Internal Revenue
bulletin

Bulletin No. 1999–29
July 19, 1999

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

T.D. 8823, page 34.

Final and temporary regulations under section 1502 of the Code relate to certain deductions and losses, including built-in deductions and losses, of members who join a consolidated group. The regulations provide rules for computing the limitation with respect to separate return limitation year (SRLY) losses, and the carryover or carryback of losses to consolidated and separate return years.

T.D. 8824, page 62.

Final and temporary regulations under section 1502 of the Code pertain to the operation of sections 382 and 383 of the Code, relating to limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change, with respect to consolidated groups.

T.D. 8826, page 107.

REG–105327–99, page 117.

Proposed and temporary regulations under section 1397E of the Code relate to the method of ascertaining the qualified zone academy bond credit rate and provide reimbursement rules. A public hearing is scheduled for November 9, 1999.

EXEMPT ORGANIZATIONS

Announcement 99–70, page 118.

A list is given of organizations now classified as private foundations.

ADMINISTRATIVE

Rev. Proc. 99–28, page 109.

Early referral of issues to Appeals. This procedure under section 7123 of the Code describes the method by which a taxpayer may request an early referral of one or more unresolved issues from the Examination or Collection Division to the Office of Appeals. A taxpayer may also request early referral of one or more unagreed issues with respect to an involuntary change in method of accounting, employment tax, employee plans, or exempt organizations. Rev. Proc. 96–9 superseded.

REG–101519–97, page 114.

Proposed regulations under section 6323 of the Code relate to the withdrawal of notices of federal tax liens in certain circumstances.

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Mission of the Service

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 1502.—Regulations

26 CFR 1.1502–21: Net operating losses.

T.D. 8823

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 301, and 602

Consolidated Returns— Limitations on the Use of Certain Losses and Deductions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding certain deductions and losses, including built-in deductions and losses, of members who join a consolidated group. The regulations provide rules for computing the limitation with respect to separate return limitation year (SRLY) losses, and the carryover or carryback of losses to consolidated and separate return years. The regulations also eliminate the application of the SRLY rules in certain circumstances in which the rules of section 382 of the Internal Revenue Code also apply.

DATES: *Effective Dates:* These regulations are effective June 25, 1999.

Applicability Dates: For dates of applicability, see the "Dates of Applicability" portion of this preamble.

FOR FURTHER INFORMATION CONTACT: Jeffrey L. Vogel, or Marie Milnes-Vasquez at (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in this final rule has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1237.

The collection of information in this regulation is in §1.1502–21(b)(3). This information is required to ensure that an election to relinquish a carryback period is properly documented, and will be used for that purpose. The collection of information is required to obtain a benefit (relating to the carryover of losses which would otherwise be carried back). The likely respondents are consolidated groups.

Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by August 31, 1999.

Comments are specifically requested concerning: Whether the collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Estimated total annual reporting burden: 2,000 hours.

Estimated average annual burden hours per respondent: 15 minutes. Estimated number of respondents: 8,000.

Estimated annual frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On February 4, 1991, the Treasury and the IRS issued three notices of proposed rulemaking, CO–132–87 (56 F.R. 4194 [1991–1 C.B. 728]), CO–077–90 (56 F.R. 4183 [1991–1 C.B. 749]), and CO–078–90 (56 F.R. 4228 [1991–1 C.B. 757]), setting forth amendments to the rules regarding net operating losses, built-in deductions, and capital losses of consolidated groups. Those proposed regulations also included rules regarding the carryover and carryback of losses to consolidated return years and separate return years, and rules regarding the application of section 382 and 383 by consolidated groups and by controlled groups. A public hearing regarding the three sets of proposed regulations was held on April 8, 1991.

On June 27, 1996, the Treasury and the IRS published temporary regulations regarding the separate return limitation year (SRLY) limitation (T.D. 8677, 61 F.R. 33321 [1996–2 C.B. 119]). These regulations were substantially identical to the proposed regulations. A notice of proposed rulemaking cross-referencing the temporary regulations, the 1996 proposed SRLY regulations, was published in the **Federal Register** on the same day (CO–024–96, 61 F.R. 33393 [1996–2 C.B. 437]), and the proposed regulations published in 1991 were withdrawn. The Treasury and the IRS also published temporary regulations (T.D. 8678, 61 F.R. 33335 [1996–2 C.B. 134]) setting forth rules regarding the application of section 382 to affiliated groups of corporations filing consolidated returns, and controlled group losses (T.D. 8679, 61 F.R. 33313 [1996–2 C.B. 25]). Notices of proposed rulemaking cross-referencing these temporary regulations were published on the same day (CO–026–96, 61 F.R. 33391 [1996–2 C.B. 440] and CO–025–96, 61 F.R. 33395 [1996–2 C.B. 439]), and the

earlier proposed regulations published in 1991 were withdrawn.

On August 10, 1998, the Treasury and the IRS issued Notice 98–38 (1998–32 I.R.B. 4). The Notice requested comments about the advisability of adopting rules that would replace the existing SRLY rules with an approach modeled on section 382.

As companions to this Treasury decision, which adopts the 1996 proposed SRLY regulations with certain revisions and modifications, the Treasury and the IRS are also issuing final regulations relating to the application of sections 382 and 383 by members of consolidated and controlled groups. See T.D. 8824 on page 62, and T.D. 8825, 1999–28 I.R.B. 3.

On January 12, 1998, the Treasury and IRS issued temporary and proposed regulations governing the use of tax credits of a consolidated group and its members (T.D. 8751, 63 F.R. 1740 [1998–10 I.R.B. 23]). The Treasury and IRS intend to finalize those regulations at a later date.

Operation of the Proposed and Temporary Regulations

The 1991 proposed regulations generally retained the approach of the prior SRLY regulations in limiting a consolidated group's use of attributes arising in or attributable to a SRLY, but altered the manner in which the limitation is computed. While the pre-1991 regulations determined the limitation separately for each member (fragmentation), and under a year-by-year approach, the proposed regulations introduced two new concepts: subgrouping and the cumulative register.

Subgrouping was added because fragmentation is in many ways inconsistent with the single entity approach to the use of losses under the consolidated return regulations. For example, if an entire consolidated group were acquired by another group, under the fragmentation approach, none of the losses of a former member of the target group could be used to offset income of another former member of the target group. However, had no acquisition occurred, those losses could have been used to offset income within the target group.

The 1991 proposed regulations also introduced the concept of a cumulative register to address certain issues resulting from the year-by-year approach. The prior SRLY regulations based the limitation on the SRLY member's annual contribution to the group's consolidated taxable income. The SRLY limitation was computed by taking the difference between the group's consolidated taxable income "with" the SRLY member and "without" the SRLY member. This resulted in certain anomalies. For example, if a SRLY member produced income in a tax year but the group as a whole did not have income, the SRLY loss could not be absorbed in that year. Because the member's contribution to income was not carried over to later years, the SRLY losses also could not be absorbed in a later year unless the member also contributed to the group's taxable income in that year.

The cumulative register, rather than looking to a member's contribution for the year, includes in the limitation computation a member's complete income history while it is a member of a consolidated group. The cumulative register is determined by aggregating a member's net contribution of income in excess of losses absorbed during the entire period the member was in the consolidated group. To the extent that the cumulative register for a member is positive, that member's SRLY net operating losses can be absorbed in a consolidated return year (provided the group otherwise has taxable income) even though the member might not have contributed to taxable income in that year. On the other hand, if the cumulative register is negative, the absorption of losses is precluded even though the member might have contributed to taxable income in that consolidated return year.

Much of the complexity of the SRLY rules results from the subgroup and cumulative register concepts. In fact, the preamble to the proposed SRLY regulations acknowledged that the subgrouping approach was more complex than the fragmentation approach and solicited comments about whether the benefits provided by subgrouping outweigh and justify the additional burdens required, and whether the fragmentation approach should be retained. 1991–1 C.B. 759. No comments received in response to this request advocated the elimination of subgrouping or the cumulative register, and it was ultimately decided that these principles would be retained.

Comments

Comments were received in response to the 1991 proposed regulations, the 1996 temporary regulations and Notice 98–38. Some comments addressed whether the SRLY rules should be retained. Other comments addressed issues about the technical operation of the proposed rules.

All of the comments were evaluated in finalizing these regulations. Several suggestions were adopted while others were not. This preamble describes some of the decisions that were made in finalizing the regulations.

Elimination or Retention of SRLY

The preliminary issue considered in finalizing these regulations was the extent, if any, to which the SRLY rules should be retained. The comments were divided about whether to retain or eliminate SRLY. Some commentators asserted that the amendment to section 382 in 1986 adequately addressed Congressional concerns regarding loss trafficking. Therefore, it was argued, the SRLY rules should be eliminated because they have become superfluous, add unwarranted complexity to the consolidated return system, and are easily avoided. Other commentators asserted that the SRLY rules should be retained because in their view, policing loss trafficking is incidental to SRLY's function of resolving a single entity/separate entity conflict in applying the consolidated return regulations. A third group suggested a middle position by urging the elimination of SRLY only in those circumstances in which the rules of section 382 also apply.

Arguments for Elimination of SRLY

Some commentators urged elimination of the SRLY rules (either in whole or in part) because, in their view, section 382 provides sufficient protection against loss trafficking transactions. They asserted that the rules of section 382 provide greater precision and predictability about the consequences of a transfer of tax losses, and that section 382 promotes neutrality between a buyer and seller of tax benefits in a more efficient and more equitable way than do the SRLY rules.

Section 382 and SRLY overlap to a large extent, and the rules applying sec-

tion 382 to consolidated groups are even more complex than the SRLY rules. Thus, these commentators asserted that requiring a taxpayer to run the SRLY gauntlet in addition to the section 382 gauntlet is unwarranted because any additional revenue that might be gained from retaining a dual limitation is outweighed by the added complexity of the SRLY rules.

These commentators argued that the complexity of the SRLY rules is unwarranted because the impact of the SRLY rules is easily avoided by various "self-help" techniques. For example, taxpayers can contribute income-producing assets or built-in gain assets to the SRLY member to minimize the effect of a SRLY limitation. They also argued that the SRLY rules impose a meaningful limitation only in those cases in which, for regulatory or other reasons, loss corporations cannot be combined with other profitable businesses. Some commentators also argued that the SRLY rules improperly discriminate between stock and asset acquisitions. Other arguments urging the elimination of SRLY asserted that section 382 supercedes the SRLY rules as a Congressionally mandated rule for policing loss trafficking and that the SRLY rules are inconsistent with treating the consolidated group as a single entity.

Arguments for Retention of SRLY

Notwithstanding the substantial area of overlap between section 382 and SRLY, section 382 does not always apply when SRLY does. In fact, most commentators expressed concern about loss trafficking through carryback transactions (to which section 382 does not apply) and acknowledged the need for a rule to police those transactions. Many urged retention of the existing SRLY rules at least for that purpose. Moreover, some commentators speculated that elimination of the SRLY rules would likely present new unforeseen opportunities for trafficking in tax benefits.

Those commentators supporting retention of SRLY argued that the objectives of section 382 and SRLY differ. Section 382, which seeks to prevent loss trafficking, is based on the notion that the rate of loss utilization following a change in ownership should be based on the expected income generated if all of the assets were converted to tax-exempt debt instruments. Accordingly, section 382 permits a fixed amount of income to be used each year to absorb a loss, regardless of the actual income contribution of the loss corporation. Moreover, under section 382 and in the absence of SRLY, the available loss can be used against any member's income. SRLY, on the other hand, makes actual income generation by the SRLY member the determinant of loss usage. Thus, SRLY assures that the loss attributes that arose outside of the consolidated group are not generally available to the other group members.

