DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 5, 301, and 602

[TD 10018]

RIN 1545–BJ87

Revising Consolidated Return Regulations and Controlled Group of Corporations Regulations to Reflect Statutory Changes, Modernize Language, and Enhance Clarity

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that affect affiliated groups of corporations that file consolidated Federal income tax returns. These regulations modify the consolidated return regulations and the controlled group of corporations regulations to reflect statutory changes, update language to remove antiquated or regressive terminology, and enhance clarity. Additionally, this document withdraws certain temporary regulations.

DATES: *Effective date:* These final regulations are effective on December 30, 2024.

Applicability date: For dates of applicability, *see* §§ 1.52–1(i), 1.414(c)–6(g), 1.1502–0, 1.1502–5(e), 1.1502–45(f), 1.1552–1(g), 1.1562–1(e), 1.1563–2(d), and 1.1563–3(e).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations under section 52, Christopher Dellana of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) at (202) 317–5500; concerning the regulations under section 414, Jessica Weinberger of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes) at (202) 317–4148; concerning the regulations under all other sections, William W. Burhop or Kelton P. Frye of the Office of Associate Chief Counsel (Corporate) at (202) 317–5363 or (202) 317–6975, respectively (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Authority

Section 1502 of the Internal Revenue Code (Code) authorizes the Secretary of the Treasury or her delegate (Secretary) to prescribe consolidated return regulations for an affiliated group of corporations that join in filing (or that are required to join in filing) a consolidated return (consolidated group) to clearly reflect the Federal income tax liability of the consolidated group and to prevent avoidance of such tax liability. *See* § 1.1502–1(h) (defining the term ''consolidated group''). For purposes of carrying out those objectives, section 1502 also permits the Secretary to prescribe rules that may be different from the provisions of chapter 1 of the Code (chapter 1) that would apply if the corporations composing the consolidated group filed separate returns. Additionally, section 7805(a) of the Code authorizes the Secretary to ''prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.''

Background

I. Overview

This Treasury decision contains final regulations under sections 52, 414, 1502, 1503, 1552, and 1563 of Code. These regulations primarily revise the Income Tax Regulations (26 CFR part 1) issued under section 1502 (consolidated return regulations). Terms used in the consolidated return regulations generally are defined in § 1.1502–1.

II. 2023 Proposed Regulations

On August 7, 2023, the Department of the Treasury (Treasury Department) and the IRS published a notice of proposed rulemaking (REG–134420–10) in the **Federal Register** (88 FR 52057) under sections 1502, 1503, 1552, and 1563 (2023 proposed regulations). The 2023 proposed regulations would revise the consolidated return regulations (i) to eliminate obsolete or otherwise outdated provisions, (ii) to modernize the language and improve the clarity of the regulations, and (iii) to facilitate taxpayer compliance.

The 2023 proposed regulations also would revise the consolidated return regulations and the regulations under section 1563 to eliminate antiquated or regressive terminology. For example, the 2023 proposed regulations (i) would replace gender-specific pronouns and other identifiers with gender-neutral pronouns and identifiers, and (ii) would identify (A) American Samoa, (B) the Commonwealth of the Northern Mariana Islands, (C) the Commonwealth of Puerto Rico, (D) Guam, and (E) the U.S. Virgin Islands as ''territories'' of the United States rather than ''possessions'' in §§ 1.1502–4(d)(1) and 1.1503(d)–1(b)(7). These revisions are consistent with, and in furtherance of, the Treasury Department's Equity Action Plan, as well as Executive Order 13985 of January 20, 2021, *Advancing Racial Equity and Support for Underserved Communities Through the Federal Government,* 86 FR 7009 (January 25, 2021).

The 2023 proposed regulations also would revise or remove other regulations under the Code. These regulations are set forth in (i) the Income Tax Regulations (26 CFR part 1), (ii) the Temporary Income Tax Regulations under the Revenue Act of 1978 (26 CFR part 5), (iii) the Regulations on Procedure and Administration (26 CFR part 301), and (iv) the OMB Control Numbers under the Paperwork Reduction Act Regulations (26 CFR part 602).

The notice of proposed rulemaking (NPRM) containing the 2023 proposed regulations also withdrew or partially withdrew numerous earlier NPRMs, including: (i) NPRMs that previously had been incorporated into final regulations in revised form or that were incorporated into the 2023 proposed regulations in revised form; (ii) an NPRM that became obsolete when proposed regulations provided in a subsequent, discrete NPRM were adopted as final regulations; and (iii) NPRMs that cross-referenced temporary regulations (the text of which served as the text for those proposals) that were removed, have expired, or otherwise have become obsolete. Additionally, the 2023 proposed regulations proposed to withdraw temporary regulations that (i) no longer have practical applicability to taxpayers, or (ii) would be replaced by final regulations provided by this Treasury decision.

Finally, the 2023 proposed regulations would remove numerous provisions that cross-reference prior-law editions of the Code of Federal Regulations (CFR).

III. Correction to 2023 Proposed Regulations

The 2023 proposed regulations contained amendments to the regulations under section 1563. A correction to the 2023 proposed regulations was published in the **Federal Register** (88 FR 84770–02) on December 6, 2023, and provided an additional opportunity for public comment (2023 correction), to make parallel amendments to similar regulations under sections 52 and 414 to avoid creating inconsistencies.

IV. Comments Received

The Treasury Department and the IRS requested comments on the 2023 proposed regulations. The comments received are described in further detail in the Summary of Comments and Explanation of Revisions. No public hearing was requested or held.

Summary of Comments and Explanation of Revisions

I. Withdrawal of Proposed or Temporary Regulations

A commenter expressed concern that the withdrawal or partial withdrawal of old proposed or temporary regulations in the 2023 proposed regulations could lead to confusion or uncertainty for consolidated groups if the withdrawn regulations contain substantive provisions on which consolidated groups continue to rely. The commenter recommended either retaining or revising the withdrawn proposed or temporary regulations or providing guidance on how to apply the existing final regulations in light of the withdrawals.

The Treasury Department and the IRS are of the view that, with the exception of the proposed consolidated return regulations under § 1.1502–80(d) relating to the non-applicability of section 357(c) discussed in part VII of this Summary of Comments and Explanation of Revisions, the withdrawn or partially withdrawn regulations do not contain substantive provisions on which taxpayers continue to rely. Accordingly, these final regulations do not adopt the commenter's recommendation.

II. Section 1.1502–5 (Consolidated Estimated Tax)

Section 10101 of Public Law 117–169, 136 Stat. 1818 (August 16, 2022), commonly referred to as the Inflation Reduction Act of 2022, amended section 55 of the Code to impose a new corporate alternative minimum tax (commonly referred to as the corporate alternative minimum tax, or CAMT) based on adjusted financial statement income. To reflect this change, the 2023 proposed regulations would modify the definition of the term ''tax'' in § 1.1502–5(b)(5) by adding a reference to section 55(a). Because the amount of tax imposed under section 55 is determined in part by reference to the amount of tax imposed under section 59A of the Code (that is, the base erosion anti-abuse tax, or BEAT), the 2023 proposed regulations also would modify the definition of the term ''tax'' in § 1.1502–5(b)(5) by adding a reference to section 59A.

A commenter recommended adding the foregoing references not only in § 1.1502–5(b)(5), but also in other sections of the consolidated return regulations that use the word ''tax''. However, these changes in the 2023 proposed regulations were necessary to implement the recently enacted CAMT. The Treasury Department and the IRS have determined that similar changes to other provisions in the consolidated return regulations are beyond the scope of this guidance. Accordingly, these final regulations do not adopt the commenter's recommendation.

III. Revisions To Remove Obsolete or Outdated References or Terms

As noted in part II of the Background, the 2023 proposed regulations would make nonsubstantive changes to the consolidated return regulations and the regulations under section 1563 to replace gender-specific pronouns and other identifiers with gender-neutral pronouns and identifiers, and to replace the term ''possession'' with the defined term ''U.S. territory'' in §§ 1.1502–4(d)(1) and 1.1503(d)–1(b)(7). A commenter welcomed the removal of gender-specific pronouns and identifiers but suggested that the gender-neutral pronouns and identifiers are not entirely clear or consistent throughout the consolidated return regulations (for example, some provisions use ''its'' as a singular possessive pronoun, whereas others use ''their'' as a singular possessive pronoun). The commenter recommending either using a consistent set of gender-neutral pronouns and identifiers throughout the regulations or providing a glossary or explanation of these pronouns and identifiers.

The Treasury Department and the IRS have determined that revising all gender-neutral pronouns throughout the consolidated return regulations and the section 1563 regulations is beyond the scope of this guidance. However, the Treasury Department and the IRS will continue to consider the revision of particular pronouns when modifying the consolidated return regulations in future guidance.

The commenter also requested clarification that the replacement of the term ''possessions'' with the term ''territories'' is purely terminological and is not intended to affect the tax treatment of these jurisdictions under the consolidated return regulations. The Treasury Department and the IRS agree with the commenter that this change was intended to be purely terminological. *See https://www.doi.gov/oia/islands/politicatypes.*

IV. Revisions to §§ 1.1502–13, 1.1502–32, and 1.1502–36

A commenter raised questions about amendments to §§ 1.1502–13(c)(2)(ii) and (c)(6)(ii)(A), 1.1502–32(b)(2)(iv) and (b)(4)(i), and 1.1502–36(d)(3)(ii)(B) and (d)(6)(ii)(B) in the 2023 proposed regulations. However, neither the 2023 proposed regulations nor these final regulations would amend these provisions. Accordingly, no revisions have been made in response to this comment.

V. Definition of ''Consolidated Return Regulations''

The 2023 proposed regulations would add ''consolidated return regulations'' as a new defined term in § 1.1502–1. As defined in proposed § 1.1502–1(g), this term would mean the regulations issued under section 1502. A commenter noted that certain consolidated return regulations issued under the authority of section 1502 were not actually placed under section 1502 (for example, *see* § 1.163(j)–4 and § 1.385–4). Accordingly, these final regulations revise the term ''consolidated return regulations'' to mean the regulations issued under the authority of section 1502. These final regulations also amend §§ 1.1502–47(a)(3), (k), and (l) and 1.1504–3(d)(1)(ii) to replace the cited range of sections with the defined term ''consolidated return regulations.''

VI. Sections 52 and 414

Sections 52(a) and 414(b) provide rules for controlled groups of corporations that incorporate the definitions and rules in section 1563(a), with modifications. Sections 52(b) and 414(c)(1) authorize regulations applying principles similar to the principles that apply in the case of sections 52(a) and 414(b), respectively, to trades or businesses under common control.

A controlled group of corporations under section 52(a) or section 414(b), which cross-reference section 1563(a), is determined based on the constructive ownership rules of section 1563(e), including section 1563(e)(2) and (3) (but not section 1563(e)(3)(C)). A group of trades or businesses under common control under sections 52(b) and 414(c) is determined by taking into account the constructive ownership rules in §§ 1.52–1(b) and (c) and 1.414(c)–2(b)(1), respectively, that mirror the rules under section 1563.

As discussed in the preamble to the 2023 proposed regulations, the 2023 proposed regulations would revise § 1.1563–1(a)(2)(i)(A) and (B) to reflect an amendment to section 1563(d)(1)(B) by the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647, 102 Stat. 3342 (November 10, 1988). That amendment expanded the constructive ownership rules of section 1563(e) that apply for purposes of section 1563(d)(1) to include section 1563(e)(2) (relating to attribution from partnerships) and section 1563(e)(3) (relating to attribution from estates or trusts). The 2023 proposed regulations generally would apply to consolidated return years for which the due date of the return (without regard to extensions) is after the date of publication of the Treasury Decision adopting the regulations as final regulations in the **Federal Register**.

The 2023 correction does not specify an applicability date for the proposed revisions to §§ 1.52–1(c)(1) and 1.414(c)–2(b)(1). In addition, the Treasury Department and the IRS are of the view that applying the general applicability date in the 2023 proposed regulations to the proposed revisions to §§ 1.52–1(c)(1) and 1.414(c)–2(b)(1) may cause confusion, because the rules in §§ 1.52–1(c)(1) and 1.414(c)–2(b)(1) apply to taxpayers who may not file consolidated returns.

Accordingly, these final regulations clarify that the amendment to § 1.52–1(c)(1) applies to taxable years beginning on or after January 1, 2025, and that the amendment to § 1.414(c)–2(b)(1) applies to plan years beginning on or after January 1, 2025. The final regulations add new paragraph (i) to § 52–1 to provide that § 52–1, as amended by this Treasury decision, applies to taxable years beginning on or after January 1, 2025. Section 1.414(c)–6, which provides the effective date and various applicability dates for the regulations under sections 414(b) and (c), is amended to reflect the applicability date of the amendment to § 1.414(c)–2(b)(1); *see also* the Applicability Date section of this preamble. The amendment to section 1563(d)(1)(B) by the Technical and Miscellaneous Revenue Act of 1988 was not incorporated into the regulations under sections 52(b) and 414(c)(1) with respect to taxable years and plan years, respectively, that began prior to the applicability date for the regulations specified in this Treasury decision. Accordingly, the IRS will not challenge the application of §§ 1.52–1(c)(1) and 1.414(c)–2(b) as previously in effect or taking into account the amendment to section 1563(d)(1)(B) with respect to taxable years that began prior to January 1, 2025, for the regulations under section 52(b) or plan years that began prior to January 1, 2025, for the regulations under section 414(c)(1).

VII. Section 357(c) and § 1.1502–80(d)

A commenter raised concerns about the withdrawal of proposed consolidated return regulations under § 1.1502–80(d) relating to the non-applicability of section 357(c). The comment has led the Treasury Department and the IRS to reconsider that withdrawal. For a discussion of the comment, *see* the notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

VIII. Other Non-Substantive Revisions

To make the reading of these regulations more user-friendly, these final regulations generally restate the revised paragraphs in the regulations under sections 52, 414, 1502, 1503, 1552, and 1563. Additionally, the formatting changes to the examples in § 1.1502–13(j) in the 2023 proposed regulations were adopted by T.D. 10016, published in the **Federal Register** on December 11, 2024 (89 FR 100138).

Applicability Date

Pursuant to section 1503(a) of the Code, the regulations issued under the authority of section 1502 apply to consolidated return years for which the due date of the return (without regard to extensions) is after December 30, 2024.

In addition, § 1.52–1(c)(1) applies to taxable years beginning on or after January 1, 2025, and § 1.414(c)–2(b)(1) applies to plan years beginning on or after January 1, 2025. The amendments to §§ 1.1552–1(g), 1.1562–1(e), 1.1563–2(d), and 1.1563–3(e) apply to taxable years beginning after December 30, 2024.

Special Analyses

I. Regulatory Planning and Review

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

II. Paperwork Reduction Act

These final regulations update the consolidated return regulations by revising and removing outdated and obsolete provisions, such as cross-references to temporary regulations, regulations, and statutes that have been repealed, removed, expired, renumbered, or otherwise have become obsolete. Therefore, these final regulations would not impose an additional reporting burden beyond what is otherwise required by existing statutes, regulations, and forms. The total burden associated with these final regulations is $0.

III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these final regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these final regulations would apply only to corporations that file consolidated Federal income tax returns, and that such corporations tend to be larger businesses. Specifically, based on data available to the IRS, corporations that file consolidated Federal income tax returns represent only approximately two percent of all filers of Forms 1120 (U.S. Corporation Income Tax Return). However, these consolidated Federal income tax returns account for approximately 95 percent of the aggregate amount of receipts reported on all Forms 1120. Therefore, these final regulations would not create significant additional obligations for, or impose an economic impact on, a substantial number of small entities. Accordingly, the Secretary certifies that these final regulations will not have significant economic impact on a significant number of small entities.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business. No comments were received from the Chief Counsel for the Office of Advocacy of the Small Business Administration.

IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. [In 2024, that threshold is approximately $190 million.] These final regulations do not include any rule that would include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

V. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. These final regulations do not propose rules that would have federalism implications, impose substantial direct compliance costs on State and local governments, or preempt State law within the meaning of the Executive order.

VI. Congressional Review Act

Pursuant to the Congressional Review Act (5 U.S.C. 801 *et seq.*), the Office of Information and Regulatory Affairs designated this rule as not a major rule, as defined by 5 U.S.C. 804(2).

Drafting Information

The principal authors of this document are Kelton P. Frye and William W. Burhop of the Office of Associate Chief Counsel (Corporate). Other personnel from the Treasury Department and the IRS participated in its development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 5

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 5, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by removing the entries for §§ 1.1503–2, 1.1502–9A, 1.1502–15A, 1.1502–21A, 1.1502–22A, 1.1502–23A, 1.1502–41A, 1.1502–79A, 1.1502–91A, 1.1502–92A, 1.1502–93A, 1.1502–94A, 1.1502–95A, 1.1502–96A, 1.1502–98A, and 1.1502–99A to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

■ **Par. 2.** Section 1.52–1 is amended by revising paragraphs (c)(1)(i) and (ii) and adding paragraph (i) to read as follows:

§ 1.52–1 Trades or businesses that are under common control.

* * * * *

(c) * * *

(1) * * *

(i) A controlling interest in each of the organizations, except the common parent organization, is owned (directly and with the application of § 1.414(c)–4(b)(1), (2), and (3)) by one or more of the other organizations; and

(ii) The common parent organization owns (directly and with the application of § 1.414(c)–4(b)(1), (2), and (3)) a controlling interest in at least one of the other organizations, excluding, in computing the controlling interest, any direct ownership interest by the other organizations.

* * * * *

(i) *Applicability date.* This section applies to taxable years beginning on or after January 1, 2025. *See* 26 CFR 1.52–1, as revised April 1, 2024, for taxable years beginning before January 1, 2025.

■ **Par. 3.** Section 1.57–1 is amended by revising paragraph (b)(4)(ii) to read as follows:

§ 1.57–1 Items of tax preference defined.

* * * * *

(b) * * *

(4) * * *

(ii) Where the taxpayer acquires property in a transaction to which section 381(a) applies or from another member of an affiliated group during a consolidated return year and an ''accelerated'' method of depreciation as described in section 167(b)(2), (3), or (4) or section 167(j)(1)(B) or (C) is permitted (*see* § 1.381(c)(6)–1), the depreciation which would have been allowable under the straight line method is determined as if the property had been depreciated under the straight line method since depreciation was first taken on the property by the transferor of such property. In such cases, references in this paragraph to the period for which the property is held or useful life of the property are treated as including the period beginning with the commencement of the original use of the property.

* * * * *

■ **Par. 4.** Section 1.167(c)–1 is amended by revising paragraph (a)(5) to read as follows:

§ 1.167(c)–1 Limitations on methods of computing depreciation under section 167(b)(2), (3), and (4).

(a) * * *

(5) *See* §§ 1.1502–13 and 1.1502–68 for provisions dealing with depreciation of property received by a member of an affiliated group from another member of the group during a consolidated return period.

* * * * *

■ **Par. 5.** Section 1.279–6 is amended by revising and republishing paragraph (d) to read as follows:

§ 1.279–6 Application of section 279 to certain affiliated groups.

* * * * *

(d) *Aggregate projected earnings.* In the case of an affiliated group of corporations (whether or not such group files a consolidated return under section 1501), the aggregate projected earnings of such group is computed by separately determining the projected earnings of each member of such group under paragraph (d) of § 1.279–5, and then adding together such separately determined amounts, except that—

(1) A dividend (a distribution which is described in section 301(c)(1) other than a distribution described in section 243(c)(1)) distributed by one member to another member is eliminated;

(2) In determining the earnings and profits of any member of an affiliated group, there is eliminated any amount of interest income received or accrued, and of interest expense paid or incurred, which is attributable to intercompany indebtedness; and

(3) No gain or loss is recognized in any transaction between members of the affiliated group.

* * * * *

§ 1.382–8 [Amended]

■ **Par. 6.** Section 1.382–8 is amended by removing and reserving paragraph (i).

■ **Par. 7.** Section 1.414(c)–2 is amended by revising paragraphs (b)(1)(i) and (ii) to read as follows:

§ 1.414(c)–2 Two or more trades or businesses under common control.

* * * * *

(b) * * *

(1) * * *

(i) A controlling interest in each of the organizations, except the common parent organization, is owned (directly and with the application of § 1.414(c)–4(b)(1), (2), and (3)) by one or more of the other organizations; and

(ii) The common parent organization owns (directly and with the application of § 1.414(c)–4(b)(1), (2), and (3)) a controlling interest in at least one of the other organizations, excluding, in computing such controlling interest, any direct ownership interest by such other organizations.

* * * * *

■ **Par. 8.** Section 1.414(c)–6 is amended by revising and republishing paragraph (a) and adding paragraph (g) to read as follows:

§ 1.414(c)–6 Effective date.

(a) *General rule.* Except as provided in paragraph (b), (c), (e), (f), or (g) of this section, the provisions of § 1.414(b)–1 and §§ 1.414(c)–1 through 1.414(c)–4 apply for plan years beginning after September 2, 1974.

* * * * *

(g) *Special rule.* Notwithstanding paragraph (a), (b), or (c) of this section, § 1.414(c)–2(b)(1) applies to plan years beginning on or after January 1, 2025.

■ **Par. 9.** Section 1.1502–0 is revised to read as follows:

§ 1.1502–0 Effective/applicability dates.

(a) *In general.* Except as provided in paragraph (b) of this section, the consolidated return regulations (as defined in § 1.1502–1(g)) are applicable to taxable years beginning after December 31, 1965.

(b) *Exceptions.* The applicability date described in paragraph (a) of this section does not apply to any provision of the consolidated return regulations with an applicability or effective date different than the date provided by paragraph (a) of this section.

■ **Par. 10.** Section 1.1502–1 is amended by:

■ a. Adding introductory text;

■ b. Revising and republishing paragraphs (f)(2) and (3) and (g);

■ c. Redesignating paragraph (l) as paragraph (m); and

■ d. Adding a new paragraph (l).

The additions and revisions read as follows:

§ 1.1502–1 Definitions.

For purposes of the consolidated return regulations (and any provision of this chapter that refers to the consolidated return regulations):

* * * * *

(f) * * *

(2) *Exceptions.* The term *separate return limitation year* (or SRLY) does not include:

(i) A separate return year of the corporation which is the common parent for the consolidated return year to which the tax attribute is to be carried (except as provided in § 1.1502–75(d)(2)(ii) and paragraph (f)(3) of this section);

(ii) A separate return year of any corporation which was a member of the group for each day of such year; or

(iii) A separate return year of a predecessor of any member if such predecessor was a member of the group for each day of such year.

(3) *Reverse acquisitions.* In the event of an acquisition to which § 1.1502–75(d)(3) applies, all taxable years of the first corporation and of each of its subsidiaries ending on or before the date of the acquisition are treated as separate return limitation years, and the separate return years (if any) of the second corporation and each of its subsidiaries are not treated as separate return limitation years (unless they were so treated immediately before the acquisition). For example, if corporation P merges into corporation T, and the persons who were stockholders of P immediately before the merger, as a result of owning the stock of P, own more than 50 percent of the fair market value of the outstanding stock of T, then a loss incurred before the merger by T (even though it is the common parent), or by a subsidiary of T, is treated as having been incurred in a separate return limitation year. Conversely, a loss incurred before the merger by P, or by a subsidiary of P in a separate return year during all of which such subsidiary was a member of the group of which P was the common parent, is treated as having been incurred in a year which is not a separate return limitation year.

* * * * *

(g) *Consolidated return regulations.* The term *consolidated return regulations* means the regulations issued under the authority of section 1502.

* * * * *

(l) *U.S. territory.* The *term U.S. territory* means—

(1) American Samoa;

(2) The Commonwealth of the Northern Mariana Islands;

(3) The Commonwealth of Puerto Rico;

(4) Guam; and

(5) The U.S. Virgin Islands.

* * * * *

§ 1.1502–3 [Amended]

■ **Par. 11.** Section 1.1502–3 is amended by removing and reserving paragraph (e).

■ **Par. 12.** Section 1.1502–4 is amended by revising paragraph (d)(1) to read as follows:

§ 1.1502–4 Consolidated foreign tax credit.

* * * * *

(d) * * *

(1) *Allowance of unused foreign tax as consolidated carryover or carryback.* The consolidated group's carryovers and carrybacks of unused foreign tax (as defined in § 1.904–2(c)(1)) to the taxable year is determined on a consolidated basis under the principles of section 904(c) and § 1.904–2 and is deemed to be paid or accrued to a foreign country or U.S. territory (as defined in § 1.1502–1(l)) for that year. The consolidated group's unused foreign tax carryovers and carrybacks to the taxable year consist of any unused foreign tax of the consolidated group, plus any unused foreign tax of members for separate return years, which may be carried over or back to the taxable year under the principles of section 904(c) and § 1.904–2. The consolidated group's unused foreign tax carryovers and carrybacks do not include any unused foreign taxes apportioned to a corporation for a separate return year pursuant to § 1.1502–79(d). A consolidated group's unused foreign tax in each separate category is the excess of the foreign taxes paid, accrued or deemed paid under section 960 by the consolidated group over the limitation in the applicable separate category for the consolidated return year. *See* paragraph (c) of this section.

* * * * *

■ **Par. 13.** Section 1.1502–5 is revised to read as follows:

§ 1.1502–5 Estimated tax.

