

Request for Permission to Proceed with the Formal Regulatory Process to Adopt Proposed Regulation Section 23663-6 Relating to Assignment of Credits After Corporate Reorganizations Or Other Corporate Restructurings And Amend Proposed Regulation Section 23663-1 Relating to Definitions for Credit Assignment Regulations

The purpose of Proposed Regulation 23663-6 is to provide taxpayers clarity regarding when credits can be assigned after a corporate reorganization or other corporate restructuring. The purpose of amending Proposed Regulation 23663-1 is to expand its scope so that the definitions in Proposed Regulation 23663-1 also apply to Proposed Regulation 23663-6.

Background

Revenue and Taxation Code (RTC) section 23663 permits the assignment of credits among affiliated members of the same combined reporting group. RTC section 23663 was added by Section 10 of AB 1452 (Stats. 2008, ch. 763) and is specifically operative for assignments made in taxable years beginning on or after July 1, 2008. The statute permits assigned credits to be claimed against the "tax" of the assignee in taxable years beginning on or after January 1, 2010.

For an assignment to be valid, a taxpayer must first make an election to assign credits on Form FTB 3544, which the taxpayer must file with the original tax return for the taxable year in which the assignment is made. The election to assign credits is irrevocable under RTC section 23663, subdivision (c).

Purpose and Explanation of the Proposed Regulation

To receive a valid assignment of credits, the assignee must be an "eligible assignee" as defined in RTC section 23663(b)(3). Specifically, the assignee must have been in the same combined reporting group as the assignor assigning the credits at two points in time: 1) the last day of the taxable year in which the credits were earned (or June 30, 2008 for credits earned prior to July 1, 2008); and 2) the last day of the taxable year in which the credits are assigned. However, when the assignor or assignee of credits has been involved in a corporate reorganization or other corporate restructuring, taxpayers can be uncertain regarding whether the assignor and assignee meet the requirement of being in the same combined reporting group on both aforementioned dates.

Therefore, the proposed regulation provides clear rules so that taxpayers have certainty regarding the assignment of credits after the assignor or assignee has been involved in a corporate reorganization or other corporate restructuring.

It is notable that the credit assignment statute specifically authorizes the proposed regulation, as RTC section 23663(e)(4) states that the Franchise Tax Board is specifically authorized to issue any regulations necessary to implement the purposes of this section, including any regulations necessary to specify when a taxpayer and eligible assignee are not properly treated as members of the same combined reporting group.

Interested Parties Meetings

At the first interested parties meeting, held on June 12, 2014, staff and attendees discussed the purpose of the proposed regulation, which is to give taxpayers guidance regarding situations that result from corporate reorganizations and other corporate restructurings. Staff discussed with attendees a general structure to determine which members of an assignor's combined reporting group were "eligible assignees" in situations in which the assignor was not the taxpayer that originally earned the credit and when the members of the assignor's combined reporting group changed in the time between when the credit was earned and when the credit was assigned.

The first interested parties meeting for the proposed regulation was held concurrently with the third interested parties meeting for Proposed Regulations 23663-1 through 23663-5. Proposed Regulations 23663-1 through 23663-5 are the first major regulations (regulations defined as having an economic impact of \$50 million or more) promulgated by the Franchise Tax Board, and are currently in the final stage of review by the Office of Administrative Law.

At the second interested parties meeting, held on June 12, 2018, staff presented draft language as well as an explanation of the draft language, and responded to questions from the public. Staff has not received any concerns or suggested changes to this draft regulatory language.

Ancillary Changes

In addition to staff's request for permission to proceed to the formal regulatory process for Proposed Regulation 23663-6. Staff also requests permission to move directly into the formal regulatory process in order to make a minor amendment to Proposed Regulation 23663-1 so that the definitions contained therein also apply to Proposed Regulation 23663-6. This amendment will avoid the need to redefine various terms in Proposed Regulation 23663-6. As noted above, Proposed Regulation 23663-1 is currently in the final stage of review by the Office of Administrative Law, and it is expected that adoption of those proposed regulations will occur before staff proceeds with the amendatory process for the proposed regulation that is the subject of this request.

Further, as discussed at the second interested parties meeting, subsection (f) of Proposed Regulation 23663-6 has been revised so that the fair market value of both the total assets and the acquired assets is determined as of the time immediately after the acquisition. This change results in both tests occurring at the same time as opposed to different times.

Request for Permission

Staff believes that the proposed regulations provide important guidance consisting of clear rules to give taxpayers certainty regarding when credits can be assigned after a corporate reorganization or other corporate restructuring has occurred. Staff now requests permission to commence the formal regulatory process under the Administrative Procedure Act.

