



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

CASE ID: SPRO-121611-98

MEMORANDUM FOR:

FROM: CC:DOM:CORP: 5

SUBJECT: § 382(h)(8) of the Code

As requested, set forth below is the substance of a memorandum prepared with respect to a Private Letter Ruling request submitted by taxpayer. The memorandum sets forth certain conclusions regarding § 382(h)(8) reached by this office in considering the ruling request.

This document is not binding on examination or appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

LC =

Date 1 =

Y =

Date 2 =

A =

B =

Date 3 =

C =

D =

E =

Date 4 =

F =

Date 5 =

Date 6 =

G =

H =

M =

N =

O =

I =

Q =

R =

U =

V =

W =

Z =

ISSUE(S)

Whether § 382(h)(8) of the Code applies to the taxpayer's proposed transaction for purposes of determining the loss corporation's ("LC") net unrealized built-in loss ("NUBIL").

FACTS

On Date 1, M issued a N against LC, a Y. The N requires LC to Q by Date 2. A failure to satisfy the N could subject LC to regulatory sanctions, including the possibility of Q.

At the time the N was issued, LC and its subsidiaries were members of the P consolidated group. P, a publicly-traded corporation, owned all of the common stock and W stock of LC. P had convertible subordinated debentures outstanding in the amount of A. LC had subordinated debt outstanding in the amount of B.

On Date 3, as a preliminary step to Q as mandated by the M, LC engaged in the following transaction:

- (i) P exchanges its LC W stock for additional shares of LC common stock on a share for share basis.
- (ii) LC issued new Z stock¹ and warrants to its creditors (hereinafter "Old Creditors") in exchange for C percent of the \$B of subordinated debt.

LC now proposes to fully satisfy the I mandated by M by engaging in the following transaction:

- (i) P will merge into a subsidiary (S) of LC in a transaction intended to qualify under § 368(a)(2)(D) of the code (the "Merger"). Pursuant to the Merger:
 - (a) P shareholders will exchange their P stock for LC common stock and rights to acquire LC common stock.

¹ According to the taxpayer, the Z stock qualify as § 382 stock pursuant to §§ 382(k)(6)(A) and 1504(a)(4)(C) of the Code because

- (b) P debenture holders will exchange D to E percent of their debentures for LC common stock and rights to acquire LC common stock (the “Debenture Exchange”).
- (ii) The Old Creditors will exchange all of their Z stock for LC convertible preferred stock² and rights to acquire LC common stock (the “Stock Exchange”).
- (iii) Standby investors will be issued rights to acquire LC common stock, LC convertible preferred stock, ³LC pure preferred stock, and warrants exercisable not sooner than U after the sale of stock pursuant to the rights.⁴
- (iv) LC common stock will be issued to the taxpayer’s financial advisors.

The proxy solicitation for the Merger and the Stock Exchange will commence on Date 2, and these transactions will be consummated on or about Date 4. The rights to acquire LC stock and warrants will be issued to the P shareholders, debenture holders, Old Creditors, and Standby Investors (as described above) immediately after the Merger and Stock Exchange are consummated (the issuance of these rights are hereinafter referred to as the “Right Offering”). The right to acquire LC stock and warrants will be exercisable for F days.⁵

DISCUSSION

According to the taxpayer, application of § 382(h)(8) of the Code to the proposed transaction will cause LC to have a significant NUBIL. Consequently, LC will be required to make an accounting adjustment by reducing its R. According to

²The taxpayer suggests that the LC convertible preferred stock is “stock” for § 382 purposes. See § 1.382-4(d)(2) of the proposed regulations.

³According to the taxpayer, the LC pure preferred stock is not “stock” for § 382 purposes. See §§ 382(k)(6)(A) and 1504 (a)(4)(C).

⁴According to the taxpayer, these perpetual warrants are out-of-the money.

⁵If the rights are exercised and warrants are acquired within the E day period, the warrants are then exercisable no sooner than 1 year after the purchase of LC stock pursuant to the Rights Offer.

the taxpayer, this accounting adjustment will impact LC's ability to satisfy the I mandated by the M.