These commentators noted that the consolidated return system combines single and separate entity treatment. The ability to offset the income of one member with the losses of another member reflects single entity treatment of the consolidated group. But, when a corporation becomes a member of a consolidated group, it retains its separate existence and individual status, its own accounting methods, and its own separate attributes, including its losses that are carried from a separate return year to a consolidated return year. These aspects reflect treatment of each member of a consolidated group as a separate entity. The carryover of losses from separate return years reflects separate entity treatment, while the sharing of losses among the members of a consolidated group reflects single entity treatment. Thus, there is a conflict between single entity and separate entity treatment. Single entity treatment in computing consolidated taxable income is inconsistent with permitting a corporation's losses to straddle consolidated and separate return years when it enters or leaves a consolidated group. These commentators argued that the SRLY rules present a resolution of this conflict and protect the integrity of the consolidated return system by ensuring that attributes arising in a separate return year belong to, and remain with, the SRLY member, and attributes arising in a consolidated return year belong to the group.

Through these rules, according to these commentators, SRLY seeks to provide that the manner and extent to which a corporation's separate tax attributes are absorbed or utilized should not vary based on whether the corporation is inside or outside a consolidated group. Unlike in the case of section 382, the policy objectives underlying these rules do not hinge on whether the ownership of the corporation changes upon its entrance into or departure from the group.

Moreover, commentators urging the retention of SRLY pointed out that the rules of section 381 dictate the circumstances under which one corporation can use the tax attributes of another corporation. In certain reorganizations, section 381 allows the tax attributes of one corporation to be used by another corporation after an acquisition, but in those transactions generally stock basis is also lost. By contrast, in a taxable stock purchase where the stock takes a cost basis and the corporation retains its existence, including its underlying attributes, there is no policy reason for those attributes to be freely available to the purchaser. In essence, these commentators argued, the SRLY limitation prevents the benefits provided by section 381 in certain reorganization transactions from being extended to acquisitions and restructurings that do not involve the commingling of assets in one entity that section 381 transactions generally require. A consolidated group's acquisition of the stock of a corporation should not be treated the same way as an asset acquisition.

Notice 98–38

Notice 98–38 announced that the Treasury and the IRS were considering an approach that would model the SRLY limitation on the mechanism of section 382. One intended advantage of this approach was to reduce complexity in cases of overlap of the SRLY rules with section 382. In those cases, the SRLY limitation would be the same as the section 382 limitation, and consolidated groups would not need to make two computations to determine how much income could be used to absorb a loss. A second intended advantage was to address concerns that the impact of a SRLY limitation can be minimized by stuffing transactions (e.g., transferring income-producing assets to the loss corporation) which could not be used to affect the section 382 limitation.

Although many commentators favor the elimination of a separate SRLY limita-

tion in the case where section 382 also applies, commentators did not favor adoption of the section 382 mechanism in cases where section 382 does not otherwise apply. Commentators argued that imposing a limitation based on section 382 in a case where section 382 would not otherwise apply would be inordinately burdensome. Because (absent an ownership change) the owners of a loss corporation held outside a consolidated group could engage in a stuffing transaction in order to increase that corporation's loss absorption, commentators argued that a SRLY limitation that could not be increased through stuffing transactions would violate the objective of providing that the extent of a corporation's loss absorption should not vary based on whether it is inside or outside a consolidated group.

In light of these concerns, the Treasury and the IRS decided not to impose a SRLY limitation based on the mechanism of section 382.

The Overlap Rule

The Treasury and the IRS believe that limitations on the extent to which a consolidated group can use attributes arising in a separate return limitation year remain necessary. However, the Treasury and the IRS remain concerned about complexity in applying the current SRLY rules, particularly with respect to situations where both the SRLY rules and section 382 apply. As described above, the SRLY limitation is based on the member's (or subgroup's) actual contribution to consolidated taxable income. The section 382 limitation is based on the expected income generation of the member (or subgroup) determined with reference to its value on the change date. On balance, the Treasury and the IRS believe that the simultaneous or proximate imposition of a section 382 limitation reasonably approximates a corresponding SRLY limitation. Accordingly, these regulations generally eliminate the SRLY limitation in circumstances in which its application overlaps with that of section 382.

In the majority of cases, the date on which a corporation becomes a member of a consolidated group (and thus subject to the SRLY rules) is also a "change date" as defined in section 382(j), determined as a result of an ownership change as defined in section 382(g). In this situation, under the temporary regulations, taxpayers must calculate two separate limitations for loss carryovers — the SRLY limitation and the section 382 limitation. The final regulations provide an overlap rule which eliminates the application of the SRLY rules in this situation. As a result, the final regulations remove the burden of determining two limitations, and simplify the loss limitation rules applicable to consolidated groups in most instances in which both the SRLY and the section 382 limitations would otherwise arise.

To address situations in which not all of an acquisition occurs simultaneously, the overlap rule also applies if the acquisition results in a corporation joining the consolidated group on a date other than the "change date", provided the transactions are separated by no more than six months. Additional rules have been included to prevent the inappropriate operation of the overlap rule in certain cases involving the acquisition of multiple corporations.

Net Operating Losses

Generally, to qualify for the net operating loss overlap rule, a corporation must become a member of a consolidated group (a SRLY event) within six months of the change date of an ownership change that gives rise to a section 382(a) limitation with respect to that carryover (a section 382 event). For net operating losses, an overlap also will generally include situations in which a net operating loss arises in the maximum six month period after the section 382 event but before the SRLY event.

For example, if a section 382 event occurs on April 1 and a SRLY event occurs on September 1, any losses that arise between April 1 and September 1 would not be subject to a section 382 limitation because they would be allocable to the post-change period. However, in the absence of the overlap rule, those losses would be subject to a SRLY limitation. The overlap rule of the final regulations eliminates the application of SRLY to those post-change losses. In cases of an acquisition of a single corporation, the elimination of SRLY has been determined to be an appropriate result and is a trade-off to promote simplicity in the consolidated return regulations.

The final regulations provide special overlap rules for subgroups. In general, the overlap rule applies to the subgroup and not separately to the members of the subgroup. However, the overlap rule does not apply unless the SRLY subgroup is coextensive with the section 382 loss subgroup. This rule is necessary because a section 382 subgroup limitation that is computed with respect to the expected income generation of a group of corporations does not reasonably approximate a limitation that would be based on the actual contribution to consolidated taxable income by a smaller number of corporations. In the reverse case, where the SRLY subgroup is larger than any corresponding section 382 loss subgroup or single new loss member, and particularly with respect to built-in losses, it is unclear in certain circumstances how the overlap rule could be applied. To address such circumstances in which a SRLY subgroup would otherwise be larger than the corresponding section 382 subgroup or single new loss member, the accompanying final regulations relating to the application of sections 382 and 383 provide for an election effectively to expand a newly-formed section 382 subgroup to conform with a SRLY subgroup.

For example, assume that the S consolidated group (composed entirely of S and T) has a $200 consolidated net operating loss, of which $100 is attributable to S and $100 is attributable to T. If the M group acquires the S group, S and T compose both a SRLY subgroup as well as a section 382 loss subgroup. Because the subgroups are coextensive, the overlap rule applies to eliminate the application of SRLY in the M group for the $200 consolidated net operating loss.

The overlap rule will not apply, however, if all the corporations included in a section 382 loss subgroup are not also included in a SRLY subgroup. For example, in Year 1, T joins the S group with a net operating loss carryover in a transaction that is not subject to section 382, and T does not subsequently have an ownership change. Under §1.1502–96 (relating to the end of separate tracking), after five years, T's net operating loss becomes an attribute of the S group (also referred to as

a “fold-in”) for section 382 purposes. If the P group later acquires S in a transaction to which section 382 applies, the section 382 loss subgroup with respect to the T loss would include S and T, but for SRLY purposes there would be no subgroup. In this situation, the overlap rule would not apply, and the limitations under both SRLY and section 382 would continue to apply.

To preserve the effect of the elimination of SRLY under the overlap rule as corporations move from group to group, the final regulations also provide a special rule expanding the definition of SRLY subgroups. Under this rule, a SRLY subgroup includes a member carrying over a loss that was subject to the overlap rule in a former group, and all members of that former group who become a member of the current group at the same time as the loss member. The effect of this rule is to increase the number of circumstances in which SRLY subgroups and section 382 subgroups will be coextensive as corporations move from group to group. However, SRLY and section 382 subgroups may not be coextensive with respect to losses that were carried into a former group in a transaction to which the overlap rule does not apply. Subgroups may not be coextensive, as demonstrated above, if for purposes of section 382, such losses “fold-in” to the former group by virtue of an ownership change occurring more than six months after the SRLY event or because the loss member remains a member of the former group for at least five years.

Operating Rules

If the section 382 event occurs on the same date as the SRLY event or precedes the SRLY event, the overlap rule, and therefore the elimination of SRLY, is applicable to the tax year that includes the SRLY event. If the SRLY event precedes the section 382 event, the elimination of SRLY is delayed until the first tax year that begins after the section 382 event. The delay is necessary to ensure that an adequate limitation is always in effect for a net operating loss carryover.

For example, for a calendar year consolidated group, if the SRLY event occurs December 1, Year 1, but the section 382 event occurs on April 1, Year 2, it is necessary to maintain the application of the SRLY rules between such dates because otherwise no limitation would be applicable and the separate attributes could be freely absorbed during that period.

Built-in Losses

The overlap rule for built-in losses is very similar to the overlap rule for net operating losses. Generally, to qualify for the built-in loss overlap rule, a SRLY event must occur within six months of the change date of an ownership change that gives rise to a section 382(a) limitation that would apply to recognized built-in losses (a section 382 event). However, the overlap rule does not apply (even with respect to assets held on the date of the section 382 event) if assets are transferred to a corporation after the section 382 event and before the SRLY event that exceed the de minimis threshold of section 382(h). In that case, both the SRLY rules and the section 382 rules will apply. Even after the application of the overlap rule, the SRLY rules for built-in losses apply to asset acquisitions by an acquired corporation that occur after the latter or the SRLY event or section 382 event.

Special Subgroup Rule for Built-in Losses

The temporary regulations provide that, for purposes of built-in losses, a SRLY subgroup consists of those members that have been continuously affiliated for the 60-month period ending immediately before they become members of the group in which the loss is recognized. Generally, the final regulations maintain the subgroup rule provided by the temporary regulations. The final regulations, however, modify the subgroup rules to take account of the overlap rule. These modifications, in effect, conform the SRLY subgroup rules to adopt principles contained in §§1.1502–91 through 1.1502–98 (regarding the application of section 382 to consolidated groups) where necessary to preserve the effect of an overlap transaction in a former group and to increase the number of SRLY and section 382 subgroups that are coextensive and eligible for future operation of the overlap rule as corporations move from group to group.

The final regulations provide that after a corporation joins a group in an overlap transaction, it is deemed to have been affiliated with the common parent of the acquiring group for 60 consecutive months. Those corporations that join the group in the same transaction, but that were not part of a subgroup eligible for the overlap rule, begin measuring the period of their affiliation immediately after joining the group, notwithstanding their actual affiliation history. This rule may prevent some corporations from subsequently qualifying as a SRLY subgroup, notwithstanding their actual affiliation history. For example, assume that after four years of affiliation, S and T join the P group without any net operating loss carryovers. S, which has a net unrealized built-in loss, and T, which has a net unrealized built-in gain, would not qualify as a SRLY subgroup with respect to their built-in items because they do not have the requisite affiliation history. Therefore, S and T are tested separately under section 382 and §1.1502–15. The acquisition results in S becoming subject to section 382 (but owing to the overlap rule, not to the limitation contained in §1.1502–15(a)). T is not subject to either. Because S joined the P group in a transaction subject to the overlap rule, it is deemed to have been affiliated with P for 60 consecutive months. T, however, is required to begin measuring its affiliation with P and S from the date it joined the group, notwithstanding its historic affiliation with S.

