayer's applicable financial statement and adjusted financial statement income (AFSI), including as it relates to consolidated groups and certain foreign corporations.
- **Notice 2024-10** provided targeted relief to reduce double-counting of AFSI for a controlled foreign corporation that pays a dividend to a U.S. shareholder.

- **Notice 2024-33** extended the relief for CAMT liability estimated tax payments due on or before April 15, 2024.
- **Notice 2024-47** further extended the relief for CAMT liability estimated tax payments due on or before August 15, 2024.

Taxpayers may generally rely on these notices from their publication date to the publication of the proposed regulations (discussed below).

In the above-mentioned guidance, the Service released Form 4626, *Alternative Minimum Tax—Corporations* and accompanying instructions for corporate taxpayers to report their applicable corporation calculations and CAMT liability. In addition, Schedule K to Form 1120, *U.S. Corporation Income Tax Return*, was modified to add Line 29 relating to CAMT.

Proposed Regulations

The proposed regulations conform to many aspects of the prior notices but expand on the interim guidance in noteworthy ways, some of which are described below. The length and detail of the proposed regulations highlight the technical complexity of administering and complying with the CAMT regime.

Effective Dates*.* The proposed regulations are prospective in nature. In general, the proposed regulations apply to tax years and transfers ending or occurring, respectively, after September 13, 2024 (i.e., the date the proposed regulations were published in the Federal Register). However, certain aspects of the proposed regulations have different effective dates tied to the date the final regulations are published in the Federal Register, or to the period between September 13, 2024, and the date the final regulations are published in the Federal Register.

Taxpayers may rely on the proposed regulations, subject to a consistency requirement.

Safe Harbor*.* Notice 2023-7 contained a safe harbor that allowed a taxpayer to use a simplified method with fewer adjustments to calculate its AFSI for purposes of determining its applicable corporation status, which dictates whether the corporation is subject to the CAMT regime. The safe harbor reduced the threshold AFSI needed to be an applicable corporation from $1 billion to $500 million (and from $100 million to $50 million for the U.S.-specific prong of the foreign-parented multinational group test). The original safe harbor was only available for the first taxable year beginning after December 31, 2022.

The proposed regulations contain a slightly modified version of the $500 million (or $50 million) safe harbor that is available for years not covered by the original safe harbor.

Other Noteworthy Areas. The following are key areas in which the proposed regulations provide new or more detailed guidance:

- Calculating a corporate partner's distributive share of partnership AFSI;
- Creating deemed foreign-parented multinational groups when there is a non-corporate parent;
- Addressing purchase accounting and other AFSI impacts resulting from M&A transactions;
- Adjusting AFSI for financial statement loss carryforwards;
- Allowing corporations to cease being applicable corporations; and

- Providing relief for bankruptcy or insolvency transactions.

Penalty Waiver: Notice 2024-66

In addition to the proposed regulations, the Service issued Notice 2024-66, which provides a waiver for additional taxes imposed on a corporation that fails to make estimated tax payments related to its CAMT liability for tax years beginning after December 31, 2023, and before January 1, 2025.

As with the previous waivers, this waiver only covers taxes imposed under Section 6655 and does not waive additional taxes for underpayments under other Code Sections, such as Section 6651, which imposes additional tax for payments not made by the due date of the corporation's return (without extension).

Planning Considerations

The proposed CAMT regulations are substantial in detail, technical complexity, and length and include guidance on many areas applicable to M&A transactions. For example, the proposed regulations address certain effects of M&A transactions on the calculation of AFSI. The proposed regulations also significantly increase the scope of the definition of a foreign-parented multinational group to include some common investment structures. Taxpayers should carefully review the potential impact of the proposed regulations when engaging in M&A transactions and restructurings.

IRS, Treasury Issue Final Procedural Regulations on Stock Repurchase Excise Tax

Under the new corporate excise tax, a 1% corporate-level tax is imposed on net stock repurchases occurring after December 31, 2022. The excise tax applies to "covered corporations," which are generally publicly traded domestic corporations, with certain foreign-owned domestic structures being included as well.