(a) *General rule*—(1) *Consolidated estimated tax.* If a group files a consolidated return for two consecutive taxable years, it must make payments of estimated tax on a consolidated basis for each subsequent taxable year until separate returns are filed. When filing on a consolidated basis, the group is generally treated as a single corporation for purposes of section 6655 (relating to payment of estimated tax by corporations). If separate returns are filed by the members for a taxable year, the amount of any estimated tax payments made with respect to a consolidated estimated tax for the year is credited against the separate tax liabilities of the members in any reasonable manner designated by the common parent.

(2) *First two consolidated return years.* For its first two consolidated return years, a group may make payments of estimated tax on either a consolidated or a separate member basis. The amount of any separate estimated tax payments is credited against the consolidated tax liability of the group.

(b) *Addition to tax for failure to pay estimated tax under section 6655*—(1) *Consolidated return filed.* For its first two consolidated return years, a group may compute the amount of the penalty (if any) under section 6655 on a consolidated basis or a separate member basis, regardless of the method of payment. Thereafter, the group must compute the penalty for any consolidated return year on a consolidated basis.

(2) *Computation of penalty on consolidated basis*—(i) *In general.* This paragraph (b)(2) provides rules for computing the penalty under section 6655 on a consolidated basis.

(ii) *Preceding taxable year.* The tax shown on the return for the preceding taxable year referred to in section 6655(d)(1)(B)(ii) is, if a consolidated return was filed for that preceding year, the tax shown on the consolidated return for that preceding year or, if a consolidated return was not filed for that preceding year, the aggregate of the taxes shown on the separate returns of the common parent and any other corporation that was a member of the same affiliated group as the common parent for that preceding year.

(iii) *Aggregate of payments made by all members.* If estimated tax was not paid on a consolidated basis, the amount of the group's payments of estimated tax for the taxable year is the aggregate of the payments made by all members for the year.

(iv) *Required annual payment rule.* If the common parent is otherwise eligible to use the section 6655(d)(1)(B)(ii) required annual payment rule, that rule applies only if the group's consolidated return, or each member's separate return if the group did not file a consolidated return, for the preceding taxable year was a taxable year of 12 months.

(3) *Computation of penalty on separate member basis.* To compute any penalty under section 6655 on a separate member basis, for purposes of section 6655(d)(1)(B)(i), the ''tax shown on the return'' for the taxable year is the portion of the tax shown on the consolidated return allocable to the member under paragraph (b)(6) of this section. If the member was included in the consolidated return filed by the group for the preceding taxable year, for purposes of section 6655(d)(1)(B)(ii), the ''tax shown on the return'' for the preceding taxable year for any member is the portion of the tax shown on the consolidated return for the preceding year allocable to the member under paragraph (b)(6) of this section.

(4) *Consolidated payments if separate returns filed.* If the group does not file a consolidated return for the taxable year but makes payments of estimated tax on a consolidated basis, for purposes of section 6655(b)(1)(B), the ''amount (if any) of the installment paid'' by any member is an amount apportioned to the member in any reasonable manner designated by the common parent. If a member was included in the consolidated return filed by the group for the preceding taxable year, the amount of the member's penalty under section 6655 is computed on the separate member basis described in paragraph (b)(3) of this section.

(5) *Tax defined.* For purposes of this section, the term *tax* means the excess of—

(i) The sum of—

(A) The consolidated tax imposed by section 11 or subchapter L of chapter 1, whichever applies;

(B) The tax imposed by section 55(a); plus

(C) The tax imposed by section 59A; over

(ii) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

(6) *Allocation of consolidated tax liability for determining earnings and profits.* For purposes of this section, the tax shown on a consolidated return is allocated to the members of the group by allocating any tax described in paragraph (b)(5)(i) of this section, net of allowable credits under paragraph (b)(5)(ii) of this section, under the method that the group has elected pursuant to section 1552 and § 1.1502–33(d).

(c) *Examples.* The provisions of this section are illustrated by the following examples.

(1) *Example 1.* Corporations P and S1 file a consolidated return for the first time for calendar year 2021. P and S1 also file consolidated returns for calendar year 2022 and calendar year 2023. Under paragraph (a)(2) of this section, for the 2021 and 2022 taxable years, P and S1 may pay estimated tax on either a separate or consolidated basis. Under paragraph (a)(1) of this section, for the 2023 taxable year, the group must pay its estimated tax on a consolidated basis. In determining whether P and S1 come within the exception provided in section 6655(d)(1)(B)(ii) for 2023, the ''tax shown on the return'' is the tax shown on the consolidated return for the 2022 taxable year.

(2) *Example 2.* Corporations P, S1, and S2 file a consolidated return for the first time for calendar year 2021 and file their second consolidated return for calendar year 2022. S2 ceases to be a member of the group on September 15, 2023. Under paragraph (b)(2) of this section, in determining whether the group (which no longer includes S2) comes within the exception provided in section 6655(d)(1)(B)(ii) for 2023, the ''tax shown on the return'' is the tax shown on the consolidated return for calendar year 2022.

(3) *Example 3.* Corporations P and S1 file a consolidated return for the first time for calendar year 2021 and file their second consolidated return for calendar year 2022. Corporation S2 becomes a member of the group on July 1, 2023, and joins in the filing of the consolidated return for calendar year 2023. Under paragraph (b)(2) of this section, in determining whether the group (which now includes S2) comes within the exception provided in section 6655(d)(1)(B)(ii) for 2023, the ''tax shown on the return'' is the tax shown on the consolidated return for calendar year 2022. Any tax of S2 for any separate return year is not included as a part of the ''tax shown on the return'' for purposes of applying section 6655(d)(1)(B)(ii).

(4) *Example 4.* Corporations X and Y file consolidated returns for the calendar years 2021 and 2022 and separate returns for calendar year 2023. Under paragraph (b)(3) of this section, in determining whether X or Y comes within the exception provided in section 6655(d)(1)(B)(ii) for 2023, the ''tax shown on the return'' is the amount of tax shown on the consolidated return for 2022 allocable to X and to Y in accordance with paragraph (b)(6) of this section.

(d) *Cross-references*—(1) For provisions relating to quick refunds of corporate estimated tax payments, *see* §§ 1.1502–78 and 1.6425–1 through 1.6425–3.

(2) For provisions relating to depositing estimated taxes, *see* § 1.6302–1(b).

(e) *Applicability date.* This section applies to any taxable year for which the due date of the income tax return (without regard to extensions) is after December 30, 2024. For prior years, *see* § 1.1502–5 (as contained in the 26 CFR edition revised as of April 1, 2024).

■ **Par. 14.** Section 1.1502–6 is amended by revising paragraph (b) to read as follows:

§ 1.1502–6 Liability for tax.

* * * * *

(b) *Liability of subsidiary after withdrawal.* If a subsidiary has ceased to be a member of the group and in such cessation resulted from a bona fide sale or exchange of its stock for fair value and occurred prior to the date upon which any deficiency is assessed, the Commissioner may, if the Commissioner believes that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former subsidiary in an amount not exceeding the portion of such deficiency which the Commissioner may determine to be allocable to it. If the Commissioner makes assessment and collection of any part of a deficiency from such former subsidiary, then for purposes of any credit or refund of the amount collected from such former subsidiary the agency of the common parent under the provisions of § 1.1502–77 does not apply.

* * * * *

■ **Par. 15.** Section 1.1502–9 is amended by revising and republishing paragraphs (a), (b)(1), and (c)(2)(ii) and (iii) to read as follows:

§ 1.1502–9 Consolidated overall foreign losses, separate limitation losses, and overall domestic losses.

(a) *In general.* This section provides rules for applying section 904(f) and (g) (including its definitions and nomenclature) to a group and its members. Generally, section 904(f) concerns rules relating to overall foreign losses (OFLs) and separate limitation losses (SLLs) and the consequences of such losses. Under section 904(f)(5), losses are computed separately in each category of income described in section 904(d)(1) or § 1.904–5(a)(4)(v) (separate category). Section 904(g) concerns rules relating to overall domestic losses (ODLs) and the consequences of such losses. Paragraph (b) of this section defines terms and provides computational and accounting rules, including rules regarding recapture. Paragraph (c) of this section provides rules that apply to OFLs, SLLs, and ODLs when a member becomes or ceases to be a member of a group. Paragraph (d) of this section provides a predecessor and successor rule. Paragraph (e) of this section provides effective dates.

(b) * * *

(1) *Computation of CSLI or CSLL and consolidated U.S.-source taxable income or CDL.* The group computes its consolidated separate limitation income (CSLI) or consolidated separate limitation loss (CSLL) for each separate category under the principles of § 1.1502–11 by aggregating each member's foreign-source taxable income or loss in such separate category computed under the principles of § 1.1502–12, and taking into account the foreign portion of the consolidated items described in § 1.1502–11(a)(2) through (a)(6) for such separate category. The group computes its consolidated U.S.-source taxable income or consolidated domestic loss (CDL) under similar principles.

* * * * *

(c) * * *

(2) * * *

(ii) *Departing member's portion of group's account.* A departing member's portion of a group's COFL, CSLL or CODL account for a loss category is computed based upon the member's share of the group's assets that generate income subject to recapture at the time that the member ceases to be a member. Under the characterization principles of §§ 1.861–9T(g)(3), 1.861–12, and 1.861–13, the group identifies the assets of the departing member and the remaining members that generate U.S.-source income (domestic assets) and foreign-source income (foreign assets) in each separate category. The assets are characterized based upon the income that the assets are reasonably expected to generate after the member ceases to be a member. The member's portion of a group's COFL or CSLL account for a loss category is the group's COFL or CSLL account, respectively, multiplied by a fraction, the numerator of which is the value of the member's foreign assets for the loss category and the denominator of which is the value of the foreign assets of the group (including the departing member) for the loss category. The member's portion of a group's CODL account for each income category is the group's CODL account multiplied by a fraction, the numerator of which is the value of the member's domestic assets and the denominator of which is the value of the domestic assets of the group (including the departing member). The value of the domestic and foreign assets is determined under the asset valuation rules of § 1.861–9(g)(1) and (2) using either tax book value or alternative tax book value under the method chosen by the group for purposes of interest apportionment as provided in § 1.861–9(g)(1)(ii). For purposes of this paragraph (c)(2)(ii), § 1.861–9T(g)(2)(iv) (assets in intercompany transactions) applies, but § 1.861–9T(g)(2)(iii) (adjustments for directly allocated interest) does not apply. The member's portions of COFL, CSLL, and CODL accounts are limited by paragraph (c)(2)(iii) of this section. In addition, for purposes of this paragraph (c)(2)(ii), the tax book value of assets transferred in intercompany transactions is determined without regard to previously deferred gain or loss that is taken into account by the group as a result of the transaction in which the member ceases to be a member. The assets should be valued at the time the member ceases to be a member, but values on other dates may be used unless this creates substantial distortions. For example, if a member ceases to be a member in the middle of the group's consolidated return year, an average of the values of assets at the beginning and end of the year (as provided in § 1.861–9(g)(2)) may be used or, if a member ceases to be a member in the early part of the group's consolidated return year, values at the beginning of the year may be used, unless this creates substantial distortions.

(iii) *Limitation on member's portion.* If the aggregate of a member's portions of COFL and CSLL accounts for a loss category (with respect to one or more income categories) determined under paragraph (c)(2)(ii) of this section exceeds 150 percent of the actual fair market value of the member's foreign assets in the loss category, the member's portion of the COFL or CSLL accounts for the loss category is reduced (proportionately, in the case of multiple accounts) by such excess. In addition, if the aggregate of a member's portions of CODL accounts (with respect to one or more income categories) determined under paragraph (c)(2)(ii) of this section exceeds 150 percent of the actual fair market value of the member's domestic assets, the member's portion of the CODL accounts is reduced (proportionately, in the case of multiple accounts) by such excess. This rule does not apply in the case of COFL or CSLL accounts if the departing member and all other members that cease to be members as part of the same transaction own all (or substantially all) the foreign assets in the loss category. In the case of CODL accounts, this rule does not apply if the departing member and all other members that cease to be members as part of the same transaction own all (or substantially all) the domestic assets.

* * * * *

■ **Par. 16.** Section 1.1502–11 is amended by:

■ 1. Revising and republishing paragraph (a).

■ 2. In paragraph (b)(2)(iii), redesignating *Examples 1* through *3* as paragraphs (b)(2)(iii)(A) through (C), respectively.

■ 3. In newly redesignated paragraphs (b)(2)(iii)(A) through (C), further redesignating the paragraphs in the first column as the paragraphs in the second column:

Old paragraphs	New paragraphs
(b)(2)(iii)(A)(a), (b), and (c).	(b)(2)(iii)(A)(*1*), (*2*), and (*3*).
(b)(2)(iii)(B)(a), (b), (c), and (d).	(b)(2)(iii)(B)(*1*), (*2*), (*3*), and (*4*).
(b)(2)(iii)(C)(a), (b), (c), (d), and (e).	(b)(2)(iii)(C)(*1*), (*2*), (*3*), (*4*), and (*5*),.

■ 4. Revising newly redesignated paragraphs (b)(2)(iii)(A)(*3*) and (b)(2)(iii)(B)(*4*).

■ 5. Revising and republishing paragraph (c)(7).

The revisions read as follows:

§ 1.1502–11 Consolidated taxable income.

(a) *In general.* The consolidated taxable income (CTI) for a consolidated return year is determined by taking into account:

(1) The separate taxable income of each member of the group (*see* § 1.1502–

12 for the computation of separate taxable income);

(2) Any consolidated net operating loss (CNOL) deduction (*see* § 1.1502–21 for the computation of the CNOL deduction);

(3) Any consolidated capital gain net income (*see* § 1.1502–22 for the computation of consolidated capital gain net income);

(4) Any consolidated section 1231 net loss (*see* § 1.1502–23 for the computation of consolidated section 1231 net loss);

(5) Any consolidated charitable contributions deduction (*see* § 1.1502–24 for the computation of the consolidated charitable contributions deduction); and

(6) Any consolidated dividends received deduction (*see* § 1.1502–26 for the computation of the consolidated dividends received deduction).

(b) * * *

(2) * * *

(iii) * * *

(A) * * *

(*3*) Because $30 of S's loss is absorbed in the determination of consolidated taxable income under paragraph (b)(2)(ii) of this section, P's basis in S's stock is reduced under § 1.1502–32(b) from $500 to $470 immediately before the disposition. Consequently, P recognizes a $50 gain from the sale of S's stock and the group has consolidated taxable income of $50 for Year 1 (P's $30 of ordinary income and $50 gain from the sale of S's stock, less the $30 of S's loss). In addition, S's limited loss of $50 is treated as a separate net operating loss attributable to S and, because S ceases to be a member, the loss is apportioned to S under § 1.1502–21 and carried to its first separate return year.

(B) * * *

(*4*) Under paragraph (b)(2)(ii) of this section, S's $40 ordinary loss from Year 2 that is limited under this paragraph (b) is treated as a separate net operating loss arising in Year 2. Similarly, $40 of the consolidated net capital loss from Year 1 attributable to S is treated as a separate net capital loss carried over from Year 1. Because S ceases to be a member, the $40 net operating loss from Year 2 and the $40 consolidated net capital loss from Year 1 are allocated to S under §§ 1.1502–21 and 1.1502–22, respectively and are carried to S's first separate return year.

* * * * *

(c) * * *

(7) *Effective date.* This paragraph (c) applies to dispositions of subsidiary stock that occur after March 22, 2005.

* * * * *

■ **Par. 17.** Section 1.1502–12 is amended by:

■ a. Revising paragraph (b);

■ b. Removing and reserving paragraphs (e), (g), and (m);

■ c. Revising paragraph (n); and

■ d. Removing and reserving paragraph (q).

The revisions read as follows:

§ 1.1502–12 Separate taxable income.

* * * * *

(b) Any deduction that is disallowed under § 1.1502–15 must be taken into account as provided in that section.

* * * * *

(n) No deduction under section 243(a)(1) or section 245 (relating to deductions with respect to dividends received) is taken into account;

* * * * *

■ **Par. 18.** Section 1.1502–13 is amended by:

■ a. Revising and republishing paragraphs (a)(3)(i), (a)(6)(ii), (c)(4)(i)(B), (c)(5), (d)(3), (e)(1)(v), (f)(5)(ii)(B)(*2*), (f)(5)(ii)(F), (f)(6)(ii) and (v), (f)(7), and (g)(7)(ii).b. Redesignating paragraphs (h)(2)(v)(a) and (b) as paragraphs (h)(2)(v)(A) and (B).

■ c. Revising paragraph (l)(6).

■ d. Adding paragraphs (l)(8) through (10).

■ e. Removing paragraph (m).

The revisions and additions read as follows:

§ 1.1502–13 Intercompany transactions.

(a) * * *

(3) * * *

(i) *In general.* The timing rules of this section are a method of accounting for intercompany transactions, to be applied by each member in addition to the member's other methods of accounting. *See* §§ 1.1502–17 and 1.446–1(c)(2)(iii). To the extent the timing rules of this section are inconsistent with a member's otherwise applicable methods of accounting, the timing rules of this section control. For example, if S sells property to B in exchange for B's note, the timing rules of this section apply instead of the installment sale rules of section 453. S's or B's application of the timing rules of this section to an intercompany transaction clearly reflects income only if the effect of that transaction as a whole (including, for example, related costs and expenses) on consolidated taxable income is clearly reflected.

* * * * *

(6) * * *

(ii) *Table of examples.* This section contains the following examples:

Rule	General location	Paragraph	Example
(A) Matching rule	§ 1.1502–13(c)(7)(ii)	(A)	Example 1. Intercompany sale of land followed by sale to a nonmember.
		(B)	Example 2. Dealer activities.
		(C)	Example 3. Intercompany section 351 transfer.
		(D)	Example 4. Depreciable property.
		(E)	Example 5. Intercompany sale followed by installment sale.
		(F)	Example 6. Intercompany sale of installment obligation.
		(G)	Example 7. Performance of services.
		(H)	Example 8. Rental of property.
		(I)	Example 9. Intercompany sale of a partnership interest.
		(J)	Example 10. Net operating losses subject to section 382 or the SRLY rules.
		(K)	Example 11. Section 475.
		(L)	Example 12. Section 1092.
		(M)	Example 13. [Reserved]
		(N)	Example 14. Source of income under section 863.
		(O)	Example 15. Section 1248.
		(P)	Example 16. Intercompany stock distribution followed by section 332 liquidation.

Rule	General location	Paragraph	Example
		(Q)	Example 17. Intercompany stock sale followed by section 355 distribution.
		(R)	Example 18. Redetermination of attributes for section 250 purposes.
(B) Acceleration rule	§ 1.1502–13(d)(3)	(i)	Example 1. Becoming a nonmember—timing.
		(ii)	Example 2. Becoming a nonmember—attributes.
		(iii)	Example 3. Selling member's disposition of installment note.
		(iv)	Example 4. Cancellation of debt and attribute reduction under section 108(b).
		(v)	Example 5. Section 481.
(C) Simplifying rules—inventory	§ 1.1502–13(e)(1)(v)	(A)	Example 1. Increment averaging method.
		(B)	Example 2. Increment valuation method.
		(C)	Example 3. Other reasonable inventory methods.
(D) Stock of members	§ 1.1502–13(f)(7)	(i)	Example 1. Dividend exclusion and property distribution.
		(ii)	Example 2. Excess loss accounts.
		(iii)	Example 3. Intercompany reorganization.
		(iv)	Example 4. All cash intercompany reorganization under section 368(a)(1)(D).
		(v)	Example 5. Stock redemptions and distributions.
		(vi)	Example 6. Intercompany stock sale followed by section 332 liquidation.
		(vii)	Example 7. Intercompany stock sale followed by section 355 distribution.
(E) Obligations of members	§ 1.1502–13(g)(7)(ii)	(A)	Example 1. Interest on intercompany obligation.
		(B)	Example 2. Intercompany obligation becomes nonintercompany obligation.
		(C)	Example 3. Loss or bad debt deduction with respect to intercompany obligation.
		(D)	Example 4. Intercompany nonrecognition transactions.
		(E)	Example 5. Assumption of intercompany obligation.
		(F)	Example 6. Extinguishment of intercompany obligation.
		(G)	Example 7. Exchange of intercompany obligations.
		(H)	Example 8. Tax benefit rule.
		(I)	Example 9. Issuance at off-market rate of interest.
		(J)	Example 10. Nonintercompany obligation becomes intercompany obligation.
		(K)	Example 11. Notional principal contracts.
(F) Anti-avoidance rules	§ 1.1502–13(h)(2)	(i)	Example 1. Sale of a partnership interest.
		(ii)	Example 2. Transitory status as an intercompany obligation.
		(iii)	Example 3. Corporate mixing bowl.
		(iv)	Example 4. Partnership mixing bowl.
		(v)	Example 5. Sale and leaseback.
		(vi)	Example 6. Section 163(j) interest limitation.
(G) Miscellaneous operating rules	§ 1.1502–13(j)(10)	(i)	Example 1. Intercompany sale followed by section 351 transfer to member.
		(ii)	Example 2. Intercompany sale of member stock followed by recapitalization.
		(iii)	Example 3. Back-to-back intercompany transactions—matching.
		(iv)	Example 4. Back-to-back intercompany transactions—acceleration.
		(v)	Example 5. Successor group.
		(vi)	Example 6. Liquidation—80% distributee.
		(vii)	Example 7. Liquidation—no 80% distributee.
		(viii)	Example 8: Loan by section 987 QBU.
		(ix)	Example 9: Sale of property by section 987 QBU.

* * * * *

(c) * * *

(4) * * *

(i) * * *

(B) *B controls unreasonable.* To the extent the results under paragraph (c)(4)(i)(A) of this section are inconsistent with treating S and B as divisions of a single corporation, the attributes of the offsetting items must be redetermined in a manner consistent with treating S and B as divisions of a single corporation. To the extent, however, that B's corresponding item on a separate entity basis is excluded from gross income, is a noncapital, nondeductible amount, or is otherwise permanently disallowed or eliminated, the attributes of B's corresponding item always control the attributes of S's offsetting intercompany item.

* * * * *

(5) *Special status.* Notwithstanding the general rule of paragraph (c)(1)(i) of this section, to the extent an item's attributes determined under this section

are permitted or not permitted to a member under the Internal Revenue Code or regulations by reason of the member's special status, the attributes required under the Internal Revenue Code or regulations apply to that member's items (but not the other member). For example, if S is a bank to which section 582(c) applies, and sells debt securities at a gain to B, a nonbank, the character of S's intercompany gain is ordinary as required under section 582(c), but the character of B's corresponding item as capital or ordinary is determined under paragraph (c)(1)(i) of this section without the application of section 582(c). For other special status issues, *see,* for example, sections 818(b) (life insurance company treatment of capital gains and losses) and 1503(c) (limitation on absorption of certain losses).

* * * * *

(d) * * *

(3) *Examples.* The acceleration rule of this paragraph (d) is illustrated by the following examples.

(i) *Example 1. Becoming a nonmember—timing*—(A) *Facts.* S owns land with a basis of $70. On January 1 of Year 1, S sells the land to B for $100. On July 1 of Year 3, P sells 60% of S's stock to X for $60 and, as a result, S becomes a nonmember.

(B) *Matching rule.* Under the matching rule, none of S's $30 gain is taken into account in Years 1 through 3 because there is no difference between B's $0 gain or loss taken into account and the recomputed gain or loss.

(C) *Acceleration of S's intercompany items.* Under the acceleration rule of paragraph (d) of this section, S's $30 gain is taken into account in computing consolidated taxable income (and consolidated tax liability) immediately before the effect of treating S and B as divisions of a single corporation cannot be produced. Because the effect cannot be produced once S becomes a nonmember, S takes its $30 gain into account in Year 3 immediately before becoming a nonmember. S's gain is reflected under § 1.1502–32 in P's basis in the S stock immediately before P's sale of the stock. Under § 1.1502–32, P's basis in the S stock is increased by $30, and therefore P's gain is reduced (or loss is increased) by $18 (60% of $30). *See also* §§ 1.1502–33 and 1.1502–76(b). (The results would be the same if S sold the land to B in an installment sale to which section 453 would otherwise apply, because S must take its intercompany gain into account under this section.)

(D) *B's corresponding items.* Notwithstanding the acceleration of S's gain, B continues to take its corresponding items into account under its accounting method. Thus, B's items from the land are taken into account based on subsequent events (for example, its sale of the land).

(E) *Sale of B's stock.* The facts are the same as in paragraph (d)(3)(i)(A) of this section (*Example 1*), except that P sells 60% of B's stock (rather than S stock) to X for $60 and, as a result, B becomes a nonmember. Because the effect of treating S and B as divisions of a single corporation cannot be produced once B becomes a nonmember, S takes its $30 gain into account under the acceleration rule immediately before B becomes a nonmember. (The results would be the same if S sold the land to B in an installment sale to which section 453 would otherwise apply, because S must take its intercompany gain into account under this section.)

(F) *Discontinue filing consolidated returns.* The facts are the same as in paragraph (d)(3)(i)(A) of this section (*Example 1*), except that the P group receives permission under § 1.1502–75(c) to discontinue filing consolidated returns beginning in Year 3. Under the acceleration rule, S takes its $30 gain into account on December 31 of Year 2.