Other Substantive Changes

Predecessors and Successors
Material Difference Requirement

The temporary regulations provide that a reference to a corporation or member also includes, as the context may require, a reference to a successor or predecessor. See, §1.1502–15T(e) and §1.1502–21T(f). The definition of predecessor is provided in §1.1502–1(f)(4). In general, a predecessor is any transferor of assets in a section 381(a) transaction. A predecessor also includes any transferor of assets in a transaction in which the basis of assets to the transferee (successor) is determined by reference to the transferor’s basis, but only if there is a “material difference” between the basis and the value of assets. Thus the application of the predecessor rule to a section 351 transaction is dependent upon the specific assets transferred, and consequently a transferor in a section 351 transaction might not

qualify as a predecessor. Also, in the case of such a section 351 transaction, the temporary regulations provided that there be a maximum of one predecessor to, or successor of, any member.

Commentators objected to the "material difference" requirement and suggested that a section 351 transferee should not be excluded from successor status solely because there was no material difference between the basis and value of the assets transferred. The final regulations eliminate both the material difference and the single predecessor-successor requirements.

CNOL Carrybacks

Section 1.1502–21T(b)(2)(B) of the temporary regulations provides an offspring rule which generally permits the common parent of a group to carryback a consolidated net operating loss (CNOL) attributable to a member that did not exist in the year to which the loss is carried, provided that the member has been a member of the group continuously since its organization. In that section, there is also a reference to the application of the predecessor and successor rule of §1.1502–21T(f), which states that a reference to a member also includes references to a predecessor of the member, as the context may require.

Commentators were concerned that the combination of the predecessor and successor rule would deny any carryback in the case of a merger under section 368(a)(1)(A) and (a)(2)(D). For example, assume that P, the common parent of a consolidated group, forms Newco in Year 2 for the sole purpose of acquiring T, in a merger with and into Newco. In Year 3, there is a CNOL all of which is attributable to Newco. Newco appears to be within the scope of the offspring rule, and therefore a carryback to P's Year 1 consolidated return, a year before Newco's existence, would be permitted. However, because the merger is a transaction to which section 381(a) applies, Newco is also a successor to T. Under this analysis, Newco would not be considered to have been a member of the P group continuously since its organization, so a carryback to the P group's consolidated return year would not be permitted. Moreover, Newco would not be permitted to carryback the loss to any year of T. Thus, no carryback of Newco's loss would be permitted.

The Treasury and the IRS believe that the denial of any carryback in this situation is inappropriate. In general, a newly-formed group member should be permitted to carry back its contribution to the consolidated net operating loss, whether or not it is a successor to a corporation that was acquired by the group. Moreover, the Treasury and the IRS believe that rules providing for a carryback within — rather than outside — the group would be more administrable than rules requiring taxpayers to trace the assets of a newly-formed member to determine whether such corporation's contribution to the consolidated net operating loss should be carried back to the pre-consolidation years of an acquired corporation or back within the group. The Treasury and the IRS also considered whether to provide that all consolidated net operating losses should be carried back within the group, even if attributable to a corporation that was itself acquired from outside the group. Whether or not such a rule is appropriate, it was determined that such a change should not be adopted in final regulations. Accordingly, the final regulations provide that the offspring rule applies regardless of whether the newly-formed member is a successor to any other corporation.

Successor's Income

Section 1.1502–21T(f)(2) of the temporary regulations provides, "Except as the Commissioner may otherwise determine, any increase in the taxable income of a SRLY subgroup that is attributable to a successor is disregarded unless the successor acquires substantially all of the assets and liabilities of its predecessor and the predecessor ceases to exist." The rule was intended to prevent the subgroup from inappropriately affecting the determination of its taxable income either by removing assets that would generate losses or by bringing into the subgroup income generated by members outside the subgroup.

Some commentators stated that they did not understand whether the rule was intended to require the subgroup to disregard all income of the successor, or only that income of the successor in excess of that generated by the transferred assets. In the event that all the successor's income is disregarded, commentators argued that the rule produced unduly harsh results. A particularly sympathetic case is a divisive section 351 transaction. For example, if T, a member of a SRLY subgroup, formed T1, by contributing to it one of its businesses, and T1 produced net operating losses, those losses would be included in determining the taxable income of the subgroup. On the other hand, if T1 produced taxable income, that income would not be included in the subgroup's taxable income. If no transfer to T1 had occurred, and the business had remained in T, all of its income or loss, as the case may be, would be included in determining the subgroup's taxable income.

The Treasury and the IRS have determined that a broad rule disregarding all income contributed by the successor is necessary to avoid an unadministrable requirement that the successor's income be traced to particular assets, but that the rule should only be applied in more limited circumstances. Thus, the final regulations provide that the net positive income attributable to the successor generally is disregarded, but provide four exceptions to this rule: (A) the successor acquires substantially all of the assets and liabilities of its predecessor, and the predecessor ceases to exist; (B) the successor became a member of the SRLY subgroup at the time the subgroup was formed (e.g., the successor was organized before it and its affiliates joined the current group and thus qualifies in its own right as a subgroup member); (C) 100 percent of the stock of the successor is owned directly by corporations that were members of the SRLY subgroup when the subgroup was formed; or (D) the Commissioner determines otherwise. The IRS might, for example, publish a revenue ruling or other guidance expanding the list of exceptions if it is later determined that other circumstances should be excluded from the general rule. It is also anticipated that through the letter ruling process, the IRS will evaluate individual cases upon request and determine whether income attributable to a successor will be included in determining the subgroup's taxable income. See also §1.1502–21(c)(2)(iv) of the regulations (an anti-abuse rule deny-

ing SRLY subgroup treatment in certain circumstances.)

Built-in Losses
Non-Corporate Transferors

Section 1.1502–15T(a) of the temporary regulations provides that solely for the purpose of determining the amount of, and the extent to which, a built-in loss is limited by the SRLY rules for the year in which it is recognized, a built-in loss is treated as a hypothetical net operating loss carryover or net capital loss arising in a SRLY, instead of as a deduction or loss in the year recognized.

Some commentators thought the rule was anomalous as applied to transfers of built-in loss assets by individuals. In their view, because a SRLY is defined only with respect to corporations (see §1.1502–1(f)), it would be inappropriate to view a corporate transferee as a successor to a non-corporate transferor. Other commentators asserted that because the built-in loss concept is a subset of the SRLY limitations, the built-in loss rules should not apply to transfers by an individual or other non-corporate transferor to a member of a consolidated group in a section 351 transaction.

The temporary regulation does not base the determination of whether a corporation has built-in losses on any application of the predecessor and successor rule. If an asset enters the group with a built-in loss, in general, the temporary regulation deems the built-in loss to have arisen in a SRLY without regard to whether the asset was owned by a corporation when the built-in loss arose. Moreover, §1.1502–15T(b)(2)(i) provides that in the case of an asset acquisition by a group, the assets and liabilities acquired directly from the same transferor pursuant to the same plan are treated as the assets and liabilities of a corporation that becomes a member of the group on the date of the acquisition. That corporation would generally be subject to the SRLY built-in loss rules when it becomes a member of the consolidated group. The Treasury and the IRS continue to believe that a separate tax attribute arising outside the consolidated group should not be freely absorbed within the group, regardless of where that separate attribute arose. Accordingly, these final regulations reaffirm that a built-in loss asset transferred to a group by a non-corporate transferor is subject to the SRLY rules. An example explains that for purposes of applying the SRLY limitation to that built-in loss, all of the items contributed by the acquiring member (and not just items attributable to that asset) to consolidated taxable income are taken into account.

Lonely Parent

Under §1.1502–15T of the temporary regulations, the SRLY limitation on recognized built-in losses applies to a loss recognized by the group on an asset the common parent held prior to the formation of a group. In contrast, net operating loss carryovers of a corporation that becomes the common parent of a consolidated group are not subject to a SRLY limitation within the group under the so-called "lonely parent" rule (see §1.1502–1(f)(2)(i)).

The final regulations conform the built-in loss rules to the net operating loss rules as applied in conjunction with the lonely parent rule. Therefore, a loss recognized by any member of the group on an asset that was held by the corporation that becomes the common parent when the group is formed is not subject to the SRLY rules. However, a built-in loss asset acquired by the common parent after the formation of the group remains subject to the SRLY limitation. An anti-abuse rule is also provided to apply the SRLY limitation to built-in loss assets transferred to a corporation prior to and in anticipation of the corporation becoming the common parent of a group.

For example, in Year 1, P, a stand alone corporation holds Asset 1, a built-in loss asset. In Year 3, P forms S but retains Asset 1. In Year 4, P sells Asset 1, recognizing a loss. Section 1.1502–15(f) of the final regulations provides that the loss is not subject to the SRLY limitation. Similarly if P transferred Asset 1 with an unrealized built-in loss to S, the SRLY limitation on built-in losses would not apply if S sold Asset 1 and recognized the loss. However if, after the formation of the P/S group, P acquired an asset with an unrealized built-in loss and sold the asset, recognizing that loss during the recognition period, a SRLY limitation would apply with respect to that loss.

Split Election Rule

Section 1.1502–21T(b)(3)(i) of the temporary regulations permits a consolidated group to waive the entire carryback period provided by section 172. This irrevocable election is not available on a member by member basis, but rather requires that the common parent waive the carryback period for all members of the group.

Some commentators suggested that the election be permitted on a member-by-member basis. The commentators expressed concern that requiring the whole group to waive the carryback period makes it difficult for sellers and purchasers to negotiate who gets the benefit of a post-acquisition loss. Because section 172 generally requires a carryback to the earliest year, absent the purchaser's waiver of the carryback, a seller could be required to disclose confidential tax information to the purchaser relating to the ability to use the loss carryback. In situations where such disclosure is a concern, an election to waive the loss carryback, available on a member by member basis, could ensure the separation of a particular purchaser and seller without requiring the group to waive the remaining amount of the consolidated net operating loss carryback.

The final regulations permit taxpayers to waive, with respect to all consolidated net operating losses attributable to a member, the portion of the carryback period for which the corporation was a member of another group. If an election is made for any member, all members acquired from the same group, in the same transaction, are required to make the election. The election must be made on the timely filed original return for the year of the acquisition.

Absorption of Losses

Section 1.1502–21T(b)(1) provides general rules concerning the absorption of losses within a consolidated group. Although the rules refer to section 382(l)(2)(B), commentators stated that the absorption rules were ambiguous with respect to establishing the priority of absorption of multiple losses carried from the same taxable year if only a portion of the losses were subject to limitation under

section 382. The final regulations make clear that the rule of section 382(l)(2)(B) applies, and that losses limited by section 382 are absorbed before losses from the same taxable year that are not subject to a section 382 limitation, regardless of whether such losses are attributable to the same member.

A comment was also received requesting guidance on how to determine the amount of a subgroup member's net operating loss carryover that was absorbed so that it can determine how much of the loss it retains when it leaves the group. In response to this comment, the final regulations provide that within a subgroup, losses are absorbed on a pro rata basis. Thus, when a subgroup member leaves the group, its net operating loss carryover is treated as having been absorbed on a pro rata basis, determined by comparing its initial net operating loss carryover and the subgroup's initial net operating loss carryover.

Dates of Applicability

The final regulations generally are applicable for taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However, there are several special effective dates, including an effective date which addresses transitional issues relating to the adoption of the rule eliminating SRLY in the event of an overlap with section 382. Generally, if a particular attribute would not have been subject to a SRLY limitation as of June 25, 1999 if these final regulations had always been in effect, and the overlap transaction occurred after the effective date of section 382 as amended by the 1986 Tax Reform Act, then the existing SRLY limitation will not apply in taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999 (but will not be eliminated retroactively with respect to earlier taxable years).

