Mastering Corporate E&P Calculations and Rules: Maintaining Current Earnings and Profits Balance

TUESDAY, AUGUST 18, 2015, 1:00-2:50 pm Eastern

**IMPORTANT INFORMATION**

This program is approved for 2 CPE credit hours. To earn credit you must:

- **Participate in the program on your own computer connection (no sharing)** - if you need to register additional people, please call customer service at 1-800-926-7926 x10 (or 404-881-1141 x10). Strafford accepts American Express, Visa, MasterCard, Discover.

- Listen on-line via your computer speakers.

- Respond to five prompts during the program plus a single verification code. You will have to write down only the final verification code on the attestation form, which will be emailed to registered attendees.

- To earn full credit, you must remain connected for the entire program.

**WHO TO CONTACT**

For Additional Registrations:
- Call Strafford Customer Service 1-800-926-7926 x10 (or 404-881-1141 x10)

For Assistance During the Program:
- On the web, use the chat box at the bottom left of the screen

If you get disconnected during the program, you can simply log in using your original instructions and PIN.
Tips for Optimal Quality

**Sound Quality**
When listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, please e-mail sound@straffordpub.com immediately so we can address the problem.

**Viewing Quality**
To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.
Mastering Corporate E&P Calculations and Rules

Aug. 18, 2015

Jason W. Malinowski, Tax Director
PricewaterhouseCoopers
jason.w.malinowski@us.pwc.com
Notice

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY THE SPEAKERS’ FIRMS TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.
Mastering Corporate E&P Calculations and Rules: Maintaining Current Earnings and Profits Balances

August 18, 2015
Presenters

Jason Malinowski, Tax Director
PricewaterhouseCoopers LLP – Boston, MA
(617)530-7962
jason.w.malinowski@us.pwc.com
Definition of E&P and Where It Applies
What is E&P?

- E&P is NOT specifically defined in the code, but §312 provides guidance.
- Corporation’s economic ability to pay a dividend without invading capital.

Consolidated Return Years

- Beginning E&P
- Annual “Investment Adjustments”
- Adjusted E&P

Distributions

- S/H
- P
- S

$20

$20
Why Does It Matter?

Accurate and timely calculations of Earnings and Profits are necessary to make informed and tax-efficient business decisions.

Assist in answering the following:

Impacts Amount of Withholding on Distribution to Foreign Shareholders

Amount of Distribution Treated as a Dividend

Amount of E&P to be Purged in a REIT Conversion

Amount of E&P Allocated to “Spin Co” in a Spin-Off
Stock Basis vs. E&P

Similarities:

Computation of E&P usually begins with taxable income.
E&P (or deficit) tiers up and is reflected at higher tiers
Most of the investment adjustments are same for stock basis and E&P

Differences:

• Timing of inclusion of loss items;
• E&P depreciation;
• E&P gain or loss on sales/distributions; and
• Redemptions.
**E&P – Common Adjustments**

Federal Taxable Income – Line 28 (Start Here)*
+ Tax Exempt Income Items
- Federal Income Taxes
- Noncapital/Nondeductible Expenses
+/- Depreciation
- Distributions

= Current Year Adjustments

* BE CAREFUL OF DIVIDENDS FROM SUBSIDIARIES INCLUDED IN LINE 4 THAT ARE SUBJECT TO 100% DRD
Earnings and Profits
Operating Rules

Adjustments to E&P — Treas. Reg. § 1.1502-33

• In the consolidated return context, a parent corporation’s E&P is adjusted to reflect its share of a subsidiary’s E&P for the period the subsidiary is in the consolidated group

Treas. Reg. § 1.1502-33(a)(1)

• Adjustments must not have the effect of duplicating E&P adjustments

Treas. Reg. § 1.1502-33(a)(2)

• Tiering up of E&P adjustments — Treas. Reg. § 1.1502-33(b)

Treas. Reg. § 1.1502-33(e)(1)

• Departing member’s E&P eliminated to the extent taken into account by a member of the group.
E&P - Tax Return Forms to Use