The excise tax was enacted as part of the Inflation Reduction Act of 2022, and the Service provided interim guidance in the form of Notice 2023-2 in December 2022. In April 2024, Treasury released proposed regulations incorporating the operating rules set forth in the notice, proposing additional guidance on foreign stock acquisitions, and responding to feedback received with respect to the notice. Separately but on the same day, Treasury also released proposed procedural regulations that articulate how to report and pay the excise tax.

Specifically for the procedural regulations, the Department of the Treasury and the IRS released final regulations on June 28, 2024. The final regulations largely adopt the proposed regulations. For taxable years ending on or before June 28, 2024, stock repurchase excise tax returns were required to be filed by October 31, 2024 (the due date for Form 720 for the third quarter of calendar year 2024). If a covered corporation has more than one taxable year ending after December 31, 2022, and on or before June 28, 2024, it should file a single Form 720 with a separate Form 7208 attached for each year.

Consistent with the proposed regulations, future stock repurchase excise tax returns must be filed by the due date of Form 720 for the first full calendar quarter after the end of the taxable year of the covered corporation. For example, a covered corporation with a tax year ending on December 31, 2024, must file its return by April 30, 2025 (the due date for a first-quarter Form 720).

Planning Considerations

Taxpayers should be aware that in certain leveraged transactions – those involving third-party debt – there may be ambiguity in the application of the excise tax depending on the nature of the funding and the obligors on the facility. Any transactions involving exchanges of public company stock should consider these rules and their impact on structuring.

Tax Court Rules for Taxpayer on Related-Party Advances

In *Estate of Thomas H. Fry v. Commissioner of Internal Revenue,* TC Memo 2024-8 (2024), the Tax Court held Section 385(c), which generally binds a taxpayer to its initial characterization of an investment as either debt or equity, did not apply to cash advances where no formal instruments had been issued. This case may have implications for corporations with undocumented related party advances.

Determining Debt or Equity Treatment for Tax Purposes

Determining whether an interest in a corporation is debt or equity is a fact-intensive inquiry. Courts have traditionally applied multi-factor tests that look at the intent and relationship of the parties, the financial condition of the corporation, and each party's legal and economic rights. As these factors are weighted in each case, and the form or name of the instrument is not necessarily determinative of its treatment, taxpayers face uncertainty as to whether the IRS will agree with their chosen characterization.

In addition, Section 385(c) binds taxpayers to their characterization of an interest in a corporation once a position is taken. The IRS, on the other hand, is not bound by the taxpayer's characterization and can reclassify an instrument from debt to equity, and vice versa. As a result, taxpayers should perform a detailed assessment to determine the correct treatment before reporting a position on a return. In practice, however, this does not always occur, and later discovery that an instrument's treatment may be questionable often results in taxpayers' performing this assessment after the fact, thereby potentially triggering the application of the Section 385(c) rules.

Estate of Fry v. Commissioner

Mr. Fry was the sole shareholder of two S corporations, Crown and CR Maintenance. CR Maintenance encountered financial difficulties, and Crown provided financial assistance that allowed CR Maintenance to continue operations. Specifically, Crown transferred money directly to CR Maintenance and paid bills on CR Maintenance's behalf. The amounts were accounted for as loans on both parties' general ledgers and tax returns but were not otherwise documented. CR Maintenance did not claim interest deductions and Crown did not report interest income related to the amounts. In a dispute concerning Mr. Fry's basis in his CR Maintenance stock, Mr. Fry argued that these transactions should not be considered debt but, instead, should be treated as constructive equity contributions and distributions. The Service disagreed with Mr. Fry, asserting that Section 385(c) precluded him from recharacterizing the transactions as equity contributions.

Tax Court Holdings

In its memorandum opinion, the Tax Court held that Section 385(c) did not apply in this case because there was "no formal issuance of any instrument evidencing the creation of an interest in stock or equity." In

addition, the Tax Court suggested that Section 385 might not apply to S corporations based on the exclusion of S corporations from the regulations promulgated under Section 385(a) in 2016. The court further held that the transfers and payments more likely than not failed to constitute debt based on an analysis using traditional debt-equity factors. The court then determined that the transfers and payments primarily benefited Mr. Fry and, as a result, held they should be considered deemed distributions to Mr. Fry and subsequent contributions to CR Maintenance.