If an existing SRLY limitation for which the cumulative register began in a taxable year prior to a taxable year for which the due date (without extensions) of the consolidated return is after June 25, 1999 would not be eliminated by the overlap rule, that SRLY limitation continues to be applied without regard to the changes applicable to the definition of SRLY subgroups (so that a member or SRLY subgroup is not forced to alter the application of a SRLY limitation in midstream). However, when corporations enter a group in a new SRLY event occurring in a taxable year for which the due date (without extensions) of the consolidated return is after June 25, 1999, the regulations apply (with respect to any overlap transactions occurring after the effective date of section 382 as amended by the 1986 Tax Reform Act) as if the final regulations had always been in effect.

Thus, for example, and assuming that all corporations are on a calendar taxable year, if a corporation S joins the P group in an overlap transaction in 1996, and the first year for which this final regulation is effective is 1999, then any losses carried by S into the P group are subject to a SRLY limitation in 1996, 1997 and 1998. However, the losses are no longer subject to a SRLY limitation within the P group starting in 1999.

If, in the above example, the M group had acquired both P and S on January 1, 1998 in a non-overlap transaction, and S carried into the M group its losses arising before it joined the P group, then, in 1998, under the temporary regulations as then in effect, those S losses would have been subject to a SRLY limitation computed with reference only to S's cumulative register. Under the special transition rule, the new regulations would not operate in 1999 or thereafter to cause S and P to constitute a SRLY subgroup in the M group with respect to those S losses, even though P and S would otherwise qualify as a SRLY subgroup with respect to those losses under the new rules. However, if the X group acquires both P and S from M in or after 1999, P and S would constitute a SRLY subgroup with respect to those S loss carryovers.

Need for Immediate Guidance

Because the temporary regulations are not applicable for taxable years ending after June 26, 1999, it is necessary to implement these final regulations without delay to ensure continuity of treatment of certain attributes and to ensure that there is no period within which the treatment of such attributes is inconsistent with the temporary regulations and these final regulations. See section 7805(e)(2). Accordingly, it is impracticable and contrary to the public interest to issue this Treasury decision subject to the effective date limitation of section 553(d) of title 5 of the United States Code (if applicable).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect corporations filing consolidated federal income tax returns that have carryover or carryback of certain losses from separate return limitation years. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have loss carryovers or carrybacks that are subject to the separate return limitation year rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was sent to the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Jeffrey L. Vogel of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the Treasury and the IRS participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 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 sections 1.1502–15T, 1.1502–21T, 1.1502–22T, and 1.1502–23T and adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.1502–12 also issued under 26 U.S.C. 1502.* * *

Section 1.1502–15 also issued under 26 U.S.C. 1502.* * *
Section 1.1502–22 also issued under 26 U.S.C. 1502.
Section 1.1502–23 also issued under 26 U.S.C. 1502.* * *

Par. 2. In the list below, for each section indicated in the left column, remove the wording indicated in the middle column, and add the wording indicated in the right column.

Affected Section	*Remove*	*Add*
1.469–1(h)(2)	1.1502–21T (net operating losses (temporary)), and 1.1502–22T (consolidated net capital gain and loss (temporary))	1.1502–21 (net operating losses), and 1.1502–22 (consolidated net capital gain and loss)
1.597–2(c)(5), first sentence	1.1502–15T, 1.1502–21T, and 1.1502–22T	1.1502–15, 1.1502–21, and 1.1502–22
1.597–2(c)(5), second sentence	1.1502–15T, 1.1502–21T or 1.1502–22T	1.1502–15, 1.1502–21 or 1.1502–22
1.597–4(g)(3), fifth sentence	1.1502–15T, 1.1502–21T and 1.1502–22T	1.1502–15, 1.1502–21 and 1.1502–22
1.597–4(g)(3), sixth sentence	1.1502–15T, 1.1502–21T, or 1.1502–22T	1.1502–15, 1.1502–21, or 1.1502–22
1.904(f)–3(a), first sentence	(or §1.1502–21T(b)	(or §1.1502–21(b)
1.904(f)–3(b), first sentence	(or §1.1502–22T(b)	(or §1.1502–22(b)
1.1502–2(h)	1.1502–22T)(or, for consolidated return years to which §1.1502–22T	1.1502–22)(or, for consolidated return years to which §1.1502–22
1.1502–3T(c)(2)(iii), first sentence	1.1502–21T(c)(2)	1.1502–21(c)(2)
1.1502–3T(c)(2)(iii), second sentence	1.1502–21T(f)	1.1502–21(f)
1.1502–9(a), seventh sentence	§1.1502–21T(b)(2)	1.1502–21(b)(2)
1.1502–9(a), eighth sentence	1.1502–21T(b)(1)	1.1502–21(b)(1)
1.1502–11(a)(2)	§1.1502–21T	1.1502–21
1.1502–11(a)(3)	§1.1502–22T	1.1502–22
1.1502–11(a)(4)	§1.1502–23T	1.1502–23
1.1502–11(b)(2)(iii) *Example 1*(c), last sentence	1.1502–21T	1.1502–21
1.1502–11(b)(2)(iii) *Example 2*(d), last sentence	1.1502–21T and 1.1502–22T	1.1502–21 and 1.1502–22
1.1502–12(b)	1.1502–15T	1.1502–15
1.1502–13(c)(7)(ii) *Example 10*(d), first and second sentences	S's net operating loss carryovers are subject to the separate return limitation year (SRLY) rules. See §1.1502–21T(c)	P's acquisition of S is not subject to the overlap rule of §1.1502–21(g), and S's net operating loss carryovers are subject to the separate return limitation year (SRLY) rules. See §1.1502–21(c)
1.1502–13(g)(5) *Example 4*(b), fourth sentence	1.1502–15T (or §1.1502–15A, as appropriate) (limitations on the absorption of built in losses)	1.1502–15 (as appropriate)

1.1502–13(h)(2) *Example 1*(a), second sentence	1.1502–21T(c)	1.1502–21(c)
1.1502–13(h)(2) *Example 1*(b), first sentence	1.1502–21T(c)	1.1502–21(c)
1.1502–13(h)(2) *Example 2*(a), last sentence	1.1502–15T	1.1502–15
1.1502–13(h)(2) *Example 2*(b), second sentence	1.1502–22T	1.1502–22
1.1502–20(c)(4) *Example 7*(iii), first sentence	1.1502–21T	1.1502–21
1.1502–20(g)(3) *Example 1*(i), second sentence	1.1502–21T	1.1502–21
1.1502–20(g)(3) *Example 2*(i), third sentence	§1.1502–21A or 1.1502–21T	1.1502–21A or 1.1502–21
1.1502–23A(a), third sentence	1.1502–21T(c) and 1.1502–22T(c), as provided in 1.1502–15T(a)	(1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999 and 1.1502–22T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as provided in 1.1502–15T(a) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999) or (1.1502–21(c) and 1.1502–22(c), as provided in 1.1502–15(a), as applicable))
1.1502–23A(b), first sentence	1.1502–21T(g)	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–23A(b), second sentence	1.1502–21T(g) for effective dates of that section	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable for effective dates of these sections
1.1502–26(a)(1) concluding text	1.1502–21T(e)	1.1502–21(e)
1.1502–32(b)(5)(ii) *Example 2*(b), third sentence	1.1502–21T(b)	1.1502–21(b)
1.1502–41A(c), first sentence	1.1502–21T(g)	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–41A(c), second sentence	1.1502–21T(g) for effective dates of that section	1.1502–21(h) or 1.1502–21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable for effective dates of these sections

1.1502–42(f)(4)(i)(A)	1.1502–21T(b)	1.1502–21(b)
1.1502–43(b)(2)(iv)	1.1502–21T(a)	1.1502–21(a)
1.1502–43(b)(2)(v)	1.1502–22T(a)	1.1502–22(a)
1.1502–43(b)(2)(vi)(A)	1.1502–22T(a)	1.1502–22(a)
1.1502–43(b)(2)(vii)	1.1502–22T(b)	1.1502–22(b)
1.1502–43(b)(2)(viii)	1.1502–15T) and 1.1502–15T (SRLY limitation on built–in losses (temporary))	1.1502–15) and 1.1502–15
1.1502–44(b)(2)	§1.1502–21T	1.1502–21
1.1502–44(b)(3)	§1.1502–22T	1.1502–22
1.1502–47(h)(2)(i)	1.1502–21T	1.1502–21
1.1502–47(h)(2)(ii)	1.1502–21T(e)	1.1502–21(e)
1.1502–47(h)(2)(iii),first sentence	1.1502–21T	1.1502–21
1.1502–47(h)(2)(iv), first sentence	1.1502–21T	1.1502–21
1.1502–47(h)(3)(iii)	1.1502–21T(c)	1.1502–21(c)
1.1502–47(h)(4)(i), first sentence	1.1502–22T	1.1502–22
1.1502–47(h)(4)(i), second sentence	1.1502–22T	1.1502–22
1.1502–47(h)(4)(ii), first sentence	1.1502–22T	1.1502–22
1.1502–47(h)(4)(ii), first sentence	1.1502–21T	1.1502–21
1.1502–47(h)(4)(iii)	1.1502–22T(b)	1.1502–22(b)
1.1502–47(k)(5) introductory text	1.1502–22T	1.1502–22
1.1502–47(l)(3)(i), second sentence	1.1502–21T	1.1502–21
1.1502–47(m)(2)(ii), first sentence	1.1502–21T	1.1502–21
1.1502–47(m)(2)(ii), first sentence	1.1502–22T	1.1502–22
1.1502–47(m)(3)(i), first sentence	1.1502–21T and 1.1502–22T	1.1502–21 and 1.1502–22
1.1502–47(m)(3)(vi)(A), second sentence	1.1502–21T(b) or 1.1502–79A(a)(3) (as appropriate)	1.1502–21(b))
1.1502–47(m)(3)(vi)(A), second sentence	§1.1502–21T(b) or 1.1502–79A(a)(3) (as appropriate)	1.1502–21(b)
1.1502–47(m)(3)(vii)(A)	1.1502–21A(b)(3)(ii)	1.1502–21A(b)(3)(ii) or 1.1502–21(b)
1.1502–47(m)(3)(ix), last sentence	1.1502–15T	1.1502–15
1.1502–47(q), last sentence	1.1502–21T	1.1502–21
1.1502–55T(h)(4)(iii) (B)(*4*), first sentence	1.1502–21T(c)(2)	1.1502–21(c)(2)

1.1502–55T(h)(4)(iii)(B)(*4*), second sentence	1.1502–21T(f)	1.1502–21(f)
1.1502–78(a), first sentence	1.1502–21T(b), 1.1502–22T(b)	1.1502–21(b), 1.1502–22(b)
1.1502–79(a), second sentence	1.1502–21T(b)	1.1502–21(b)
1.1502–79(b), second sentence	1.1502–22T(b)	1.1502–22(b)
1.1502–79(c)(1)	1.1502–21T(b)	1.1502–21(b)
1.1502–79(d)(1)	1.1502–21T(b)	1.1502–21(b)
1.1502–79(e)(1)	1.1502–21T(b)	1.1502–21(b)
1.1502–91T(a)(2), last sentence	1.1502–21T(a)	1.1502–21(a) or 1.1502–21T(a) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(c)(3) *Example* (b), first sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(d)(1)(iii)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(d)(6) *Example 1*(a), fourth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(d)(6) *Example 2*(a), fourth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–91T(f)(2) *Example* (a), last sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–92T(b)(2) *Example 3*(a), fourth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–93T(e)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–94T(a)(1)(i)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable

1.1502–94T(b)(4) *Example 1*(c), last sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–95T(b)(1)(i)	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–95T(b)(4) *Example 1*(a), sixth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–95T(c)(7) *Example 1*(a), fifth sentence	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(a)(1) introductory text sixth sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(a)(2), first sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(a)(5), first sentence	1.1502–15T and 1.1502–21T	1.1502–15 and 1.1502–21 (or §1.1502–15T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999 and 1.1502–21T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable)
1.1502–96T(b)(2)(ii)(A)	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–96T(b)(2)(ii)(B)	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–99T(c)(2)(i), fourth sentence	1.1502–21T(c)	1.1502–21(c) or 1.1502–21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–99T(c)(2)(ii)	1.1502–21T(b)	1.1502–21(b) or 1.1502–21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502–100(c)(2)	§§1.1502–21A or 1.1502–21T	§1.1502–21A or 1.1502–21

1.1503–2(d)(2)(i), last sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(d)(2)(ii), last sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(d)(4) *Example 1* (iv), last sentence	1.1502–22T(c)	1.1502–22(c)
1.1503–2(g)(2)(vii)(B)(*1*), second sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(g)(2)(vii)(B)(*2*), first sentence	§1.1502–21A(c) or 1.1502-21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(g)(2)(vii)(G) *Example 1*, ninth sentence	§1.1502–21A(c) or 1.1502–21T(c)	1.1502–21A(c) or 1.1502–21(c)
1.1503–2(g)(2)(vii)(G) *Example 2*, last sentence	§§1.1502–21A(c) or 1.1502–21T(c)	§1.1502–21A(c) or 1.1502–21(c)
1.1503–2(h)(3), second sentence	§§1.1502–21A(c) or 1.1502–21T(c))	(§1.1502–21A(c) or 1.1502–21(c)
1.1503–2A(f)(1)(i) introductory text	1.1502–21T(b)	1.1502–79A(a)(3)
1.1503–2A(f)(1)(i)(C)	1.1502–22T(b)	1.1502–22
1.1503–2A(f)(2)(i), fourth sentence	1.1502–21T(c)	1.1502–21(c)
1.1503–2A(f)(2)(ii), last sentence	1.1502–21T(c)	1.1502–21(c)
301.6402–7(g)(2)(iii), first sentence	§1.1502–21T(b)	1.1502–21(b)
301.6402–7(g)(3) *Example 2*, second sentence	1.1502–21T	1.1502–21
301.6402–7(g)(3) *Example 2*, third sentence	1.1502–21T(c)	1.1502–21(c)
301.6402–7(h)(1)(ii) *Example* (b), first sentence	1.1502–21T(b) and 1.1502–22T(b)	1.1502–21(b) and 1.1502–22(b)

Par. 3. Section 1.1502–1 is amended by revising paragraph (f)(4) to read as follows:

§1.1502–1 Definitions.

* * * * *

(f) * * *

(4) *Predecessor and successors.* The term *predecessor* means a transferor or distributor of assets to a member (the successor) in a transaction-

(i) To which section 381(a) applies; or

(ii) That occurs on or after January 1, 1997, in which the successor's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the assets of the transferor or distributor, but in the case of a transaction that occurs before June 25, 1999, only if the amount by which basis differs from value, in the aggregate, is material. For a transaction that occurs before June 25, 1999, only one member may be considered a predecessor to or a successor of one other member.

* * * * *

Par. 4. Section 1.1502–15 is added to read as follows:

§1.1502–15 SRLY limitation on built-in losses.

(a) *SRLY limitation.* Except as provided in paragraph (f) of this section (relating to built-in losses of the common parent) and paragraph (g) of this section (relating to an overlap with section 382), built-in losses are subject to the SRLY limitation under §§1.1502–21(c) and 1.1502–22(c) (including applicable subgroup principles). Built-in losses are treated as deductions or losses in the year recognized, except for the purpose of determining the amount of, and the extent to which the built-in loss is limited by, the SRLY limitation for the year in which it is recognized. Solely for such purpose, a built-in loss is treated as a hypothetical net operating loss carryover or net capital loss carryover arising in a SRLY, instead of as a deduction or loss in the year recognized. To the extent that a built-in loss is allowed as a deduction under this section in the year it is recognized, it offsets any consolidated taxable income for the year before

any loss carryovers or carrybacks are allowed as a deduction. To the extent not so allowed, it is treated as a separate net operating loss or net capital loss carryover or carryback arising in the year of recognition and, under §1.1502–21(c) or 1.1502–22(c), the year of recognition is treated as a SRLY.

(b) *Built-in losses*—(1) *Defined.* If a corporation has a net unrealized built-in loss under section 382(h)(3) (as modified by this section) on the day it becomes a member of the group (whether or not the group is a consolidated group), its deductions and losses are built-in losses under this section to the extent they are treated as recognized built-in losses under section 382(h)(2)(B) (as modified by this section). This paragraph (b) generally applies separately with respect to each member, but see paragraph (c) of this section for circumstances in which it is applied on a subgroup basis.

(2) *Operating rules.* Solely for purposes of applying paragraph (b)(1) of this section, the principles of §1.1502–94(c) apply with appropriate adjustments, including the following:

(i) *Stock acquisition.* A corporation is treated as having an ownership change under section 382(g) on the day the corporation becomes a member of a group, and no other events (e.g., a subsequent ownership change under section 382(g) while it is a member) are treated as causing an ownership change.

(ii) *Asset acquisition.* In the case of an asset acquisition by a group, the assets and liabilities acquired directly from the same transferor (whether corporate or non-corporate, foreign or domestic) pursuant to the same plan are treated as the assets and liabilities of a corporation that becomes a member of the group (and has an ownership change) on the date of the acquisition.

(iii) *Recognized built-in gain or loss.* A loss that is included in the determination of net unrealized built-in gain or loss and that is recognized but disallowed or deferred (e.g., under §1.1502–20 or section 267) is not treated as a built-in loss unless and until the loss would be allowed during the recognition period without regard to the application of this section. Section 382(h)(1)(B)(ii) does not apply to the extent it limits the amount of recognized built-in loss that may be treated as a pre-change loss to the amount of the net unrealized built-in loss.

(c) *Built-in losses of subgroups*—(1) *In general.* In the case of a subgroup, the principles of paragraph (b) of this section apply to the subgroup, and not separately to its members. Thus, the net unrealized built-in loss and recognized built-in loss for purposes of paragraph (b) of this section are based on the aggregate amounts for each member of the subgroup.

(2) *Members of subgroups.* A subgroup is composed of those members that have been continuously affiliated with each other for the 60 consecutive month period ending immediately before they become members of the group in which the loss is recognized. A member remains a member of the subgroup until it ceases to be affiliated with the loss member. For this purpose, the principles of §1.1502–21(c)(2)(iv) through (vi) apply with appropriate adjustments.

(3) *Coordination of 60 month affiliation requirement with the overlap rule.* If one or more corporations become members of a group and are included in the determination of a net unrealized built-in loss that is subject to the overlap rule described in paragraph (g)(1) of this section, then for purposes of paragraph (c)(2) of this section, such corporations that become members of the group are treated as having been affiliated for 60 consecutive months with the common parent of the group and are also treated as having been affiliated with any other members who have been affiliated or are treated as having been affiliated with the common parent at such time. The corporations are treated as having been affiliated with such other members for the same period of time that those members have been affiliated or are treated as having been affiliated with the common parent. If two or more corporations become members of the group at the same time, but this paragraph (c)(3) does not apply to every such corporation, then immediately after the corporations become members of the group, and solely for purposes of paragraph (c)(2) of this section, the corporations to which this paragraph (c)(3) applies are treated as having not been previously affiliated with the corporations to which this paragraph (c)(3) does not apply. If the common parent has become the common parent of an existing group within the previous five year period in a transaction described in §1.1502–75(d)(2)(ii) or (3), the principles of §§1.1502–91(g)(6) and 1.1502–96(a)(2)(iii) shall apply.

(4) *Built-in amounts.* Solely for purposes of determining whether the subgroup has a net unrealized built-in loss or whether it has a recognized built-in loss, the principles of §1.1502–91(g) and (h) apply with appropriate adjustments.

(d) *Examples.* For purposes of the examples in this section, unless otherwise stated, all groups file consolidated returns, all corporations have calendar taxable years, the facts set forth the only corporate activity, value means fair market value and the adjusted basis of each asset equals its value, all transactions are with unrelated persons, and the application of any limitation or threshold under section 382 is disregarded. The principles of this section are illustrated by the following examples:

Example 1. Determination of recognized built-in loss. (i) Individual A owns all of the stock of P and T. T has two depreciable assets. Asset 1 has an unrealized loss of $55 (basis $75, value $20), and asset 2 has an unrealized gain of $20 (basis $30, value $50). P acquires all the stock of T from Individual A during Year 1, and T becomes a member of the P group. P's acquisition of T is not an ownership change as defined by section 382(g). Paragraph (g) of this section does not apply because there is not an overlap of the application of the rules contained in paragraph (a) of this section and section 382.

(ii) Under paragraph (b)(2)(i) of this section, and solely for purposes of applying paragraph (b)(1) of this section, T is treated as having an ownership change under section 382(g) on becoming a member of the P group. Under paragraph (b)(1) of this section, none of T's $55 of unrealized loss is treated as a built-in loss unless T has a net unrealized built-in loss under section 382(h)(3) on becoming a member of the P group.

(iii) Under section 382(h)(3)(A), T has a $35 net unrealized built-in loss on becoming a member of the P group (($55) + $20 = ($35)). Assume that this amount exceeds the threshold requirement in section 382(h)(3)(B). Under section 382(h)(2)(B), the entire amount of T's $55 unrealized loss is treated as a built-in loss to the extent it is recognized during the 5-year recognition period described in section 382(h)(7). Under paragraph (b)(2)(iii) of this section, the restriction under section 382(h)(1)(B)(ii), which limits the amount of recognized built-in loss that is treated as pre-change loss to the amount of the net unrealized built-in loss, is inapplicable for this purpose. Consequently, the entire $55 of unrealized loss (not just the $35 net unrealized loss) is treated under paragraph (b)(1) of this section as a built-in loss to the extent it is recognized within 5 years of T's becoming a member of the P group. Under paragraph (a) of this section, a built-in loss is

subject to the SRLY limitation under §1.1502–21(c)(1).

(iv) Under paragraph (b)(2)(ii) of this section, the built-in loss would similarly be subject to a SRLY limitation under §1.1502–21(c)(1) if T transferred all of its assets and liabilities to a subsidiary of the P group in a single transaction described in section 351. To the extent the built-in loss is recognized within 5 years of T's transfer, all of the items contributed by the acquiring subsidiary to consolidated taxable income (and not just the items attributable to the assets and liabilities transferred by T) are included for purposes of determining the SRLY limitation under §1.1502–21(c)(1).

Example 2. Actual application of section 382 not relevant. (i) Individual A owns all of the stock of P, and Individual B owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized loss of $25 (basis $75, value $50), and asset 2 has an unrealized gain of $20 (basis $30, value $50). P buys 55 percent of the stock of T in January of Year 1, resulting in an ownership change of T under section 382(g). During March of Year 2, P buys the 45 percent balance of the T stock, and T becomes a member of the P group.

(ii) Although T has an ownership change for purposes of section 382 in Year 1 and not Year 2, T's joining the P group in Year 2 is treated as an ownership change under section 382(g) solely for purposes of this section. Consequently, for purposes of this section, whether T has a net unrealized built-in loss under section 382(h)(3) is determined as if the day T joined the P group were a change date.

Example 3. Determination of a recognized built-in loss of a subgroup. (i) Individual A owns all of the stock of P, S, and M. P and M are each common parents of a consolidated group. During Year 1, P acquires all of the stock of S from Individual A, and S becomes a member of the P group. P's acquisition of S is not an ownership change as defined by section 382(g). At the beginning of Year 7, M acquires all of the stock of P from Individual A, and P and S become members of the M group. M's acquisitions of P and S are also not ownership changes as defined by section 382(g). At the time of M's acquisition of the P stock, P has (disregarding the stock of S) a $10 net unrealized built-in gain (two depreciable assets, asset 1 with a basis of $35 and a value of $55, and asset 2 with a basis of $55 and a value of $45), and S has a $75 net unrealized built-in loss (two depreciable assets, asset 3 with a basis of $95 and a value of $10, and asset 4 with a basis of $10 and a value of $20).