I. § 382(h)(8)

§ 382(h)(8) of the Code provides that if 80 percent or more in value of the stock of a corporation is acquired in 1 transaction (or in a series of related transactions during any 12-month period), for purposes of determining the net unrealized built-in loss, the fair market value of the assets of such corporation shall not exceed the grossed up amount paid for such stock properly adjusted for indebtedness of the corporation and other relevant items.

II. Stock "Acquired" For § 382(h)(2) Purposes

The conferees discussed whether all of the stock acquired in the Date 3 transaction and the proposed transaction should be treated as "acquired" for purposes of § 382(h)(8) of the Code.

A. Stock for Stock

It was suggested that generally stock should only be treated as "acquired" for § 382(h)(8) purposes if a 5 percent shareholder acquires loss corporation stock that the 5 percent shareholder did not already own either directly or by § 382 attribution rules.

The conferees agreed that stock should not be treated as "acquired" to the extent loss corporation stock is exchanged for loss corporation stock of the same value. Applying § 382(h)(8) to a stock for stock exchange is inappropriate because in many cases (e.g., a pro rata spin-off, a stock split, or the formation of a holding company) the underlying value of the loss corporation's assets is irrelevant to the acquiror. Moreover, it is difficult to say that stock is "acquired" when one equity interest in a corporation is exchanged for another equity interest of equal value even if the underlying value of the corporation's assets is taken into account in striking the bargain (e.g., in an exchange of common stock for preferred stock).

Consequently, the conferees agreed that stock acquired in the following transactions should not be treated as "acquired" for § 382(h)(8) purposes:

- (i) P's Date 3 acquisition of LC common stock in exchange for P's W stock on a share for share basis (provided the W stock is "stock for § 382 purposes").⁶

⁶On Date 5, the taxpayer advised that the W stock is probably not "stock" for § 382 purposes. The conferees did

- (ii) The acquisition by P shareholders of LC common stock in exchange for their P stock in connection with the proposed Merger (assuming this exchange of stock is value for value).
- (iii) The Old Creditors' acquisition of LC convertible preferred stock pursuant to the Stock Exchange (assuming this exchange of stock is value for value). But see discussion (III) below with respect to the Old Creditors' Date 3 exchange of debt for stock.

B. Stock For Debt

The taxpayer suggests that a stock for debt exchange should not be treated as an acquisition for § 382(h)(8) purposes. A conferee suggested that an exchange of debt for loss corporation stock is an appropriate time to apply § 382(h)(8) of the Code because the amount of stock received by the creditors depends on a bargained-for exchange based on the underlying value of loss corporation's assets.

The conferees agreed that stock acquired in the following transactions should be treated as "acquired" for § 382(h)(8) purposes:

- (i) The Old Creditors' Date 3 acquisition of LC preferred stock in exchange for their debt.
- (ii) The debenture holders' acquisition of LC common stock pursuant to the Debenture Exchange.⁷

C. Stock Acquired In a § 1032 Transaction

The taxpayer suggests that loss corporation stock acquired in § 1032 transaction should not be treated as "acquired" for § 382(h)(8) purposes. Arguably,

not decide whether this will cause P to be treated as acquiring stock under § 382(h)(8).

⁷For purposes of § 382, convertible debt is treated as an option under both 1.382-2T(h)(4)(v) of the temporary regulations and § 1.382-4(d)(3) of the proposed regulations. Thus, an exchange of convertible debentures for LC stock is not treated as a stock for stock exchange. In addition, the conferees agreed that the conversion feature of the convertible debt is not treated as equity, particularly when the conversion feature is out-of-the-money.

the amount of consideration paid to a loss corporation for its stock has no relevance to the value of the corporation's assets prior to the transaction.

It was acknowledged that the payment for stock is not part of the value of the corporation prior to the transaction. However, a conferee suggested that the amount paid for stock in a § 1032 transaction is relevant to determine and establish the value of the stock outstanding (and the loss corporation's assets) before the payment. In applying § 382(h)(8) of the Code, the grossed-up value of all the stock will be adjusted by "backing-out" the cost of the newly issued stock as an "other relevant item".