Items to look at:
- Page one
- Incorporation date
- Line 28 taxable income
- NOLs
- Special deductions (if applicable)
- Total Tax
- M-2
- Distributions (cash and property)
- 851: Affiliation Schedule
- Schedule D: “Capital Gains and Losses”
- Form 1118 “Foreign Tax Credit”
- Form 4626: “Alternative Minimum Tax”
- Form 4562: if Bonus depreciation applies
- Standard annual adjustments (M-1 or M-3)
- Revenue of all statements included in Return
**Common Additions:**
- Tax Exempt Interest
- Proceeds of Life Insurance
  - Depreciation in Excess of Straight-line
  - Capital Loss Carrybacks and Carryovers
  - LIFO Inventory costs in excess of FIFO
  - COD Income – Consider applicable rules

**Common Subtractions:**
- Federal Income Taxes
- Expenses & Interest Related to tax exempt income
- Excess Charitable Contributions
- Nondeductible life insurance premiums
- Net Capital Loss
- Unreasonable Compensation
- Excess Parachute Payments
Federal Taxes
Earnings and Profits – Federal Taxes

• Federal income taxes are not deductible in computing taxable income. However, the payment of Federal income tax results in a decrease in E&P.

• Under the consolidated return regulations, it is necessary to allocate the group’s consolidated tax liability among its members for purposes of determining the amounts by which their E&P is reduced for federal income taxes. I.R.C. §1552 and the Regulations thereunder set forth the methods for allocating the group’s actual consolidated tax liability among its members.

• Treas. Reg. §1.1552-1 sets forth three basic tax allocation methods:
  - the contribution to consolidated taxable income method,
  - the separate return tax liability method, and
  - the separate allocation of tax increases arising from consolidation method.

• In addition, Treas. Reg. §1.1502-33(d) provides for the ability to elect two “extended tax allocation” methods: the wait-and-see method and the percentage method because I.R.C. §1552 does not reflect compensation by one member for use of another member’s losses.
• A group may elect one of the three basic allocation methods by attaching a statement to the first consolidated return filed by the group.

• Such election is irrevocable unless the IRS approves a request to change to a different method. If the group does not elect one of the basic methods in its first consolidated return, the group is required to utilize the contribution to consolidated taxable income method for purposes of determining E&P.
## Earnings & Profits: Taxes

In each of these scenarios, P is the common parent of a consolidated group owning all of the stock of corporations S1 and S2. S1 wholly owns S3.

### CONTRIBUTION TO CONSOLIDATED INCOME METHOD

<table>
<thead>
<tr>
<th>Scenario #1</th>
<th>Line 30 Taxable Income</th>
<th>Income to be Allocated</th>
<th>Tax Liability</th>
<th>Ending E&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parent</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>S1</td>
<td>$11,000</td>
<td>$11,000</td>
<td>($3,667)</td>
<td>$7,333</td>
</tr>
<tr>
<td>S2</td>
<td>($1,000)</td>
<td>$0</td>
<td>$0</td>
<td>($1,000)</td>
</tr>
<tr>
<td>S3</td>
<td>$10,000</td>
<td>$10,000</td>
<td>($3,333)</td>
<td>$6,667</td>
</tr>
<tr>
<td>Consolidated</td>
<td>$20,000</td>
<td>$21,000</td>
<td>($7,000)</td>
<td>$13,000</td>
</tr>
</tbody>
</table>

**Tax Rate** 35.00%

**Consolidated Tax Liability** $7,000
In each of these scenarios, P is the common parent of a consolidated group owning all of the stock of corporations S1 and S2. S1 wholly owns S3.