(ii) Under paragraph (c) of this section, P and S compose a subgroup on becoming members of the M group because P and S were continuously affiliated for the 60 month period ending immediately before they became members of the M group. Consequently, paragraph (b) of this section does not apply to P and S separately. Instead, their separately computed unrealized gains and losses are aggregated for purposes of determining whether, and the extent to which, any unrealized loss is treated as built-in loss under this section and is subject to the SRLY limitation under §1.1502–21(c).

(iii) Under paragraph (c) of this section, the P subgroup has a net unrealized built-in loss on the day P and S become members of the M group, determined by treating the day they become members as a change date. The net unrealized built-in loss is the aggregate of P's net unrealized built-in gain of $10 and S's net unrealized built-in loss of $75, or an aggregate net unrealized built-in loss of $65. (The stock of S owned by P is disregarded for purposes of determining the net unrealized built-in loss. However, any loss allowed on the sale of the stock within the recognition period is taken into account in determining recognized loss.) Assume that the $65 net unrealized built-in loss exceeds the threshold requirement under section 382(h)(3)(B).

(iv) Under paragraphs (b)(1), (b)(2)(iii), and (c) of this section, a loss recognized during the 5-year recognition period on an asset of P or S held on the day that P and S became members of the M group is a built-in loss except to the extent the group establishes that such loss exceeds the amount by which the adjusted basis of such asset on the day the member became a member exceeded the fair market value of such asset on that same day. If P sells asset 2 for $45 in Year 7 and recognizes a $10 loss, the entire $10 loss is treated as a built-in loss under paragraphs (b)(2)(iii) and (c) of this section. If S sells asset 3 for $10 in Year 7 and recognizes an $85 loss, the entire $85 loss is treated as a built-in loss under paragraphs (b)(2)(iii) and (c) of this section (not just the $55 balance of the P subgroup's $65 net unrealized built-in loss).

(v) The determination of whether P and S constitute a SRLY subgroup for purposes of loss carryovers and carrybacks, and the extent to which built-in losses are not allowed under the SRLY limitation, is made under §1.1502–21(c).

Example 4. Computation of SRLY limitation. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. During Year 1, Individual A forms T by contributing $300 and T sustains a $100 net operating loss. During Year 2, T's assets decline in value to $100. At the beginning of Year 3, P acquires all the stock of T from Individual A, and T becomes a member of the P group with a net unrealized built-in loss of $100. P's acquisition of T is not an ownership change as defined by section 382(g). Assume that $100 exceeds the threshold requirements of section 382(h)(3)(B). During Year 3, T recognizes its unrealized built-in loss as a $100 ordinary loss. The members of the P group contribute the following net income to the consolidated taxable income of the P group (disregarding T's recognized built-in loss and any consolidated net operating loss deduction under §1.1502–21) for Years 3 and 4:

	Year 3	Year 4	Total
P group (without T)	$100	$100	$200
T	$60	$40	$100
CT	$160	$140	$300

(ii) Under paragraph (b) of this section, T's $100 ordinary loss in Year 3 (not taken into account in the consolidated taxable income computations above) is a built-in loss. Under paragraph (a) of this section, the built-in loss is treated as a net operating loss carryover for purposes of determining the SRLY limitation under §1.1502–21(c).

(iii) For Year 3, §1.1502–21(c) limits T's $100 built-in loss and $100 net operating loss carryover from Year 1 to the aggregate of the P group's consolidated taxable income through Year 3, determined by reference to only T's items. For this purpose, consolidated taxable income is determined without regard to any consolidated net operating loss deductions under §1.1502–21(a).

(iv) The P group's consolidated taxable income through Year 3 is $60 when determined by reference to only T's items. Under §1.1502–21(c), the SRLY limitation for Year 3 is therefore $60.

(v) Under paragraph (a) of this section, the $100 built-in loss is treated as a current deduction for all purposes other than determination of the SRLY limitation under §1.1502–21(c). Consequently, a deduction for the built-in loss is allowed in Year 3 before T's loss carryover from Year 1 is allowed, but only to the extent of the $60 SRLY limitation. None of T's Year 1 loss carryover is allowed because the built-in loss ($100) exceeds the SRLY limitation for Year 3.

(vi) The $40 balance of the built-in loss that is not allowed in Year 3 because of the SRLY limitation is treated as a $40 net operating loss arising in Year 3 that is carried to other years in accordance with the rules of §1.1502–21(b). The $40 net operating loss is treated under paragraph (a) of this section and §1.1502–21(c)(1)(ii) as a loss carryover or carryback from Year 3 that arises in a SRLY, and is subject to the rules of §1.1502–21 (including §1.1502–21(c)) rather than this section. See also §1.1502–21(c)(1)(iii) *Example 4*.

(vii) The facts are the same as in paragraphs (i) through (vi) of this *Example 4,* except that T has an additional built-in loss when it joins the P group which is recognized in Year 4. For purposes of determining the SRLY limitation for these additional losses in Year 4 (or any subsequent year), the $60 of built-in loss allowed as a deduction in Year 3 is treated under paragraph (a) of this section as a deduction in Year 3 that reduces the P group's consolidated taxable income when determined by reference to only T's items.

Example 5. Built-in loss exceeding consolidated taxable income in the year recognized. (i) Individual A owns all of the stock of P and T. During Year 1, P acquires all the stock of T from Individual A, and T becomes a member of the P group. P's acquisition of T was not an ownership change as defined by section 382(g). At the time of acquisition, T has a noncapital asset with an unrealized loss of $45 (basis $100, value $55), which exceeds the threshold requirements of section 382(h)(3)(B). During Year 2, T sells its asset for $55 and recognizes the unrealized built-in loss. The P group has $10 of consolidated taxable income in Year 2, computed by disregarding T's recognition of the $45 built-in loss and the consolidated net operating loss deduction, while the consolidated taxable income would be $25 if determined by reference to only T's items (other than the $45 loss).

(ii) T's $45 loss is recognized in Year 2 and, under paragraph (b) of this section, constitutes a built-in loss. Under paragraph (a) of this section and §1.1502–21(c)(1)(ii), the loss is treated as a net operating loss carryover to Year 2 for purposes of applying the SRLY limitation under §1.1502–21(c).

(iii) For Year 2, T's SRLY limitation is the aggregate of the P group's consolidated taxable income through Year 2 determined by reference to only T's items. For this purpose, consolidated taxable income is determined by disregarding any built-in loss that is treated as a net operating loss carryover, and any consolidated net operating loss deductions under

§1.1502–21(a). Consolidated taxable income so determined is $25.

(iv) Under §1.1502–21(c), $25 of the $45 built-in loss could be deducted in Year 2. Because the P group has only $10 of consolidated taxable income (determined without regard to the $45), the $25 loss creates a consolidated net operating loss of $15. This loss is carried back or forward under the rules of §1.1502–21(b) and absorbed under the rules of §1.1502–21(a). This loss is not treated as arising in a SRLY (see §1.1502–21(c)(1)(ii)) and therefore is not subject to the SRLY limitation under §1.1502–21(c) in any consolidated return year of the group to which it is carried. The remaining $20 is treated as a loss carryover arising in a SRLY and is subject to the limitation of §1.1502–21(c) in the year to which it is carried.

(e) *Predecessors and successors.* For purposes of this section, any reference to a corporation or member includes, as the context may require, a reference to a successor or predecessor, as defined in §1.1502–1(f)(4).

(f) *Built-in losses recognized by common parent of group*—(1) *General rule.* Paragraph (a) of this section does not apply to any loss recognized by the group on an asset held by the common parent on the date the group is formed. Following an acquisition described in §1.1502–75(d)(2) or (3), references to the common parent are to the corporation that was the common parent immediately before the acquisition.

(2) *Anti-avoidance rule.* If a corporation that becomes a common parent of a group acquires assets with a net unrealized built-in loss in excess of the threshold requirement of section 382(h)(3)(B) (and thereby increases its net unrealized built-in loss or decreases its net unrealized built-in gain) prior to, and in anticipation of, the formation of the group, paragraph (f)(1) of this section does not apply.

(g) *Overlap with section 382*—(1) *General rule.* The limitations provided in §§1.1502-21(c) and 1.1502–22(c) do not apply to recognized built-in losses or to loss carryovers or carrybacks attributable to recognized built-in losses when the application of paragraph (a) of this section results in an overlap with the application of section 382.

(2) *Definitions*—(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in section 382, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap*—(A) An overlap of the application of paragraph (a) of this section and the application of section 382 with respect to built-in losses occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382(a) limitation that would apply with respect to the corporation's recognized built-in losses (the section 382 event). Except as provided in paragraph (g)(3) of this section, application of the overlap rule does not require that the size and composition of the corporation's net unrealized built-in loss is the same on the date of the section 382 event and the SRLY event.

(B) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(2) with respect to built-in losses, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 382 event before SRLY event.* If a SRLY event occurs on the same date as a section 382 event or within the six month period beginning on the date of the section 382 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event. Paragraph (g)(1) of this section does not apply, however, if a corporation that would otherwise be subject to the overlap rule acquires assets from a person other than a member of the group with a net unrealized built-in loss in excess of the threshold requirement of section 382(h)(3)(B) (and thereby increases its net unrealized built-in loss) after the section 382 event, and before the SRLY event.

(ii) *SRLY event before section 382 event.* If a section 382 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 382 event. However, paragraph (g)(1) of this section does not apply at any time if a corporation that otherwise would be subject to paragraph (g)(1) of this section transfers assets with an unrealized built-in loss to another member of the group after the SRLY event, but before the section 382 event, unless the corporation recognizes the built-in loss upon the transfer.

(4) *Subgroup rules.* In general, in the case of built-in losses for which there is a SRLY subgroup and the corporations joining the group at the time of the SRLY event also constitute a loss subgroup (as defined in §1.1502–91(d)(2)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies with respect to built-in losses only if—

(i) all members of the SRLY subgroup with respect to those built-in losses are also included in a loss subgroup; and

(ii) all members of a loss subgroup are also members of a SRLY subgroup with respect to those built-in losses.

(5) *Asset acquisitions.* Notwithstanding the application of this paragraph (g), paragraph (a) of this section applies to asset acquisitions by the corporation that occurs after the latter of the SRLY event and the section 382 event. See, paragraph (b)(2)(ii) of this section.

(6) *Examples.* The principles of this paragraph (g) are illustrated by the following examples:

Example 1. Determination of subgroup. (i) Individual A owns all of the stock of P, P1, and S. In Year 1, P acquires all of the stock of P1, and they file a consolidated return. In Year 3, P acquires all of the stock of S, and S joins the P group. Individual B, unrelated to Individual A, owns all of the stock of M and K, each the common parent of a consolidated group. Individual C, unrelated to either Individual A or Individual B, owns all of the stock of T.

(ii) At the beginning of Year 7, M acquires all of the stock of P from Individual A, and, as a result, P, P1, and S become members of the M group. At the time of M's acquisition of the P stock, P has a $15 net unrealized built-in loss (disregarding the stock of P1), P1 has a net unrealized built-in gain of $10, and S has a net unrealized built-in gain of $5.

(iii) During Year 8, M acquires all of the stock of T, and T joins the M group. At the time of M's acquisition of the T stock, T had an unrealized built-in loss of $15. At the beginning of Year 9, K acquires all of the stock of M from Individual B, and the members of the M consolidated group including P, P1, S, and T become members of the K group. At the time of K's acquisition of the M stock, M has (disregarding the stock of P and T) a $15 net unrealized built-in loss, P has a $20 net unrealized built-in loss (disregarding the stock of P1), P1 has a net unrealized built-in gain of $5, S has a net unrealized built-in loss of $35, and T has a $15 net unrealized built-in loss.