The following example illustrates why the acquisition of stock in a § 1032 transaction should be treated as "acquired" for § 382(h)(8) purposes:

A owns all 20 shares of X corporation which holds Blackacre as its only asset. B purchases 80 newly issued shares of X stock for \$80. The value of Blackacre is relevant to B because the value of the X stock acquired by B will equal B's investment of \$80 only if Blackacre was worth \$20 prior to the purchase (i.e., after the exchange, B will have an 80 percent interest in both Blackacre and the \$80 paid by B worth \$16 and \$64 respectively. The 80 shares acquired by B should count toward the 80 percent test because the \$80 paid for the X stock establishes the value of X stock and Blackacre prior to the purchase. The X stock is grossed-up to \$100 and adjusted by "backing-out" the \$80 payment, leaving \$20 (\$100-80) as the asset value. The result under § 382(h)(8) should be the same had B acquired 80 percent of X stock for A prior to both A and B contributing \$80 to X (\$16 by A and \$64 by B).

The conferees agreed that the acquisition of stock in a § 1032 transaction should be treated as "acquired" for § 382(h)(8) purposes.

D. Stock Acquired Pursuant To The Rights Offering

In addition to acquiring LC stock in the proposed transaction, P shareholders will acquire rights to purchase additional shares of LC common stock pursuant to the Rights Offering. Although P shareholders will not be treated as acquiring stock when they exchange stock for stock (see discussion (II.A) above), the question remains whether the stock acquired pursuant to the Rights Offering should be treated as "acquired" for § 382(h)(8) purposes. According to the taxpayer, a portion of the stock acquired pursuant to the Rights Offering should be treated as merely returning the acquiror to its prior equity position.

The conferees discussed this issue using the following example:

X corporation has 100 shares of stock outstanding and its assets are worth \$100. A owns 20 shares of X stock worth \$20 and B owns 80 shares of X stock worth \$80. X makes a \$100 stock offering. Pursuant to the stock offering, (i) A exchanges its stock with X for 10 shares of X stock (worth \$10) and rights to acquire 50 additional shares for \$40 (the rights are worth \$10), and (ii) C pays \$60 for 60 shares of X stock. After the stock offering and exercise of the rights, A, B, and C, will own 30 percent, 40 percent, and 30 percent of X stock respectively.

The conferees discussed three approaches to determine what percentage of X stock will be acquired by A pursuant to the rights:

- (i) The approach favored by the taxpayer would treat the acquisition of stock by A pursuant to the rights as “acquired” for § 382(h)(8) purposes only to the extent A’s percentage interest in X stock is increased over the percentage interest previously owned. Under this approach only 10 percent (20 shares worth \$20) of the stock acquired by A is treated as “acquired” (A’s interest increased from 20 to 30 percent).
- (ii) Treat all of the stock acquired by A pursuant to the rights as “acquired” for § 382(h)(8) purposes. Under this approach, 25 percent (50 shares worth \$50) of X stock is treated as “acquired.”
- (iii) Treat the stock acquired by A pursuant to the rights as “acquired” for § 382(h)(8) purposes only to the extent that A exchanged cash for stock. Under this approach, the value of the rights is treated as a return of A’s previous equity interest (i.e., stock acquired equal to the value of the rights is not treated as “acquired”). Under this approach, 20 percent (40 shares worth \$40) of the X stock acquired by A pursuant to the rights is treated as “acquired.” The other 5 percent (10 shares worth \$10) of X stock acquired pursuant to the rights is treated as a return of A’s prior equity interest since the rights were worth \$10.⁸

The conferees agreed that approach (iii) was the appropriate test to apply since it allows A to return to its previous equity position (20 shares worth \$20) without treating such stock as “acquired” for § 382(h)(8) purposes. In the case under consideration, the fact that the rights to purchase LC stock are outstanding for only E days was a factor in choosing this approach.