### SEPARATE RETURN TAX LIABILITY METHOD

<table>
<thead>
<tr>
<th>Scenario #1</th>
<th>Line 30 Taxable Income</th>
<th>Income to be Allocated</th>
<th>Separate Company Income Tax</th>
<th>Sep Co. Tax Credits</th>
<th>Final Sep. Co. Tax</th>
<th>Consolidated Tax Liability</th>
<th>Ending E&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parent</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>S1</td>
<td>$11,000</td>
<td>$11,000</td>
<td>($3,850)</td>
<td>$2000</td>
<td>($1,850)</td>
<td>($1,750)</td>
<td>$9,250</td>
</tr>
<tr>
<td>S2</td>
<td>($1,000)</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>($1,000)</td>
</tr>
<tr>
<td>S3</td>
<td>$10,000</td>
<td>$10,000</td>
<td>($3,500)</td>
<td>$0</td>
<td>($3,500)</td>
<td>($3,250)</td>
<td>$6,750</td>
</tr>
<tr>
<td>Consolidated</td>
<td>$20,000</td>
<td>$21,000</td>
<td>N/A</td>
<td>N/A</td>
<td>($5,350)</td>
<td>($5,000)</td>
<td>$15,000</td>
</tr>
<tr>
<td>Tax Rate</td>
<td>35.00%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consolidated Tax Liability</td>
<td>$5,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
**Earnings and Profits – Federal Taxes, con’t**

- The effect of the tax allocation is that the amount of tax allocated to a member decreases the E&P of such member and is treated as a liability of that member for such amount.

- If the full amount of such liability is not paid, the amount which is not paid will generally be treated as a deemed contribution, a deemed distribution, or both, depending upon the relationships between the corporation and the other member(s) paying taxes on its behalf or generating tax attributes that offset the tax liability.

- Similarly, if an amount paid for federal taxes is greater than the allocated federal tax liability, then the difference is treated as a deemed distribution and/or deemed contribution.
In each of these scenarios, P is the common parent of a consolidated group owning all of the stock of corporations S1 and S2. S1 wholly owns S3. Assume default method contribution of consolidated income method used for E&P tax allocation.

<table>
<thead>
<tr>
<th>Scenario #2</th>
<th>Line 30 Taxable Income</th>
<th>Income to be Allocated</th>
<th>Tax Liability</th>
<th>Intercompany Actual Tax Paid</th>
<th>Deemed Contribution**</th>
<th>Deemed Distribution</th>
<th>Ending E&amp;P</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parent</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>S1</td>
<td>$10,000</td>
<td>$10,000</td>
<td>($3,667)</td>
<td>$0</td>
<td>$3,667</td>
<td>$0</td>
<td>$10,000</td>
</tr>
<tr>
<td>S2</td>
<td>($1,000)</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>($1,000)</td>
</tr>
<tr>
<td>S3</td>
<td>$11,000</td>
<td>$11,000</td>
<td>($3,333)</td>
<td>($7,000)</td>
<td>($3,667)</td>
<td>$4,000</td>
<td></td>
</tr>
<tr>
<td>Consolidated</td>
<td>$20,000</td>
<td>$21,000</td>
<td>($7,000)</td>
<td>($7,000)</td>
<td>($3,667)</td>
<td>$13,000</td>
<td></td>
</tr>
</tbody>
</table>

** Contributions are not relevant to computing E&P
E&P Depreciation
Depreciation

- Depreciation is an adjustment for E&P purposes only
- Allowance for depreciation for E&P purposes is determined in accordance with I.R.C. § 312(k) for tax years after June 30, 1972
- If performing E&P calculation, calculate depreciation generally on assets using ADS lives, straight-line
- Bonus depreciation is not allowed.
Depreciation (continued)

• Doing full E&P depreciation calculation can be time consuming and costly
• There are potentially reasonable assumptions that can be made
• Some use AMT preference (Line 2a – Form 4626) and AMT Gain/Loss (Line 2e – Form 4626)
• Need to remember to adjust for bonus depreciation
Earnings & Profits - Distributions

Effect of Distributions on E&P
– Reduce E&P to extent of current year plus accumulated E&P.
– Reduction applied first to current year E&P, second to accumulated E&P.
– Distributions CANNOT create or increase E&P deficit.
– Distributions in excess of current plus accumulated E&P are return of capital up to extent of shareholder basis. Further distributions in excess of basis are treated as capital gain.
**Earnings & Profits – Distributions**