(iv) M's acquisition of P in Year 7 results in P, P1, and S becoming members of the M group (the SRLY event). Under paragraph (c) of this section, P and P1 compose a SRLY built-in loss subgroup because they have been affiliated for the 60 consecutive

month period immediately preceding joining the M group. S is not a member of the subgroup because on becoming a member of the M group it had not been continuously affiliated with P and P1 for the 60 month period ending immediately before it became a member of the M group. Consequently, §1.1502–15 applies to S separately from the P and P1 subgroup.

(v) Assuming that the $5 net unrealized built-in loss of the P/P1 subgroup exceeds the threshold requirement under section 382(h)(3)(B), M's acquisition of P resulted in an ownership change of P and P1 within the meaning of section 382(g) that subjects P and P1 to a limitation under section 382(a) (the section 382 event). Because, with respect to P and P1, the SRLY event and the change date of the section 382 event occur on the same date and because the loss subgroup and SRLY subgroup are coextensive, there is an overlap of the application of the SRLY rules and the application of the section 382.

(vi) S was not a loss corporation because it did not have a net operating loss carryover, or a net unrealized built-in loss, and therefore, M's acquisition of P did not result in an ownership change of S within the meaning of section 382(g). S, therefore is not subject to the overlap rule of paragraph (g) of this section.

(vii) M's acquisition of T resulted in T becoming a member of the M group (the SRLY event). Assuming that T's $15 net unrealized built-in loss exceeds the threshold requirement under section 382(h)(3)(B), M's acquisition of T also resulted in an ownership change of T within the meaning of section 382(g) that subjects T to a limitation under section 382(a) (the section 382 event). Because, with respect to T, the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section.

(viii) K's acquisition of M results in the members of the M consolidated group, including T, P, P1, and S, becoming members of the K group (the SRLY event). Because T, P, and P1 were each included in the determination of a net unrealized built-in loss that was subject to the overlap rule described in paragraph (g)(1) of this section when they each became members of the M group, they are deemed under paragraph (c)(3) of this section to have been continuously affiliated with M for the 60 month period ending immediately before becoming a member of the M group, notwithstanding their actual affiliation history. As a result, M, T, P, and P1 compose a SRLY built-in loss subgroup under paragraph (c)(2) of this section. K's acquisition of M is not subject to paragraph (g) of this section because it does not result in a section 382 event.

(ix) S, however, is not a member of the subgroup under paragraph (c)(2) of this section. Because S was not included in the determination of a net unrealized built-in loss that was subject to the overlap rule described in paragraph (g)(1) of this section when it joined the M group, S is treated as becoming an affiliate of M on the date it joined the M group. Furthermore, under paragraph (c)(3) of this section, S is deemed to have begun its affiliation with P and P1 on the date it joined the M group. Consequently, §1.1502–15 applies to S separately to the extent its built-in loss is recognized with the recognition period.

Example 2. Post-overlap acquisition of assets. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized built-in loss of $25 (basis $75, value $50), and asset 2 has an unrealized built-in gain of $20 (basis $30, value $50). During Year 3, P buys all of the stock of T from Individual B. On January 1, Year 4, P contributes $80 cash and Individual A contributes asset 3, a depreciable asset, with a net unrealized built-in loss of $45 (basis $65, value $20), in exchange for T stock in a transaction that is described in section 351.

(ii) P's acquisition of T results in T becoming a member of the P group (the SRLY event) and also results in an ownership change of T, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event).

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382. Consequently, under paragraph (g) of this section, the limitation under paragraph (a) of this section does not apply to T's net unrealized built-in loss when it joined the P group.

(iv) Individual A's Year 4 contribution of a depreciable asset occurred after T was a member of the P group. Assuming that the amount of the net unrealized built-in loss exceeds the threshold requirement of section 382(h)(3)(B), the sale of asset 3 within the recognition period is subject to the SRLY limitation of paragraphs (a) and (b)(2)(ii) of this section.

Example 3. Overlap rule. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized loss of $55 (basis $75, value $20), and asset 2 has an unrealized gain of $30 (basis $30, value $60). On February 28 of Year 2, P purchases 55% of T from Individual B. On June 30, of Year 2, P purchases an additional 35% of T from Individual B.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T that gives rise to a section 382(a) limitation. The June 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382, and paragraph (a) of this section does not apply. Therefore, the SRLY limitation does not apply to any of the $55 loss in asset 1 recognized by T after T joined the P group. See §1.1502–94 for rules relating to the application of section 382 with respect to T's $25 unrealized built-in loss.

Example 4. Overlap rule-Fluctuation in value. (i) The facts are the same as in *Example 3*, except that by June 30, of Year 2, asset 1 had declined in value by a further $10. Thus asset 1 had an unrealized loss of $65 (basis $75, value $10), and asset 2 had an unrealized gain of $30 (basis $30, value $60).

(ii) Because paragraph (a) of this section does not apply, the further decrease in asset 1's value is disregarded. Consequently, the results are the same as in *Example 3*.

(h) *Effective date*—(1) *In general.* This section generally applies to built-in losses recognized in taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraphs (f)(1) and (g)(1) of this section do not apply to a particular built-in loss in the current group, then solely for purposes of applying paragraph (a) of this section to determine a limitation with respect to that built-in loss and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's (or subgroup's) items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), paragraph (c)(3) of this section shall not apply; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 382(a) as amended by the Tax Reform Act of 1986 applies shall constitute a section 382 event.

(2) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502–15T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

§1.1502–15T [Removed]

Par. 5. Section 1.1502–15T is removed.

Par. 6. Section 1.1502–21 is added to read as follows:

§1.1502–21 Net operating losses.

(a) *Consolidated net operating loss deduction.* The consolidated net operating loss deduction (or CNOL deduction) for any consolidated return year is the aggregate of the net operating loss carryovers and carrybacks to the year. The net operating loss carryovers and carrybacks consist of—

(1) Any CNOLs (as defined in paragraph (e) of this section) of the consolidated group; and

(2) Any net operating losses of the members arising in separate return years.

(b) *Net operating loss carryovers and carrybacks to consolidated return and separate return years.* Net operating losses of members arising during a consolidated return year are taken into account in determining the group's CNOL

under paragraph (e) of this section for that year. Losses taken into account in determining the CNOL may be carried to other taxable years (whether consolidated or separate) only under this paragraph (b).

(1) *Carryovers and carrybacks generally.* The net operating loss carryovers and carrybacks to a taxable year are determined under the principles of section 172 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose, and losses carried from taxable years ending on the same date, and which are available to offset consolidated taxable income for the year, generally are absorbed on a pro rata basis. Additional rules provided under the Internal Revenue Code or regulations also apply. See, e.g., section 382(l)(2)(B) (if losses are carried from the same taxable year, losses subject to limitation under section 382 are absorbed before losses that are not subject to limitation under section 382). See *Example 2* of paragraph (c)(1)(iii) of this section for an illustration of pro rata absorption of losses subject to a SRLY limitation.

(2) *Carryovers and carrybacks of CNOLs to separate return years*—(i) *In general.* If any CNOL that is attributable to a member may be carried to a separate return year of the member, the amount of the CNOL that is attributable to the member is apportioned to the member (apportioned loss) and carried to the separate return year. If carried back to a separate return year, the apportioned loss may not be carried back to an equivalent, or earlier, consolidated return year of the group; if carried over to a separate return year, the apportioned loss may not be carried over to an equivalent, or later, consolidated return year of the group. For rules permitting the reattribution of losses of a subsidiary to the common parent when loss is disallowed on the disposition of subsidiary stock, see §1.1502–20(g).

(ii) *Special rules*—(A) *Year of departure from group.* If a corporation ceases to be a member during a consolidated return year, net operating loss carryovers attributable to the corporation are first carried to the consolidated return year, and only the amount so attributable that is not absorbed by the group in that year is carried to the corporation's first separate return year. For rules concerning a member departing a subgroup, see paragraph (c)(2)-(vii) of this section.

(B) *Offspring rule.* In the case of a member that has been a member continuously since its organization (determined without regard to whether the member is a successor to any other corporation), the CNOL attributable to the member is included in the carrybacks to consolidated return years before the member's existence. If the group did not file a consolidated return for a carryback year, the loss may be carried back to a separate return year of the common parent under paragraph (b)(2)(i) of this section, but only if the common parent was not a member of a different consolidated group or of an affiliated group filing separate returns for the year to which the loss is carried or any subsequent year in the carryback period. Following an acquisition described in §1.1502–75(d)(2) or (3), references to the common parent are to the corporation that was the common parent immediately before the acquisition.

(iii) *Equivalent years.* Taxable years are equivalent if they bear the same numerical relationship to the consolidated return year in which a CNOL arises, counting forward or backward from the year of the loss. For example, in the case of a member's third taxable year (which was a separate return year) that preceded the consolidated return year in which the loss arose, the equivalent year is the third consolidated return year preceding the consolidated return year in which the loss arose. See paragraph (b)(3)(iii) of this section for certain short taxable years that are disregarded in making this determination.

(iv) *Amount of CNOL attributable to a member.* The amount of a CNOL that is attributable to a member is determined by a fraction the numerator of which is the separate net operating loss of the member for the year of the loss and the denominator of which is the sum of the separate net operating losses for that year of all members having such losses. For this purpose, the separate net operating loss of a member is determined by computing the CNOL by reference to only the member's items of income, gain, deduction, and loss, including the member's losses and deductions actually absorbed by the group in the taxable year (whether or not absorbed by the member).

(v) *Examples.* For purposes of the examples in this section, unless otherwise stated, all groups file consolidated returns, all corporations have calendar taxable years, the facts set forth the only corporate activity, value means fair market value and the adjusted basis of each asset equals its value, all transactions are with unrelated persons, and the application of any limitation or threshold under section 382 is disregarded. The principles of this paragraph (b)(2) are illustrated by the following examples:

Example 1. Offspring rule. (i) During Year 1, Individual A forms P and T, and they each file a separate return. P forms S on March 15 of Year 2, and P and S file a consolidated return. P acquires all the stock of T from Individual A at the beginning of Year 3, and T becomes a member of the P group. P's acquisition of T is not an ownership change within the meaning of section 382. P, S, and T sustain a $1,100 CNOL in Year 3 and, under paragraph (b)(2)(iv) of this section, the loss is attributable $200 to P, $300 to S, and $600 to T.

(ii) Of the $1,100 CNOL in Year 3, the $500 amount of the CNOL that is attributable to P and S ($200 + $300) may be carried to P's separate return in Year 1. Even though S was not in existence in Year 1, the $300 amount of the CNOL attributable to S may be carried back to P's separate return in Year 1 because S (unlike T) has been a member of the P group since its organization and P is a qualified parent under paragraph (b)(2)(ii)(B) of this section. To the extent not absorbed in that year, the loss may then be carried to the P group's return in Year 2. The $600 amount of the CNOL attributable to T is a net operating loss carryback to T's separate return in Year 1, and if not absorbed in Year 1, then to Year 2.

Example 2. Departing members. (i) The facts are the same as in *Example 1.* In addition, on June 15 of Year 4, P sells all the stock of T. The P group's consolidated return for Year 4 includes the income of T through June 15. T files a separate return for the period from June 16 through December 31.

(ii) $600 of the Year 3 CNOL attributable to T is apportioned to T and is carried back to its separate return in Year 1. To the extent the $600 is not absorbed in T's separate return in Year 1 or Year 2, it is carried to the consolidated return in Year 4 before being carried to T's separate return in Year 4. Any portion of the loss not absorbed in T's Year 1 or Year 2 or in the P group's Year 4 is then carried to T's separate return in Year 4.