(G) *No subgroups.* The facts are the same as in paragraph (d)(3)(i)(A) of this section (*Example 1*), except that P simultaneously sells all of the stock of both S and B to X (rather than 60% of S's stock), and S and B become members of the X consolidated group. Because the effect of treating S and B as divisions of a single corporation in the P group cannot be produced once S and B become nonmembers, S takes its $30 gain into account under the acceleration rule immediately before S and B become nonmembers. (Paragraph (j)(5) of this section does not apply to treat the X consolidated group as succeeding to the P group because the X group acquired only the stock of S and B.) However, so long as S and B continue to join with each other in the filing of consolidated returns, B continues to treat S and B as divisions of a single corporation for purposes of determining the attributes of B's corresponding items from the land.

(ii) *Example 2. Becoming a nonmember—attributes*—(A) *Facts.* S holds land for investment with a basis of $70. On January 1 of Year 1, S sells the land to B for $100. B holds the land for sale to customers in the ordinary course of business, and expends substantial resources over a two-year period subdividing, developing, and marketing the land. On July 1 of Year 3, before B has sold any of the land, P sells 60% of S's stock to X for $60 and, as a result, S becomes a nonmember.

(B) *Attributes.* Under the acceleration rule, the attributes of S's gain are redetermined under the principles of the matching rule as if B sold the land to an affiliated corporation that is not a member of the group for a cash payment equal to B's adjusted basis in the land (because the land continues to be held within the group). Thus, whether S's gain is capital gain or ordinary income depends on the activities of both S and B. Because S and B no longer join with each other in the filing of consolidated returns, the attributes of B's corresponding items (for example, from its subsequent sale of the land) are redetermined under the principles of the matching rule as if the S division (but not the B division) were transferred by the single corporation to an unrelated person at the time of P's sale of the S stock. Thus, B continues to take into account the activities of S with respect to the land before the intercompany transaction.

(C) *Depreciable property.* The facts are the same as in paragraph (d)(3)(ii)(A) of this section (*Example 2*), except that the property sold by S to B is depreciable property. Section 1239 applies to treat all of S's gain as ordinary income because it is taken into account as a result of B's deemed sale of the property to an affiliated corporation that is not a member of the group (a related person within the meaning of section 1239(b)).

(iii) *Example 3. Selling member's disposition of installment note*—(A) *Facts.* S owns land with a basis of $70. On January 1 of Year 1, S sells the land to B in exchange for B's $110 note. The note bears a market rate of interest in excess of the applicable Federal rate, and provides for principal payments of $55 in Year 4 and $55 in Year 5. On July 1 of Year 3, S sells B's note to X for $110.

(B) *Timing.* S's intercompany gain is taken into account under this section, and not under the rules of section 453. Consequently, S's sale of B's note does not result in its intercompany gain from the land being taken into account (for example, under section 453B). The sale does not prevent S's intercompany items and B's corresponding items from being taken into account in determining the group's consolidated taxable income under the matching rule, and X does not reflect any aspect of the intercompany transaction (X has its own cost basis in the note). S will take the intercompany gain into account under the matching rule or acceleration rule based on subsequent events (for example, B's sale of the land). *See also* paragraph (g) of this section for additional rules applicable to B's note as an intercompany obligation.

(iv) *Example 4. Cancellation of debt and attribute reduction under section 108(b)*—(A) *Facts.* S holds land for investment with a basis of $0. On January 1 of Year 1, S sells the land to B for $100. B also holds the land for investment. During Year 3, B is insolvent and B's nonmember creditors discharge $60 of B's indebtedness. Because of insolvency, B's $60 discharge is excluded from B's gross income under section 108(a), and B reduces the basis of the land by $60 under sections 108(b) and 1017.

(B) *Acceleration rule.* As a result of B's basis reduction under section 1017, $60 of S's intercompany gain will not be taken into account under the matching rule (because there is only a $40 difference between B's $40 basis in the land and the $0 basis the land would have if S and B were divisions of a single corporation). Accordingly, S takes $60 of its gain into account under the acceleration rule in Year 3. S's gain is long-term capital gain, determined under paragraph (d)(1)(ii) of this section as if B sold the land to an affiliated corporation that is not a member of the group for $100 immediately before the basis reduction.

(C) *Purchase price adjustment.* Assume instead that S sells the land to B in exchange for B's $100 purchase money note, B remains solvent, and S subsequently agrees to discharge $60 of the note as a purchase price adjustment to which section 108(e)(5) applies. Under applicable principles of tax law, $60 of S's gain and $60 of B's basis in the land are eliminated and never taken into account. Similarly, the note is not treated as satisfied and reissued under paragraph (g) of this section.

(v) *Example 5. Section 481*—(A) *Facts.* S operates several trades or businesses, including a manufacturing business. S receives permission to change its method of accounting for valuing inventory for its manufacturing business. S increases the basis of its ending inventory by $100, and the related $100 positive section 481(a) adjustment is to be taken into account ratably over six taxable years, beginning in Year 1. During Year 3, S sells all of the assets used in its manufacturing business to B at a gain. Immediately after the transfer, B does not use the same inventory valuation method as S. On a separate entity basis, S's sale results in an acceleration of the balance of the section 481(a) adjustment to Year 3.

(B) *Timing and attributes.* Under paragraph (b)(2) of this section, the balance of S's section 481(a) adjustment accelerated to Year 3 is intercompany income. However, S's $100 basis increase before the intercompany transaction eliminates the related difference for this amount between B's corresponding items taken into account and the recomputed corresponding items in subsequent periods. Because the accelerated section 481(a) adjustment will not be taken into account in determining the group's consolidated taxable income (and consolidated tax liability) under the matching rule, the balance of S's section 481 adjustment is taken into account under the acceleration rule as ordinary income at the time of the intercompany transaction. (If S's sale had not resulted in accelerating S's section 481(a) adjustment on a separate entity basis, S would have no intercompany income to be taken into account under this section.)

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(e) * * *

(1) * * *

(v) *Examples.* The inventory rules of this paragraph (e)(1) are illustrated by the following examples.

(A) *Example 1. Increment averaging method*—(*1*) *Facts.* Both S and B use a double-extension, dollar-value LIFO inventory method, and both value inventory increments using the earliest acquisitions cost valuation method. During Year 2, S sells 25 units of product Q to B on January 15 at $10/unit. S sells another 25 units on April 15, on July 15, and on September 15, at $12/unit. S's earliest cost of product Q is $7.50/unit and S's most recent cost of product Q is $8.00/unit. Both S and B have an inventory increment for the year. B's total inventory costs incurred during Year 2 are $6,000 and the LIFO value of B's Year 2 layer of increment is $600.

(*2*) *Intercompany inventory income.* Under paragraph (e)(1)(iii) of this section, S must use a reasonable method of allocating its LIFO inventory costs to intercompany transactions. Because S has an inventory increment for Year 2 and uses the earliest acquisitions cost method, a reasonable method of determining its intercompany cost of goods sold for product Q is to use its most recent costs. Thus, its intercompany cost of goods sold is $800 ($8.00 most recent cost, multiplied by 100 units sold to B), and its intercompany inventory income is $350 ($1,150 sales proceeds from B minus $800 cost).

(*3*) *Timing.* (*i*) Under the increment averaging method of paragraph (e)(1)(ii)(B) of this section, $35 of S's $350 of intercompany inventory income is not taken into account in Year 2, computed as follows: LIFO value of B's Year 2 layer of increment/B's total inventory costs for year 2, or $600/$6,000 = 10%. 10% × S's $350 intercompany inventory income = $35.

(*ii*) Thus, $315 of S's intercompany inventory income is taken into account in Year 2 ($350 of total intercompany inventory income minus $35 not taken into account).

(*4*) *S incurs a decrement.* The facts are the same as in paragraph (e)(1)(v)(A)(*1*) of this section (*Example 1*), except that in Year 2, S incurs a decrement equal to 50% of its Year 1 layer. Under paragraph (e)(1)(iii) of this section, S must reasonably allocate the LIFO cost of the decrement to the cost of goods sold to B to determine S's intercompany inventory income.

(*5*) *B incurs a decrement.* The facts are the same as in paragraph (e)(1)(v)(A)(*1*) of this section (*Example 1*), except that B incurs a decrement in Year 2. S must take into account the entire $350 of Year 2 intercompany inventory income because all 100 units of product Q are deemed sold by B in Year 2.

(B) *Example 2. Increment valuation method*—(*1*) *Facts.* The facts are the same as in paragraph (e)(1)(v)(A)(*1*) of this section (*Example 1*). In addition, B's use of the earliest acquisition's cost method of valuing its increments results in B valuing its year-end inventory using costs incurred from January through March. B's costs incurred during the year are: $1,428 in the period January through March; $1,498 in the period April through June; $1,524 in the period July through September; and $1,550 in the period October through December. S's intercompany inventory income for these periods is: $50 in the period January through March ((25 × $10) − (25 × $8)); $100 in the period April through June ((25 × $12) − (25 × $8)); $100 in the period July through September ((25 × $12) − (25 × $8)); and $100 in the period October through December ((25 × $12) − (25 × $8)).

(*2*) *Timing.* (*i*) Under the increment valuation method of paragraph (e)(1)(ii)(C) of this section, $21 of S's $350 of intercompany inventory income is not taken into account in Year 2, computed as follows: LIFO value of B's Year 2 layer of increment/B's total inventory costs from January through March of Year 2, or $600/$1,428 = 42%. 42% × S's $50 intercompany inventory income for the period from January through March = $21.

(*ii*) Thus, $329 of S's intercompany inventory income is taken into account in Year 2 ($350 of total intercompany inventory income minus $21 not taken into account).

(*3*) *B incurs a subsequent decrement.* The facts are the same as in paragraph (e)(1)(v)(B)(*1*) of this section (*Example 2*). In addition, assume that in Year 3, B experiences a decrement in its pool that receives intercompany purchases from S. B's decrement equals 20% of the base-year costs for its Year 2 layer. The fact that B has incurred a decrement means that all of its inventory costs incurred for Year 3 are included in cost of goods sold. As a result, S takes into account its entire amount of intercompany inventory income from its Year 3 sales. In addition, S takes into account $4.20 of its Year 2 layer of intercompany inventory income not already taken into account (20% of $21).

(C) *Example 3. Other reasonable inventory methods*—(*1*) *Facts.* Both S and B use a dollar-value LIFO inventory method for their inventory transactions. During Year 1, S sells inventory to B and to X. Under paragraph (e)(1)(iv) of this section, to compute its intercompany inventory income and the amount of this income not taken into account, S computes its intercompany inventory income using the transfer price of the inventory items less a FIFO cost for the goods, takes into account these items based on a FIFO cost flow assumption for B's corresponding items, and the LIFO methods used by S and B are ignored for these computations. These computations are comparable to the methods used by S and B for financial reporting purposes, and the book methods and results are used for tax purposes. S adjusts the amount of intercompany inventory items not taken into account as required by section 263A.

(*2*) *Reasonable method.* The method used by S is a reasonable method under paragraph (e)(1)(iv) of this section if the cumulative amount of intercompany inventory items not taken into account by S is not significantly greater than the cumulative amount that would not be taken into account under the methods specifically described in paragraph (e)(1) of this section. If, for any year, the method results in a cumulative amount of intercompany inventory items not taken into account by S that significantly exceeds the cumulative amount that would not be taken into account under the methods specifically provided, S must take into account for that year the amount necessary to eliminate the excess. The method is thereafter applied with appropriate adjustments to reflect the amount taken into account (for example, to prevent the amount from being taken into account more than once).

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(ii) * * *

(B) * * *

(*2*) *Time limitation and adjustments.* The transfer of old T's assets to new T qualifies under paragraph (f)(5)(ii)(B)(*1*) of this section only if B has entered into a written plan, on or before the due date of the group's consolidated income tax return (including extensions) for the tax year that includes the date of old T's liquidation, to transfer the old T assets to new T, and the statement described in paragraph (f)(5)(ii)(E) of this section is included on or with a timely filed consolidated income tax return (including extensions) for the tax year that includes the date of the liquidation. The transfer of substantially all of T's assets to new T must be completed within 12 months of the filing of the return. Appropriate adjustments are made to reflect any events occurring before the formation of new T and to reflect any assets not transferred to new T, or liabilities not assumed by new T. For example, if B retains an asset of old T, the asset is treated under paragraph (f)(3) of this section as acquired by new T but distributed to B immediately after the reorganization.

* * * * *

(F) *Applicability date.* Paragraphs (f)(5)(ii)(B)(*1*) and (*2*) of this section apply to transactions in which old T's liquidation into B occurs on or after October 25, 2007.

(6) * * *

(ii) *Gain stock.* For dispositions of P stock, *see* § 1.1032–3.

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(v) *Applicability date.* This paragraph (f)(6) applies to gain or loss taken into account on or after July 12, 1995, and to transactions occurring on or after July 12, 1995.

(7) *Examples—In general.* The application of this section to intercompany transactions with respect to stock of members is illustrated by the following examples.

(i) *Example 1. Dividend exclusion and property distribution*—(A) *Facts.* S owns land with a $70 basis and $100 value. On January 1 of Year 1, P's basis in S's stock is $100. During Year 1, S declares and makes a dividend distribution of the land to P. Under section 311(b), S has a $30 gain. Under section 301(d), P's basis in the land is $100. On July 1 of Year 3, P sells the land to X for $110.

(B) *Dividend elimination and stock basis adjustments.* Under paragraph (b)(1) of this section, S's distribution to P is an intercompany distribution. Under paragraph (f)(2)(ii) of this section, P's $100 of dividend income is not included in gross income. Under § 1.1502–32, P's basis in S's stock is reduced from $100 to $0 in Year 1.

(C) *Matching rule and stock basis adjustments.* Under the matching rule (treating P as the buying member and S as the selling member), S takes its $30 gain into account in Year 3 to reflect the $30 difference between P's $10 gain taken into account and the $40 recomputed gain. Under § 1.1502–32, P's basis in S's stock is increased from $0 to $30 in Year 3.

(D) *Loss property.* The facts are the same as in paragraph (f)(7)(i)(A) of this section (*Example 1*), except that S has a $130 (rather than $70) basis in the land. Under paragraph (f)(2)(iii) of this section, the principles of section 311(b) apply to S's loss from the intercompany distribution. Thus, S has a $30 loss that is taken into account under the matching rule in Year 3 to reflect the $30 difference between P's $10 gain taken into account and the $20 recomputed loss. (The results are the same under section 267(f).) Under § 1.1502–32, P's basis in S's stock is reduced from $100 to $0 in Year 1, and from $0 to a $30 excess loss account in Year 3. (If P had distributed the land to its shareholders, rather than selling the land to X, P would take its $10 gain under section 311(b) into account, and S would take its $30 loss into account under the matching rule with $10 offset by P's gain and $20 recharacterized as a noncapital, nondeductible amount.)

(E) *Entitlement rule.* The facts are the same as in paragraph (f)(7)(i)(A) of this section (*Example 1*), except that, after P becomes entitled to the distribution but before the distribution is made, S issues additional stock to the public and becomes a nonmember. Under paragraph (f)(2)(i) of this section, the determination of whether a distribution is an intercompany distribution is made under the entitlement rule of paragraph (f)(2)(iv) of this section. Treating S's distribution as made when P becomes entitled to it results in the distribution being an intercompany distribution. Under paragraph (f)(2)(ii) of this section, the distribution is not included in P's gross income. S's $30 gain from the distribution is intercompany gain that is taken into account under the acceleration rule immediately before S becomes a nonmember. Thus, there is a net $70 decrease in P's basis in its S stock under § 1.1502–32 ($100 decrease for the distribution and a $30 increase for S's $30 gain). Under paragraph (f)(2)(iv) of this section, P does not take the distribution into account again under separate return rules when received, and P is not entitled to a dividends received deduction.

(ii) *Example 2. Excess loss accounts*—(A) *Facts.* S owns all of T's only class of stock with a $10 basis and $100 value. S has substantial earnings and profits, and T has $10 of earnings and profits. On January 1 of Year 1, S declares and distributes a dividend of all of the T stock to P. Under section 311(b), S has a $90 gain. Under section 301(d), P's basis in the T stock is $100. During Year 3, T borrows $90 and declares and makes a $90 distribution to P to which section 301 applies, and P's basis in the T stock is reduced under § 1.1502–32 from $100 to $10. During Year 6, T has $5 of earnings that increase P's basis in the T stock under § 1.1502–32 from $10 to $15. On December 1 of Year 9, T issues additional stock to X and, as a result, T becomes a nonmember.

(B) *Dividend exclusion.* Under paragraph (f)(2)(ii) of this section, P's $100 of dividend income from S's distribution of the T stock, and its $10 of dividend income from T's $90 distribution, are not included in gross income.

(C) *Matching and acceleration rules.* Under § 1.1502–19(b)(1), when T becomes a nonmember P must include in income the amount of its excess loss account (if any) in T stock. P has no excess loss account in the T stock. Therefore P's corresponding item from the deconsolidation of T is $0. Treating S and P as divisions of a single corporation, the T stock would continue to have a $10 basis after the distribution, and the adjustments under § 1.1502–32 for T's $90 distribution and $5 of earnings would result in a $75 excess loss account. Thus, the recomputed corresponding item from the deconsolidation is $75. Under the matching rule, S takes $75 of its $90 gain into account in Year 9 as a result of T becoming a nonmember, to reflect the difference between P's $0 gain taken into account and the $75 recomputed gain. S's remaining $15 of gain is taken into account under the matching and acceleration rules based on subsequent events (for example, under the matching rule if P subsequently sells its T stock, or under the acceleration rule if S becomes a nonmember).

(D) *Reverse sequence.* The facts are the same as in paragraph (f)(7)(ii)(A) of this section (*Example 2*), except that T borrows $90 and makes its $90 distribution to S before S distributes T's stock to P. Under paragraph (f)(2)(ii) of this section, T's $90 distribution to S ($10 of which is a dividend) is not included in S's gross income. The corresponding negative adjustment under § 1.1502–32 reduces S's basis in the T stock from $10 to an $80 excess loss account. Under section 311(b), S has a $90 gain from the distribution of T stock to P. Under section 301(d) P's initial basis in the T stock is $10 (the stock's fair market value), and the basis increases to $15 under § 1.1502–32 as a result of T's earnings in Year 6. The timing and attributes of S's gain are determined in the manner provided in paragraph (f)(7)(ii)(C) of this section (*Example 2*). Thus, $75 of S's gain is taken into account under the matching rule in Year 9 as a result of T becoming a nonmember, and the remaining $15 is taken into account under the matching and acceleration rules based on subsequent events.

(E) *Partial stock sale.* The facts are the same as in paragraph (f)(7)(ii)(A) of this section (*Example 2*), except that P sells 10% of T's stock to X on December 1 of Year 9 for $1.50 (rather than T's issuing additional stock and becoming a nonmember). Under the matching rule, S takes $9 of its gain into account to reflect the difference between P's $0 gain taken into account ($1.50 sale proceeds minus $1.50 basis) and the $9 recomputed gain ($1.50 sale proceeds plus $7.50 excess loss account).

(F) *Loss, rather than cash distribution.* The facts are the same as in paragraph (f)(7)(ii)(A) of this section (*Example 2*), except that T retains the loan proceeds and incurs a $90 loss in Year 3 that is absorbed by the group. The timing and attributes of S's gain are determined in the same manner provided in paragraph (f)(7)(ii)(C) of this section (*Example 2*). Under § 1.1502–32, the loss in Year 3 reduces P's basis in the T stock from $100 to $10, and T's $5 of earnings in Year 6 increase the basis to $15. Thus, $75 of S's gain is taken into account under the matching rule in Year 9 as a result of T becoming a nonmember, and the remaining $15 is taken into account under the matching and acceleration rules based on subsequent events. (The timing and attributes of S's gain would be determined in the same manner provided in paragraph (f)(7)(ii)(D) of this section (*Example 2*) if T incurred the $90 loss before S's distribution of the T stock to P.)

(G) *Stock sale, rather than stock distribution.* The facts are the same as in paragraph (f)(7)(ii)(A) of this section (*Example 2*), except that S sells the T stock to P for $100 (rather than distributing the stock). The timing and attributes of S's gain are determined in the same manner provided in paragraph (f)(7)(ii)(C) of this section (*Example 2*). Thus, $75 of S's gain is taken into account under the matching rule in Year 9 as a result of T becoming a nonmember, and the remaining $15 is taken into account under the matching and acceleration rules based on subsequent events.

(iii) *Example 3. Intercompany reorganization*—(A) *Facts.* P forms S and B by contributing $200 to the capital of each. During Years 1 through 4, S and B each earn $50, and under § 1.1502–32 P adjusts its basis in the stock of each to $250. (*See* § 1.1502–33 for adjustments to earnings and profits.) On January 1 of Year 5, the fair market value of S's assets and its stock is $500, and S merges into B in a tax-free reorganization. Pursuant to the plan of reorganization, P receives B stock with a fair market value of $350 and $150 of cash.

(B) *Treatment as a section 301 distribution.* The merger of S into B is a transaction to which paragraph (f)(3) of this section applies. P is treated as receiving additional B stock with a fair market value of $500 and, under section 358, a basis of $250. Immediately after the merger, $150 of the stock received is treated as redeemed, and the redemption is treated under section 302(d) as a distribution to which section 301 applies. Because the $150 distribution is treated as not received as part of the merger, section 356 does not apply and no basis adjustments are required under section 358(a)(1)(A) and (B). Because B is treated under section 381(c)(2) as receiving S's earnings and profits and the redemption is treated as occurring after the merger, $100 of the distribution is treated as a dividend under section 301 and P's basis in the B stock is reduced correspondingly under § 1.1502–32. The remaining $50 of the distribution reduces P's basis in the B stock. Section 301(c)(2) and § 1.1502–32. Under paragraph (f)(2)(ii) of this section, P's $100 of dividend income is not included in gross income. Under § 1.302–2(c), proper adjustments are made to P's basis in its B stock to reflect its basis in the B stock redeemed, with the result that P's basis in the B stock is reduced by the entire $150 distribution.

(C) *Depreciated property.* The facts are the same as in paragraph (f)(7)(iii)(A) of this section (*Example 3*), except that property of S with a $200 basis and $150 fair market value is distributed to P (rather than cash of B). As in paragraph (f)(7)(iii)(B) of this section (*Example 3*), P is treated as receiving additional B stock in the merger and a $150 distribution to which section 301 applies immediately after the merger. Under paragraph (f)(2)(iii) of this section, the principles of section 311(b) apply to B's $50 loss and the loss is taken into account under the matching and acceleration rules based on subsequent events (for example, under the matching rule if P subsequently sells the property, or under the acceleration rule if B becomes a nonmember). The results are the same under section 267(f).

(D) *Divisive transaction.* Assume instead that, pursuant to a plan, S distributes the stock of a lower-tier subsidiary in a spin-off transaction to which section 355 applies together with $150 of cash. The distribution of stock is a transaction to which paragraph (f)(3) of this section applies. P is treated as receiving the $150 of cash immediately before the section 355 distribution, as a distribution to which section 301 applies. Section 356(b) does not apply and no basis adjustments are required under section 358(a)(1) (A) and (B). Because the $150 distribution is treated as made before the section 355 distribution, the distribution reduces P's basis in the S stock under § 1.1502–32, and the basis allocated under section 358(c) between the S stock and the lower-tier subsidiary stock received reflects this basis reduction.

(iv) *Example 4. All cash intercompany reorganization under section 368(a)(1)(D)*—(A) *Facts.* P owns all of the stock of M and B. M owns all of the stock of S with a basis of $25. On January 1 of Year 2, the fair market value of S's assets and its stock is $100, and S sells all of its assets to B for $100 cash and liquidates. The transaction qualifies as a reorganization described in section 368(a)(1)(D). Pursuant to § 1.368–2(l), B will be deemed to issue a nominal share of B stock to S in addition to the $100 of cash actually exchanged for the S assets, and S will be deemed to distribute all of the consideration to M. M will be deemed to distribute the nominal share of B stock to P.

(B) *Treatment as a section 301 distribution.* The sale of S's assets to B is a transaction to which paragraph (f)(3) of this section applies. In addition to the nominal share issued by B to S under § 1.368–2(l), S is treated as receiving additional B stock with a fair market value of $100 (in lieu of the $100) and, under section 358, a basis of $25 which S distributes to M in liquidation. Immediately after the sale, the B stock (with the exception of the nominal share which is still held by M) received by M is treated as redeemed for $100, and the redemption is treated under section 302(d) as a distribution to which section 301 applies. M's basis of $25 in the B stock is reduced under § 1.1502–32(b)(3)(v), resulting in an excess loss account of $75 in the nominal share. (*See* § 1.302–2(c)). M's deemed distribution of the nominal share of B stock to P under § 1.368–2(l) will result in M generating an intercompany gain under section 311(b) of $75, to be subsequently taken into account under the matching and acceleration rules.

(v) *Example 5. Stock redemptions and distributions*—(A) *Facts.* Before becoming a member of the P group, S owns P stock with a $30 basis. On January 1 of Year 1, P buys all of S's stock. On July 1 of Year 3, P redeems the P stock held by S for $100 in a transaction to which section 302(a) applies.

(B) *Gain under section 302.* Under paragraph (f)(4) of this section, P's basis in the P stock acquired from S is treated as eliminated. As a result of this elimination, S's intercompany item will never be taken into account under the matching rule because P's basis in the stock does not reflect S's intercompany item. Therefore, S's $70 gain is taken into account under the acceleration rule in Year 3. The attributes of S's item are determined under paragraph (d)(1)(ii) of this section by applying the matching rule as if P had sold the stock to an affiliated corporation that is not a member of the group at no gain or loss. Although P's corresponding item from a sale of its stock would have been excluded from gross income under section 1032, paragraph (c)(6)(ii) of this section prevents S's gain from being treated as excluded from gross income; instead S's gain is capital gain.