**Example 1:**

1 / 1 / Y1: C’s beginning E&P is $100

During Y1: C has $150 income

12 / 31 / Y1: C makes distribution of $200 on 12/31/Y1

<table>
<thead>
<tr>
<th>Description</th>
<th>Consolidated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated E&amp;P</td>
<td>$100</td>
</tr>
<tr>
<td>Current Y1 E&amp;P</td>
<td>$150</td>
</tr>
<tr>
<td>Distribution on 12/31/Y1</td>
<td>($200)</td>
</tr>
<tr>
<td>First use Current Year</td>
<td>($150)</td>
</tr>
<tr>
<td>Then use Accumulated E&amp;P</td>
<td>($50)</td>
</tr>
<tr>
<td><strong>Accumulated E&amp;P on 1/1/Y2</strong></td>
<td><strong>$50</strong></td>
</tr>
</tbody>
</table>

The full $200 distribution is treated as a dividend to the shareholder.
Earnings & Profits – Distributions

Example 2:

1 / 1 / Y1: C’s beginning E&P is $100

During Y1: C has $150 income

12 / 31 / Y1: C makes distribution of $300 on 12/31/Y1

Consolidated

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated E&amp;P</td>
<td>$100</td>
</tr>
<tr>
<td>Current Y1 E&amp;P</td>
<td>$150</td>
</tr>
<tr>
<td>Distribution on 12/31/Y1</td>
<td>($300)</td>
</tr>
<tr>
<td>First use Current Year</td>
<td>($150)</td>
</tr>
<tr>
<td>Then use Accumulated E&amp;P</td>
<td>($100)</td>
</tr>
<tr>
<td>Accumulated E&amp;P on 1/1/Y2</td>
<td>$0</td>
</tr>
</tbody>
</table>

Assuming sufficient basis, $250 is treated as a dividend to the shareholder and the remaining $50 is return of capital.
**Earnings & Profits – Distributions**

**Example 3:**

- **1 / 1 / Y1:** C’s beginning E&P is ($200)
- **During Y1:** C has $150 income
- **12 / 31 / Y1:** C makes distribution of $300 on 12/31/Y1

**Consolidated**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accumulated E&amp;P</td>
<td>($200)</td>
</tr>
<tr>
<td>Current Y1 E&amp;P</td>
<td>$150</td>
</tr>
<tr>
<td>Distribution on 12/31/Y1</td>
<td>($300)</td>
</tr>
<tr>
<td>First use Current Year</td>
<td>($150)</td>
</tr>
<tr>
<td>Then use Accumulated E&amp;P</td>
<td>$0</td>
</tr>
<tr>
<td>Accumulated E&amp;P on 1/1/Y2</td>
<td>($200)</td>
</tr>
</tbody>
</table>

Assuming sufficient basis, $150 is treated as a dividend to the shareholder and the remaining $150 is return of capital.
Redemptions
Earnings & Profits – Redemptions

- A corporation’s purchase of its own stock.
- IRC Sec. 312(n)(7) states that in the event of a distribution by a corporation in redemption of its stock treated as an exchange under IRC Sec. 302(a), E&P available on the date of the redemption must be reduced.
- E&P is reduced in proportion to the amount of the corporation’s outstanding stock that is redeemed, not to exceed the amount of the redemption.
- Note this rule only applies to redemptions occurring in tax years beginning after September 30, 1984. Separate rules apply prior to this date so care should be taken with studies that begin earlier than 1984.
Example 1:
100 Shares Redeemed on 12/31/Y1
1,000 Shares Outstanding at time of Redemption
200,000 of Accumulated E&P
4,000 of Current E&P as of 12/31/Y1
Cash of 21,000
**Earnings & Profits – Redemptions**

Example 2:
100 Shares Redeemed on 12/31/Y1
1,000 Shares Outstanding at time of Redemption
200,000 of Accumulated E&P
4,000 of Current E&P as of 12/31/Y1
Cash of 15,000
Earnings & Profits – Redemptions