FRANCHISE TAX BOARD

Title 18, Division 3, California Code of Regulations
Amend Article 3. Tax Credits,
amending section 23663-1, adopting section 23663-6

Chapter 3.5. Bank and Corporation Tax
Subchapter 3. Corporation Income Tax
Article 3. Tax Credits

Section 23663-1 is amended to read:

23663-1. Definitions

Definitions. For purposes of Regulations 23663-1 through 23663-56, inclusive, the following definitions shall apply:

- (a) *Adjustment Date.* The term "adjustment date" shall mean the calendar date on which any adjustment under Regulations 23663-2 through 23663-5 is made by either the mailing by the Franchise Tax Board of a notice of corrected credit adjustments under Regulations 23663-2 through 23663-5, including a notice of proposed assessment under Revenue and Taxation Code section 19033, or the date on which the FTB receives a request which is later approved for either a correction of an error under Regulation 23663-4 or to apply Regulation 23663-2 or 23663-3. To the extent a final determination of a notice mailed by the FTB modifies, in whole or in part, the allocations reflected in that notice, then such modifications are treated as if made on the adjustment date on which that notice was mailed.
- (b) *Affiliated Corporation.* The term "affiliated corporation" shall mean any corporation that is a member of the same commonly controlled group within the meaning of Revenue and Taxation Code section 25105 as the assignor.
- (c) *Aggregated Eligible Assignees.* The term "aggregated eligible assignees" shall mean all eligible assignees assigned the same type of identical credits in the same taxable year.
- (d) *Assignee.* The term "assignee" shall mean any corporation (including a successor in interest) to whom an assignor has made an election to assign a credit under Revenue and Taxation Code section 23663, and shall also include any affiliated corporation (including a successor in interest) whose identifying information is listed on the defective assignment.
- (e) *Assignment.* The term "assignment" shall mean any election by an assignor to assign a credit to an assignee under the provisions of Revenue and Taxation Code section 23663. For purposes of Regulations 23663-1 through 23663-5, each election by an assignor to assign any credit to an assignee shall be treated as a separate assignment.

- (f) *Assignor*. The term "assignor" shall mean any taxpayer (including any successor in interest) who made an election to assign any credit to an assignee.
- (g) *Closed Year*. The term "closed year" shall mean any taxable year for which the Franchise Tax Board determines that it is precluded from mailing a notice of proposed deficiency assessment.
- (h) *Defective Assignment*.
- (1) The term "defective assignment" shall mean any assignment under Revenue and Taxation Code section 23663 which does not comply with the requirements of Revenue and Taxation Code section 23663, including, but not limited to, any assignment which:
 - (A) fails to clearly identify the taxable year from which the credit to be assigned was earned by the assignor;
 - (B) fails to clearly identify the amount of any credit to be assigned;
 - (C) fails to clearly identify the type of credit intended to be assigned;
 - (D) assigns an amount of credit, or when aggregated with other assignments of the same credit in the same taxable year, which exceeds the amount of the assignor's eligible credits for that taxable year;
 - (E) assigns a credit that is not an eligible credit; or
 - (F) assigns a credit to an assignee who is not clearly identified or who is not an eligible assignee.
- (2) An assignor's intent or purpose in making an assignment is not relevant in determining whether an assignment is a defective assignment.
- (3) *Examples*.

Example 1: X reported that it has \$200 of 2010 R & D credits. On its original tax return for the 2010 taxable year, X elects to assign \$100 of the 2010 R & D credits to Y. Subsequently, X discovers that it only had \$120 of 2010 R & D credits. The assignment to Y is a not a defective assignment because X had the \$100 of 2010 R & D credits assigned to Y. The fact that X retained less 2010 R & D credits than it expected does not make the assignment to Y a defective assignment. Therefore, X retained \$20 of 2010 R & D credits and Y received \$100 of 2010 R & D credits.

Example 2: Assume the same facts as in Example 1, except that X elects to assign all \$200 of the 2010 R & D credits to Y. Subsequently, X discovers that it had \$300 of 2010 R & D credits. The assignment to Y is a not a defective assignment because X had all \$200 of the 2010 R & D credits assigned to Y. Even if X can demonstrate that X intended to assign all of its 2010 R & D credits to Y, the assignment of 2010 R & D credits to Y will be limited to \$200 of 2010 R & D credits because this is the amount assigned in the valid assignment.