(C) *Gain under section 311.* The facts are the same as in paragraph (f)(7)(v)(A) of this section (*Example 5*), except that S distributes the P stock to P in a transaction to which section 301 applies (rather than the stock being redeemed), and S has a $70 gain under section 311(b). The timing and attributes of S's gain are determined in the manner provided in paragraph (f)(7)(v)(B) of this section (*Example 5*).

(D) *Loss stock.* The facts are the same as in paragraph (f)(7)(v)(A) of this section (*Example 5*), except that S has a $130 (rather than $30) basis in the P stock and has a $30 loss under section 302(a). The limitation under paragraph (c)(6)(ii) of this section does not apply to intercompany losses. Thus, S's loss is taken into account in Year 3 as a noncapital, nondeductible amount.

(vi) *Example 6. Intercompany stock sale followed by section 332 liquidation*—(A) *Facts.* S owns all of the stock of T, with a $70 basis and $100 value, and T's assets have a $10 basis and $100 value. On January 1 of Year 1, S sells all of T's stock to B for $100. On July 1 of Year 3, when T's assets are still worth $100, T distributes all of its assets to B in an unrelated complete liquidation to which section 332 applies.

(B) *Timing and attributes.* Under paragraph (b)(3)(ii) of this section, B's unrecognized gain or loss under section 332 is a corresponding item for purposes of applying the matching rule. In Year 3 when T liquidates, B has $0 of unrecognized gain or loss under section 332 because B has a $100 basis in the T stock and receives a $100 distribution with respect to its T stock. Treating S and B as divisions of a single corporation, the recomputed corresponding item would have been $30 of unrecognized gain under section 332 because B would have succeeded to S's $70 basis in the T stock. Thus, under the matching rule, S's $30 intercompany gain is taken into account in Year 3 as a result of T's liquidation. Under paragraph (c)(1)(i) of this section, the attributes of S's gain and B's corresponding item are redetermined as if S and B were divisions of a single corporation. Although S's gain ordinarily would be redetermined to be treated as excluded from gross income to reflect the nonrecognition of B's gain under section 332, S's gain remains capital gain because B's unrecognized gain under section 332 is not permanently and explicitly disallowed under the Code. *See* paragraph (c)(6)(ii) of this section. However, relief may be elected under paragraph (f)(5)(ii) of this section.

(C) *Intercompany sale at a loss.* The facts are the same as in paragraph (f)(7)(vi)(A) of this section (*Example 6*), except that S has a $130 (rather than $70) basis in the T stock. The limitation under paragraph (c)(6)(ii) of this section does not apply to intercompany losses. Thus, S's intercompany loss is taken into account in Year 3 as a noncapital, nondeductible amount. However, relief may be elected under paragraph (f)(5)(ii) of this section.

(vii) *Example 7. Intercompany stock sale followed by section 355 distribution*—(A) *Facts.* S owns all of the stock of T with a $70 basis and a $100 value. On January 1 of Year 1, S sells all of T's stock to M for $100. On June 1 of Year 6, M distributes all of its T stock to its nonmember shareholders in a transaction to which section 355 applies. At the time of the distribution, M has a basis in T stock of $100 and T has a value of $150.

(B) *Timing and attributes.* Under paragraph (b)(3)(ii) of this section, M's $50 gain not recognized on the distribution under section 355 is a corresponding item. Treating S and M as divisions of a single corporation, the recomputed corresponding item would be $80 of unrecognized gain under section 355 because M would have succeeded to S's $70 basis in the T stock. Thus, under the matching rule, S's $30 intercompany gain is taken into account in Year 6 as a result of the distribution. Under paragraph (c)(1)(i) of this section, the attributes of S's intercompany item and M's corresponding item are redetermined to produce the same effect on consolidated taxable income as if S and M were divisions of a single corporation. Although S's gain ordinarily would be redetermined to be treated as excluded from gross income to reflect the nonrecognition of M's gain under section 355(c), S's gain remains capital gain because M's unrecognized gain under section 355(c) is not permanently and explicitly disallowed under the Code. *See* paragraph (c)(6)(ii) of this section. Because M's distribution of the T stock is not an intercompany transaction, relief is not available under paragraph (f)(5)(ii) of this section.

(C) *Section 355 distribution within the group.* The facts are the same as under paragraph (f)(7)(vii)(A) of this section (*Example 7*), except that M distributes the T stock to B (another member of the group), and B takes a $75 basis in the T stock under section 358. Under paragraph (j)(2) of this section, B is a successor to M for purposes of taking S's intercompany gain into account, and therefore both M and B might have corresponding items with respect to S's intercompany gain. To the extent it is possible, matching with respect to B's corresponding items produces the result most consistent with treating S, M, and B as divisions of a single corporation. *See* paragraphs (j)(3) and (j)(4) of this section. However, because there is only $5 difference between B's $75 basis in the T stock and the $70 basis the stock would have if S, M, and B were divisions of a single corporation, only $5 can be taken into account under the matching rule with respect to B's corresponding items. (This $5 is taken into account with respect to B's corresponding items based on subsequent events.) The remaining $25 of S's $30 intercompany gain is taken into account in Year 6 under the matching rule with respect to M's corresponding item from its distribution of the T stock. The attributes of S's remaining $25 of gain are determined in the same manner as in paragraph (f)(7)(vii)(B) of this section (*Example 7*).

(D) *Relief elected.* The facts are the same as in paragraph (f)(7)(vii)(C) of this section (*Example 7*) except that P elects relief pursuant to paragraph (f)(5)(ii)(D) of this section. As a result of the election, M's distribution of the T stock is treated as subject to sections 301 and 311 instead of section 355. Accordingly, M recognizes $50 of intercompany gain from the distribution, B takes a basis in the stock equal to its fair market value of $150, and S and M take their intercompany gains into account with respect to B's corresponding items based on subsequent events. (None of S's gain is taken into account in Year 6 as a result of M's distribution of the T stock.)

* * * * *

(g) * * *

(7) *Examples*—(i) *In general.* For purposes of the examples in this paragraph (g), unless otherwise stated, interest is qualified stated interest under § 1.1273–1(c), and the intercompany obligations are capital assets and are not subject to section 475.

(ii) The application of this section to obligations of members is illustrated by the following examples:

(A) *Example 1. Interest on intercompany obligation*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. B fully performs its obligations. Under their separate entity methods of accounting, B accrues a $10 interest deduction annually under section 163, and S accrues $10 of interest income annually under section 61(a)(4) and § 1.446–2.

(*2*) *Matching rule.* Under paragraph (b)(1) of this section, the accrual of interest on B's note is an intercompany transaction. Under the matching rule, S takes its $10 of income into account in each of years 1 through 5 to reflect the $10 difference between B's $10 of interest expense taken into account and the $0 recomputed expense. S's income and B's deduction are ordinary items. (Because S's intercompany item and B's corresponding item would both be ordinary on a separate entity basis, the attributes are not redetermined under paragraph (c)(1)(i) of this section.)

(*3*) *Original issue discount.* The facts are the same as in paragraph (g)(7)(ii)(A)(*1*) of this section (*Example 1*), except that B borrows $90 (rather than $100) from S in return for B's note providing for $10 of interest annually and repayment of $100 at the end of year 5. The principles described in paragraph (g)(7)(ii)(A)(*2*) of this section (*Example 1*) for stated interest also apply to the $10 of original issue discount. Thus, as B takes into account its corresponding expense under section 163(e), S takes into account its intercompany income under section 1272. S's income and B's deduction are ordinary items.

(*4*) *Tax-exempt income.* The facts are the same as in paragraph (g)(7)(ii)(A)(*1*) of this section (*Example 1*), except that B's borrowing from S is allocable under section 265 to B's purchase of state and local bonds to which section 103 applies. The timing of S's income is the same as in paragraph (g)(7)(ii)(A)(*2*) of this section (*Example 1*). Under paragraph (c)(4)(i) of this section, the attributes of B's corresponding item of disallowed interest expense control the attributes of S's offsetting intercompany interest income. Paragraph (c)(6) of this section does not prevent the redetermination of S's intercompany item as excluded from gross income because section 265(a)(2) permanently and explicitly disallows B's corresponding deduction and because, under paragraph (g)(4)(i)(B) of this section, paragraph (c)(6)(ii) of this section does not apply to prevent any intercompany income from the B note from being excluded from gross income. Accordingly, S's intercompany income is treated as excluded from gross income.

(B) *Example 2. Intercompany obligation becomes nonintercompany obligation*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. As of January 1 of year 3, B has paid the interest accruing under the note and S sells B's note to X for $70, reflecting an increase in prevailing market interest rates. B is never insolvent within the meaning of section 108(d)(3).

(*2*) *Deemed satisfaction and reissuance.* Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $70 immediately before S's sale to X. As a result of the deemed satisfaction of the note for less than its adjusted issue price, B takes into account $30 of discharge of indebtedness income under § 1.61–12. On a separate entity basis, S's $30 loss would be a capital loss under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's $30 of discharge of indebtedness income control the attributes of S's loss. Thus, S's loss is treated as ordinary loss. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $70 issue price, a $100 stated redemption price at maturity, and a $70 basis in the hands of S. S is then treated as selling the new note to X for the $70 received by S in the actual transaction. Because S has a basis of $70 in the new note, S recognizes no gain or loss from the sale to X. After the sale, the new note held by X is not an intercompany obligation, it has a $70 issue price, a $100 stated redemption price at maturity, and a $70 basis. The $30 of original issue discount will be taken into account by B and X under sections 163(e) and 1272.

(*3*) *Creditor deconsolidation.* The facts are the same as in paragraph (g)(7)(ii)(B)(*1*) of this section (*Example 2*), except that P sells S's stock to X (rather than S selling B's note to X). Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its $70 fair market value immediately before S becomes a nonmember. The treatment of S's $30 of loss and B's $30 of discharge of indebtedness income is the same as in paragraph (g)(7)(ii)(B)(*2*) of this section (*Example 2*). The new note held by S upon deconsolidation is not an intercompany obligation, it has a $70 issue price, a $100 stated redemption price at maturity, and a $70 basis. The $30 of original issue discount will be taken into account by B and S under sections 163(e) and 1272.

(*4*) *Debtor deconsolidation.* The facts are the same as in paragraph (g)(7)(ii)(B)(*1*) of this section (*Example 2*), except that P sells B's stock to X (rather than S selling B's note to X). The results to S and B are the same as in paragraph (g)(7)(ii)(B)(*3*) of this section (*Example 2*).

(*5*) *Subgroup exception.* The facts are the same as in paragraph (g)(7)(ii)(B)(*1*) of this section (*Example 2*), except that P owns all of the stock of S, S owns all of the stock of B, and P sells all of the S stock to X, the parent of another consolidated group. Because B and S, members of an intercompany obligation subgroup, cease to be members of the P group in a transaction that does not cause either member to recognize an item with respect to the B note, and such members constitute an intercompany obligation subgroup in the X group, P's sale of S stock is not a triggering transaction under paragraph (g)(3)(i)(B)(*8*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section. After the sale, the note held by S has a $100 issue price, a $100 stated redemption price at maturity, and a $100 basis. The results are the same if the S stock is sold to an individual and the S–B affiliated group elects to file a consolidated return for the period beginning on the day after S and B cease to be members of the P group.

(*6*) *Section 338 election.* The facts are the same as in paragraph (g)(7)(ii)(B)(*1*) of this section (*Example 2*), except that P sells S's stock to X and a section 338 election is made with respect to the stock sale. Under section 338, S is treated as selling all of its assets to new S, including the B note, at the close of the acquisition date. The aggregate deemed sales price (within the meaning of § 1.338–4) allocated to the B note is $70. Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(2) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued immediately before S's deemed sale to new S for $70, the amount realized with respect to the note (the aggregate deemed sales price allocated to the note under § 1.338–6). The results to S and B are the same as in paragraph (g)(7)(ii)(B)(*2*) of this section (*Example 2*).

(*7*) *Appreciated note.* The facts are the same as in paragraph (g)(7)(ii)(B)(*1*) of this section (*Example 2*), except that S sells B's note to X for $130 (rather than $70), reflecting a decline in prevailing market interest rates. Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $130 immediately before S's sale to X. As a result of the deemed satisfaction of the note for more than its adjusted issue price, B takes into account $30 of repurchase premium under § 1.163–7(c). On a separate entity basis, S's $30 gain would be a capital gain under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's premium deduction control the attributes of S's gain. Accordingly, S's gain is treated as ordinary income. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $130 issue price, $100 stated redemption price at maturity, and $130 basis in the hands of S. S is then treated as selling the new note to X for the $130 received by S in the actual transaction. Because S has a basis of $130 in the new note, S recognizes no gain or loss from the sale to X. After the sale, the new note held by X is not an intercompany obligation, it has a $130 issue price, a $100 stated redemption price at maturity, and a $130 basis. The treatment of B's $30 of bond issuance premium under the new note is determined under § 1.163–13.

(*8*) *Deferral of loss or deduction with respect to nonmember indebtedness acquired in debt exchange.* The facts are the same as in paragraph (g)(7)(ii)(B)(*1*) of this section (*Example 2*), except that S sells B's note to X for a non-publicly traded X note with an issue price and face amount of $100 and a fair market value of $70, and that, subsequently, S sells the X note for $70. Because the B note becomes an obligation that is not an intercompany obligation, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*2*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued immediately before S's sale to X for $100, the amount realized with respect to the note (determined under section 1274). As a result of the deemed satisfaction, neither S nor B take into account any items of income, gain, deduction, or loss. S is then treated as selling the new B note to X for the X note received by S in the actual transaction. Because S has a basis of $100 in the new note, S recognizes no gain or loss from the sale to X. After the sale, the new B note held by X is not an intercompany obligation, it has a $100 issue price, a $100 stated redemption price at maturity, and a $100 basis. S also holds an X note with a basis of $100 but a fair market value of $70. When S disposes of the X note, S's loss on the disposition is deferred under paragraph (g)(4)(iv) of this section, until B retires its note (the former intercompany obligation in the hands of X).

(C) *Example 3. Loss or bad debt deduction with respect to intercompany obligation*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. On January 1 of year 3, the fair market value of the B note has declined to $60 and S sells the B note to P for property with a fair market value of $60. B is never insolvent within the meaning of section 108(d)(3). The B note is not a security within the meaning of section 165(g)(2).

(*2*) *Deemed satisfaction and reissuance.* Because S realizes an amount of loss from the assignment of the B note, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $60 immediately before S's sale to P. As a result of the deemed satisfaction of the note for less than its adjusted issue price ($100), B takes into account $40 of discharge of indebtedness income under § 1.61–12. On a separate entity basis, S's $40 loss would be a capital loss under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's $40 of discharge of indebtedness income control the attributes of S's loss. Thus, S's loss is treated as ordinary loss. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $60 issue price, $100 stated redemption price at maturity, and $60 basis in the hands of S. S is then treated as selling the new note to P for the $60 of property received by S in the actual transaction. Because S has a basis of $60 in the new note, S recognizes no gain or loss from the sale to P. After the sale, the note is an intercompany obligation, it has a $60 issue price and a $100 stated redemption price at maturity, and the $40 of original issue discount will be taken into account by B and P under sections 163(e) and 1272.

(*3*) *Partial bad debt deduction.* The facts are the same as in paragraph (g)(7)(ii)(C)(*1*) of this section (*Example 3*), except that S claims a $40 partial bad debt deduction under section 166(a)(2) (rather than selling the note to P). Because S realizes a deduction from a transaction comparable to an assignment of the B note, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $60 immediately before section 166(a)(2) applies. The treatment of S's $40 loss and B's $40 of discharge of indebtedness income are the same as in paragraph (g)(7)(ii)(C)(*2*) of this section (*Example 3*). After the reissuance, S has a basis of $60 in the new note. Accordingly, the application of section 166(a)(2) does not result in any additional deduction for S. The $40 of original issue discount on the new note will be taken into account by B and S under sections 163(e) and 1272.

(*4*) *Insolvent debtor.* The facts are the same as in paragraph (g)(7)(ii)(C)(*1*) of this section (*Example 3*), except that B is insolvent within the meaning of section 108(d)(3) at the time that S sells the note to P. As explained in paragraph (g)(7)(ii)(C)(*2*) of this section (*Example 3*), the transaction is a triggering transaction and the B note is treated as satisfied and reissued for its fair market value of $60 immediately before S's sale to P. On a separate entity basis, S's $40 loss would be capital, B's $40 income would be excluded from gross income under section 108(a), and B would reduce attributes under section 108(b) or section 1017 (*see also* § 1.1502–28). However, under paragraph (g)(4)(i)(C) of this section, section 108(a) does not apply to characterize B's income as excluded from gross income. Accordingly, the attributes of S's loss and B's income are redetermined in the same manner as in paragraph (g)(7)(ii)(C)(*2*) of this section (*Example 3*).

(D) *Example 4. Intercompany nonrecognition transactions*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. As of January 1 of year 3, B has fully performed its obligations, but the note's fair market value is $130, reflecting a decline in prevailing market interest rates. On January 1 of year 3, S transfers the note and other assets to a newly formed corporation, Newco, for all of Newco's common stock in an exchange to which section 351 applies.

(*2*) *No deemed satisfaction and reissuance.* Because the assignment of the B note is an exchange to which section 351 applies and neither S nor B recognize gain or loss, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*1*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section.

(*3*) *Receipt of other property.* The facts are the same as in paragraph (g)(7)(ii)(D)(*1*) of this section (*Example 4*), except that the other assets transferred to Newco have a basis of $100 and a fair market value of $260, and S receives, in addition to Newco common stock, $15 of cash. Because S would recognize $15 of gain under section 351(b), the assignment of the B note is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value of $130 immediately before the transfer to Newco. As a result of the deemed satisfaction of the note for more than its adjusted issue price, B takes into account $30 of repurchase premium under § 1.163–7(c). On a separate entity basis, S's $30 gain would be a capital gain under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's premium deduction control the attributes of S's gain. Accordingly, S's gain is treated as ordinary income. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $130 issue price, $100 stated redemption price at maturity, and $130 basis in the hands of S. S is then treated as transferring the new note to Newco for the Newco stock and cash received by S in the actual transaction. Because S has a basis of $130 in the new B note, S recognizes no gain or loss with respect to the transfer of the note in the section 351 exchange, and S recognizes $10 of gain with respect to the transfer of the other assets under section 351(b). After the transfer, the note has a $130 issue price and a $100 stated redemption price at maturity. The treatment of B's $30 of bond issuance premium under the new note is determined under § 1.163–13.

(*4*) *Transferee loss subject to limitation.* The facts are the same as in paragraph (g)(7)(ii)(D)(*1*) of this section (*Example 4*), except that T is a member with a loss from a separate return limitation year that is subject to limitation under § 1.1502–21(c) (a SRLY loss), and on January 1 of year 3, S transfers the assets and the B note to T in an exchange to which section 351 applies. Because the transferee, T, has a loss that is subject to a limitation, the assignment of the B note is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section (the exception in paragraph (g)(3)(i)(B)(*1*) of this section does not apply). Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value, immediately before S's transfer to T. As a result of the deemed satisfaction of the note for more than its adjusted issue price, B takes into account $30 of repurchase premium under § 1.163–7(c). On a separate entity basis, S's $30 gain would be a capital gain under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's premium deduction control the attributes of S's gain. Accordingly, S's gain is treated as ordinary income. B is also treated as reissuing, immediately after the satisfaction, a new note to S with a $130 issue price, $100 stated redemption price at maturity, and $130 basis in the hands of S. The treatment of B's $30 of bond issuance premium under the new note is determined under § 1.163–13. S is then treated as transferring the new note to T as part of the section 351 exchange. Because T will have a fair market value basis in the reissued B note immediately after the exchange, T's intercompany item from the subsequent retirement of the B note will not reflect any of S's built-in gain (and the amount of T's SRLY loss that may be absorbed by such item will be limited to any appreciation in the B note accruing after the exchange).

(*5*) *Intercompany obligation transferred in section 332 transaction.* The facts are the same as paragraph (g)(7)(ii)(D)(*1*) of this section (*Example 4*), except that S transfers the B note to P in complete liquidation under section 332. Because the transaction is an exchange to which section 332 and section 337(a) applies, and neither S nor B recognize gain or loss, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*1*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section.

(E) *Example 5. Assumption of intercompany obligation*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. The note is fully recourse and is incurred for use in Business Z. As of January 1 of year 3, B has fully performed its obligations, but the note's fair market value is $110 reflecting a decline in prevailing market interest rates. Business Z has a fair market value of $95. On January 1 of year 3, B transfers all of the assets of Business Z and $15 of cash (substantially all of B's assets) to member T in exchange for the assumption by T of all of B's obligations under the note in a transaction in which gain or loss is recognized under section 1001. The terms and conditions of the note are not modified in connection with the sales transaction, the transaction does not result in a change in payment expectations, and no amount of income, gain, deduction, or loss is recognized by S, B, or T with respect to the note.

(*2*) *No deemed satisfaction and reissuance.* Because all of B's obligations under the B note are assumed by T in connection with the sale of the Business Z assets, the assignment of B's obligations under the note is not a triggering transaction under paragraph (g)(3)(i)(B)(*2*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section.

(F) *Example 6. Extinguishment of intercompany obligation*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 20. The note is a security within the meaning of section 351(d)(2). As of January 1 of year 3, B has fully performed its obligations, but the fair market value of the B note is $130, reflecting a decline in prevailing market interest rates, and S transfers the note to B in exchange for $130 of B stock in a transaction to which both section 351 and section 354 applies.

(*2*) *No deemed satisfaction and reissuance.* As a result of the satisfaction of the note for more than its adjusted issue price, B takes into account $30 of repurchase premium under § 1.163–7(c). Although the transfer of the B note is a transaction to which both section 351 and section 354 applies, under paragraph (g)(4)(i)(C) of this section, any gain or loss from the intercompany obligation is not subject to either section 351(a) or section 354, and therefore, S has a $30 gain under section 1001. Because the note is extinguished in a transaction in which the adjusted issue price of the note is equal to the creditor's basis in the note, and the debtor's and creditor's items offset in amount, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*5*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section. On a separate entity basis, S's $30 gain would be a capital gain under section 1271(a)(1). Under the matching rule, however, the attributes of S's intercompany item and B's corresponding item must be redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of B's premium deduction control the attributes of S's gain. Accordingly, S's gain is treated as ordinary income. Under paragraph (g)(4)(i)(D) of this section, section 108(e)(7) does not apply upon the extinguishment of the B note, and therefore, the B stock received by S in the exchange will not be treated as section 1245 property.

(G) *Example 7. Exchange of intercompany obligations*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 20. As of January 1 of year 3, B has fully performed its obligations and, pursuant to a recapitalization to which section 368(a)(1)(E) applies, B issues a new note to S in exchange for the original B note. The new B note has an issue price, stated redemption price at maturity, and stated principal amount of $100, but contains terms that differ sufficiently from the terms of the original B note to cause a realization event under § 1.1001–3. The original B note and the new B note are both securities (within the meaning of section 354(a)(1)).

(*2*) *No deemed satisfaction and reissuance.* Because the original B note is extinguished in exchange for a newly issued B note and the issue price of the new B note is equal to both the adjusted issue price of the original B note and S's basis in the original B note, the transaction is not a triggering transaction under paragraph (g)(3)(i)(B)(*6*) of this section, and the note is not treated as satisfied and reissued under paragraph (g)(3)(ii) of this section. B has neither income from discharge of indebtedness under section 108(e)(10) nor a deduction for repurchase premium under § 1.163–7(c). Although the exchange of the original B note for the new B note is a transaction to which section 354 applies, under paragraph (g)(4)(i)(C) of this section, any gain or loss from the intercompany obligation is not subject to section 354. Under section 1001, S has no gain or loss from the exchange of notes.

(H) *Example 8. Tax benefit rule*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. As of January 1 of year 3, B has fully performed its obligations, but the note's fair market value has depreciated, reflecting an increase in prevailing market interest rates. On that date, S transfers the B note to member T as part of an exchange for T common stock which is intended to qualify for nonrecognition treatment under section 351 but with a view to sell the T stock at a reduced gain. On February 1 of year 4, all of the stock of T is sold at a reduced gain.

(*2*) *Deemed satisfaction and reissuance.* Because the assignment of the B note does not occur within 12 months of the sale of T stock, paragraph (g)(3)(i)(B)(*1*)(*vi*) of this section does not apply to treat the assignment as a triggering transaction. However, because the assignment of the B note was engaged in with a view to shift built-in loss from the obligation in order to secure a tax benefit that the group or its members would not otherwise enjoy, under paragraph (g)(3)(i)(C) of this section, the assignment of the B note is a triggering transaction to which paragraph (g)(3)(ii) of this section applies. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied and reissued for its fair market value, immediately before S's transfer to T. As a result of the deemed satisfaction of the note for less than its adjusted issue price, B takes into account discharge of indebtedness income and S has a corresponding loss which is treated as ordinary loss. B is also treated as reissuing, immediately after the deemed satisfaction, a new note to S with an issue price and basis equal to its fair market value. S is then treated as transferring the new note to T as part of the section 351 exchange. Because S's basis in the T stock received with respect to the transferred B note is equal to its fair market value, S's gain with respect to the T stock will not reflect any of the built-in loss attributable to the B note. (This example does not address common law doctrines or other authorities that might apply to recharacterize the transaction or to otherwise affect the tax treatment of the transaction.)