⁸Thus, in determining the percentage of LC stock “acquired” by A in the example, this approach would place the cash paid by A for each share of stock pursuant to the rights into the numerator (\$40) and the fair market value of the LC stock outstanding after the exchange into the denominator (\$200).

E. Perpetual Warrants Issued To Standby Investors

Pursuant to the proposed transaction, LC will issue perpetual warrants to standby investors, exercisable no sooner than U after the sale of stock pursuant to the Rights Offering. According to the taxpayer, the standby investors will not “acquire” LC stock when the warrants are issued because (i) the warrants themselves are not stock, and (ii) the standby investors will not actually receive LC stock until the warrants are exercised V after the Rights Offering.

Generally, a warrant to purchase stock from a loss corporation is treated as an interest that is similar to an option and not as stock. § 1.382-2T(h)(4)(v) of the regulations. However, there are at least two exceptions to this general rule. First, options have been treated as stock under substance over form principles. See Rev. Rul. 82-150, 1982-2 C.B. 110 (treating very deep in-the-money options as stock). Second, warrants (whether in-the-money or not) are treated as stock when determining the value of a loss corporation (for § 382 limitation purposes) under § 382(e). See TAM-9332004, which reached this result by taking into account the authority in § 382(k)(6)(B) to prescribe regulations treating options as stock, and the legislative history indicating that such treatment is “for purposes of determining the value of the loss corporation.”

The conferees agreed that the perpetual warrants at issue should not be treated as stock. The first exception to the general rule does not apply, because the perpetual warrants (which are out-of-the-money) are not, in substance, ownership of the underlying stock. The second exception also does not apply, because the term “stock” has different meanings under §§ 382(e) and 382(h)(8) of the Code. § 382(k)(6)(A) provides that, except as provided in regulations and § 382(e), the term “stock” for § 382 purposes (including § 382(h)(8)) means stock other than stock described in § 1504(a)(4). Cf. § 382(e)(1) (loss corporation stock includes stock described in § 1504(a)(4)). Although § 382(k)(6)(B) provides regulatory authority to treat warrants as stock, no regulations have been issued under § 382(k)(6)(B). Moreover, as indicated above, the legislative history for § 382(k)(6)(B) indicates that such treatment is “for purposes of determining the value of the loss corporation” (the term used in § 382(e), not § 382(h)(8)).

The conferees also agreed that LC stock will not be “acquired” within the meaning of § 382(h)(8) of the Code until the warrants are actually exercised. Treating the stock subject to the warrants as “acquired” under a deemed exercise of the warrants approach on the day they are issued is not appropriate for § 382(h)(8) purposes, because § 382(h)(8) looks to amounts paid, not to appraised values of stock where there is no value for value exchange. No amount will be actually paid for the stock until the warrants are exercised. Consequently, any LC stock acquired pursuant to the warrants will not count in determining whether prior acquisitions of LC stock, such stock will not be acquired during the 12 month period provided by § 382(h)(8).

III. Whether The Proposed Transaction Is “Related” To The Date 3 Transaction For § 382(h)(8) Purposes?

It was explained that the taxpayer’s arguments against application of § 382(h)(8) of the Code to the proposed transaction assume that such transaction is not “related” to the Date 3 transaction within the meaning of § 382(h)(8). According to the taxpayer, if the Date 3 transaction between LC and the Old Creditors is considered “related” to the proposed transaction, then 80 percent of LC stock will be “acquired” within the meaning of § 382(h)(8).

There is nothing in the legislative history and no regulations which indicate what “related” means under § 382(h)(8) of the Code. However, the taxpayer suggests that the Date 3 and proposed transactions are not “related” within the meaning of this term in other provisions of the Code and regulations.

For example, under § 168(g) of the Code, property subject to a lease to tax exempt entities is subject to the alternative depreciation system which generally provides for less accelerated depreciation deductions. Such property may not be depreciated over any period shorter than 125 percent of the term of the lease to a tax exempt entity. To prevent avoidance, § 168(i)(3)(A) provides that, in determining a lease term, two or more successive leases which are part of the same transaction (or a series of related transactions) shall be treated as one lease. In interpreting the meaning of “series of related transactions”, § 1.168(j)-1T, Q&A 17, of the temporary regulations provides that multiple leases will be considered part of the same transaction if entered into at substantially the same time or as part of one arrangement. According to the taxpayer, the Date 3 and proposed transactions are unrelated because the transactions were not entered into at the same time or as part of the same arrangement among the acquirors of LC stock.