Example 3:
100 Shares Redeemed on 12/31/Y1
1,000 Shares Outstanding at time of Redemption
200,000 of Accumulated E&P
4,000 of Current E&P as of 12/31/Y1
1,000 of Current Year Distributions
Cash of 15,000
Impact of Transactions
Opening E&P/ Pre-affiliated E&P

- Opening E&P is determined based upon if the entity was formed or if the entity was acquired.
  - Note: if the entity was an S Corporation no E&P would have been generated. However, must confirm the entity never had C Corporation earnings.
- If formed, opening E&P is zero
- If acquired, must calculate “pre-affiliated” E&P
  - Pre-affiliated E&P is the E&P generated by the target entity prior to its inclusion in the acquirors’ consolidated group
**Opening E&P/ Pre-affiliated E&P**

• Determination of pre-affiliated E&P: how was the target entity acquired?
  • Reorganizations under I.R.C. §368(a)(1)(A) and §386(a)(2)(E):
    • Targets pre-affiliated E&P is calculated and stays at the subsidiary level until liquidated
  • Taxable stock acquisition:
    • Targets pre-affiliated E&P is calculated and stays at the subsidiary level until liquidated
  • §338(h)(10) Transactions:
    • Targets pre-affiliated E&P for the subsidiary is zero as all of the tax attributes were either eliminated or remain in the prior consolidated group
  • Taxable asset acquisitions:
    • Targets pre-affiliated E&P does not carryover
**Earnings and Profits**

SRLY E&P — Example 1 (“Disappearing E&P”)

**Analysis**

- P’s E&P is not automatically adjusted when T joins the P Group
- T’s entire $300 distribution is a dividend out of T’s SRLY E&P
- T reduces its E&P by $300 because it made the distribution
- P increases its E&P by $300 because it received T’s distribution — § 312
- P decreases its E&P by $300 because T’s $300 E&P reduction tiers up to P
- **Thus, P has no net E&P increase or decrease**
- Treas. Reg. § 1.1502-33(b)(1)
I.R.C. § 381 Attribution Rules:

- If targets pre-affiliated E&P is trapped at the subsidiary level it may succeed to the parent only after a liquidation pursuant to I.R.C. §§ 332 and 337.
- When liquidation of pre-affiliated E&P occurs § 381 must be taken into account.
- If the acquiring corporation and each target corporation has accumulated E&P as of the date of the distribution or transfer, or if each of such corporations has a deficit in accumulated earnings, then the accumulated E&P (or deficit) of each such corporation shall be consolidated as of the close of the date of distribution or transfer in the accumulated E&P account of the acquiring corporation.
- If a party to a distribution or transfer, has accumulated E&P and one corporations has a deficit in accumulated E&P, the total of any deficit is used only to offset E&P accumulated by the acquiring corporation after the date of distribution or transfer.
- In certain situations, the acquirer must maintain two separate E&P accounts, one positive and one negative. The negative amount is ignored in determining the amount of E&P available for distribution of a dividend to shareholders as of any distribution date. The negative amount may, however, be used to offset E&P accumulated subsequent to the date of the distribution or transfer.
**Earnings and Profits**

SRLY E&P — Example 2 (Treas. Reg. § 1.1502-33(b)(1))

**Year 1: P Acquires X**

- **P** acquires X with $1,000 Accum. E&P
- $500 SRLY E&P Deficit

**Year 2: X Liquidates**

- **X** liquidates with $500 SRLY E&P Deficit

**Analysis**

- X has a $300 E&P deficit when it liquidates in Year 2 under sections 332 and 381.
- However, P should succeed to the $500 SRLY E&P deficit that X had when it joined the group — otherwise X’s $200 of Year 1 E&P would be reflected twice in P’s E&P.
- Under the Hovering Deficit Rule, P can only use the $500 SRLY E&P deficit to offset E&P accumulated after X’s liquidation — Treas. Reg. § 1.381(c)(2)-1(a)(5).
- In post-liquidation years, positive undistributed E&P is first used to reduce the inherited deficit — Treas. Reg. § 1.381(c)(2)-1(a)(7), Ex. 7.
**Earnings and Profits**