(I) *Example 9. Issuance at off-market rate of interest*—(*1*) *Facts.* T is a member with a SRLY loss. T's sole shareholder, P, borrows an amount of cash from T in return for a P note that provides for a materially above market rate of interest. The P note is issued with a view to generate additional interest income to T over the term of the note to facilitate the absorption of T's SRLY loss.

(*2*) *With a view.* Because the P note is issued with a view to shift interest income from the off-market obligation in order to secure a tax benefit that the group or its members would not otherwise enjoy, under paragraph (g)(4)(iii) of this section, the intercompany obligation is treated, for all Federal income tax purposes, as originally issued for its fair market value so T is treated as purchasing the note at a premium. The difference between the amount loaned and the fair market value of the obligation is treated as transferred from P to T as a capital contribution at the time the note is issued. Throughout the term of the note, T takes into account interest income and bond premium and P takes into account interest deduction and bond issuance premium under generally applicable Internal Revenue Code sections. The adjustment under paragraph (g)(4)(iii) of this section is made without regard to the application of, and in lieu of any adjustment under, section 482 or 1274.

(J) *Example 10. Nonintercompany obligation becomes intercompany obligation*—(*1*) *Facts.* On January 1 of year 1, B borrows $100 from X in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of year 5. As of January 1 of year 3, B has fully performed its obligations, but the note's fair market value is $70, reflecting an increase in prevailing market interest rates. On January 1 of year 3, P buys all of X's stock. B is solvent within the meaning of section 108(d)(3).

(*2*) *Deemed satisfaction and reissuance.* Under paragraph (g)(5)(ii) of this section, B's note is treated as satisfied for $70 (determined under the principles of § 1.108–2(f)(2)) immediately after it becomes an intercompany obligation. Both X's $30 capital loss (under section 1271(a)(1)) and B's $30 of discharge of indebtedness income (under § 1.61–12) are taken into account in determining consolidated taxable income for year 3. Under paragraph (g)(6)(i)(B) of this section, the attributes of items resulting from the satisfaction are determined on a separate entity basis. *But see* section 382 and § 1.1502–15 (as appropriate). B is also treated as reissuing a new note to X. The new note is an intercompany obligation, it has a $70 issue price and $100 stated redemption price at maturity, and the $30 of original issue discount will be taken into account by B and X in the same manner as provided in paragraph (g)(7)(ii)(A)(*3*) of this section (*Example 1*).

(*3*) *Amortization of repurchase premium.* The facts are the same as in paragraph (g)(7)(ii)(J)(*1*) of this section (*Example 10*), except that on January 1 of year 3, the B note has a fair market value of $130 and rather than P purchasing the X stock, P purchases the B note from X by issuing its own note. The P note has an issue price, stated redemption price at maturity, stated principal amount, and fair market value of $130. Under paragraph (g)(5)(ii) of this section, B's note is treated as satisfied for $130 (determined under the principles of § 1.108–2(f)(1)) immediately after it becomes an intercompany obligation. As a result of the deemed satisfaction of the note, P has no gain or loss and B has $30 of repurchase premium. Under paragraph (g)(6)(iii) of this section, B's $30 of repurchase premium from the deemed satisfaction is amortized by B over the term of the newly issued P note in the same manner as if it were original issue discount and the newly issued P note had been issued directly by B. B is also treated as reissuing a new note to P. The new note is an intercompany obligation, it has a $130 issue price and $100 stated redemption price at maturity, and the treatment of B's $30 of bond issuance premium under the new B note is determined under § 1.163–13.

(*4*) *Election to file consolidated returns.* Assume instead that B borrows $100 from S during year 1, but the P group does not file consolidated returns until year 3. Under paragraph (g)(5)(ii) of this section, B's note is treated as satisfied and reissued as a new note immediately after the note becomes an intercompany obligation. The satisfaction and reissuance are deemed to occur on January 1 of year 3, for the fair market value of the obligation (determined under the principles of § 1.108–2(f)(2)) at that time.

(K) *Example 11. Notional principal contracts*—(*1*) *Facts.* On April 1 of year 1, M1 enters into a contract with counterparty M2 under which, for a term of five years, M1 is obligated to make a payment to M2 each April 1, beginning in year 2, in an amount equal to the London Interbank Offered Rate (LIBOR), as determined by reference to LIBOR on the day each payment is due, multiplied by a $1,000 notional principal amount. M2 is obligated to make a payment to M1 each April 1, beginning in year 2, in an amount equal to 8 percent multiplied by the same notional principal amount. LIBOR is 7.80 percent on April 1 of year 2, and therefore, M2 owes $2 to M1.

(*2*) *Matching rule.* Under § 1.446–3(d), the net income (or net deduction) from a notional principal contract for a taxable year is included in (or deducted from) gross income. Under § 1.446–3(e), the ratable daily portion of M2's obligation to M1 as of December 31 of year 1 is $1.50 ($2 multiplied by 275/365). Under the matching rule, M1's net income for year 1 of $1.50 is taken into account to reflect the difference between M2's net deduction of $1.50 taken into account and the $0 recomputed net deduction. Similarly, the $.50 balance of the $2 of net periodic payments made on April 1 of year 2 is taken into account for year 2 in M1's and M2's net income and net deduction from the contract. In addition, the attributes of M1's intercompany income and M2's corresponding deduction are redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of M2's corresponding deduction control the attributes of M1's intercompany income. (Although M1 is the selling member with respect to the payment on April 1 of year 2, it might be the buying member in a subsequent period if it owes the net payment.)

(*3*) *Dealer.* The facts are the same as in paragraph (g)(7)(ii)(K)(*1*) of this section (*Example 11*), except that M2 is a dealer in securities, and the contract with M1 is not inventory in the hands of M2. Under section 475, M2 must mark its securities to fair market value at year-end. Assume that under section 475, M2's loss from marking to fair market value the contract with M1 is $10. Because M2 realizes an amount of loss from the mark to fair market value of the contract, the transaction is a triggering transaction under paragraph (g)(3)(i)(A)(*1*) of this section. Under paragraph (g)(3)(ii) of this section, M2 is treated as making a $10 payment to M1 to terminate the contract immediately before a new contract is treated as reissued with an up-front payment by M1 to M2 of $10. M1's $10 of income from the termination payment is taken into account under the matching rule to reflect M2's deduction under § 1.446–3(h). The attributes of M1's intercompany income and M2's corresponding deduction are redetermined to produce the same effect as if the transaction had occurred between divisions of a single corporation. Under paragraph (c)(4)(i) of this section, the attributes of M2's corresponding deduction control the attributes of M1's intercompany income. Accordingly, M1's income is treated as ordinary income. Under § 1.446–3(f), the deemed $10 up-front payment by M1 to M2 in connection with the issuance of a new contract is taken into account over the term of the new contract in a manner reflecting the economic substance of the contract (for example, allocating the payment in accordance with the forward rates of a series of cash-settled forward contracts that reflect the specified index and the $1,000 notional principal amount). (The timing of taking items into account is the same if M1, rather than M2, is the dealer subject to the mark-to-market requirement of section 475 at year-end. However in this case, because the attributes of the corresponding deduction control the attributes of the intercompany income, M1's income from the deemed termination payment from M2 might be ordinary or capital). Under paragraph (g)(3)(ii)(A) of this section, section 475 does not apply to mark the notional principal contract to fair market value after its deemed satisfaction and reissuance.

* * * * *

(l) * * *

(6) *Applicability date regarding paragraph (f)(7)(iv) of this section (Example 4).* Paragraph (f)(7)(iv) of this section (*Example 4*) applies to transactions occurring on or after December 18, 2009.

* * * * *

(8) *Election to apply paragraph (f)(5)(ii) of this section to an intercompany transaction.* Paragraph (f)(5)(ii)(E) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007.

(9) *Election to reduce basis of parent stock under paragraph (f)(6) of this section.* Paragraph (f)(6)(i)(C)(*2*) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007.

(10) *Certain qualified stock dispositions.* Paragraph (f)(5)(ii)(C) of this section applies to any qualified stock disposition (as defined in § 1.336–1(b)(6)) for which the disposition date (as defined in § 1.336–1(b)(8)) is on or after May 15, 2013.

■ **Par. 19.** Section 1.1502–17 is amended by revising and republishing paragraphs (a) and (e) to read as follows:

§ 1.1502–17 Methods of accounting.

(a) *General rule.* The method of accounting to be used by each member of the group is determined in accordance with the provisions of section 446 as if such member filed a separate return.

* * * * *

(e) *Effective dates.* Paragraph (b) of this section applies to changes in method of accounting effective for years beginning on or after July 12, 1995. Paragraphs (c) and (d) of this section apply with respect to acquisitions occurring or activities undertaken in years beginning on or after July 12, 1995.

§ 1.1502–18 [Removed]

■ **Par. 20.** Section 1.1502–18 is removed.

■ **Par. 21.** Section 1.1502–21 is amended by:

■ a. Revising paragraphs (b)(3)(i) and (b)(4);

■ b. Removing and reserving paragraph (d); and

■ c. Revising paragraphs (h)(6) and (8).

The revisions read as follows:

§ 1.1502–21 Net operating losses.

* * * * *

(b) * * *

(3) * * *

(i) *In general.* A group may make an irrevocable election under section 172(b)(3) to relinquish the entire carryback period with respect to a CNOL for any consolidated return year. Except as provided in paragraphs (b)(4) and (5) of this section, the election may not be made separately for any member (whether or not it remains a member), and must be made in a separate statement titled ''THIS IS AN ELECTION UNDER § 1.1502–21(b)(3)(i) TO WAIVE THE ENTIRE CARRYBACK PERIOD PURSUANT TO SECTION 172(b)(3) FOR THE [insert consolidated return year] CNOLs OF THE CONSOLIDATED GROUP OF WHICH [insert name and employer identification number of common parent] IS THE COMMON PARENT.'' The statement must be filed with the group's income tax return for the consolidated return year in which the loss arises. The election may be made in an unsigned statement.

* * * * *

(4) *General split-waiver election.* If one or more members of a consolidated group becomes a member of another consolidated group, the acquiring group may make an irrevocable election to relinquish, with respect to all consolidated net operating losses attributable to the member, the portion of the carryback period for which the corporation was a member of another group, provided that any other corporation joining the acquiring group that was affiliated with the member immediately before it joined the acquiring group is also included in the waiver. This election is not a yearly election and applies to all losses that would otherwise be subject to a carryback to a former group under section 172. The election must be made in a separate statement titled ''THIS IS AN ELECTION UNDER § 1.1502–21(b)(4) TO WAIVE THE PRE- [insert first taxable year for which the member (or members) was not a member of another group] CARRYBACK PERIOD FOR THE CNOLs attributable to [insert names and employer identification number of members].'' The statement must be filed with the acquiring consolidated group's original income tax return for the year the corporation (or corporations) became a member. The election may be made in an unsigned statement.

* * * * *

(h) * * *

(6) *Certain prior periods.* Paragraphs (b)(1), (b)(2)(iv)(A), (b)(2)(iv)(B)(1), and (c)(2)(vii) of this section apply to taxable

years for which the due date of the original return (without regard to extensions) is after March 21, 2005.

* * * * *

(8) *Losses treated as expired under § 1.1502–35(f)(1).* For rules regarding losses treated as expired under § 1.1502–35(f) on or after March 10, 2006, *see* § 1.1502–21(b)(3)(v) as contained in 26 CFR part 1 in effect on April 1, 2006.

* * * * *

§ 1.1502–22 [Amended]

■ **Par. 22.** Section 1.1502–22 is amended by removing and reserving paragraph (d).

■ **Par. 23.** Section 1.1502–24 is amended by revising paragraphs (a)(2) and (c) to read as follows:

§ 1.1502–24 Consolidated charitable contributions deduction.

(a) * * *

(2) The percentage limitation on the total charitable contribution deduction provided in section 170(b)(2)(A) applied to adjusted consolidated income as determined under paragraph (c) of this section.

* * * * *

(c) *Adjusted consolidated taxable income.* For purposes of this section, the adjusted consolidated taxable income of the group for any consolidated return year is the consolidated taxable income computed without regard to this section, section 243(a)(2) and (3), and § 1.1502–26, and without regard to any consolidated net operating or net capital loss carrybacks to such year.

■ **Par. 24.** Section 1.1502–26 is amended by revising paragraphs (a) and (c) to read as follows:

§ 1.1502–26 Consolidated dividends received deduction.

(a) *In general.* The consolidated dividends received deduction for the taxable year is the lesser of—

(1) The aggregate of the deduction of the members of the group allowable under sections 243(a)(1), 245(a) and (b), and 250 (computed without regard to the limitations provided in section 246(b)), or

(2) The aggregate amount described in section 246(b), determined by substituting, wherever it appears—

(i) The term *consolidated taxable income* for *taxable income,*

(ii) The term *consolidated net operating loss* for *net operating loss,* and

(iii) The term *consolidated net capital loss* for *capital loss.*

* * * * *

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

(1) *Example 1.* (i) Corporations P, S, and S–1 filed a consolidated return for the calendar year 2023 showing consolidated taxable income of $100,000 (determined without regard to the consolidated net operating loss deduction, and the consolidated dividends received deduction). These corporations received dividends during such year from less than 20-percent owned domestic corporations as follows:

TABLE 1 TO PARAGRAPH (c)(1)(i)

Corporation	Dividends
P	$6,000
S	10,000
S–1	34,000
Total	50,000

(ii) The dividends received deduction allowable to each member under section 243(a)(1) (computed without regard to the limitation in section 246(b)) is as follows: P has $3,000 (50 percent of $6,000), S has $5,000 (50 percent of $10,000), and S–1 has $17,000 (50 percent of $34,000), or a total of $25,000. Since $25,000 is less than $50,000 (50 percent of $100,000), the consolidated dividends received deduction is $25,000.

(2) *Example 2.* Assume the same facts as in paragraph (c)(1)(i) of this section (*Example 1*), except that consolidated taxable income (computed without regard to the consolidated net operating loss deduction and the consolidated dividends received deduction) was $40,000. The aggregate of the dividends received deductions, $42,500, computed without regard to section 246(b), results in a consolidated net operating loss of $2,500. *See* section 172(d)(5). Therefore, paragraph (a)(2) of this section does not apply and the consolidated dividends received deduction is $42,500.

§ 1.1502–27 [Removed]

■ **Par. 25.** Section 1.1502–27 is removed.

■ **Par. 26.** Section 1.1502–32 is amended by:

■ a. Revising paragraphs (b)(4)(v) and (vii).

■ b. Revising and republishing paragraphs (b)(5), (h)(2)(i), and (h)(5) through (8).

■ c. Redesignating paragraph (j) as paragraph (h)(10) and revising newly designated paragraph (h)(10).

■ d. Removing paragraph (k).

The revisions read as follows:

§ 1.1502–32 Investment adjustments.

* * * * *

(b) * * *

(4) * * *

(v) *Special rule for loss carryovers of a subsidiary acquired in a transaction for which an election under § 1.1502–20(i)(2) is made. See* paragraph (b)(4)(v) of this section as contained in 26 CFR part 1 revised as of April 1, 2005.

* * * * *

(vii) *Special rules for amending waiver of loss carryovers from separate return limitation year relating to the acquisition of a subsidiary in a transaction subject to § 1.1502–20. See* paragraph (b)(4)(vii) of this section as contained in 26 CFR part 1 revised as of April 1, 2005.

(5) *Examples*—(i) *In general.* For purposes of the examples in this section, unless otherwise stated, M owns all of the only class of S's stock, the stock is owned for the entire year, S owns no stock of lower-tier members, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, preferred stock is described in section 1504(a)(4), all transactions are between unrelated persons, and tax liabilities are disregarded.

(ii) *Stock basis adjustments.* The principles of this paragraph (b) are illustrated by the following examples.

(A) *Example 1. Taxable income*—(*1*) *Current taxable income.* For Year 1, the M group has $100 of taxable income when determined by including only S's items of income, gain, deduction, and loss taken into account. Under paragraph (b)(1) of this section, M's basis in S's stock is adjusted under this section as of the close of Year 1. Under paragraph (b)(2) of this section, M's basis in S's stock is increased by the amount of the M group's taxable income determined by including only S's items taken into account. Thus, M's basis in S's stock is increased by $100 as of the close of Year 1.

(*2*) *Intercompany gain that is not taken into account.* The facts are the same as in paragraph (b)(5)(ii)(A)(*1*) of this section (*Example 1*), except that S also sells property to another member at a $25 gain in Year 1, the gain is deferred under § 1.1502–13 and taken into account in Year 3, and M sells 10% of S's stock to nonmembers in Year 2. Under paragraph (b)(3)(i) of this section, S's deferred gain is not additional taxable income for Year 1 or 2 because it is not taken into account in determining the M group's consolidated taxable income for either of those years. The deferred gain is not tax-exempt income under paragraph (b)(3)(ii) of this section because it is not permanently excluded from S's gross income. The deferred gain does not result in a basis adjustment until Year 3, when it is taken into account in determining the M group's consolidated taxable income. Consequently, M's basis in the S shares sold is not increased to reflect S's gain from the intercompany sale of the property. In Year 3, the deferred gain is taken into account, but the amount allocable to the shares sold by M does not increase their basis because these shares are held by nonmembers.

(*3*) *Intercompany gain taken into account.* The facts are the same as in paragraph (b)(5)(ii)(A)(*2*) of this section (*Example 1*), except that M sells all of S's stock in Year 2 (rather than only 10%). Under § 1.1502–13, S takes the $25 gain into account immediately before S becomes a nonmember. Thus, M's basis in S's stock is increased to reflect S's gain from the intercompany sale of the property.

(B) *Example 2. Tax loss*—(*1*) *Current absorption.* For Year 2, the M group has a $50 consolidated net operating loss when determined by taking into account only S's items of income, gain, deduction, and loss. S's loss is absorbed by the M group in Year 2, offsetting M's income for that year. Under paragraph (b)(3)(i)(A) of this section, because S's loss is absorbed in the year it arises, M has a $50 negative adjustment with respect to S's stock. Under paragraph (b)(2) of this section, M reduces its basis in S's stock by $50. Under paragraph (a)(3)(ii) of this section, if the decrease exceeds M's basis in S's stock, the excess is M's excess loss account in S's stock.

(*2*) *Interim determination from stock sale.* The facts are the same as in paragraph (b)(5)(ii)(B)(*1*) of this section (*Example 2*), except that S's Year 2 loss arises in the first half of the calendar year, M sells 50% of S's stock on July 1 of Year 2, and M's income for Year 2 does not arise until after the sale of S's stock. M's income for Year 2 (exclusive of the sale of S's stock) is offset by S's loss, even though the income arises after the stock sale, and no loss remains to be apportioned to S. *See* §§ 1.1502–11 and 1.1502–21(b). Under paragraph (b)(3)(i)(A) of this section, because S's $50 loss is absorbed in the year it arises, it reduces M's basis in the S shares sold by $25 immediately before the stock sale. Because S becomes a nonmember, the loss also reduces M's basis in the retained S shares by $25 immediately before S becomes a nonmember.

(*3*) *Loss carryback.* The facts are the same as in paragraph (b)(5)(ii)(B)(*1*) of this section (*Example 2*), except that M has no income or loss for Year 2, S's $50 loss is carried back and absorbed by the M group in Year 1 (offsetting the income of M or S), and the M group receives a $17 tax refund in Year 2 that is paid to S. Under paragraph (b)(3)(i)(B) of this section, because the $50 loss is carried back and absorbed in Year 1, it is treated as a tax loss for Year 2 (the year in which it arises). Under paragraph (b)(3)(ii) of this section, the refund is treated as tax-exempt income of S. Under paragraph (b)(3)(iv)(C) of this section, the tax-exempt income is taken into account in Year 2 because that is the year it would be taken into account under S's method of accounting if it were subject to Federal income taxation. Thus, under paragraph (b)(2) of this section, M reduces its basis in S's stock by $33 as of the close of Year 2 (the $50 tax loss, less the $17 tax refund).

(*4*) *Loss carryforward.* The facts are the same as in paragraph (b)(5)(ii)(B)(*1*) of this section (*Example 2*), except that M has no income or loss for Year 2, and S's loss is carried forward and absorbed by the M group in Year 3 (offsetting the income of M or S). Under paragraph (b)(3)(i)(A) of this section, the loss is not treated as a tax loss under paragraph (b)(2) of this section until Year 3.

(C) *Example 3. Tax-exempt income and noncapital, nondeductible expenses*—(*1*) *Facts.* For Year 1, the M group has $500 of consolidated taxable income. However, the M group has a $100 consolidated net operating loss when determined by including only S's items of income, gain, deduction, and loss taken into account. Also for Year 1, S has $80 of interest income that is permanently excluded from gross income under section 103, and S incurs $60 of related expense for which a deduction is permanently disallowed under section 265.

(*2*) *Analysis.* Under paragraph (b)(3)(i)(A) of this section, S has a $100 tax loss for Year 1. Under paragraph (b)(3)(ii)(A) of this section, S has $80 of tax-exempt income. Under paragraph (b)(3)(iii)(A) of this section, S has $60 of noncapital, nondeductible expense. Under paragraph (b)(3)(iv)(C) of this section, the tax-exempt income and noncapital, nondeductible expense are taken into account in Year 1 because that is the year they would be taken into account under S's method of accounting if they were subject to Federal income taxation. Thus, under paragraph (b) of this section, M reduces its basis in S's stock as of the close of Year 1 by an $80 net amount (the $100 tax loss, less $80 of tax-exempt income, plus $60 of noncapital, nondeductible expenses).

(D) *Example 4. Discharge of indebtedness*—(*1*) *Facts.* M forms S on January 1 of Year 1 and S borrows $200. During Year 1, S's assets decline in value and the M group has a $100 consolidated net operating loss. Of that amount, $10 is attributable to M and $90 is attributable to S under the principles of § 1.1502–21(b)(2)(iv). None of the loss is absorbed by the group in Year 1, and S is discharged from $100 of indebtedness at the close of Year 1. M has a $0 basis in the S stock. M and S have no attributes other than the consolidated net operating loss. Under section 108(a), S's $100 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and § 1.1502–28, the consolidated net operating loss is reduced to $0.

(*2*) *Analysis.* Under paragraph (b)(3)(iii)(A) of this section, the reduction of $90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense in Year 1 because that loss is permanently disallowed by section 108(b) and § 1.1502–28. Under paragraph (b)(3)(ii)(C)(*1*) of this section, all $100 of S's discharge of indebtedness income is treated as tax-exempt income in Year 1 because the discharge results in a $100 reduction to the consolidated net operating loss. Consequently, the loss and the cancellation of the indebtedness result in a net positive $10 adjustment to M's basis in its S stock.

(*3*) *Insufficient attributes.* The facts are the same as in paragraph (b)(5)(ii)(D)(*1*) of this section (*Example 4*), except that S is discharged from $120 of indebtedness at the close of Year 1. Under section 108(a), S's $120 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and § 1.1502–28, the consolidated net operating loss is reduced by $100 to $0 after the determination of tax for Year 1. Under paragraph (b)(3)(iii)(A) of this section, the reduction of $90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense. Under paragraph (b)(3)(ii)(C)(*1*) of this section, only $100 of the discharge is treated as tax-exempt income because only that amount is applied to reduce tax attributes. The remaining $20 of discharge of indebtedness income excluded from gross income under section 108(a) has no effect on M's basis in S's stock.

(*4*) *Purchase price adjustment.* Assume instead that S buys land in Year 1 in exchange for S's $100 purchase money note (bearing interest at a market rate of interest in excess of the applicable Federal rate, and providing for a principal payment at the end of Year 10), and the seller agrees with S in Year 4 to discharge $60 of the note as a purchase price adjustment to which section 108(e)(5) applies. S has no discharge of indebtedness income that is treated as tax-exempt income under paragraph (b)(3)(ii) of this section. In addition, the $60 purchase price adjustment is not a noncapital, nondeductible expense under paragraph (b)(3)(iii) of this section. A purchase price adjustment is not equivalent to a discharge of indebtedness that is offset by a deduction or loss. Consequently, the purchase price adjustment results in no net adjustment to M's basis in S's stock under paragraph (b) of this section.

(E) *Example 5. Distributions*—(*1*) *Amounts declared and distributed.* For Year 1, the M group has $120 of consolidated taxable income when determined by including only S's items of income, gain, deduction, and loss taken into account. S declares and makes a $10 dividend distribution to M at the close of Year 1. Under paragraph (b) of this section, M increases its basis in S's stock as of the close of Year 1 by a $110 net amount ($120 of taxable income, less a $10 distribution).

(*2*) *Distributions in later years.* The facts are the same as in paragraph (b)(5)(ii)(E)(*1*) of this section (*Example 5*), except that S does not declare and distribute the $10 until Year 2. Under paragraph (b) of this section, M increases its basis in S's stock by $120 as of the close of Year 1, and decreases its basis by $10 as of the close of Year 2. (If M were also a subsidiary, the basis of its stock would also be increased in Year 1 to reflect M's $120 adjustment to basis of S's stock; the basis of M's stock would not be changed as a result of S's distribution in Year 2, because M's $10 of tax-exempt dividend income under paragraph (b)(3)(ii) of this section would be offset by the $10 negative adjustment to M's basis in S's stock for the distribution.)