The conferees believe that the related transaction standard of § 1.168(j)-1T, Q&A 17, is inconsistent with § 382(h)(8) of the Code for two reasons. First, § 382(h)(8) does not require “related” transactions to occur at the same time since the § refers to a series of related transactions during any 12-month period. Second, § 382(h)(8) does not merely focus on the acquirors of loss corporation stock. While § 1.168(j)-1T, Q&A 17, generally focuses on a two party agreement (*i.e.*, between the lessor and lessee), in § 382(h)(8) can involve multiple party transactions involving not only the acquirors of loss corporation stock, but also the loss corporation.

The conferees also discussed whether the notion of related transactions within the meaning of § 1.382-3(a) of the regulations (the “Entity Regulations”) can be applied to § 382(h)(8) of the Code. The Entity Regulations define the term “entity” for purposes of defining a “5-percent shareholder” under § 382. An entity includes a group of persons who have a formal or informal understanding among themselves to make a coordinated acquisition of stock.

According to the taxpayer, the Entity Regulations are particularly compatible to § 382(h)(8) because both §§ focus on acquirors, rather than the corporation. The taxpayer suggests that there could have been no formal or informal agreement between the acquirors in the Date 3 transaction and the acquirors in the proposed transaction because the identity of the acquirors in the proposed transaction was unknown in Date 3 (the Date 3 acquirors contemplated a subsequent sale of control transaction rather than the proposed transaction).

The conferees agreed that the Entity Regulations should not be applied as narrowly as the taxpayer suggests. The Entity Regulations do not completely ignore the activities of the loss corporation. For example, under § 1.382-3(a)(1)(ii), Example 2, a group of investors are defined as an “entity” after the loss corporation facilitated an informal agreement among the investors in separate meetings. Under the Entity Regulations, it is important that multiple acquirors of loss corporation stock know of each other’s existence if they are to be grouped together and treated as one “entity”. However, there is no reason that § 382(h)(8) should be applied only if acquirors can be grouped together and viewed as acting in concert. The price paid for loss corporation stock will measure the value of the loss corporation’s assets whether there is only one acquiror or multiple acquirors who do not know of each other’s existence.

The conferees also discussed whether several transactions should be treated as “related” under § 382(h)(8) of the Code if such transactions are collapsible pursuant to the step transaction doctrine. A question arose whether it is appropriate to apply the step transaction doctrine since § 382(h)(8) does not require transactions to be collapsed into one transaction.

The conferees agreed that transactions do not have to be collapsed into one transaction in order to be “related” within the meaning of § 382(h)(8) of the Code. However, the Date 3 and proposed transactions are arguably “related” within the meaning of the step transaction doctrine under the “mutual interdependent” test and the “end result” test.⁹

The mutual interdependent test is applied when a series of transactions are so interdependent that the legal relations created by one transaction would be fruitless without a completion of the series. The end result test is applied when separate steps are really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result. See Tax Management Portfolio, Corporate Acquisitions—D Reorganizations, 417-2nd T.M. A-15.

The Date 3 and proposed transactions are arguably related under a broad application of the mutual interdependence test because the Old Creditors’ exchange of debt for LC stock in Date 3 makes no economic sense unless the proposed transaction is consummated. In Date 3, the Old Creditors were in a superior position (as creditors) than equity holders had LC gone into receivership and liquidated. Presumably, the Old Creditors would not have given up this superior position without the expectation of a subsequent transaction that would

The Date 3 and proposed transaction are also arguably related under a broad application of the end result test.

The conferees agreed that the Date 3 transaction is “related” to the proposed transaction for § 382(h)(8) purposes.

Furthermore, it was decided that we cannot rule on the proposed transaction and caveat the related transaction issue.