**SRLY E&P — Example 3**

**Year 1: P Acquires Z**
- P’s E&P is not automatically adjusted when Z joins the P Group
- Z’s $200 of current E&P in Year 1 increases Z’s and P’s E&P by $200
- When P sells its Z stock, Z is deconsolidated and is required to eliminate $200 of its E&P (i.e., the amount that tiered up to P) — Treas. Reg. § 1.1502-33(e)(1)
- The elimination of Z’s E&P does not tier up to P
- Treas. Reg. § 1.1502-33(b)

**Analysis**

**Year 2: Z Departs**
# Opening E&P/ Pre-affiliated E&P

## Impact of Transactions

<table>
<thead>
<tr>
<th>Type of Transaction</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formation pursuant to Section 351 or subsequent capital contributions</strong></td>
<td>In general, the E&amp;P of the newly formed subsidiary will be equal to zero and the parent corporation's E&amp;P will not be affected by the formation of a subsidiary. In special circumstances, however, E&amp;P may be carried over to the contributee.</td>
</tr>
<tr>
<td><strong>Taxable stock acquisition</strong></td>
<td>In general, the E&amp;P of an acquired entity is unchanged in connection with a taxable stock purchase. Two exceptions exist: 1) the acquisition is a qualified stock purchase and a section 338 election is made, or 2) a member is acquired out of a consolidated group.</td>
</tr>
<tr>
<td><strong>Tax-free stock transactions:</strong></td>
<td></td>
</tr>
<tr>
<td>&quot;B&quot; reorganization</td>
<td>The E&amp;P of the acquired entity is unchanged.</td>
</tr>
<tr>
<td>Triangular &quot;B&quot; reorganization</td>
<td>The E&amp;P of the acquired entity is unchanged.</td>
</tr>
<tr>
<td>Reverse triangular merger - Section 368(a)(2)(E)</td>
<td>Subsidiary inherits Target's E&amp;P.</td>
</tr>
<tr>
<td><strong>Tax-free asset transactions</strong></td>
<td></td>
</tr>
<tr>
<td>Triangular &quot;C&quot; reorganization</td>
<td>Subsidiary inherits Target's E&amp;P.</td>
</tr>
<tr>
<td>Forward triangular reorganization - Section 368(a)(2)(D)</td>
<td>Subsidiary inherits Target's E&amp;P.</td>
</tr>
<tr>
<td>&quot;A&quot; reorganization</td>
<td>Subsidiary inherits Target's E&amp;P.</td>
</tr>
<tr>
<td><strong>Section 355 Transactions (Preceded by &quot;D&quot; reorg.)</strong></td>
<td>The E&amp;P of the distributing corporation immediately before the transaction must be allocated between the distributing and controlled corporation. More complex rules apply in the event that the transaction is not preceded by a &quot;D&quot; reorg.</td>
</tr>
<tr>
<td><strong>Group Structure Change</strong></td>
<td>The new parent will succeed to the E&amp;P of the former common parent.</td>
</tr>
</tbody>
</table>
Sec. 355 Transactions with Sec. 368(a)(1)(D) Reorganization Preceding

- Sec. 312(h) requires proper allocation of E&P between Distributing and Controlled in accordance with the Regs.
- Treas. Reg. 1.312-10(a) provides guidance on allocating E&P between Distributing and Controlled.
- Use of Fair Value vs. Net Tax Basis
**Sec. 355 Transactions with Sec. 368(a)(1)(D) Reorganization Preceding (continued)**

**Example:**

P (“Distributing”) is the parent of a consolidated group and is planning to spin out S (“Controlled”) in a transaction determined to be tax-free pursuant to Sec. 368(a)(1)(D) and Sec. 355.