Planning Considerations

Estate of Fry appears to limit the application of Section 385(c) where no formal notes or stock instruments are issued. However, the broader implications of the ruling and its reasoning are unclear. In non-precedential guidance, the Service has inconsistently applied Section 385(c) in circumstances where the issuer reports an instrument on its tax return differently from the label given to the legal documents. The Service has also indicated that Section 385(c)(1) precludes a taxpayer from arguing that undocumented cash transfers were equity transactions when the transfers were reported as loans on the taxpayer's books, records, and tax return balance sheets. In *Estate of Fry*, however, the Tax Court appears to shed some light on what actions constitute a characterization for purposes of Section 385(c). Specifically, where there has been no formal issuance of an instrument that purports to be either debt or equity, the application of Section 385(c) may be precluded.

Estate of Fry may support the proposition that related party advances are not characterized as either debt or equity for purposes of Section 385(c) unless there has been a formal issuance of an instrument that purports to be either debt or equity, even if the taxpayer has reported the transaction as debt or equity on its books, records, or tax return balance sheets. However, taxpayers are reminded that memorandum opinions are not binding on the Tax Court, although they can be used as persuasive authority. Taxpayers should exercise caution in attempting to rely on *Estate of Fry,* particularly in cases that involve distinguishable fact patterns (for example, if one party to the cash transfer accrues or deducts interest on the advance), due to the lack of reasoning in support of the Tax Court's holding regarding Section 385(c) and the limited precedential value inherent in a memorandum opinion.

IRS Rules Stock Contributions Will Not Result in Deemed Dividends or Application of Gift Tax

A shareholder may, for valid business reasons (e.g., to improve the marketability of an investment), voluntarily surrender shares to the capital of a corporation, which raises questions of how the surrender impacts the other shareholders in the corporation. In PLR 202406002, the IRS ruled that a proposed voluntary surrender of shares to the capital of a corporation will not create deemed dividend income for the noncontributing shareholders and will not result in a taxable gift to the noncontributing shareholders.

In the proposed transaction, an executive of the company and a series of trusts established by that executive will contribute a proportionate amount of their common shares to the company for no consideration. The contribution of the shares may occur in one or more installments. The company has in place a share repurchase program, but neither the executive nor the trusts have participated in the program. The share repurchase program and the proposed contribution each have separate independent business purposes.

Income Tax Rulings

Citing *Commissioner v. Fink*, 483 U.S. 89 (1987), the Service ruled in PLR 202406002 that the executive and the trusts will not recognize gain or loss because of the contribution and that the basis in the shares contributed will be preserved in the basis of the executive's and the trusts' respective retained shares. In addition, the Service ruled that the contribution will be a contribution to the capital of the company and, therefore, will not be taxable to the company under Internal Revenue Code (IRC) Section 118(a).

The Service also indicated that the noncontributing shareholders will not recognize income because of the contribution and specifically provided that the contribution will not be treated as a distribution of property to the noncontributing shareholders. The ruling is subject to many key representations, including that (i) there is no belief that any purchase pursuant to the share repurchase program will be taxed as a dividend to the participating shareholder or is a dividend within the meaning of IRC Sections 301 and 302; (ii) the contribution is an isolated transaction; and (iii) the contribution is not part of a plan to periodically increase the proportionate share of any shareholder in the assets or earnings and profits of the company. Nevertheless, the contribution will have the economic effect of increasing the noncontributing shareholders' proportionate interest in the assets and earnings and profits of the company.

IRC Section 305(c) provides a broad rule that creates a deemed distribution of stock in certain transactions involving a corporation and its shareholder(s) (e.g., recapitalizations), which may be taxable under the general distribution rules of Section 301. By ruling that the contribution will not result in a deemed distribution to the noncontributing shareholders (likely because no deemed dividend results when a recapitalization is not undertaken pursuant to a plan to increase a shareholder's proportionate interest in the assets or earnings and profits of the corporation), the IRS eliminated any potential taxation of the economic benefit conferred on the noncontributing shareholders under Section 305 or Section 301.

Gift Tax Rulings

The Service also ruled that gift tax will not apply to the increase in value bestowed on the noncontributing shareholders by the executive and the trusts as a result of the contribution, because the contribution is a transaction occurring in the ordinary course of business (i.e., it is undertaken for bona fide business reasons, it is an arm's length transaction, and the executive and the trusts lack donative intent). The Service also recognized that the executive and the trusts are conferring an economic benefit on each other and between each of the trusts. However, the Service ruled that these are effectively value-for-value exchanges and, therefore, will not be subject to gift tax.