⁹ The conferees agreed that the Date 3 and proposed transactions would not be related pursuant to the “binding commitment” test, because there is no legally binding obligation to effect the proposed transaction.

(ii) Effect of N On the FMV Of LC StockA. Does § 382(h)(8) Apply When A Loss Corporation Is Subject To A N?

The taxpayer suggests that § 382(h)(8) of the Code is inapplicable to the Date 3 transaction and the proposed transaction because the N distorted the fair market value of LC stock. According to the taxpayer, Congress only intended § 382(h)(8) to apply when the price paid to acquire loss corporation stock is a reasonable presumption of the value of the corporation's assets.

The current provisions of § 382(h)(8) of the Code were originally proposed as § 382(h)(5) in the Tax Reform Bill of 1985. The statutory language of both § 382(h)(8) and § 382(h)(5) provides for mandatory application whenever 80 percent or more in value of loss corporation stock is acquired. However, the legislative history of § 382(h)(5) states:¹⁰

The committee's bill also provides a simplifying presumption in the case of certain stock acquisitions where it is reasonable to equate the value of the consideration used to acquire the stock with the value of the corporation's assets.

See House Ways and Means Committee Report, H.R. Rep. No. 426, 99th Cong., 1st Sess., Dec. 7, 1985, at 261 (emphasis added).

The conferees agreed that application of § 382(h)(8) of the Code should not be limited in the way suggested by the taxpayer since application of the statute is mandatory. If there is a presumption at all, it is an irrefutable presumption that the amount paid for 80 percent of a loss corporation's stock is always a reasonable measure of the corporation's assets.

Furthermore, the conferees agreed that a ruling based on a factual determination that the N distorted the value of LC stock would be precluded by Rev. Proc. G, and Rev. Proc. H.

B. Is The N An "Other Relevant Item"?

The conferees discussed whether any distortion to the value of LC stock as a result of the N should be treated as an "other relevant item" for purposes of determining the amount paid for LC stock under § 382(h)(8) of the Code. According to the taxpayer, the appropriate adjustment under § 382(h)(8) would be to deem the fair market value of the corporation's assets as the amount paid for the stock.

¹⁰The legislative history for the Tax Reform Act of 1986 offers no guidance for the application of § 382(h)(8) of the Code.

The conferees agreed that it would be inappropriate to treat the N as an “other relevant item” without regulations. Cf. § 1.338(b)-1T(f)(3) of the temporary regulations (authorizing the District Director to make an adjustment so that adjusted grossed-up basis and the basis of Target’s assets properly reflect the cost of the interest in Target’s assets). In addition, the Service is precluded from issuing a ruling on such a factual issue (i.e., the existence and extent of a distortion to stock value). See Rev. Proc. G, and H. It was also suggested that the N is not necessarily a corporate item (e.g., liabilities) within the meaning of § 382(h)(8).

V. Intervening Ownership Change

The taxpayer suggests that only acquisitions of stock in the same testing period should be treated as “acquired” within the meaning of § 382(h)(8) of the Code.

For example, the Merger, Debenture Exchange, and Stock Exchange are expected to cause an ownership change on or about Date 4. But, according to the taxpayer, these transactions will not result in an acquisition of 80 percent of LC stock.¹¹ Under the intervening ownership change approach, any stock acquired during the testing period ending with the Date 4 ownership change will not count in determining if the § 382(h)(8) 80 percent test is satisfied upon any subsequent acquisition of LC stock. Consequently, the acquisition of stock pursuant to the Rights Offering subsequent to the Date 4 ownership change will not result in the acquisition of 80 percent of LC stock.

The conferees agreed that it would be inappropriate to limit § 382(h)(8) of the Code to acquisitions of stock in the same testing period since testing periods only apply for ownership change purposes. In addition, Congress would have included such a limitation in the statute if it intended such a result. The conferees also rejected the taxpayer’s argument that testing periods should only be straddled in abuse situations.