Example 3: Assume the same facts as in Example 1, except that X discovers that X has no credits and the election to assign credits to Y was meant to have been made by its affiliate, E, the entity that had \$200 of 2010 R & D credits. No credits

are transferred because the assignment of credits from X to Y was a defective assignment, and E did not elect to assign any credits. Therefore, E retained all \$200 of 2010 R & D credits, and Y received no 2010 R & D credits.

Example 4: Assume the same facts as in Example 1, except that X can demonstrate with contemporaneous evidence, such as emails, correspondence, memos and tax preparation workpapers, that X intended to assign no credits to Y and, instead, meant to assign the \$100 of 2010 R & D credits to M. Pursuant to paragraph (2), X's intent to assign to M is not relevant in determining whether the assignment is a defective assignment. Accordingly, the assignment of credits to Y is not a defective assignment. Therefore, X retained \$20 of 2010 R & D credits, Y received \$100 of 2010 R & D credits, and M received no credits.

Example 5: Assume the same facts as in Example 1, except that on X's original tax return for the 2010 taxable year, X did not elect to assign any credits, but Y's Form 3544A states that Y received \$100 of 2010 R & D credits from X in 2010. An assignment of credits in 2010 did not occur because X did not make an election to assign credits on its original tax return. Therefore, X retained \$200 of 2010 R & D credits and Y received no credits.

- (i) *Effective Date of the Adjustment.* The term "effective date of the adjustment" shall mean the date an allocation or reduction pursuant to Regulations 23663-2 through 23663-5 is treated as having occurred, which date shall be the same time that an assignor or eligible assignee would otherwise have retained or received the credits if the original assignment had reflected such an allocation.
- (j) *Election.* The term "election" shall mean an irrevocable election by an assignor to assign to an assignee a credit under the rules of Revenue and Taxation Code section 23663, in the form and manner specified by the FTB in forms and instructions, including FTB Form 3544 (and any successor form thereto).
- (k) *Eligible Assignee.* The term "eligible assignee" shall mean any affiliated corporation that is properly treated as a member of the same combined reporting group under Revenue and Taxation Code sections 25101 or 25110 as the assignor, determined as of (i) in the case of credits earned in taxable years beginning before July 1, 2008, June 30, 2008 and the last day of the taxable year of the assignor in which the eligible credit is assigned, or (ii) in the case of credits earned in taxable years beginning on or after July 1, 2008, the last day of the first taxable year in which the credit was allowed to the assignor and the last day of the taxable year of the assignor in which the eligible credit is assigned.
- (l) *Eligible Credit.* The term "eligible credit" shall mean any credit earned by a taxpayer (i) in a taxable year beginning on or after July 1, 2008, or (ii) in a taxable year beginning before July 1, 2008, provided that such pre-July 1, 2008 credit is eligible to be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008 under the provisions of Part 11 of the Revenue and Taxation Code.

- (m) *FTB*. The term "FTB" shall mean Franchise Tax Board.
- (n) *First Contact*. The term "first contact" shall mean the date the initial audit contact as defined in Regulation 19032 occurs for any assignor or assignee with respect to any taxable year in which an assignment of credits is made or in which credits which were the subject of an assignment are claimed.
- (o) *Identical Credit*. The term "identical credit" shall mean any credit that:
 - (1) is allowed under the same section of the Revenue and Taxation Code as any other credit,
 - (2) is originally allowed in the same taxable year, and
 - (3) in the case of certain credits, such as credits for activities in enterprise zones, program areas or similar geographic-based credits, is a credit based on activity in the same enterprise zone or program area.
- (p) *Parties to a Defective Assignment*. The term "parties to a defective assignment" shall mean the assignor and each potential assignee for all defective assignments the assignor made of the same type of identical credit in the same taxable year as the defective assignment.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23663, Revenue and Taxation Code.

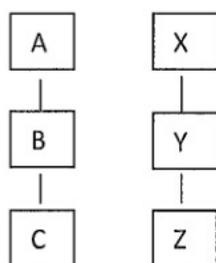
Regulation Section 23663-6 is adopted to read:

23663-6. Corporate Reorganizations and Other Corporate Restructurings

- (a) *In general.* The purpose of this regulation is to provide rules regarding the assignment of credits following corporate reorganizations and other corporate restructurings.
- (b) *Eligible Credit.* For purposes of Revenue and Taxation Code section 23663(b)(2), "any credit earned by the taxpayer" includes any credit allowed to the taxpayer for any reason other than that the credit was sold or assigned to the taxpayer pursuant to Revenue and Taxation Code section 23663, or any other section which permits the sale or assignment of credits.
- (c) *Eligible Assignee.* In addition to the requirements set forth in Revenue and Taxation Code section 23663(b)(3), an eligible assignee is a taxpayer that:
 - (1) In the case of credits earned in taxable years beginning before July 1, 2008, was a member of the same combined reporting group as the taxpayer that was allowed the credit as of June 30, 2008; or
 - (2) In the case of credits earned in taxable years beginning on or after July 1, 2008, was a member of the same combined reporting group as the taxpayer that originally earned the credit as of the last day of the taxable year in which the credit was originally earned.