Planning Considerations

PLR 202406002 closes the loop started by *Commissioner v. Fink* and provides answers that avoid adding unintended tax consequences and complexity to a transaction that is usually undertaken for independent, nontax business reasons. In *Fink*, the Supreme Court denied a loss to a corporation's dominant shareholder following the shareholder's voluntary surrender of shares to the corporation, viewing the surrender as a contribution to capital. Instead, the Court held that the basis in the contributed shares must be added to the shares retained by the shareholder. The Supreme Court case serves as authority for the shareholder's gain or loss and basis consequences resulting from a stock surrender. The classification of the transaction as a contribution to the capital of a corporation supports the application of IRC Section 118(a) to prevent the transferee corporation from including any amount in its gross income. With the issuance of PLR

202406002, taxpayers and practitioners now have an indication of the Service's view of the other aspects of a stock surrender—namely, the treatment to the noncontributing shareholders. Taxpayers considering surrendering shares to the capital of a corporation should consult with their advisors regarding the application of PLR 202406002 to their facts.

Uncertainties Surround Treatment of S Corporation State Law Conversions

Comments submitted on behalf of the American Bar Association Section of Taxation (ABA tax section) in a letter dated July 2, 2024, suggest the IRS should supplement or expand its 2008 guidance on F reorganizations involving S corporations and qualified subchapter S subsidiaries (QSubs) to include consequences of an F reorganization accomplished by state law conversion to a limited liability company (LLC). The additional guidance is needed to address uncertainties in planning and other transactions commonly used by S corporations and their shareholders.

Summary of 2008 IRS Guidance

Rev. Rul. 2008-18 provides guidance on whether, in an F reorganization involving an S corporation, the historic Subchapter S election and employer identification number (EIN) continue for the reorganized (surviving) entity. The revenue ruling addresses two specific transactions, each of which meet the requirements of an F reorganization under Section 368(a)(1)(F):

Situation 1: The shareholder of an S corporation contributes all the S corporation stock to a newly formed corporation (Newco). A valid QSub election is made for the contributed corporation, causing it to be a disregarded entity treated as a division of Newco.

Situation 2: In a plan of reorganization, an S corporation creates a newly formed corporation (Newco), which also creates a newly formed corporation (Mergeco). Mergeco merges into the S corporation, with the S corporation's shareholder receiving the stock of Newco. A valid QSub election is made for the S corporation (now a subsidiary of Newco), causing it to be a disregarded entity treated as a division of Newco.

The 2008 ruling concludes that under these two fact patterns, the historic S corporation election does not terminate but continues for the corporation that is the survivor of the reorganization (Newco). However, Newco must obtain a new EIN.

Uncertainties Surrounding S Corporation State Law Conversions

Rev. Rul. 2008-18 does not address the continuation of an S corporation election or EIN when the S corporation undergoes an F reorganization (with or without a QSub election made for the contributed corporation) through a state law "conversion" to an LLC. Whether a QSub election is necessary in a state law conversion is also unclear, since – assuming no entity classification election is made to treat the LLC as a regarded corporation – the surviving LLC would be disregarded under Treas. Reg. §301.7701-3. If a QSub election is required by the IRS, the election would not be valid if made after the corporation converts to an LLC.

In addition, any delay by the state in processing the conversion raises questions about whether the subsidiary loses its S corporation status in the reorganization transaction and, therefore, reverts to C

corporation status for a period of time. If so, the corporation could be subject to built-in gains tax under Section 1374.

Comment Letter Recommendations

To address the uncertainties for S corporations surrounding F reorganizations accomplished by state law conversions, the ABA tax section in its comment letter recommends the IRS supplement or expand Rev. Rul. 2008-18 to address a third situation:

Situation 3: The shareholder of an S corporation contributes all the S corporation stock to a newly formed corporation (Newco). The contributed corporation is converted under state law from a corporation to an LLC for which no entity classification election is made. In addition, no QSub election is made for the contributed corporation.