(*3*) *Amounts declared but not distributed.* The facts are the same as in paragraph (b)(5)(ii)(E)(*1*) of this section (*Example 5*), except that, during December of Year 1, S declares (and M becomes entitled to) another $70 dividend distribution with respect to its stock, but M does not receive the distribution until after it sells all of S's stock at the close of Year 1. Under § 1.1502–13(f)(2)(iv), S is treated as making a $70 distribution to M at the time M becomes entitled to the distribution. (If S is distributing an appreciated asset, its gain under section 311 is also taken into account under paragraph (b)(3)(i) of this section at the time M becomes entitled to the distribution.) Consequently, under paragraph (b) of this section, M increases its basis in S's stock as of the close of Year 1 by only a $40 net amount ($120 of taxable income, less two distributions totaling $80). Any further adjustments after S ceases to be a member and the $70 distribution is made would be duplicative, because the stock basis has already been adjusted for the distribution. Accordingly, the distribution will not result in further adjustments or gain, even if the distribution is a payment to which section 301(c)(2) or (3) applies.

(F) *Example 6. Reorganization with boot*—(*1*) *Facts.* M owns all the stock of S and T. M owns ten shares of the same class of common stock of S and ten shares of the same class of common stock of T. The fair market value of each share of S stock is $10 and the fair market value of each share of T stock is $10. On January 1 of Year 1, M has a $5 basis in each of its ten shares of S stock and a $10 basis in each of its ten shares of T stock. S and T have no items of income, gain, deduction, or loss for Year 1. S and T each have substantial earnings and profits. At the close of Year 1, T merges into S in a reorganization described in section 368(a)(1)(A) (and in section 368(a)(1)(D)). M receives no additional S stock, but does receive $10 which is treated as received by M in a separate transaction occurring immediately after the merger of T into S.

(*2*) *Analysis.* The merger of T into S is a transaction to which § 1.1502–13(f)(3) applies. Under §§ 1.1502–13(f)(3) and 1.358–2(a)(2)(iii), M is deemed to receive ten additional shares of S stock with a total fair market value of $100 (the fair market value of the T stock surrendered by M). Under § 1.358–2(a)(2)(i), M will have a basis of $10 in each share of S stock deemed received in the reorganization. Under § 1.358–2(a)(2)(iii), M is deemed to surrender all twenty shares of its S stock in a recapitalization under section 368(a)(1)(E) in exchange for the ten shares of S stock, the number of shares of S stock held by M immediately after the transaction. Thus, under § 1.358–2(a)(2)(i), M has five shares of S stock each with a basis of $10 and five shares of S stock each with a basis of $20. The $10 M received is treated as a dividend distribution under section 301 and, under paragraph (b)(3)(v) of this section, the $10 is a distribution to which paragraph (b)(2)(iv) of this section applies. Accordingly, M's total basis in the S stock is decreased by the $10 distribution.

(G) *Example 7. Tiering up of basis adjustments.* M owns all of S's stock, and S owns all of T's stock. For Year 1, the M group has $100 of consolidated taxable income when determined by including only T's items of income, gain, deduction, and loss taken into account, and $50 of consolidated taxable income when determined by including only S's items taken into account. S increases its basis in T's stock by $100 under paragraph (b) of this section. Under paragraph (a)(3) of this section, this $100 basis adjustment is taken into account in determining M's adjustments to its basis in S's stock. Thus, M increases its basis in S's stock by $150 under paragraph (b) of this section.

(H) *Example 8. Allocation of items*—(*1*) *Acquisition in mid-year.* M is the common parent of a consolidated group, and S is an unaffiliated corporation filing separate returns on a calendar-year basis. M acquires all of S's stock and S becomes a member of the M group on July 1 of Year 1. For the entire calendar Year 1, S has $100 of ordinary income and under § 1.1502–76(b) $60 is allocated to the period from January 1 to June 30 and $40 to the period from July 1 to December 31. Under paragraph (b) of this section, M increases its basis in S's stock by $40.

(*2*) *Sale in mid-year.* The facts are the same as in paragraph (b)(5)(ii)(H)(*1*) of this section (*Example 8*), except that S is a member of the M group at the beginning of Year 1 but ceases to be a member on June 30 as a result of M's sale of S's stock. Under paragraph (b) of this section, M increases its basis in S's stock by $60 immediately before the stock sale. (M's basis increase would be the same if S became a nonmember because S issued additional shares to nonmembers.)

(*3*) *Absorption of loss carryovers.* Assume instead that S is a member of the M group at the beginning of Year 1 but ceases to be a member on June 30 as a result of M's sale of S's stock, and a $100 consolidated net operating loss attributable to S is carried over by the M group to Year 1. The consolidated net operating loss may be apportioned to S for its first separate return year only to the extent not absorbed by the M group during Year 1. Under paragraph (b)(3)(i) of this section, if the loss is absorbed by the M group in Year 1, whether the offsetting income arises before or after M's sale of S's stock, the absorption of the loss carryover is included in the determination of S's taxable income or loss for Year 1. Thus, M's basis in S's stock is adjusted under paragraph (b) of this section to reflect any absorption of the loss by the M group.

(I) *Example 9. Gross-ups*—(*1*) *Facts.* M owns all of the stock of S, and S owns all of the stock of T, a newly formed controlled foreign corporation that is not a passive foreign investment company. In Year 1, T has $100 of subpart F income and pays $34 of foreign income tax, leaving T with $66 of earnings and profits. The M group has $100 of consolidated taxable income when determined by taking into account only S's items (the inclusion under section 951(a), taking into account the section 78 gross-up). As a result of the section 951(a) inclusion, S increases its basis in T's stock by $66 under section 961(a).

(*2*) *Analysis.* Under paragraph (b)(3)(i) of this section, S has $100 of taxable income. Under paragraph (b)(3)(iii)(B) of this section, the $34 gross-up for taxes paid by T that S is treated as having paid is a noncapital, nondeductible expense (whether or not any corresponding amount is claimed by the M group as a tax credit). Thus, M increases its basis in S's stock under paragraph (b) of this section by the net adjustment of $66.

(*3*) *Subsequent distribution.* The facts are the same as in paragraph (b)(5)(ii)(I)(*1*) of this section (*Example 9*), except that T distributes its $66 of earnings and profits in Year 2. The $66 distribution received by S is excluded from S's income under section 959(a) because the distribution represents earnings and profits attributable to amounts that were included in S's income under section 951(a) for Year 1. In addition, S's basis in T's stock is decreased by $66 under section 961(b). The excluded distribution is not tax-exempt income under paragraph (b)(3)(ii) of this section because of the corresponding reduction to S's basis in T's stock. Consequently, M's basis in S's stock is not adjusted under paragraph (b) of this section for Year 2.

(J) *Example 10. Recapture of tax-exempt items*—(*1*) *Facts.* S is a life insurance company. For Year 1, the M group has $200 of consolidated taxable income, determined by including only S's items of income, gain, deduction, and loss taken into account (including a $300 small company deduction under section 806). In addition, S has $100 of tax-exempt interest income, $60 of which is S's company share. The remaining $40 of tax-exempt income is the policyholders' share that reduces S's deduction for increase in reserves.

(*2*) *Tax-exempt items generally.* Under paragraph (b)(3)(i) of this section, S has $200 of taxable income for Year 1. Also for Year 1, S has $100 of tax-exempt income under paragraph (b)(3)(ii)(A) of this section, and another $300 is treated as tax-exempt income under paragraph (b)(3)(ii)(B) of this section because of the deduction under section 806. Under paragraph (b)(3)(iii) of this section, S has $40 of noncapital, nondeductible expenses for Year 1 because S's deduction under section 807 for its increase in reserves has been permanently reduced by the $40 policyholders' share of the tax-exempt interest income. Thus, M increases its basis in S's stock by $560 under paragraph (b) of this section.

(*3*) *Recapture.* Assume instead that S is a property and casualty company and, for Year 1, S accrues $100 of estimated salvage recoverable under section 832. Of this amount, $87 (87% of $100) is excluded from gross income because of the ''fresh start'' provisions of Sec. 11305(c) of Public Law 101–508 (the Omnibus Budget Reconciliation Act of 1990). Thus, S has $87 of tax-exempt income under paragraph (b)(3)(ii)(A) of this section that increases M's basis in S's stock for Year 1. (S also has $13 of taxable income over the period of inclusion under section 481.) In Year 5, S determines that the $100 salvage recoverable was overestimated by $30 and deducts $30 for the reduction of the salvage recoverable. However, S has $26.10 (87% of $30) of taxable income in Year 5 due to the partial recapture of its fresh start. Because S has no basis corresponding to this income, S is treated under paragraph (b)(3)(iii)(B) of this section as having a $26.10 noncapital, nondeductible expense in Year 5. This treatment is necessary to reflect the elimination of the erroneous fresh start in S's stock basis and causes a decrease in M's basis in S's stock by $30 for Year 5 (a $3.90 taxable loss and a $26.10 special adjustment).

* * * * *

(h) * * *

(2) * * *

(i) *In general.* If M disposes of stock of S in a consolidated return year beginning before January 1, 1995, the amount of M's income, gain, deduction, or loss, and the basis reflected in that amount, are not redetermined under this section.

* * * * *

(5) *Continuing basis reductions for certain deconsolidated subsidiaries.* If a subsidiary ceases to be a member of a group in a consolidated return year beginning before January 1, 1995, and its basis was subject to reduction under § 1.1502–32T or § 1.1502–32(g) as contained in the 26 CFR part 1 edition revised as of April 1, 1994, its basis remains subject to reduction under those principles. For example, if S ceased to be a member in 1990, and M's basis in any retained S stock was subject to a basis reduction account, the basis remains subject to reduction. Similarly, if an election could be made to apply § 1.1502–32T instead of § 1.1502–32(g), the election remains available. However, §§ 1.1502–32T and 1.1502–32(g) do not apply as a result of a subsidiary ceasing to be a member in tax years beginning on or after January 1, 1995.

(6) *Loss suspended under § 1.1502–35(c) or disallowed under § 1.1502–35(g)(3)(iii).* Paragraphs (a)(2), (b)(3)(iii)(C) and (D), and (b)(4)(vi) of this section are applicable on and after March 10, 2006.

(7) *Rules related to discharge of indebtedness income excluded from gross income.* Paragraphs (b)(1)(ii), (b)(3)(ii)(C)(*1*), (b)(3)(iii)(A), and (b)(5)(ii), *Example 4,* paragraphs (a), (b), and (c) of this section apply with respect to determinations of the basis of the stock of a subsidiary in consolidated return years the original return for which is due (without regard to extensions) after March 21, 2005. However, groups may apply those provisions with respect to determinations of the basis of the stock of a subsidiary in consolidated return years the original return for which is due (without regard to extensions) on or before March 21, 2005, and after August 29, 2003.

(8) *Determination of stock basis in reorganization with boot.* Paragraph (b)(5)(ii)(F) of this section (*Example 6*) applies only with respect to determinations of the basis of the stock of a subsidiary on or after January 23, 2006.

* * * * *

(10) *Election to treat loss carryover as expiring.* Paragraph (b)(4)(iv) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, *see* § 1.1502–32T as contained in 26 CFR part 1 in effect on April 1, 2007.

* * * * *

■ **Par. 27.** Section 1.1502–34 is revised to read as follows:

§ 1.1502–34 Special aggregate stock ownership rules.

(a) *Determination of stock ownership.* For purposes of the consolidated return regulations, in determining the stock ownership of a member of a group in another corporation (issuing corporation) for purposes of determining the application of section 165(g)(3)(A), 332(b)(1), 351(a), 732(f), or 904(f) in a consolidated return year, stock in the issuing corporation owned by all other members of the group is included. For the determination of whether a member of the group is an 80-

percent distributee, *see* section 337(c) (providing that, for purposes of section 337, the determination of whether any corporation is an 80-percent distributee is made without regard to any consolidated return regulation).

(b) *Example regarding liquidation of member.* The following example illustrates the stock ownership aggregation rule set forth in paragraph (a) of this section.

(1) *Facts.* P wholly owns A, B, and C, each of which is a member of the P group. A, B, and C each owns 33⅓ percent of the stock of D. D liquidates in a transaction purported to qualify under section 332.

(2) *Analysis.* For purposes of determining satisfaction of the 80-percent stock ownership requirement under section 332(b)(1), under the stock ownership aggregation rule set forth in paragraph (a) of this section: A is treated as owning all of the D stock owned by B and C; B is treated as owning all of the D stock owned by A and C; and C is treated as owning all of the D stock owned by A and B. Therefore, each of A, B, and C is treated as owning 100 percent of the stock of D and thus meeting the 80-percent stock ownership requirement for purposes of section 332. However, none of A, B, or C is treated as an 80-percent distributee for purposes of section 337. *See* section 337(c). Therefore, section 337(a) does not apply.

§ 1.1502–42 [Removed]

■ **Par. 28.** Section 1.1502–42 is removed.

■ **Par. 29.** Section 1.1502–43 is amended by revising paragraphs (b)(2)(iii) through (viii) and (e) to read as follows:

§ 1.1502–43 Consolidated accumulated earnings tax.

* * * * *

(b) * * *

(2) * * *

(iii) Under section 535(b)(3), the deduction determined under § 1.1502–26 is not allowed.

(iv) Under section 535(b)(4), the consolidated net operating loss deduction described in § 1.1502–21(a) is not allowed.

(v) Under section 535(b)(5), there is allowed as a deduction the consolidated net capital loss, determined under § 1.1502–22(a).

(vi) Under section 535(b)(6), there is allowed as a deduction an amount equal to—

(A) The consolidated capital gain net income for the taxable year (determined under § 1.1502–22(a) and without the consolidated net capital loss carryovers and carrybacks to the taxable year), minus

(B) The taxes attributable to such gain.

(vii) Under section 535(b)(7), the consolidated net capital loss carryovers and carrybacks are not allowed. *See* § 1.1502–22(b).

(viii) Section 1.1502–15 does not apply.

* * * * *

(e) *Effective/applicability date.* This section applies to any consolidated Federal income tax return due (without extensions) on or after December 21, 2009.

■ **Par. 30.** Section 1.1502–44 is amended by revising paragraph (b) to read as follows:

§ 1.1502–44 Percentage depletion for independent producers and royalty owners.

* * * * *

(b) *Adjusted consolidated taxable income.* For purposes of this section, adjusted consolidated taxable income is an amount (not less than zero) equal to the group's consolidated taxable income determined without—

(1) Any depletion with respect to an oil or gas property (other than a gas property with respect to which the depletion allowance for all production is determined pursuant to section 613A(b)) for which percentage depletion would exceed cost depletion in the absence of the depletable quantity limitations contained in section 613A(c)(1) and (6) and the consolidated taxable income limitation contained in paragraph (a) of this section;

(2) Any consolidated net operating loss carryback to the consolidated return year under § 1.1502–21; and

(3) Any consolidated net capital loss carryback to the consolidated return year under § 1.1502–22.

* * * * *

■ **Par. 31.** Section 1.1502–45 is added to read as follows:

§ 1.1502–45 Limitation on losses to amount at risk.

(a) *In general*—(1) *Scope.* This section applies to a loss of any subsidiary if the common parent's stock meets the stock ownership requirement described in section 465(a)(1)(B).

(2) *Limitation on use of losses.* Except as provided in paragraph (a)(4) of this section, a loss from an activity of a subsidiary during a consolidated return year is includible in the computation of consolidated taxable income (or consolidated net operating loss) and consolidated capital gain net income (or consolidated net capital loss) only to the extent the loss does not exceed the amount that the parent is at risk in the activity at the close of that subsidiary's taxable year. In addition, the sum of a subsidiary's losses from all its activities is includible only to the extent that the parent is at risk in the subsidiary at the close of that year. Any excess may not be taken into account for the consolidated return year but will be treated as a deduction allocable to that activity of the subsidiary in the first succeeding taxable year.

(3) *Amount parent is at risk in subsidiary's activity.* The amount the parent is at risk in an activity of a subsidiary is the lesser of the amount the parent is at risk in the subsidiary, or the amount the subsidiary is at risk in the activity. These amounts are determined under paragraph (b) of this section and the principles of section 465. *See* section 465 and the regulations thereunder and the examples in paragraph (e) of this section.

(4) *Excluded activities.* The limitation on the use of losses in paragraph (a)(2) of this section does not apply to a loss attributable to an activity described in section 465(c)(4).

(5) *Substance over form.* Any transaction or arrangement between members (or between a member and a person that is not a member) which does not cause the parent to be economically at risk in an activity of a subsidiary will be treated in accordance with the substance of the transaction or arrangement notwithstanding any other provision of this section.

(b) *Rules for determining amount at risk*—(1) *Excluded amounts.* The amount a parent is at risk in an activity of a subsidiary at the close of the subsidiary's taxable year does not include any amount that would not be taken into account under section 465 were the subsidiary not a separate corporation. Thus, for example, if the amount a parent is at risk in the activity of a subsidiary is attributable to nonrecourse financing, the amount at risk is not more than the fair market value of the property (other than the subsidiary's stock or debt or assets) pledged as security.

(2) *Guarantees.* If a parent guarantees a loan by a person other than a member to a subsidiary, the loan increases the amount the parent is at risk in the activity of the subsidiary.

(c) *Application of section 465.* This section applies in a manner consistent with the provisions of section 465. Thus, for example, the recapture of losses provided in section 465(e) applies if the amount the parent is at risk in the activity of a subsidiary is reduced below zero.

(d) *Other consolidated return provisions unaffected.* This section limits only the extent to which losses of a subsidiary may be used in a consolidated return year. This section does not apply for other purposes, such as §§ 1.1502–32 and 1.1502–19, relating to investment in stock of a subsidiary and excess loss accounts, respectively. Thus, a loss which reduces a subsidiary's earnings and profits in a consolidated return year, but is disallowed as a deduction for the year by reason of this section, may nonetheless result in a negative adjustment to the basis of an owning member's stock in the subsidiary or create (or increase) an excess loss account.

(e) *Examples.* The provisions of this section may be illustrated by the examples in this paragraph (e). In each example, the stock ownership requirement of section 465(a)(1)(B) is met for the stock of the parent (P), and each affiliated group files a consolidated return on a calendar year basis and comprises only the members described.

(1) *Example 1.* In 2022, P forms S with a contribution of $200 in exchange for all of S's stock. During the year, S borrows $400 from a commercial lender and P guarantees $100 of the loan. S uses $500 of its funds to acquire a motion picture film. S incurs a loss of $120 for the year with respect to the film. At the close of 2022, the amount P is at risk in S's activity is $300 ($200 contribution plus $100 guarantee). If S has no gain or loss in 2023, and there are no contributions from or distributions to P, at the close of 2023 P's amount at risk in S's activity will be $180.

(2) *Example 2.* P forms S–1 with a capital contribution of $1 on January 1, 2023. On February 1, 2023. S–1 borrows $100 with full recourse and contributes all $101 to its newly formed subsidiary S–2. S–2 uses the proceeds to explore for natural oil and gas resources. S–2 incurs neither gain nor loss from its explorations during the taxable year. As of December 31, 2023, P is at risk in the exploration activity of S–2 only to the extent of $1.

(f) *Applicability date.* This section applies to consolidated return years for which the due date of the income tax return (without regard to extensions) is after December 30, 2024.

■ **Par. 32.** Section 1.1502–47 is amended by revising and republishing paragraphs (a)(3), (b)(14)(iii), (c)(2)(ii), (h)(3)(i), (ii), and (x), (h)(4) introductory text, (h)(4)(ii) and (iii), (k), (l), and (m)(1)(i), (iv), and (v) to read as follows:

§ 1.1502–47 Consolidated returns by life-nonlife groups.

(a) * * *

(3) *Other provisions.* The provisions of the consolidated return regulations apply unless this section provides otherwise. Further, unless otherwise indicated in this section, a term used in this section has the same meaning as in sections 801–848.

(b) * * *

(14) * * *

(iii) *Example 3.* Since 2012, L has owned all the stock of L_1, which has owned all the stock of S_1, a nonlife insurance company. L_1 writes some accident and health insurance business. In 2018, L_1 transfers this business, and S_1 transfers some of its business, to a new nonlife insurance company, S_2, in a transaction described in section 351(a). The property transferred to S_2 by L_1 had a fair market value of $50 million. The property transferred by S_1 had a fair market value of $40 million. S_2 is ineligible for 2020 because the tacking rule in paragraph (b)(12)(v) of this section does not apply. The old corporations (L_1 and S_1) and the new corporation (S_2) do not all have the same tax character. *See* paragraph (b)(12)(v)(B) and (D) of this section. The result would be the same if L_1 transferred other property (for example, stock and securities) with the same value, rather than accident and health insurance contracts, to S_2.

* * * * *

(c) * * *

(2) * * *

(ii) *Special rule.* Notwithstanding the general rule, however, if the nonlife members in the group filed a consolidated return for the immediately preceding taxable year and had executed and filed a Form 1122 (or successor form) that is effective for the preceding year, then such members will be treated as if they filed a Form 1122 (or successor form) when they join in the filing of a consolidated return under section 1504(c)(2) and they will be deemed to consent to the regulations under this section. However, an affiliation schedule (Form 851, or any successor form) must be filed by the group and the life members must execute a Form 1122 (or successor form) in the manner prescribed in § 1.1502–75(h)(2).

* * * * *

(h) * * *

(3) * * *

(i) *Separate return years.* The carryovers in paragraph (h)(2)(ii) of this section may include net operating losses and net capital losses of the nonlife members arising in separate return years, that may be carried over to a succeeding year under the principles (including limitations) of §§ 1.1502–21 and 1.1502–22. *But see* paragraph (h)(3)(ix) of this section.

(ii) *Capital loss.* Nonlife consolidated net capital loss sets off consolidated LICTI only to the extent of life consolidated capital gain net income (as determined under paragraph (g)(3) of this section) and this setoff applies before any nonlife consolidated net operating loss sets off consolidated LICTI.

* * * * *

(x) *Percentage limitation.* The offsetable nonlife consolidated net operating losses that may be set off against consolidated LICTI in a particular year may not exceed a percentage limitation. This limitation is the applicable percentage in section 1503(c)(1) of the lesser of two amounts—

(A) The first amount is the sum of the offsetable nonlife consolidated net operating losses under paragraph (h)(2) of this section that may serve in the particular year (determined without this limitation) as a setoff against consolidated LICTI.

(B) The second amount is consolidated LICTI in the particular year reduced by any nonlife consolidated net capital loss that sets off consolidated LICTI in that year.

* * * * *

(4) *Examples.* The following examples illustrate the principles of this paragraph (h). In the examples, L indicates a life company, S is a nonlife insurance company, another letter indicates a nonlife company that is not an insurance company, no company has farming losses (within the meaning of section 172(b)(1)(B)(ii)), and each corporation uses the calendar year as its taxable year.

* * * * *

(ii) *Example 2.* (A) The facts are the same as in paragraph (h)(4)(i) of this section (*Example 1*), except that, for 2021, S's separate net operating loss is $200. Assume further that L's consolidated LICTI is $200. Under paragraph (h)(3)(vi) of this section, the offsetable nonlife consolidated net operating loss is $100 (the nonlife consolidated net operating loss computed under paragraph (f)(2)(ii) of this section ($200), reduced by the separate net operating loss of I ($100)). The offsetable nonlife consolidated net operating loss that may be set off against consolidated LICTI in 2021 is $35 (35 percent of the lesser of the offsetable $100 or consolidated LICTI of $200). *See* section 1503(c)(1) and paragraph (h)(3)(x) of this section. S carries over a loss of $65, and I carries over a loss of $100, to 2022 under paragraph (f)(2) of this section to be used against nonlife consolidated taxable income (consolidated net operating loss ($200) less amount used in 2021 ($35)). Under paragraph (h)(2)(ii) of this section, the offsetable nonlife consolidated net operating loss that may be carried to 2022 is $65 ($100 minus $35). The facts and results are summarized in the following table.

TABLE 1 TO PARAGRAPH (h)(4)(ii)(A)

	Facts (a)	Offsetable (b)	Limit (c)	Unused loss (d)
P	100			
S	(200)	(100)		(65)
I	(100)			(100)
Nonlife subgroup	(200)	(100)	(100)	(165)
L	200		200	
35% of the lower of line 4(c) or 5(c)			35	
Unused offsetable loss				(65)

(B) Accordingly, under paragraph (e) of this section, consolidated taxable income is $165 (line 5(a) minus line 6(c)).

(iii) *Example 3.* The facts are the same as in paragraph (h)(4)(ii) of this section (*Example 2*), with the following additions for 2022. The nonlife subgroup has nonlife consolidated taxable income of $50 (all of which is attributable to I) before the nonlife consolidated net operating loss deduction under paragraph (f)(2) of this section. Consolidated LICTI is $100. Under paragraph (f)(2) of this section, $50 of the nonlife consolidated net operating loss carryover ($165) is used in 2022 and, under paragraph (h)(3)(vi) and (vii) of this section, the portion used in 2022 is attributable to I, the ineligible nonlife member. Accordingly, the offsetable nonlife consolidated net operating loss from 2021 under paragraph (h)(3)(ii) of this section is $65, the unused loss from 2021. The offsetable nonlife consolidated net operating loss in 2022 is $22.75 (35 percent of the lesser of the offsetable loss of $65 or consolidated LICTI of $100). Accordingly, under paragraph (e) of this section, consolidated taxable income is $77.25 (consolidated LICTI of $100 minus the offsetable loss of $22.75).