<table>
<thead>
<tr>
<th>P Group E&amp;P</th>
<th>$1,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair Market Value</td>
<td></td>
</tr>
<tr>
<td>S = $2,500</td>
<td></td>
</tr>
<tr>
<td>P (including S) = $10,000</td>
<td></td>
</tr>
<tr>
<td>Allocation of E&amp;P</td>
<td></td>
</tr>
<tr>
<td>P = 1,000 x 75% = $750</td>
<td></td>
</tr>
<tr>
<td>S = 1,000 x 25% = $250</td>
<td></td>
</tr>
</tbody>
</table>
Sec. 355 Transaction – No “D” Reorganization

Treas. Reg. 1.312-10(b) provides the following guidance:

Reduction to Distributing

Lesser of:
- Reduction that would occur under Treas. Reg. 1.312-10(a)
- Net Worth of Controlled

Amount of E&P that Controlled Leaves With

Greater of:
- Amount of E&P Allocated under Treas. Reg. 1.312-10(a)
- Historic E&P
**Sec. 355 Transaction – No “D” Reorganization (continued)**

**Example:**

P (“Distributing”) is the parent of a consolidated group and is planning to spin out S (“Controlled”) in a transaction determined to be tax-free pursuant to Sec. 355.

<table>
<thead>
<tr>
<th>E&amp;P on Spin Date</th>
<th>Fair Market Values</th>
</tr>
</thead>
<tbody>
<tr>
<td>P Group E&amp;P =</td>
<td>S                  =</td>
</tr>
<tr>
<td>$1,000</td>
<td>$25</td>
</tr>
<tr>
<td>S E&amp;P =</td>
<td>P (including S) =</td>
</tr>
<tr>
<td>$400</td>
<td>$100</td>
</tr>
</tbody>
</table>

**Reduction to E&P**

<table>
<thead>
<tr>
<th>Lesser of:</th>
<th>Greater of:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction under 1.312-10(a) = $250</td>
<td>Amount allocated under 1.312-10(a) = $250</td>
</tr>
<tr>
<td>Net Worth of S = $2,500</td>
<td>Historic E&amp;P = $400</td>
</tr>
</tbody>
</table>
**Earnings and Profits**

**Group Structure Changes**

**Group Structure Change — Treas. Reg. § 1.1502-31**

- A group structure change occurs if one corporation succeeds another as common parent of a group, and the group remains in existence under the *principles* of the reverse acquisition rule or the downstream merger rule of Treas. Reg. § 1.1502-75(d); see also Rev. Rul. 82-152.

**Treas. Reg. § 1.1502-33(f)**

- If a corporation becomes the new common parent of a group in a group structure change, its E&P is adjusted immediately after it becomes the new common parent to reflect the E&P of the former common parent (immediately before the former common parent ceases to be the common parent)

**In other words . . .**

- The former common parent’s E&P is replicated in the new common parent’s E&P, as though the new common parent succeeded to it under section 381; if the former parent is not wholly owned by the new parent only a proportionate amount is replicated.
**Earnings and Profits**
Group Structure Change — Example

**Analysis**
- The exchange is a reverse acquisition under Treas. Reg. § 1.1502-75(d)(3); the USP Group is treated as remaining in existence with New HoldCo as new common parent
- New HoldCo’s E&P is adjusted immediately after to reflect USP’s $100 of E&P
- USP continues to have $100 of E&P
**Earnings and Profits**

Restructuring within the Group — Example

**Analysis**

- If a member’s location within a group changes, E&P must be adjusted to prevent E&P from being eliminated — Treas. Reg. § 1.1502-33(f)(2)

- If P contributes S to NewCo in an intercompany sec. 351 transaction, NewCo’s E&P is adjusted to reflect S’s E&P

- If NewCo purchases S’s stock from P, its E&P is not adjusted
This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers LLP, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2014 PricewaterhouseCoopers LLP. All rights reserved. In this document, “PwC” refers to PricewaterhouseCoopers LLP which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.
Disclaimer

- In this document, "PwC" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

- This presentation is ©2015 PwC. All rights reserved. No part of this document may be reproduced, transmitted, or otherwise distributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, rekeying, or using any information storage and retrieval system, without written permission from PwC. Any reproduction, transmission, or distribution of this form or any of the material herein is prohibited and is in violation of U.S. and international law. PwC expressly disclaims any liability in connection with use of this presentation or its contents by any third party.

- This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.