The comment letter concludes that this fact pattern should have the following consequences:

- The historic S corporation election would not terminate but would continue for the newly formed corporation as the survivor of the reorganization.
- The LLC (formerly the S corporation) would retain its historic EIN.
- The newly formed survivor corporation would need to obtain a new EIN.
- The LLC would be respected as a disregarded entity, eliminating the need to make a QSub election, and would *not* be treated as a C corporation for federal income tax purposes for any period during the reorganization transaction, including for purposes of taxing built-in gains under Section 1374.

Should the IRS not accept the comment letter's suggestions to update or supplement their 2008 guidance, the ABA tax section alternatively recommends the IRS provide a streamlined procedure for curing a timely but invalid QSub election. This would be similar to Rev. Proc. 2013-30, where an election has been deemed invalid because the subsidiary did not meet the domestic corporation requirement at the time the election was made.

Planning Considerations

A QSub can provide tax planning opportunities where there is a business reason to maintain S corporation operations in a separate subsidiary. For example, since a QSub is a disregarded entity, the sale of an interest in a QSub is treated as a sale of its assets for federal income tax purposes, which provides the buyer with a step-up in the tax basis of the acquired assets. There may be other benefits as well, and F reorganizations may be used in pre-transaction planning structuring. For more information on Rev. Rul. 2008-18 and the use of F-reorganizations and QSubs, see *"F" Reorganization Under Rev. Rul. 2008-18: Timing Of QSUB Election Is Key*.

IRS Rules Professional Corporation Arrangement Requires Consolidation

Many states, through licensing and regulation of professions like medicine or law, restrict or prohibit business ownership by unlicensed individuals or entities. To invest in these types of businesses without violating state law, investors often must enter contractual arrangements pursuant to which the investor

acquires economic rights without changing the ownership of legal title. In PLR 202417008, the IRS ruled that a professional corporation must join an investor's existing consolidated group as a result of legal agreements that granted the investor beneficial ownership of the professional corporation's stock.

In the PLR, two professional corporations, PC1 and PC2 (together, the PCs), entered into agreements with a member of an existing consolidated group (Sub), either directly or indirectly through a disregarded entity of Sub, for administrative and management support services. In addition, the PCs and their respective shareholders entered into agreements with Sub (or its disregarded entity) restricting (i) the transferability of the shares in the PCs and (ii) the ability of the PCs to undertake certain corporate actions.

Citing IRC Section 1504(a) and Rev. Rul. 84-79, the IRS ruled that upon executing the above-mentioned agreements, PC1 and PC2 will join the consolidated group with respect to which Sub is a member. For a corporation (other than a common parent) to join a consolidated group, Section 1504(a) requires that members of a consolidated group directly own a certain amount of stock in the corporation. Case law and IRS guidance (including Rev. Rul. 84-79) indicate that direct ownership for purposes of Section 1504(a) means beneficial ownership (which is generally determined based on the economic substance of the arrangement), not mere possession of legal title. The IRS found that the legal agreements between the PCs, the shareholders of the PCs, and Sub (or its disregarded entity) separated legal title (i.e., legal ownership) from the economic rights (i.e., beneficial ownership), the latter of which Sub (or its disregarded entity) obtained as result of the contractual arrangements.

Planning Considerations

The PLR is consistent with similar rulings previously issued by the IRS, all of which are predicated on state law not prohibiting beneficial ownership by non-professionals and underscore the beneficial ownership aspect of the Section 1504(a) test. PLR 202417008 highlights the contractual arrangements involved in the transfer or acquisition of beneficial ownership, giving investors interested in participating in the economics of certain regulated businesses a view of the key legal documents and provisions the IRS evaluated in applying Section 1504(a).

Proactive tax planning and seamless tax compliance are essential components of financial success. At FustCharles, we are dedicated to providing year-round support, ensuring you stay informed about emerging opportunities, evolving tax laws, and optimal strategies. Our commitment is to guide you towards the most advantageous course of action aligned with your objectives, ultimately contributing to your business's financial well-being.

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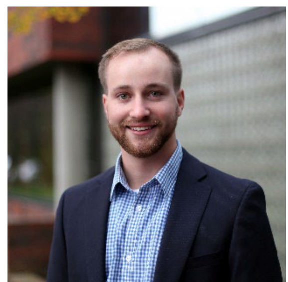

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