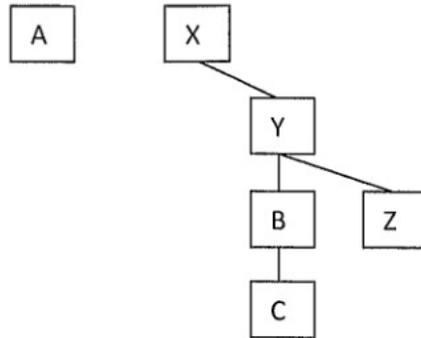
Example 1 – Assignor acquired by another combined reporting group.

In 2010, A, B and C are members of the same combined reporting group, with A owning 100 percent of B, and B owning 100 percent of C. X, Y and Z are members of an unrelated combined reporting group, with X owning 100 percent of Y, and Y owning 100 percent of Z. The ownership structures of A, B and C, as well as X, Y, and Z, are illustrated by the following diagram:



B earns credits in 2010, which are neither used against its tax, nor assigned in either 2010 or 2011. In 2012, B and C are acquired by the X-Y-Z group in a tax-free "B" reorganization so that thereafter B is wholly owned by Y. The

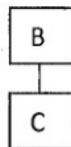
ownership structure of remaining entity A, and entities X, Y (with acquired entities B and C), and Z, is illustrated by the following diagram:



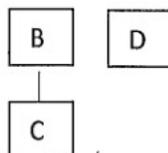
In 2013, B wants to assign its credits that it earned in 2010. C is the only eligible assignee for B's 2010 credits because C is the only entity that was in B's combined reporting group both in 2010 (the year the credits were earned) and in 2013 (the year of the assignment).

Example 2 – Spin-off.

B and C are members of the same combined reporting group, with B owning 100 percent of C. C earns credits in 2010, which are neither allowed against its tax nor assigned in either 2010 or 2011. The ownership structure of B and C is illustrated by the following diagram:



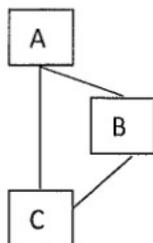
In 2012, D was formed and spun off from B, with B contributing assets to D in exchange for D stock, which qualified as a "D" reorganization under Internal Revenue Code section 368(a)(1)(D). D's stock was distributed to B's shareholders in a tax-free Internal Revenue Code section 355 transaction. The ownership structure of B, C and D thereafter is illustrated by the following diagram:



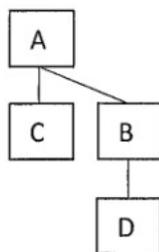
In 2013, C wants to assign the credits that it earned in 2010 to D. However, because D did not exist in 2010, D was not in the same combined reporting group as C when C earned the credits, and so, D is not an eligible assignee.

Example 3 – Split-off.

A, B and C are members of the same combined reporting group, with A owning 100 percent of B, and A and B each owning 50 percent of C. B earns credits in 2010, which are neither allowed against its tax nor assigned in either 2010 or 2011. The ownership structure of A, B and C is illustrated by the following diagram:



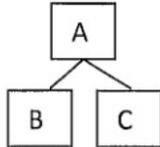
In 2012, D is formed and is split off of C, with C contributing assets to D for D's shares in a D reorganization under Internal Revenue Code section 368(a)(1)(D). C distributes D's shares to B in complete redemption of B's interest in C in a transaction that qualified under Internal Revenue Code section 355. As a result, A owns 100 percent of B and C, and B owns 100 percent of D. The ownership structure of A, B, C and D thereafter, is illustrated by the following diagram:



In 2013, B wants to assign the credits it earned in 2010 to D. However, since D was not in B's combined reporting group in 2010 because it was not in existence, D is not an eligible assignee.

Example 4 – Split-up.