* * * * *

(k) *Preemption.* The rules in this section preempt any inconsistent rules in other sections of the consolidated return regulations. For example, the rules in paragraph (h)(3)(vi) of this section apply notwithstanding § 1.1502–21.

(l) *Other consolidation principles.* The fact that this section treats the life and nonlife members as separate groups in computing, respectively, consolidated LICTI (or life consolidated net operating loss) and nonlife consolidated taxable income (or loss) does not affect the usual rules in the consolidated return regulations unless this section provides otherwise. Thus, the usual rules in § 1.1502–13 (relating to intercompany transactions) apply to both the life and nonlife members by treating them as members of one affiliated group.

(m) * * *

(1) * * *

(i) File the applicable consolidated corporate income tax return: a Form 1120–L, *U.S. Life Insurance Company Income Tax Return,* where the common parent is a life insurance company; a Form 1120–PC, *U.S. Property and Casualty Insurance Company Income Tax Return,* where the common parent is an insurance company, other than a life insurance company; a Form 1120, *U.S. Corporation Income Tax Return,* where the common parent is any other type of corporation; or any successor form;

* * * * *

(iv) Report separately the nonlife consolidated taxable income or loss, determined under paragraph (f) of this section, on a Form 1120 or 1120–PC (or any successor forms) (whether filed by the common parent or as an attachment to the consolidated return), as the case may be, of all nonlife members of the consolidated group; and

(v) Report separately the consolidated Life Insurance Company Taxable Income or life consolidated net operating loss, on a Form 1120–L (or any successor form) (whether filed by the common parent or as an attachment to the consolidated return), of all life members of the consolidated group.

* * * * *

■ **Par. 33.** Section 1.1502–75 is amended by:

■ a. Revising and republishing paragraphs (b)(1) through (3), (c)(1)(i), and (c)(2)(i) and (ii);

■ b. Removing paragraph (d)(5); and

■ c. Revising and republishing paragraphs (h)(1) and (2).

The revisions read as follows:

§ 1.1502–75 Filing of consolidated returns.

* * * * *

(b) * * *

(1) *General rule.* The consent of a corporation referred to in paragraph (a)(1) of this section is made by such corporation joining in the making of the consolidated return for such year. A corporation is deemed to have joined in the making of such return for such year if it files a Form 1122 (or successor form) in the manner specified in paragraph (h)(2) of this section.

(2) *Consent under facts and circumstances*—(i) *In general.* If a member of the group fails to file Form 1122 (or successor form), the Commissioner may under the facts and circumstances determine that such member has joined in the making of a consolidated return by such group. The following circumstances, among others, will be taken into account in making this determination—

(A) Whether or not the income and deductions of the member were included in the consolidated return;

(B) Whether or not a separate return was filed by the member for that taxable year; and

(C) Whether or not the member was included in the affiliations schedule, Form 851 (or successor form).

(ii) *Treatment of member.* If the Commissioner determines that the member described in paragraph (b)(1)(i) of this section has joined in the making of the consolidated return, such member is treated as if it had filed a Form 1122 (or successor form) for such year for purposes of paragraph (h)(2) of this section.

(3) *Failure to consent due to mistake.* If any member has failed to join in the making of a consolidated return under either paragraph (b)(1) or (2) of this section, then the tax liability of each member of the group is determined on the basis of separate returns unless the common parent corporation establishes to the satisfaction of the Commissioner

that the failure of such member to join in the making of the consolidated return was due to a mistake of law or fact, or to inadvertence. In such case, such member is treated as if it had filed a Form 1122 (or successor form) for such year for purposes of paragraph (h)(2) of this section, and thus joined in the making of the consolidated return for such year.

(c) * * *

(1) * * *

(i) *In general.* Notwithstanding that a consolidated return is required for a taxable year, the Commissioner, upon application by the common parent, may for good cause shown grant permission to a group to discontinue filing consolidated returns. Any such application must be made through a letter ruling request filed not later than the 90th day before the due date of the consolidated return for the taxable year (including extensions). In addition, if an amendment of the Code, or other law affecting the computation of tax liability, is enacted and the enactment is effective for a taxable year ending before or within 90 days after the date of enactment, then application for such a taxable year may be made not later than the 180th day after the date of enactment, and if the application is approved the permission to discontinue filing consolidated returns will apply to such taxable year notwithstanding that a consolidated return has already been filed for such year.

* * * * *

(2) * * *

(i) *Permission to all groups.* The Commissioner, in the Commissioner's discretion, may grant all groups permission to discontinue filing consolidated returns if any provision of the Code or regulations has been amended and such amendment is of the type which could have a substantial adverse effect on the filing of consolidated returns by substantially all groups, relative to the filing of separate returns. Ordinarily, the permission to discontinue applies with respect to the taxable year of each group which includes the effective date of such an amendment.

(ii) *Permission to a class of groups.* The Commissioner, in the Commissioner's discretion, may grant a particular class of groups permission to discontinue filing consolidated returns if any provision of the Code or regulations has been amended and such amendment is of the type which could have a substantial adverse effect on the filing of consolidated returns by substantially all such groups relative to the filing of separate returns. Ordinarily, the permission to discontinue applies with respect to the taxable year of each group within the class which includes the effective date of such an amendment.

* * * * *

(h) * * *

(1) *Consolidated return made by common parent or agent.* The consolidated return must be made on Form 1120, *U.S. Corporation Income Tax Return* (or any successor form), for the group by the common parent or the agent for the group as provided in § 1.1502–77(c). The consolidated return, with Form 851, *Affiliations Schedule* (or any successor form), attached, must be filed with the service center with which the common parent would have filed a separate return.

(2) *Filing of Form 1122 for first year.* If, under the provisions of paragraph (a)(1) of this section, a group wishes to file a consolidated return for a taxable year, then a Form 1122 (*Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return*) (or successor form) must be executed by each subsidiary. The group must attach either executed Forms 1122 (or successor forms) or unsigned copies of the completed Forms 1122 (or successor forms) to the consolidated return. If the group submits unsigned Forms 1122 (or successor forms) with its return, it must retain the signed originals in its records in the manner required by § 1.6001–1(e). Form 1122 (or any successor form) is not required for a taxable year if a consolidated return was filed (or was required to be filed) by the group for the immediately preceding taxable year.

* * * * *

■ **Par. 34.** Section 1.1502–76 is amended by revising and republishing paragraphs (a), (b)(1)(ii)(A)(*2*), (b)(2)(v), (b)(6), (c)(3), and (d) to read as follows:

§ 1.1502–76 Taxable year of members of group.

(a) *Taxable year of members of group.* The consolidated return of a group must be filed on the basis of the common parent's taxable year, and each subsidiary must adopt the common parent's annual accounting period for the first consolidated return year for which the subsidiary's income is includible in the consolidated return. If any member is on a 52–53-week taxable year, the rule of the preceding sentence will, with the advance consent of the Commissioner, be deemed satisfied if the taxable years of all members of the group end within the same 7-day period. Any request for such consent must be requested at the time and in the manner that the Commissioner of Internal Revenue may prescribe by Internal Revenue Service forms and instructions or by publication in the Internal Revenue Bulletin (*see* § 601.601(d)(2)(ii) of this chapter).

(b) * * *

(1) * * *

(ii) * * *

(A) * * *

(*2*) *Special rule for former S corporations.* If S becomes a member in a transaction other than in a qualified stock purchase for which an election under section 338(g) is made, and immediately before becoming a member an election under section 1362(a) was in effect, then S will become a member at the beginning of the day the termination of its S corporation election is effective. S's tax year ends for all Federal income tax purposes at the end of the preceding day.

* * * * *

(2) * * *

(v) *Acquisition of S corporation.* If a corporation is acquired in a transaction to which paragraph (b)(1)(ii)(A)(*2*) of this section applies, then paragraphs (b)(2)(ii) and (iii) of this section do not apply and items of income, gain, loss, deduction, and credit are assigned to each short taxable year on the basis of the corporation's normal method of accounting as determined under section 446.

* * * * *

(6) *Applicability date.* Except as provided in paragraphs (b)(1)(ii)(A)(*2*) and (b)(2)(v) of this section, this paragraph (b) applies to corporations becoming or ceasing to be members of consolidated groups on or after January 1, 1995.

(c) * * *

(3) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples:

(i) *Example 1.* Corporation P, which filed a separate return for the calendar year 2022, acquires all of the stock of corporation S as of the close of December 31, 2022. Corporation S reports its income on the basis of a fiscal year ending March 31. On July 15, 2023, the due date for the filing of a separate return by S (assuming no extensions of time), a consolidated return has not been filed for the group (P and S). On such date S may either file a return for the period April 1, 2022, through December 31, 2022, or it may file a return for the complete fiscal year ending March 31, 2023. If S files a return for the short period ending December 31, 2022, and if the group elects not to file a consolidated return for the calendar year 2023, S, on or before April 15, 2024 (the due date of P's return, assuming no extensions of time), must file a substituted return for the complete fiscal year ending March 31, 2023, in lieu of the return previously filed for the short period. Interest is computed from July 15, 2023. If, however, S files a return for the complete fiscal year ending March 31, 2023, and the group elects to file a consolidated return for the calendar year 2023, then S must file an amended return covering the period from April 1, 2022, through December 31, 2022, in lieu of the return previously filed for the complete fiscal year. Interest is computed from July 15, 2023.

(ii) *Example 2.* Assume the same facts as in paragraph (c)(3)(i) of this section (*Example 1*), except that corporation P acquires all of the stock of corporation S at the close of September 30, 2023, and P files a consolidated return for the group for 2023 on April 15, 2024 (not having obtained any extensions of time). Since a consolidated return has been filed on or before the due date (July 15, 2024) for the filing of the separate return for the taxable year ending March 31, 2024, the return of S for the short taxable year beginning April 1, 2023, and ending September 30, 2023, should be filed no later than April 15, 2024.

(d) *Applicability date*—(1) *Taxable years of members of group applicability date.* Paragraph (a) of this section applies to any original consolidated Federal income tax return due (without extensions) after July 20, 2007.

(2) *Election to ratably allocate items applicability date.* Paragraph (b)(2)(ii)(D) of this section applies to any original consolidated Federal income tax return due (without extensions) after July 20, 2007.

§ 1.1502–77 [Amended]

■ **Par. 35.** Section 1.1502–77 is amended by:

■ a. Designating *Examples 1* through *15* in paragraph (g) as paragraphs (g)(1) through (15), respectively.

■ b. In paragraph (g), for each newly redesignated paragraph listed in the "Paragraph" column, removing the text indicated in the "Remove" column and adding in its place the text indicated in the "Add" column:

Paragraph	Remove	Add
(g)(2)(i)	Example 1	paragraph (g)(1)(i) of this section (*Example 1*).
(g)(4)(i)	*Example 3*	paragraph (g)(3)(i) of this section (*Example 3*).
(g)(5)(i)	*Example 4*	paragraph (g)(4) of this section (*Example 4*).
(g)(11)(i)(B)(*1*)	His	the Commissioner's.
(g)(11)(ii)(A)	paragraph (i)(A) of this *Example 11*.	paragraph (g)(11)(i)(A) of this section.
(g)(12)(i)	paragraph (ii)(A) of *Example 11*	paragraph (g)(11)(ii)(A) of this section (*Example 11*).
(g)(13)(i)	March 15	April 15.

■ **Par. 36.** Section 1.1502–77A is amended by revising and republishing paragraph (d) to read as follows:

§ 1.1502–77A Common parent agent for subsidiaries applicable for consolidated return years beginning before June 28, 2002.

* * * * *

(d) *Effect of dissolution of common parent corporation.* If the common parent corporation contemplates dissolution, or is about to be dissolved, or if for any other reason its existence is about to terminate, it must forthwith notify the Commissioner of such fact and designate, subject to the approval of the Commissioner, another member to act as agent in its place to the same extent and subject to the same conditions and limitations as are applicable to the common parent. If the notice thus required is not given by the common parent, or the designation is not approved by the Commissioner, the remaining members may, subject to the approval of the Commissioner, designate another member to act as such agent, and notice of such designation must be given to the Commissioner. Until a notice in writing designating a new agent has been approved by the Commissioner, any notice of deficiency or other communication mailed to the common parent will be considered as having been properly mailed to the agent of the group; or, if the Commissioner has reason to believe that the existence of the common parent has terminated, the Commissioner may deal directly with any member in respect of its liability.

* * * * *

■ **Par. 37.** Section 1.1502–77B is amended by revising and republishing paragraphs (a)(6)(i) and (ii) to read as follows:

§ 1.1502–77B Agent for the group applicable for consolidated return years beginning on or after June 28, 2002, and before April 1, 2015.

(a) * * *

(6) * * *

(i) *Several liability.* The Commissioner may, upon issuing to the common parent written notice that expressly invokes the authority of this provision, deal directly with any member of the group with respect to its liability under § 1.1502–6 for the consolidated tax of the group, in which event such member has sole authority to act for itself with respect to that liability. However, if the Commissioner believes or has reason to believe that the existence of the common parent has terminated, the Commissioner may deal directly with any member with respect to that member's liability under § 1.1502–6 without giving the notice required by this provision.

(ii) *Information requests.* The Commissioner may, upon informing the common parent, request information relevant to the consolidated tax liability from any member of the group. However, if the Commissioner believes or has reason to believe that the existence of the common parent has terminated, the Commissioner may request such information from any member of the group without informing the common parent.

* * * * *

■ **Par. 38.** Section 1.1502–78 is amended by revising paragraph (f) to read as follows:

§ 1.1502–78 Tentative carryback adjustments.

* * * * *

(f) *Applicability date.* This section applies to taxable years to which a loss or credit may be carried back and for which the due date (without extensions) of the original return is after June 28, 2002, except that the provisions of paragraph (e)(2) of this section apply for applications by new members of consolidated groups for tentative carryback adjustments resulting from net operating losses, net capital losses, or unused business credits arising in separate return years of new members that begin on or after January 1, 2001.

■ **Par. 39.** Section 1.1502–79 is amended by revising paragraphs (a), (b), (d), and (e)(1) and (2) to read as follows:

§ 1.1502–79 Separate return years.

(a) *Carryover and carryback of consolidated net operating losses to separate return years.* For rules regarding the carryover and carryback of consolidated net operating losses to separate return years, *see* § 1.1502–21(b).

(b) *Carryover and carryback of consolidated net capital loss to separate return years.* For rules regarding the carryover and carryback of consolidated net capital losses to separate return years, *see* § 1.1502–22(b).

* * * * *

(d) *Carryover and carryback of consolidated unused foreign tax*—(1) *In general.* If a consolidated unused foreign tax can be carried under the principles of section 904(c) and § 1.1502–4(d) to a separate return year of a corporation (or could have been so carried if such corporation were in existence) that was a member of the group in the year in which the unused foreign tax arose, then the portion of the consolidated unused foreign tax attributable to the corporation (as determined under paragraph (d)(2) of this section) is apportioned to the corporation (and any successor to that corporation in a transaction to which section 381(a) applies) under the principles of § 1.1502–21(b) and is deemed paid or accrued in such separate return year to the extent provided in section 904(c).

(2) *Portion of consolidated unused foreign tax attributable to a member.* The portion of a consolidated unused foreign tax for any year attributable to a member is an amount equal to the consolidated unused foreign tax multiplied by a fraction. The numerator of the fraction is the foreign taxes paid or accrued by the member for the year (including those taxes deemed paid or accrued, other than by reason of section 904(c)). The denominator of the fraction is the aggregate of all such taxes paid or accrued for the year (including those taxes deemed paid or accrued, other than by reason of section 904(c)) by all members of the group.

(e) * * *

(1) *In general.* If the consolidated excess charitable contributions for any taxable year can be carried under the principles of section 170(b)(2) and § 1.1502–24(b) to a separate return year of a corporation (or could have been so carried if such corporation were in existence) which was a member of the group in the year in which such excess contributions arose, then the portion of such consolidated excess charitable contributions attributable to such corporation (as determined under paragraph (e)(2) of this section) is apportioned to such corporation (and any successor to such corporation in a transaction to which section 381(a) applies) under the principles of § 1.1502–21(b) and is a charitable contribution carryover to such separate return year.

(2) *Portion of consolidated excess charitable contributions attributable to a member.* The portion of the consolidated excess charitable contributions for any year attributable to a member is an amount equal to the consolidated excess contributions multiplied by a fraction. The numerator of the fraction is the charitable contributions paid by the member for the year. The denominator of the fraction is the aggregate of all charitable contributions paid for the year by all members of the group.

* * * * *

■ **Par. 40.** Section 1.1502–80 is amended by revising and republishing paragraph (c)(2) to read as follows:

§ 1.1502–80 Applicability of other provisions of law.

* * * * *

(c) * * *

(2) *Cross reference. See* § 1.1502–36 for additional rules relating to worthlessness of subsidiary stock.

* * * * *

§ 1.1502–81T [Removed]

■ **Par. 41.** Section 1.1502–81T is removed.

■ **Par. 42.** Section 1.1502–90 is amended by revising the entry for § 1.1502–99 to read as follows:

§ 1.1502–90 Table of contents.

* * * * *

§ 1.1502–91 [Amended]

■ **Par. 43.** Section 1.1502–91 is amended by removing paragraph (b)(3).

■ **Par. 44.** Section 1.1502–92 is amended by:

■ a. Designating *Examples 1* through *3* in paragraph (b)(3)(iii) as paragraphs (b)(3)(iii)(A) through (C), respectively.

■ b. In newly redesignated paragraphs (b)(3)(iii)(A) through (C), further redesignating paragraphs in the first column as paragraphs in the second column:

Old paragraphs	New paragraphs
(b)(3)(iii)(A)(i) and (ii)	(b)(3)(iii)(A)(*1*) and (*2*).
(b)(3)(iii)(B)(i), (ii), (iii), and (iv).	(b)(3)(iii)(B)(*1*), (*2*), (*3*), and (*4*).
(b)(3)(iii)(C)(i) and (ii)	(b)(3)(iii)(C)(*1*) and (*2*).

■ c. Revising newly redesignated paragraphs (b)(3)(iii)(B)(*2*) through (*4*).

The revisions read as follows:

§ 1.1502–92 Ownership change of a loss group or a loss subgroup.

* * * * *

(b) * * *

(3) * * *

(iii) * * *

(B) * * *

(*2*) For purposes of determining if the L loss group has an ownership change on November 22, Year 3, the day of the merger, P is treated as a continuation of L so that the testing period for P begins on January 1, Year 2, the first day of the taxable year of the L loss group in which the consolidated net operating loss that is carried over to Year 3 arose. Immediately after the close of November 22, Year 3, D is the only 5-percent shareholder that has increased its ownership interest in P during the testing period (from zero to 10 percentage points).

(*3*) The facts are the same as in paragraph (b)(3)(iii)(B)(*1*) of this section (*Example 2*), except that A has held 23⅓ shares (23⅓ percent) of L's stock for five years, and A purchased an additional 10 shares of L stock from E two years before the merger. Immediately after the close of the day of the merger (a testing date), A's ownership interest in P, the common parent of the L loss group, has increased by 6⅔ percentage points over A's lowest percentage ownership during the testing period (23⅓ percent to 30 percent).

(*4*) The facts are the same as in paragraph (b)(3)(iii)(B)(*1*) of this section (*Example 2*), except that P has a net operating loss arising in Year 1 that is carried to the first consolidated return year ending after the day of the merger. Solely for purposes of determining whether the L loss group has an ownership change under paragraph (b)(1)(i) of this section, the testing period for P commences on January 1, Year 2. P does not determine the earliest day for its testing period by reference to its net operating loss carryover from Year 1, which §§ 1.1502–1(f)(3) and 1.1502–75(d)(3)(i) treat as arising in a SRLY. *See* § 1.1502–94 to determine the application of section 382 with respect to P's net operating loss carryover.

* * * * *

■ **Par. 45.** Section 1.1502–99 is amended by:

■ a. Revising paragraphs (a) and (b).

■ b. Removing paragraph (c).
■ c. Redesignating paragraph (d) as paragraph (c).

The revisions read as follows:

§ 1.1502–99 Effective/applicability dates.

(a) *In general.* Sections 1.1502–91 through 1.1502–96 and § 1.1502–98 apply to any testing date that is on or after June 25, 1999. Sections 1.1502–94 through 1.1502–96 also apply to a corporation that becomes a member of a group or ceases to be a member of a group (or loss subgroup) on or after June 25, 1999.

(b) *Reattribution of losses under § 1.1502–36(d)(6).* Section 1.1502–96(d) applies to reattributions of net operating loss carryovers, capital loss carryovers, and deferred deductions in connection with a transfer of stock to which § 1.1502–36 applies, and the election under § 1.1502–96(d)(5) (relating to an election to reattribute section 382 limitation) can be made with an election under § 1.1502–36(d)(6) to reattribute a loss to the common parent that is filed at the time and in the manner provided in § 1.1502–36(e)(5)(x).

* * * * *

■ **Par. 46.** Section 1.1502–100 is amended by revising and republishing paragraphs (a)(2), (c)(2), and (d) to read as follows:

§ 1.1502–100 Corporations exempt from tax.

(a) * * *

(2) *Applicability of other consolidated return provisions.* The provisions of the consolidated return regulations are applicable to an exempt group to the extent they are not inconsistent with the provisions of this section or the provisions of subchapter F of chapter 1 of the Code. For purposes of applying the provisions of the consolidated return regulations to an exempt group, the following substitutions must be made—

(i) The term ''exempt group'' is substituted for the term ''group'';

(ii) The terms ''unrelated business taxable income'', ''separate unrelated business taxable income'', and ''consolidated unrelated business taxable income'' are substituted for the terms ''taxable income'', ''separate taxable income'', and ''consolidated taxable income''; and

(iii) The term *consolidated liability for tax determined under § 1.1502–2* (or an equivalent term) means the consolidated liability for tax of an exempt group determined under paragraph (b) of this section.

* * * * *

(c) * * *

(2) Any consolidated net operating loss deduction (determined under § 1.1502–21) subject to the limitations provided in section 512(b)(6);

* * * * *

(d) *Separate unrelated business taxable income*—(1) *In general.* The separate unrelated business taxable income of a member of an exempt group must be computed in accordance with the provisions of section 512 covering the determination of unrelated business taxable income of separate corporations, except that:

(i) The provisions of paragraphs (a) through (d), (f) through (k), and (o) of § 1.1502–12 apply; and

(ii) No charitable contributions deduction is taken into account under section 512(b)(10).

(2) *Section 501(c)(2) organizations. See* sections 511(c) and 512(a)(3)(C) for special rules applicable to organizations described in section 501(c)(2).

§§ 1.1502–9A, 1.1502–15A, 1.1502–21A, 1.1502–22A, 1.1502–23A, 1.1502–41A, 1.1502–79A, 1.1502–90A, 1.1502–91A, 1.1502–92A, 1.1502–93A, 1.1502–94A, 1.1502–95A, 1.1502–96A, 1.1502–97A, 1.1502–98A, 1.1502–99A, and 1.1503–2 [Removed]

■ **Par. 47.** Sections 1.1502–9A, 1.1502–15A, 1.1502–21A, 1.1502–22A, 1.1502–23A, 1.1502–41A, 1.1502–79A, 1.1502–90A, 1.1502–91A, 1.1502–92A, 1.1502–93A, 1.1502–94A, 1.1502–95A, 1.1502–96A, 1.1502–97A, 1.1502–98A, 1.1502–99A, and 1.1503–2 are removed.

■ **Par. 48.** Section 1.1503(d)–1 is amended by revising and republishing paragraph (b)(7) to read as follows:

§ 1.1503(d)–1 Definitions and special rules for filings under section 1503(d).

* * * * *

(b) * * *

(7) *Foreign country* includes any U.S. territory (as defined in § 1.1502–1(l)).

* * * * *

■ **Par. 49.** Section 1.1503(d)–8 is amended by:
■ a. Revising and republishing paragraph (a).
■ b. Removing and reserving paragraphs (b)(1) and (2), (b)(3)(ii) and (iii), and (b)(4).

The revision and republication read as follows:

§ 1.1503(d)–8 Effective dates.

(a) *General rule.* Except as provided in paragraph (b) of this section, this paragraph (a) provides the dates of applicability of §§ 1.1503(d)–1 through 1.1503(d)–7. Sections 1.1503(d)–1 through 1.1503(d)–7 apply to dual consolidated losses incurred in taxable years beginning on or after April 18, 2007. However, a taxpayer may apply §§ 1.1503(d)–1 through 1.1503(d)–7, in their entirety, to dual consolidated losses incurred in taxable years beginning on or after January 1, 2007, by filing its return and attaching to such return the domestic use agreements, certifications, or other information in accordance with these regulations. For purposes of this section, the term application date means either April 18, 2007, or, if the taxpayer applies these regulations pursuant to the preceding sentence, January 1, 2007. Section 1.1503–2, as contained in 26 CFR part 1, revised as of April 1, 2024, applies for dual consolidated losses incurred in taxable years beginning on or after October 1, 1992, and before the application date.

* * * * *

■ **Par. 50.** Section 1.1504–3 is amended by revising and republishing paragraph (d)(1)(ii) to read as follows:

§ 1.1504–3 Treatment of stock in a QOF C corporation for purposes of consolidation.

* * * * *

(d) * * *

(1) * * *

(ii) *Analysis.* Under paragraph (b)(1) of this section, stock of a QOF C corporation (qualifying or otherwise) is not treated as stock for purposes of determining whether the QOF C corporation may join in the filing of a consolidated return. Thus, because no election has been made under paragraph (b)(2) of this section, once Q1 becomes a QOF, Q1 ceases to be affiliated with the P group members for purposes of section 1501, and it deconsolidates from the P group. *See* the consolidated return regulations generally for the consequences of deconsolidation.