VI. Should Convertible Pure Preferred Stock Be Treated As An “Option” For § 382 Purposes?

The taxpayer’s representative telephoned to suggest an alternate plan for the proposed transaction. According to the alternate plan, LC will issue (i) common stock to P shareholders and debenture holders pursuant to the Merger, (ii) voting convertible preferred stock to Old Creditors pursuant to the

¹¹If the Date 3 exchange of debt for stock (which contributes to the Date 4 ownership change) is related to the Date 4 transaction, then there may be an 80 percent acquisition in the testing period ending with the Date 4 ownership change.

Stock Exchange, and (iii) convertible pure preferred (exercisable U after steps (i) and (ii)) pursuant to the Rights Offering.

Pursuant to this alternate plan, the taxpayer requested a ruling that the convertible pure preferred stock will be treated as an “option” (and not as “stock”) pursuant to Notice 88-67, 1998-1 C.B. 555.

In Notice 88-67, the Service determined that, pursuant to § 382(k) of the Code, convertible pure preferred stock (i.e., stock described in § 1504(a)(4) but for the conversion feature) will be treated solely as an “interest that is similar to an option.” In addition, Notice 88-67 provides that the Notice may be relied upon to the same extent as a revenue ruling or revenue procedure.

However, § 1.382-2(a)(3)(ii) of the proposed regulations treats convertible pure preferred stock as “stock” for purposes of § 382 of the Code. The proposed regulations are intended to replace Notice 88-67 for convertible stock issued after November 4, 1992.

The conferees agreed that a ruling treating the LC convertible pure preferred stock as an “option” (rather than stock) pursuant to Notice 88-67 would have to include a caveat that the ruling is subject to retroactive revocation if the provisions of § 1.382-2(a)(3)(ii) of the proposed regulations are finalized and apply to the issuance.

CONCLUSIONS

It was concluded:¹²

1. Stock is not “acquired” for § 382(h)(8) purposes to the extent loss corporation stock is exchanged for loss corporation stock of the same value.
2. Generally, stock is “acquired” for § 382(h)(8) purposes when a 5 percent shareholder acquires loss corporation stock that the 5 percent shareholder did not already own either directly or by § 382 attribution rules. Consequently, stock is treated as “acquired” in the following transactions:
 - A. An exchange of debt for loss corporation stock.
 - B. An exchange of convertible debentures for loss corporation stock (the conversion feature is generally not treated as equity).
 - C. An exchange of money or other property for loss corporation stock pursuant to a § 1032 transaction.
3. The value of the rights issued pursuant to the Rights Offering is treated as a return of the acquirer’s previous equity interest. Consequently, the cash paid for each share of loss corporation stock upon the exercise of the rights is placed in the numerator (along with the FMV of other “acquired” stock) and the FMV of such stock is placed in the denominator (along with the FMV of the remaining outstanding loss corporation stock).
4. The perpetual warrants at issue, exercisable in U, are not treated as stock “acquired” in a related transaction for § 382(h)(8) purposes if such warrants are out-of-the -money when issued.

¹²In reaching the conclusions and other decisions described above, the conferees were focusing on a fact-specific case. These conclusions and decisions were reached by applying principles and analysis to specific facts and, while appropriate for most cases, are not an attempt to “answer all questions for all time” or to (in effect) draft regulations language for § 382(h)(8) of the Code. In some cases, different facts may require different analysis and conclusions. See, e.g., note 6.

5. We will not rule that the Date 3 transaction is unrelated to the proposed transaction for § 382(h)(8) purposes. In addition, we will not rule on the proposed transaction and caveat the related transaction issue.
6. We will not rule that § 382(h)(8) does not apply when a N distorts the value of the loss corporation's stock.
7. We will not rule that a N is an "other relevant item" within the meaning of § 382(h)(8), thereby warranting an adjustment to the price paid for the loss corporation stock.
8. Related transactions can occur in different testing periods for purposes of § 382(h)(8).
9. A ruling treating convertible pure preferred stock as an "option" pursuant to Notice 88-67 would have to include a caveat that the ruling is subject to retroactive revocation if the provisions of § 1.382-2(a)(3)(ii) of the proposed regulations are finalized and apply to the issuance.