A, B and C are part of the same combined reporting group in 2010, with A owning 100 percent of B and 100 percent of C. A and B earn credits in 2010. The ownership structure of A, B and C is illustrated by the following diagram:



In 2012, A distributes B and C's shares to A's shareholders in complete redemption of their A shares. As a result, A ceases to exist, and any credits it owned from prior years are extinguished because Internal Revenue Code section 381 does not apply. The ownership structure of remaining entities B and C, is illustrated by the following diagram:



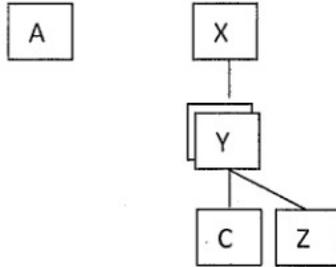
B and C continue to be in the same combined reporting group because they retain the same ownership and meet all other unitary requirements. C is an eligible assignee of the credits B earned in 2010 because C was part of B's combined reporting group at the end of the taxable year that the credits were allowed, and at the end of the taxable year that the credits were assigned.

- (d) *Pre-Reorganization Credits.* For purposes of determining whether a potential assignee meets the requirements of subsection (c) of this regulation and Revenue and Taxation Code sections 23663(b)(3)(A)(i) and (b)(3)(B)(i), when an assignor receives another taxpayer's credits as a result of a reorganization or other corporate restructuring, the taxpayer that originally earned the credits will be treated as the assignor. However, for any credits earned in taxable years beginning before July 1, 2008, the assignor will be the taxpayer that was allowed the credits as of the taxable year which includes the date of June 30, 2008.

Example 5 – Pre-Reorganization Credits.

Assume the same initial facts as in Example 1, except that both B and C earned credits in 2010 and in 2012 B was instead merged into Y in a tax-free

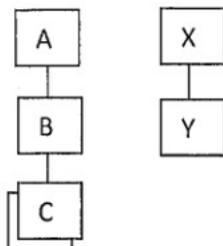
"A" reorganization under Internal Revenue Code section 368(a)(1)(A). Y is the surviving entity, and the credits B earned in 2010 are now Y's credits. As a result, X owns 100 percent of Y, and Y owns 100 percent of C and Z. The ownership structure of remaining entity A, and the X-Y-C-Z combined reporting group (with B merged into Y as represented by the layered boxes) is illustrated by the following diagram:



In 2013, Y wants to assign credits earned by B before the merger that are now held by Y. C is the only eligible assignee for the credits B earned in 2010 because B is the deemed assignor and C is the only entity that was in B's combined reporting group in 2010 (the year the credits were earned) and in Y's combined reporting group in 2013 (the year of the assignment). However, while Y may assign the credits B earned in 2010 to C under these facts, C cannot assign any of the credits C earned in 2010 to X, Y or Z because X, Y and Z were not in C's combined reporting group when C earned its credits.

Example 6 - No eligible assignees for the assignment of pre-merger credits.

Assume the same initial facts as in Example 1, except that Z also earned credits in 2010 and does not use the credits against its tax nor assigns them in either 2010 or 2011. In 2012, the A-B-C group acquires Z by having Z merge into C, with C as the surviving corporation. The ownership structure of A, B, and C (with acquired entity Z merged into C as represented by the layered boxes), and remaining entities X, and Y, is illustrated by the following diagram:

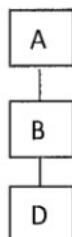


After the merger, C holds credits Z earned before the merger. C has none of its own credits. C cannot assign credits Z earned before the merger to A or B because neither A nor B were in the same combined reporting group as Z, the deemed assignor, in 2010. However, A and B can assign credits they earned before the merger to C (assuming subsection (f) of this regulation does not apply).

- (e) *F Reorganizations*. If a taxpayer would be an eligible assignee but for a reorganization under Internal Revenue Code section 368(a)(1)(F) that occurs after credits were earned, then the taxpayer will be treated as an eligible assignee for purposes of this section and Revenue and Taxation Code section 23663(b)(3).

Example 7 – F Reorganization.

Assume the same initial facts as in Example 1, except that in 2012, C, previously an Ohio corporation, reincorporates as D, a Nevada corporation, in a transaction that qualifies as an "F" reorganization under Internal Revenue Code section 368(a)(1)(F). As a result, A owns 100 percent of B, and B owns 100 percent of D, and C ceases to exist as a separate entity. The ownership structure of entities A, B, and D, is illustrated by the following diagram:



In 2013, B wants to assign its credits to D. Subsection (e) of this regulation applies, and D is an eligible assignee as to A and B for purposes of this section and Revenue and Taxation Code section 23663.