* * * * *

■ **Par. 51.** Section 1.1552–1 is amended by:
■ a. Redesignating paragraphs (a)(1)(ii)*(a)* through *(d)* as paragraphs (a)(1)(ii)(A) through (D), respectively.
■ b. Revising newly redesignated paragraph (a)(1)(ii)(B).
■ c. Redesignating paragraphs (a)(2)(ii)(*a*) through (*i*) as paragraphs (a)(2)(ii)(A) through (I), respectively.
■ d. Removing and reserving newly redesignated paragraph (a)(2)(ii)(B).
■ e. Revising newly redesignated paragraph (a)(2)(ii)(I).
■ f. Adding paragraph (g).

The revisions and addition read as follows:

§ 1.1552–1 Earnings and Profits.

(a) * * *

(1) * * *

(ii) * * *

(B) Such member's capital gain net income (determined without regard to any net capital loss carryover attributable to such member);

* * * * *

(2) * * *

(ii) * * *

(I) For purposes of subtitle A of the Code, if two or more taxable income brackets are set forth in section 11(b) of the Code, the amount in each taxable income bracket is divided by the number of members (or such portion of each bracket which is apportioned to the member pursuant to a schedule attached to the consolidated return for the consolidated return year). However, if for the taxable year some or all of the members are component members of a controlled group of corporations (within the meaning of section 1563) and if there are other such component members which do not join in filing the consolidated return for such year, the amount to be divided among the members filing the consolidated return is (in lieu of the taxable income brackets) the sum of the amounts apportioned to the component members which join in filing the consolidated return.

* * * * *

(g) *Applicability date.* This section applies to taxable years beginning on or after January 1, 2025. *See 26* CFR 1.1552–1, as revised April 1, 2024, for rules applicable prior to January 1, 2025.

■ **Par. 52.** Section 1.1563–1 is amended by:

■ a. Revising and republishing paragraphs (a)(2)(i)(A) and (B) and (a)(6);

■ b. In paragraph (b)(4), designating *Examples 1* through *4* as paragraphs (b)(4)(i) through (iv), respectively;

■ c. Revising newly designated paragraph (b)(4)(i); and

■ d. Revising paragraph (e).

The revisions read as follows:

§ 1.1563–1 Definition of controlled group of corporations and component members and related concepts.

(a) * * *

(2) * * *

(i) * * *

(A) Stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of each of the corporations, except the common parent corporation, is owned (directly and with the application of § 1.1563–3(b)(1), (2), and (3)) by one or more of the other corporations; and

(B) The common parent corporation owns (directly and with the application of § 1.1563–3(b)(1), (2), and (3)) stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of at least one of the other corporations, excluding, in computing such voting power or value, stock owned directly by such other corporations.

* * * * *

(6) *Voting power of stock.* For purposes of this section, and §§ 1.1563–2 and 1.1563–3, in determining whether the stock owned by a person (or persons) possesses a certain percentage of the total combined voting power of all classes of stock entitled to vote of a corporation, consideration will be given to all the facts and circumstances of each case. A share of stock will generally be considered as possessing the voting power accorded to such share by the corporate charter, by-laws, or share certificate. On the other hand, if there is any agreement, whether express or implied, that a shareholder will not vote the shareholder's stock in a corporation, the formal voting rights possessed by the shareholder's stock may be disregarded in determining the percentage of the total combined voting power possessed by the stock owned by other shareholders in the corporation, if the result is that the corporation becomes a component member of a controlled group of corporations. Moreover, if a shareholder agrees to vote the shareholder's stock in a corporation in the manner specified by another shareholder in the corporation, the voting rights possessed by the stock owned by the first shareholder may be considered to be possessed by the stock owned by such other shareholder if the result is that the corporation becomes a component member of a controlled group of corporations.

* * * * *

(b) * * *

(4) * * *

(i) *Example 1.* B, an individual, owns all of the stock of corporations W and X on each day of 1964. W and X each use the calendar year as their taxable year. On January 1, 1964, B also owns all the stock of corporation Y (a fiscal year corporation with a taxable year beginning on July 1, 1964, and ending on June 30, 1965), which stock B sells on October 15, 1964. On December 1, 1964, B purchases all the stock of corporation Z (a fiscal year corporation with a taxable year beginning on September 1, 1964, and ending on August 31, 1965). On December 31, 1964, W, X, and Z are members of the same controlled group. However, the component members of the group on such December 31st are W, X, and Y. Under paragraph (b)(2)(i) of this section, Z is treated as an excluded member of the group on December 31, 1964, since Z was a member of the group for less than one-half of the number of days (29 out of 121 days) during the period beginning on September 1, 1964 (the first day of its taxable year) and ending on December 30, 1964. Under paragraph (b)(3) of this section, Y is treated as an additional member of the group on December 31, 1964, since Y was a member of the group for at least one-half of the number of days (107 out of 183 days) during the period beginning on July 1, 1964 (the first day of its taxable year) and ending on December 30, 1964.

* * * * *

(e) *Applicability dates*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, this section applies to taxable years beginning on or after May 26, 2009. However, taxpayers may apply this section to taxable years beginning before May 26, 2009. For taxable years beginning before May 26, 2009, *see* § 1.1563–1T as contained in 26 CFR part 1 in effect on April 1, 2009.

(2) *Exceptions.* (i) Paragraph (a)(1)(ii) of this section applies to taxable years beginning on or after April 11, 2011.

(ii) Paragraphs (a)(2)(i)(A) and (B), (a)(6), and (b)(4) of this section apply to taxable years beginning on or after December 30, 2024.

■ **Par. 53.** Section 1.1563–2 is amended by:

■ a. Revising and republishing paragraphs (b)(2)(iii) and (b)(4)(ii);

■ b. In paragraph (b)(7), designating *Examples 1* through *3* as paragraphs (b)(7)(i) through (iii), respectively;

■ c. Revising newly designated paragraph (b)(7)(ii) and (iii); and

■ d. Adding paragraph (d).

The revisions and addition read as follows:

§ 1.1563–2 Excluded stock.

* * * * *

(b) * * *

(2) * * *

(iii) *Employees.* Stock in the subsidiary corporation owned (directly and with the application of the rules contained in § 1.1563–3(b)) by an employee of the subsidiary corporation if such stock is subject to conditions which substantially restrict or limit the employee's right (or if the employee constructively owns such stock, the direct owner's right) to dispose of such stock and which run in favor of the parent or subsidiary corporation. In general, any condition which extends, directly or indirectly, to the parent corporation or the subsidiary corporation preferential rights with respect to the acquisition of the employee's (or direct owner's) stock will be considered to be a condition described in the preceding sentence. It is not necessary, in order for a condition to be considered to be in favor of the parent corporation or the subsidiary corporation, that the parent or subsidiary be extended a discriminatory concession with respect to the price of the stock. For example, a condition whereby the parent corporation is given a right of first refusal with respect to any stock of the subsidiary corporation offered by an employee for sale is a condition which substantially restricts or limits the employee's right to dispose of such stock and runs in favor of the parent corporation. Moreover, any legally enforceable condition which prohibits the employee from disposing of the employee's stock without the consent of the parent (or a subsidiary of the parent) will be considered to be a substantial limitation running in favor of the parent corporation.

* * * * *

(4) * * *

(ii) *Employees.* Stock in such corporation owned (directly and with the application of the rules contained in § 1.1563–3(b)) by an employee of such corporation if such stock is subject to conditions which run in favor of a common owner of such corporation (or in favor of such corporation) and which substantially restrict or limit the employee's right (or if the employee constructively owns such stock, the record owner's right) to dispose of such stock. The principles of paragraph (b)(2)(iii) of this section apply in determining whether a condition satisfies the requirements of the preceding sentence. Thus, in general, a condition which extends, directly or indirectly, to a common owner or such corporation preferential rights with respect to the acquisition of the employee's (or record owner's) stock will be considered to be a condition which satisfies such requirements. For purposes of this paragraph (b)(4)(ii), if a condition which restricts or limits an employee's right (or record owner's right) to dispose of the employee's (or record owner's) stock also applies to the stock in such corporation held by such common owner pursuant to a bona fide reciprocal stock purchase arrangement, such condition is not treated as one which restricts or limits the employee's (or record owner's) right to dispose of such stock. An example of a reciprocal stock purchase arrangement is an agreement whereby a common owner and the employee are given a right of first refusal with respect to stock of the employer corporation owned by the other party. If, however, the agreement also provides that the common owner has the right to purchase the stock of the employer corporation owned by the employee in the event that the corporation should discharge the employee for reasonable cause, the purchase arrangement would not be reciprocal within the meaning of this paragraph (b)(4)(ii).

* * * * *

(7) * * *

(ii) *Example 2.* The facts are the same as in paragraph (b)(7)(i) of this section (*Example 1*), except that Jones owns 15 shares of the 100 shares of the only class of stock of corporation S–1, and corporation S owns 75 shares of such stock. P satisfies the 50 percent stock ownership requirement of paragraph (b)(1) of this section with respect to S–1 since P is considered as owning 52.5 percent (70 percent × 75 percent) of the S–1 stock with the application of § 1.1563–3(b)(4). Since Jones is an officer of P, under paragraph (b)(2)(ii) of this section, the S–1 stock owned by Jones is treated as not outstanding for purposes of determining whether S–1 is a member of the parent-subsidiary controlled group of corporations. Thus, S is considered to own stock possessing 88.2 percent (75 ÷ 85) of the voting power and value of the S–1 stock. Accordingly, P, S, and S–1 are members of a parent-subsidiary controlled group of corporations.

(iii) *Example 3.* Corporation X owns 60 percent of the only class of stock of corporation Y. D, the president of Y, owns the remaining 40 percent of the stock of Y. D has agreed that, if D offers D's stock in Y for sale, D will first offer the stock to X at a price equal to the fair market value of the stock on the first date the stock is offered for sale. Since D is an employee of Y within the meaning of section 3306(i) of the Code, and D's stock in Y is subject to a condition which substantially restricts or limits D's right to dispose of such stock and runs in favor of X, under paragraph (b)(2)(iii) of this section such stock is treated as if it were not outstanding for purposes of determining whether X and Y are members of a parent-subsidiary controlled group of corporations. Thus, X is considered to own stock possessing 100 percent of the voting power and value of the stock of Y. Accordingly, X and Y are members of a parent-subsidiary controlled group of corporations. The result would be the same if D's spouse, instead of D, owned directly the 40 percent stock interest in Y and such stock was subject to a right of first refusal running in favor of X.

* * * * *

(d) *Applicability date.* This section applies to taxable years beginning on or after December 30, 2024. For taxable years beginning before December 30, 2024, *see* § 1.1563–2 as contained in 26 CFR part 1 in effect on April 1, 2024.

■ **Par. 54.** Section 1.1563–3 is amended by revising and republishing paragraphs (b)(2)(i) and (ii), (b)(3)(i) and (ii), (b)(4)(ii), (b)(5)(i) and (ii), (b)(6)(i), (ii), and (iv), (c)(2) and (4), (d)(3), and (e) to read as follows:

§ 1.1563–3 Rules for determining stock ownership.

* * * * *

(b) * * *

(2) * * *

(i) *Rule.* Stock owned, directly or indirectly, by or for a partnership is considered as owned by any partner having an interest of 5 percent or more in either the capital or profits of the partnership in proportion to the partner's interest in capital or profits, whichever such proportion is the greater.

(ii) *Example*—(A) *Facts.* Green, Jones, and White are unrelated individuals and are partners in the GJW partnership. The partners' interests in the capital and profits of the partnership are as follows:

TABLE 1 TO PARAGRAPH (b)(2)(ii)(A)

Partner	Capital percent	Profit percent
Green	36	25
Jones	60	71
White	4	4

(B) *Analysis.* The GJW partnership owns the entire outstanding stock (100 shares) of X Corporation. Under this paragraph (b)(2), Green is considered to own the X stock owned by the partnership in proportion to Green's interest in capital (36 percent) or profits (25 percent), whichever such proportion is the greater. Therefore, Green is considered to own 36 shares of the X stock. However, since Jones has a greater interest in the profits of the partnership, Jones is considered to own the X stock in proportion to Jones's interest in such profits. Therefore, Jones is considered to own 71 shares of the X stock. Since White does not have an interest of 5 percent or more in either the capital or profits of the partnership, White is not considered to own any shares of the X stock.

(3) * * *

(i) Stock owned, directly or indirectly, by or for an estate or trust is considered as owned by any beneficiary who has an actuarial interest of 5 percent or more in such stock, to the extent of such actuarial interest. For purposes of this paragraph (b)(3)(i), the actuarial interest of each beneficiary is determined by assuming the maximum exercise of discretion by the fiduciary in favor of such beneficiary and the maximum use of such stock to satisfy the beneficiary's rights as a beneficiary. A beneficiary of an estate or trust who cannot under any circumstances receive any interest in stock held by the estate or trust, including the proceeds from the disposition thereof, or the income therefrom, does not have an actuarial interest in such stock. Thus, where stock owned by a decedent's estate has been specifically bequeathed to certain beneficiaries and the remainder of the estate is bequeathed to other beneficiaries, the stock is attributable only to the beneficiaries to whom it is specifically bequeathed. Similarly, a remainderman of a trust who cannot under any circumstances receive any interest in the stock of a corporation which is a part of the corpus of the trust (including any accumulated income therefrom or the proceeds from a disposition thereof) does not have an actuarial interest in such stock. However, an income beneficiary of a trust does have an actuarial interest in stock if that beneficiary has any right to the income from such stock even though under the terms of the trust instrument such stock can never be distributed to that beneficiary. The factors and methods prescribed in § 20.2031–7 of this chapter (Estate Tax Regulations) for use in ascertaining the value of an interest in property for estate tax purposes must be used for purposes of this paragraph (b)(3)(i) in determining a beneficiary's actuarial interest in stock owned directly or indirectly by or for a trust.

(ii) For the purposes of this paragraph (b)(3), property of a decedent is considered as owned by the decedent's estate if such property is subject to administration by the executor or administrator for the purposes of paying claims against the estate and expenses of administration notwithstanding that, under local law, legal title to such property vests in the decedent's heirs, legatees or devisees immediately upon death. With respect to an estate, the term *beneficiary* includes any person entitled to receive property of the decedent pursuant to a will or pursuant to laws of descent and distribution. A person no longer is considered a beneficiary of an estate when all the property to which the person is entitled has been received by the person, when the person no longer has a claim against the estate arising out of having been a beneficiary, and when there is only a remote possibility that it will be necessary for the estate to seek the return of property or to seek payment from the person by contribution or otherwise to satisfy claims against the estate or expenses of administration. When pursuant to the preceding sentence, a person ceases to be a beneficiary, stock owned by the estate is not thereafter considered owned by the person.

* * * * *

(4) * * *

(ii) *Example.* Brown, an individual, owns 60 shares of the 100 shares of the only class of outstanding stock of corporation P. Smith, an individual, owns 4 shares of the P stock, and corporation X owns 36 shares of the P stock. Corporation P owns, directly and indirectly, 50 shares of the stock of corporation S. Under this paragraph (b)(4), Brown is considered to own 30 shares of the S stock ($60/100 \times 50$), and X is considered to own 18 shares of the S stock ($36/100 \times 50$). Since Smith does not own 5 percent or more in value of the P stock, Smith is not considered as owning any of the S stock owned by P. If, in this example, Smith's spouse had owned directly 1 share of the P stock, Smith (and Smith's spouse) would each own 5 shares of the P stock, and therefore Smith (and Smith's spouse) would be considered as owning 2.5 shares of the S stock ($5/100 \times 50$).

(5) * * *

(i) Except as provided in paragraph (b)(5)(ii) of this section, an individual is considered to own the stock owned, directly or indirectly, by or for the individual's spouse, other than a spouse who is legally separated from the individual under a decree of divorce, whether interlocutory or final, or a decree of separate maintenance.

(ii) An individual is not considered to own stock in a corporation owned, directly or indirectly, by or for the individual's spouse on any day of a taxable year of such corporation, provided that each of the following conditions are satisfied with respect to such taxable year:

(A) Such individual does not, at any time during such taxable year, own directly any stock in such corporation.

(B) Such individual is not a member of the board of directors or an employee of such corporation and does not participate in the management of such corporation at any time during such taxable year.

(C) Not more than 50 percent of such corporation's gross income for such taxable year was derived from royalties, rents, dividends, interest, and annuities.

(D) Such stock in such corporation is not, at any time during such taxable year, subject to conditions which substantially restrict or limit the spouse's right to dispose of such stock and which run in favor of the individual or the individual's children who have not attained the age of 21 years. The principles of § 1.1563–2(b)(2)(iii) apply in determining whether a condition is a condition described in the preceding sentence.

* * * * *

(6) * * *

(i) An individual is considered to own the stock owned, directly or indirectly, by or for the individual's children who have not attained the age of 21 years, and, if the individual has not attained the age of 21 years, the stock owned, directly or indirectly, by or for the individual's parents.

(ii) If an individual owns (directly, and with the application of the rules of this paragraph but without regard to this paragraph (b)(6)(ii)) stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock in a corporation, then such individual is considered to own the stock in such corporation owned, directly or indirectly, by or for the individual's parents, grandparents, grandchildren, and children who have attained the age of 21 years. In determining whether the stock owned by an individual possesses the requisite percentage of the total combined voting power of all classes of stock entitled to vote of a corporation, *see* § 1.1563–1(a)(6).

* * * * *

(iv) *Example*—(A) *Facts.* Individual B owns directly 40 shares of the 100 shares of the only class of stock of Z Corporation. B's child, M (20 years of age), owns directly 30 shares of such stock, and B's child, A (30 years of age), owns directly 20 shares of such stock. The remaining 10 shares of the Z stock are owned by an unrelated person.

(B) *B's ownership.* Individual B owns 40 shares of the Z stock directly and is considered to own the 30 shares of Z stock owned directly by M. Since, for purposes of the more-than-50-percent stock ownership test contained in paragraph (b)(6)(ii) of this section, B is treated as owning 70 shares or 70 percent of the total voting power and value of the Z stock, B is also considered as owning the 20 shares owned by B's adult child, A.

Accordingly, B is considered as owning a total of 90 shares of the Z stock.

(C) *M's ownership.* Minor child, M, owns 30 shares of the Z stock directly, and is considered to own the 40 shares of Z stock owned directly by B. However, M is not considered to own the 20 shares of Z stock owned directly by M's sibling, A, and constructively by B, because stock constructively owned by B by reason of family attribution is not considered as owned by M for purposes of making another member of B's family the constructive owner of such stock. *See* paragraph (c)(2) of this section. Accordingly, M owns and is considered as owning a total of 70 shares of the Z stock.

(D) *A's ownership.* Adult child, A, owns 20 shares of the Z stock directly. Since, for purposes of the more-than-50-percent stock ownership test contained in paragraph (b)(6)(ii) of this section, A is treated as owning only the Z stock which A owns directly, A does not satisfy the condition precedent for the attribution of Z stock from B. Accordingly, A is treated as owning only the 20 shares of Z stock which A owns directly.

(c) * * *

(2) *Members of family.* Stock constructively owned by an individual by reason of the application of paragraph (b)(5) or (6) of this section is not treated as owned by the individual for purposes of again applying such paragraphs in order to make another the constructive owner of such stock.

* * * * *

(4) *Examples.* The provisions of this paragraph (c) may be illustrated by the following examples:

(i) *Example 1.* A, 30 years of age, has a 90 percent interest in the capital and profits of a partnership. The partnership owns all the outstanding stock of corporation X and X owns 60 shares of the 100 outstanding shares of corporation Y. Under paragraph (c)(1) of this section, the 60 shares of Y constructively owned by the partnership by reason of paragraph (b)(4) of this section is treated as actually owned by the partnership for purposes of applying paragraph (b)(2) of this section. Therefore, A is considered as owning 54 shares of the Y stock (90 percent of 60 shares).

(ii) *Example 2.* The facts are the same as in paragraph (c)(4)(i) of this section (*Example 1*), except that that B, who is 20 years of age and the sibling of A, directly owns 40 shares of Y stock. Although the stock of Y owned by B is considered as owned by C (the parent of A and B) under paragraph (b)(6)(i) of this section, under paragraph (c)(2) of this section such stock may not be treated as owned by C for purposes of applying paragraph (b)(6)(ii) of this section in order to make A the constructive owner of such stock.

(iii) *Example 3.* The facts are the same as in paragraph (c)(4)(ii) of this section (*Example 2*), except that that C has an option to acquire the 40 shares of Y stock owned by B. The rule contained in paragraph (c)(2) of this section does not prevent the reattribution of such 40 shares to A because, under paragraph (c)(3) of this section, C is considered as owning the 40 shares by reason of option attribution and not by reason of family attribution. Therefore, since A satisfies the more-than-50-percent stock ownership test contained in paragraph (b)(6)(ii) of this section with respect to Y, the 40 shares of Y stock constructively owned by C are reattributed to A, and A is considered as owning a total of 94 shares of Y stock.

(d) * * *

(3) *Examples.* The provisions of this paragraph (d) may be illustrated by the following examples, in which each corporation referred to uses the calendar year as its taxable year and the stated facts are assumed to exist on each day of 1970 (unless otherwise provided in the example):

(i) *Example 1.* Jones owns all the stock of corporation X and has an option to purchase from Smith all the outstanding stock of corporation Y. Smith owns all the outstanding stock of corporation Z. Since the Y stock is considered as owned by two or more persons, under paragraph (d)(2)(ii) of this section, the Y stock is treated as owned only by Smith since Smith has direct ownership of such stock. Therefore, on December 31, 1970, Y and Z are component members of the same brother-sister controlled group. If, however, Smith had owned Smith's stock in corporation Z for less than one-half of the number of days of Z's 1970 taxable year, then under paragraph (d)(1) of this section, the Y stock would be treated as owned only by Jones since Jones's ownership results in Y being a component member of a controlled group on December 31,1970.

(ii) *Example 2.* Individual A owns directly all the outstanding stock of corporation M. B (the spouse of A) owns directly all the outstanding stock of corporation N. Neither spouse is considered as owning the stock directly owned by the other because each of the conditions prescribed in paragraph (b)(5)(ii) of this section is satisfied with respect to each corporation's 1970 taxable year. A owns directly 60 percent of the only class of stock of corporation P and B owns the remaining 40 percent of the P stock. Under paragraph (d)(2)(iii) of this section, the stock of P is treated as owned only by A since A owns (directly and with the application of the rules contained in paragraphs (b)(1) through (4) of this section) the stock possessing the greatest percentage of the total value of shares of all classes of stock of P. Accordingly, on December 31, 1970, P is treated as a component member of a brother-sister group consisting of M and P.

(iii) *Example 3.* Unrelated individuals A and B each own 49 percent of all the outstanding stock of corporation R, which in turn owns 70 percent of the only class of outstanding stock of corporation S. The remaining 30 percent of the stock of corporation S is owned by unrelated individual C. C also owns the remaining 2 percent of the stock of corporation R. Under the attribution rule of paragraph (b)(4) of this section, A and B are each considered to own 34.3 percent of the stock of corporation S. Accordingly, since five or fewer persons own at least 80 percent of the stock of corporations R and S and also own more than 50 percent identically (A's and B's identical ownership each is 34.3 percent, C's identical ownership is 2 percent), on December 31, 1970, corporations R and S are treated as component members of the same brother-sister controlled group for purposes of § 1.1563–1(a)(3)(ii).

* * * * *

(e) *Applicability dates.* This section applies to taxable years beginning on or after December 30, 2024. For taxable years beginning before December 30, 2024, *see* § 1.1563–3 as contained in 26 CFR part 1 in effect on April 1, 2024.

PART 5—TEMPORARY INCOME TAX REGULATIONS UNDER THE REVENUE ACT OF 1978

■ **Par. 55.** The authority citation for part 5 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 5.1502–45 [Removed]

■ **Par. 56.** Section 5.1502–45 is removed.

PART 301—PROCEDURE AND ADMINISTRATION

■ **Par. 57.** The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

■ **Par. 58.** Section 301.6402–7 is amended by revising and republishing paragraph (g)(2)(iii) to read as follows:

§ 301.6402–7 Claims for refund and applications for tentative carryback adjustments involving consolidated groups that include insolvent financial institutions.

* * * * *

(g) * * *

(2) * * *

(iii) *Absorption of net operating losses.* The absorption of net operating losses generally is determined under applicable principles of the Code and regulations, including the principles of section 172 and § 1.1502–21(b) of this chapter. Notwithstanding any contrary rule or principle of the Code or regulations, if an institution and another member of the carryback year group have net operating losses that arise in taxable years ending on the same date and are carried to the same consolidated carryback year, the carryback year group's consolidated taxable income for that year is treated as offset first by the loss attributable to the institution to the extent thereof.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 59.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§ 602.101 [Amended]

■ **Par. 60.** Section 602.101 is amended in the table in paragraph (b) by removing the entries for §§ 1.1502–9A, 1.1502–18, 1.1502–76T, 1.1502–95A, 1.1503–2, and 1.1503–2A.

Douglas W. O'Donnell,

Deputy Commissioner,

Approved: November 14, 2024.

Aviva R. Aron-Dine,

Deputy Assistant Secretary of the Treasury (Tax Policy).

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