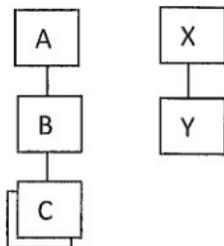
- (f) *Ineligible Assignee*. A member of the combined reporting group is not an eligible assignee for purposes of Revenue and Taxation Code section 23663(b)(3) if:
- (1) The member is the surviving entity in a reorganization or other corporate restructuring with an entity that was not a member of the combined reporting group when the assignor's credits were earned; and
 - (2) In the reorganization or restructuring, the member acquired assets (including real, personal, tangible, and intangible property) used in conducting its trade or business, with an aggregate fair market value that exceeds 80 percent of the aggregate fair market value of the total assets of the trade or business

being conducted by the member immediately after the acquisition. For purposes of this paragraph only, the following rules shall apply:

- A. The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the time immediately after the acquisition.
- B. Any acquired assets that constituted property described in Internal Revenue Code section 1221(a)(1) in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Internal Revenue Code section 1221(a)(1) in the hands of the acquiring taxpayer (or related person).

Example 8 – Ineligible assignee.

Assume the same initial facts as in Example 1, except in 2010, C is an operating business with minimal business assets, and Z is an operating business with significant business assets. In 2012, B acquires Z by having Z merge into C, with C as the surviving corporation, in a transaction that qualifies as an "A" reorganization under Internal Revenue Code section 368(a)(1)(A). The fair market value of C's assets immediately before the merger are less than 20% of the fair market value of C's total business assets immediately after the merger. The ownership structure of entity A, B and C (which merged with Z and is the surviving entity, as represented by the layered boxes) and entities X, and Y, is illustrated by the following diagram:



B wants to assign credits to C in 2013. However, C is not an eligible assignee for purposes of this section and Revenue and Taxation Code section 23663 because the fair market value of C's assets immediately prior to the merger with Z was less than 20% of the fair market value of C's assets immediately after the acquisition.

- (g) *Limitations.* For purposes of applying Revenue and Taxation Code section 23663, any limitations on the allowance of any credit against the tax that would apply to the

assignor in the absence of an assignment shall also apply to the same extent to the allowance of that assigned credit against the tax of the assignee.

Example 9 – *Application of credit limitations.*

Assume the same initial facts as in Example 1, except that B earned credits in 2010 pursuant to Revenue and Taxation Code section 23622.7 (the "EZ Credits"). The EZ Credits are allowed against B's tax subject to the limitation in Revenue and Taxation Code section 23622.7(j).

In 2013, B assigns the EZ Credits to C. After B assigns the EZ Credits to C, the EZ Credits are allowed against C's tax subject to the limitation in Revenue and Taxation Code section 23622.7(j), since the same limitation would have applied to B's use of the credits if B had not assigned the EZ Credits to C.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code.
Reference: Section 23663, Revenue and Taxation Code.

Summary and Explanation of Proposed Regulation

Proposed Regulation 23663-6 – Corporate Reorganizations and Other Corporate Restructurings

1. Subsection (a) sets forth the purpose of the regulation and provides an overview of what the regulation covers. This subsection states that this regulation gives guidance to taxpayers regarding credit assignments following reorganizations and other corporate restructurings. This subsection is necessary to provide users of Regulation 23663-6 guidance regarding its scope, so that users can identify the applicability of this regulation to their specific issues.

2. Subsection (b) clarifies the definition of eligible credit set forth in Revenue and Taxation Code ("RTC") section 23663(b)(2). An eligible credit is defined in the statute as "[a]ny credit earned by the taxpayer" on or after July 1, 2008 or earned before July 1, 2008 that can be carried forward to the taxpayer's first taxable year beginning on or after July 1, 2008. The purpose of this section is to clarify that eligible credits (credits that can be assigned) includes credits allowed to a taxpayer through corporate events, such as reorganizations and other corporate restructurings. In these situations, the taxpayer did not originally earn or generate the credits; however, such credits may be allowed to a taxpayer for reasons other than the taxpayer earned or generated the credits, and it is necessary to clarify that those credits are included in the definition of eligible credit to effectuate the purpose of the statute. Also, consistent with RTC section 23663, the proposed language clarifies that eligible credit does not include credits that a taxpayer received by assignment or sale.

3. Subsection (c) clarifies that an eligible assignee generally must have been in the same combined reporting group as the entity that earned the credit when the credit was originally earned.

This subsection is necessary to effect the purpose of the statute in the case of corporate reorganizations and other corporate restructurings. Without this subsection, users of the credit assignment statute will be left with uncertainty regarding who is an eligible assignee when there has been corporate reorganizations and other corporate restructurings.

The statute specifies that an eligible assignee had to have been in the assignor's combined reporting group when the assignor originally earned the credit. However, if the assignor was not the entity that originally earned the credit, but instead, held the credit because, for example, it merged with the entity that earned the credit, taxpayers have uncertainty as to which entity's combined reporting group satisfies the requirement – the assignor's combined reporting group when the credit was originally earned or the combined reporting group of the taxpayer that originally earned the credit. Thus, the regulation clarifies that the relevant

combined reporting group for purposes of the requirement in RTC section 23663(b)(3) is that of the taxpayer that originally earned the credit when the credit was originally earned.

This subsection contains four illustrative examples. In Example 1, B is the assignor in 2013. To determine the "eligible assignees," the regulation looks to the members of B's combined reporting group in 2010 when B earned the credits. According to this snapshot, A and C are the only potential eligible assignees. Second, the regulation looks to the members of B's combined reporting group in 2013, the year of assignment. In 2013, X, Y, Z and C are potential eligible assignees. However, C is the only potential eligible assignee in both the year the credit was earned and the year the credit is assigned. As such, C is the only eligible assignee.

Examples 2, 3 and 4 address IRC section 355 transactions – spin-offs, split-offs and split-ups. These transactions generally involve the creation of a new entity that is a continuation of a part of the prior company's business. However, the new entity is not considered an eligible assignee. The new entity does not meet the requirements of the statute because it was not a member of the assignor's combined reporting group when the assignor earned the credits.

4. Subsection (d) of the regulation addresses situations in which the assignor is not the taxpayer who originally generated the credits, but instead received the credits as a result of a corporate reorganization or other corporate restructuring. Taxpayers may have uncertainty regarding the identity of the eligible assignees when the assignor is not the taxpayer that originally earned the credits because, for purposes of the requirements found in RTC sections 23663(b)(3)(A)(i) and (b)(3)(B)(i), it is not clear which combined reporting group satisfies the requirements – the assignor's combined reporting group or the combined reporting group of the taxpayer that originally earned the credits. Thus, the regulation clarifies that the statutory requirements of RTC sections 23663(b)(3)(A)(i) and (b)(3)(B)(i) are based on the combined reporting group of the taxpayer that originally earned the credits. In this regard, the regulation clarifies that the taxpayer that earned the credits is treated as the assignor to determine which entities are eligible assignees. As such, when the assignor is not the taxpayer who originally earned the credits, but assigns credits under RTC section 23663, an eligible assignee must meet the requirements of Regulation section 23663-6 and RTC sections 23663(b)(3)(A)(i) and (b)(3)(B)(i) in relation to the taxpayer that originally earned the credits. This result is consistent with the statute because it does not allow the assignment of credits to entities that were not members of the combined reporting group of the entity that originally earned the credits.

This subsection is necessary to provide clarity and guidance to taxpayers for purposes of determining the identity of eligible assignees when the assignor was not the taxpayer that earned the credits. The statute does not clearly address these situations, and so, without

this subsection, taxpayers are left with uncertainty regarding the entities that are eligible to receive credits under the statute.

There are two examples that illustrate the rules in this subsection. In Example 5, after the corporate reorganization, B no longer exists in the year of assignment because it merged into Y, and Y wants to assign B's historical credits. In this situation, Y is the assignor, but was not the entity that earned B's historical credits. As such, the statute leaves taxpayers with uncertainty as to which entities are "eligible assignees" because it is not clear which entity is treated as the assignor for purposes of analyzing the requirements found in RTC section 23663(b)(3)(B)(i) and proposed Regulation 23663-6(c). In this situation, as the examples demonstrate, the proposed regulation determines the eligible assignees for B's historical credits by looking to B's combined reporting group in the year B earned the credits. At that time, A and C were in B's combined reporting group, and so, A and C are potential eligible assignees. In the year of assignment, of the two potential eligible assignees, only C meets the requirement found in RTC section 23663(b)(3)(B)(ii). Thus, C is the only eligible assignee, assuming C meets all other applicable requirements.

Example 6 is the reverse situation of the situation in Example 5. In Example 6, C has no eligible assignees because C did not earn the credits, and A and B were not in Z's combined reporting group when Z earned the credits. Again, the statute leaves taxpayers with uncertainty as to which entities are "eligible assignees" because the assignor (the entity C in Example 6) did not earn the credits. However, the proposed regulation clarifies this ambiguity. Since A and B were not part of Z's combined reporting group when Z earned the credits, there are no eligible assignees.

5. Subsection (e) of the regulation sets forth a rule that a potential eligible assignee that would have been an eligible assignee but for a reorganization under IRC section 368(a)(1)(F) ("F reorganization"), will be treated as an eligible assignee for purposes of this subsection. This rule would treat the resulting corporation from an F reorganization the same as the original corporation that disappeared in the F reorganization for purposes of this regulation.

An F reorganization is unique in that the new corporation is treated for tax purposes as a continuation of the old corporation. Indeed, secondary authorities note that the old and new corporations of an F reorganization are characterized as "functional equivalents in the context of the larger transaction and with respect to related transactions or events."¹ Thus, this subsection is necessary, and is consistent with the purpose of the credit assignment

¹ Bittker and Eustace, *Federal Income Taxation of Corporations and Shareholders* (Thomson Reuters/Tax & Accounting, 7th ed. 2000 & Supp. 2017-3) (accessed on Checkpoint (www.checkpoint.rlag.com) [February 2, 2018]) section 12.28.

statute, to allow corporations affected by F reorganizations to be eligible assignees, assuming the corporations have met all other requirements of the statute.

Example 7 illustrates the narrow rule found in subsection (e) of the regulation.

6. Subsection (f) imposes a business assets test to determine the eligibility of a potential eligible assignee. This subsection prevents instances where a corporation with a relatively low level of business activity and assets is combined with a corporation outside of the group which has much higher business activity and assets. The result is that the relatively much smaller corporation now houses the relatively much larger corporation that was acquired. While the relatively small corporation was part of the assignor's combined reporting group when the credits were earned and in the year of assignment, the relatively larger corporation would not have been an eligible assignee, but for the merger with the relatively smaller corporation.

This result affords consistency with the same combined reporting group requirement under RTC section 23663(b)(3) and denies positive treatment in situations that would be contrary to the purpose of the statute which requires that an assignee be in the same combined reporting group when credits are both earned and assigned. In enacting the requirement that the assignor and assignee be members of the same combined reporting group both when the credit was originally earned and when the credit was assigned, the Legislature demonstrated that its purpose was to allow utilization of credits within the assignor's combined reporting group, but only so long as the limitation rule for the year the credits were originally earned and assigned was satisfied. The fact pattern set forth above creates uncertainty for taxpayers as to whether the post-merger corporation would be an eligible assignee. However, the post-merger corporation is fundamentally almost entirely comprised of the out-of-group corporation after the merger.

Thus, this subsection disallows credit assignments to entities that engaged in a reorganization or other corporation restructuring such that the amount of business assets after the merger are more than 80% of the amount of business assets of the surviving entity before the merger. This subsection is necessary to effectuate the purpose of the statute, which was to allow the assignment of credits subject to the same combined group limitation. The Legislature's purpose was to limit the assignment of credits to members of the same combined reporting group as the taxpayer that originally earned the credit and the assignor, and so, this subsection enforces that limitation by preventing the assignment of credits to an entity that in substance was not in the same combined reporting group as the taxpayer that earned the credits.

Example 8 illustrates the exception to the "eligible assignee" requirements found in subsection (f) of the regulation. C was a relatively small corporation with minimal assets, but was a member of B's combined reporting group when B earned its credits. B acquired Z

and merged Z into C, with C being the surviving entity. Thus, C is now over 80% comprised of Z's business assets. However, to allow C to be an eligible assignee would be inconsistent with the purpose of the statute, and so, this regulation disqualifies C as an eligible assignee because C's business assets were less than 20% than the surviving entity's assets after the merger.

7. Subsection (g) states that limitations on the allowance of credits against the assignor's tax will also apply to the allowance of the credits to the assignee's tax. If the assignor's use of the credits against its tax was subject to limitations or would have been subject to limitations but for the assignment, then the same limitations apply to the assignee's ability to use the credits against its tax.

While the Legislature made it clear that a limitation attaches to a credit permanently unless a statute specifically removes the limitation, this subsection is necessary to avoid any uncertainty regarding the impact of a corporate reorganization or other corporate restructuring on the limitations that attach to credits.

Example 9 illustrates these limitations in the context of Enterprise Zone ("EZ") credits. If B had EZ credits subject to the limitations found in RTC section 23662.7(j) and assigned those credits to C, C's ability to use the credits against its tax would be subject to the same limitations that applied when B held the credits. Accordingly, the limitations on B's use of the credits do not extinguish on assignment, but instead, apply consistently to the use of the credits before and after the assignment.