Example 3. Offspring rule following acquisition. (i) Individual A owns all of the stock of P, the common parent of a consolidated group. In Year 1, B, an individual unrelated to Individual A, forms T. P acquires all of the stock of T at the beginning of Year 3, and T becomes a member of the P group. The P group has $200 of consolidated taxable income in Year 2, and $300 of consolidated taxable income in Year 3 (computed without regard to the CNOL deduction). At the beginning of Year 4, T forms a subsidiary, Y, in a transaction described in section 351. The P group has a $300 consolidated net operating

loss in Year 4, and under paragraph (b)(2)(iv) of this section, the loss is attributable entirely to Y.

(ii) Even though Y was not in existence in Year 2, $300, the amount of the consolidated net operating loss attributable to Y, may be carried back to the P group's Year 2 consolidated return under paragraph (b)(2)(ii)(B) of this section because Y has been a member of the P group since its organization. To the extent not absorbed in that year, the loss may then be carried to the P group's consolidated return in Year 3

(3) *Special rules*—(i) *Election to relinquish carryback.* 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 paragraph (b)(3)(ii)(B) 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 entitled "THIS IS AN ELECTION UNDER SECTION 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 signed by the common parent and filed with the group's income tax return for the consolidated return year in which the loss arises.

(ii) *Special elections*—(A) *Groups that include insolvent financial institutions.* For rules applicable to relinquishing the entire carryback period with respect to losses attributable to insolvent financial institutions, see §301.6402–7 of this chapter.

(B) *Acquisition of member from another consolidated group.* 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 entitled "THIS IS AN ELECTION UNDER SECTION 1.1502–21(b)(3)(ii)(B) 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, and it must be signed by the common parent and each of the members to which it applies.

(iii) *Short years in connection with transactions to which section 381(a) applies.* If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transaction does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a net operating loss may be carried.

(iv) *Special status losses.* [Reserved]

(c) *Limitations on net operating loss carryovers and carrybacks from separate return limitation years*—(1) *SRLY limitation*—(i) *General rule.* Except as provided in paragraph (g) of this section (relating to an overlap with section 382), the aggregate of the net operating loss carryovers and carrybacks of a member arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group under paragraph (a) of this section may not exceed the aggregate consolidated taxable income for all consolidated return years of the group determined by reference to only the member's items of income, gain, deduction, and loss. For this purpose—

(A) Consolidated taxable income is computed without regard to CNOL deductions;

(B) Consolidated taxable income takes into account the member's losses and deductions (including capital losses) actually absorbed by the group in consolidated return years (whether or not absorbed by the member);

(C) In computing consolidated taxable income, the consolidated return years of the group include only those years, including the year to which the loss is carried, that the member has been continuously included in the group's consolidated return, but exclude—

(*1*) For carryovers, any years ending after the year to which the loss is carried; and

(*2*) For carrybacks, any years ending after the year in which the loss arose; and

(D) The treatment under §1.1502–15 of a built-in loss as a hypothetical net operating loss carryover in the year recognized is solely for purposes of determining the limitation under this paragraph (c) with respect to the loss in that year and not for any other purpose. Thus, for purposes of determining consolidated taxable income for any other losses, a built-in loss allowed under this section in the year it arises is taken into account.

(ii) *Losses treated as arising in SRLYs.* If a net operating loss carryover or carryback did not arise in a SRLY but is attributable to a built-in loss (as defined under §1.1502–15), the carryover or carryback is treated for purposes of this paragraph (c) as arising in a SRLY if the built-in loss was not allowed, after application of the SRLY limitation, in the year it arose. For an illustration, see §1.1502–15(d), *Example 5*. But see §1.1502–15(g)(1).

(iii) *Examples.* The principles of this paragraph (c)(1) are illustrated by the following examples:

Example 1. Determination of SRLY limitation. (i) Individual A owns P. In Year 1, Individual A forms T, and T sustains a $100 net operating loss that is carried forward. P acquires all the stock of T at the beginning of Year 2, and T becomes a member of the P group. The P group has $300 of consolidated taxable income in Year 2 (computed without regard to the CNOL deduction). Such consolidated taxable income would be $70 if determined by reference to only T's items.

(ii) T's $100 net operating loss carryover from Year 1 arose in a SRLY. See §1.1502–1(f)(2)(iii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, the $100 net operating loss carryover is subject to the SRLY limitation in paragraph (c)(1) of this section. The SRLY limitation for Year 2 is consolidated taxable income determined by reference to only T's items, or $70. Thus, $70 of the loss is included under paragraph (a) of this section in the P group's CNOL deduction for Year 2.

(iii) The facts are the same as in paragraph (i) of this *Example 1*, except that such consolidated taxable income (computed without regard to the CNOL deduction and by reference to only T's items) for Year 2 is a loss (a CNOL) of $370. Because the SRLY limitation may not exceed the consolidated

taxable income determined by reference to only T's items, and such items aggregate to a CNOL, T's $ 100 net operating loss carryover from Year 1 is not allowed under the SRLY limitation in Year 2. Moreover, if consolidated taxable income (computed without regard to the CNOL deduction and by reference to only T's items) did not exceed $370 in Year 3, the carryover would still be restricted under paragraph (c) of this section in Year 3, because the aggregate consolidated taxable income for all consolidated return years of the group computed by reference to only T's items would not be a positive amount.

Example 2. Net operating loss carryovers. (i) In Year 1, Individual A forms P, and P sustains a $40 net operating loss that is carried forward. P has no income in Year 2. Individual A also owns T which sustains a net operating loss of $50 in Year 2 that is carried forward. P acquires the stock of T from Individual A during Year 3, but T is not a member of the P group for each day of the year. P and T file separate returns and sustain net operating losses of $120 and $60, respectively, for Year 3. The P group files consolidated returns beginning in Year 4. During Year 4, the P group has $160 of consolidated taxable income (computed without regard to the CNOL deduction). Such consolidated taxable income would be $70 if determined by reference to only T's items. These results are summarized as follows:

	Separate Year 1	Separate Year 2	Separate/ Affiliated Year 3	Consolidated Year 4
P	$(40)	$0	$(120)	$90
T	0	(50)	(60)	70
CTI				160

(ii) P's Year 1, Year 2, and Year 3 are not SRLYs with respect to the P group. See §1.1502–1(f)(2)(i). Thus, P's $ 40 net operating loss arising in Year 1 and $120 net operating loss arising in Year 3 are not subject to the SRLY limitation under paragraph (c) of this section. Under the principles of section 172, paragraph (b) of this section requires that the loss arising in Year 1 be the first loss absorbed by the P group in Year 4. Absorption of this loss leaves $120 of the group's consolidated taxable income available for offset by other loss carryovers.

(iii) T's Year 2 and Year 3 are SRLYs with respect to the P group. See §1.1502–1(f)(2)(ii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, T's $50 net operating loss arising in Year 2 and $60 net operating loss arising in Year 3 are subject to the SRLY limitation. Under paragraph (c)(1) of this section, the SRLY limitation for Year 4 is $70, and under paragraph (b) of this section, T's $50 loss from Year 2 must be included under paragraph (a) of this section in the P group's CNOL deduction for Year 4. The absorption of this loss leaves $70 of the group's consolidated taxable income available for offset by other loss carryovers.

(iv) P and T each carry over net operating losses to Year 4 from a taxable year ending on the same date (Year 3). The losses carried over from Year 3 total $180. Under paragraph (b) of this section, the losses carried over from Year 3 are absorbed on a pro rata basis, even though one arises in a SRLY and the other does not. However, the group cannot absorb more than $20 of T's $60 net operating loss arising in Year 3 because its $70 SRLY limitation for Year 4 is reduced by T's $50 Year 2 SRLY loss already included in the CNOL deduction for Year 4. Thus, the absorption of Year 3 losses is as follows:

Amount of P's Year 3 losses absorbed = $120/($120 + $20) × $70 = $60.

Amount of T's Year 3 losses absorbed = $20/($120 + $20) × $70 = $10.

(v) The absorption of $10 of T's Year 3 loss further reduces T's SRLY limitation to $10 ($70 of initial SRLY limitation, reduced by the $60 net operating loss already included in the CNOL deductions for Year 4 under paragraph (a) of this section).

(vi) P carries its remaining $60 Year 3 net operating loss and T carries its remaining $50 Year 3 net operating loss over to Year 5. Assume that, in Year 5, the P group has $90 of consolidated taxable income (computed without regard to the CNOL deduction). The group's CTI determined by reference to only T's items is a CNOL of $4. For Year 5, the CNOL deduction is $66, which includes $60 of P's Year 3 loss and $6 of T's Year 3 loss (the aggregate consolidated taxable income for Years 4 and 5 determined by reference to T's items, or $66, reduced by T's SRLY losses actually absorbed by the group in Year 4, or $60).

Example 3. Net operating loss carrybacks. (i) P owns all of the stock of S and T. The members of the P group contribute the following to the consolidated taxable income of the P group for Years 1, 2, and 3:

	Year 1	Year 2	Year 3	Total
P	$100	$60	$80	$240
S	20	20	30	70
T	30	10	(50)	(10)
CTI	150	90	60	300

(ii) P sells all of the stock of T to Individual A at the beginning of Year 4. For its Year 4 separate return year, T has a net operating loss of $30.

(iii) T's Year 4 is a SRLY with respect to the P group. See §1.1502–1(f)(1). T's $30 net operating loss carryback to the P group from Year 4 is not allowed under paragraph (c) of this section to be included in the CNOL deduction under paragraph (a) of this section for Year 1, 2, or 3, because the P group's consolidated taxable income would not be a positive amount if determined by reference to only T's items for all consolidated return years through Year 4 (without regard to the $30 net operating loss). The $30 loss is carried forward to T's Year 5 and succeeding taxable years as provided under the Internal Revenue Code.

Example 4. Computation of SRLY limitation for built-in losses treated as net operating loss carryovers. (i) Individual A owns P. In Year 1, Individual A forms T by contributing $300 and T sustains a $100 net operating loss. During Year 2, T's assets decline in value by $100. At the beginning of Year 3, P acquires all the stock of T from Individual A, and T becomes a member of the P group in a transaction that does not result in an ownership change under section 382(g). At the time of the acquisition, T has a $100 net unrealized built-in loss, which exceeds the threshold requirements of section 382(h)(3)(B). During Year 3, T recognizes its unrealized loss as a $100 ordinary loss. The members of the P group contribute the following to the consolidated taxable income of the P group for Years 3 and 4 (computed without regard to T's recognition of its unrealized loss and any CNOL deduction under this section):

	Year 3	Year 4	Total
P group (without T)	$100	$100	$200
T	60	40	100
CTI	160	140	300

(ii) Under §1.1502–15(a), T's $100 of ordinary loss in Year 3 constitutes a built-in loss that is subject to the SRLY limitation under paragraph (c) of this section. The amount of the limitation is determined by treating the deduction as a net operating loss carryover from a SRLY. The built-in loss is therefore subject to a $60 SRLY limitation for Year 3. The built-in loss is treated as a net operating loss carryover solely for purposes of determining the extent to which the loss is not allowed by reason of the SRLY limitation, and for all other purposes the loss remains a loss arising in Year 3. Consequently, under paragraph (b) of this section, the $60 allowed under the SRLY limitation is absorbed by the P group before T's $100 net operating loss carryover from Year 1 is allowed.

(iii) Under §1.1502–15(a), the $40 balance of the built-in loss that is not allowed in Year 3 because of the SRLY limitation is treated as a $40 net operating loss arising in Year 3 that is subject to the SRLY limitation because, under paragraph (c)(1)(ii) of this section, Year 3 is treated as a SRLY, and is carried to other years in accordance with the rules of paragraph (b) of this section. The SRLY limitation for Year 4 is the P group's consolidated taxable income for Year 3 and Year 4 determined by reference to only T's items and without regard to the group's CNOL deductions ($60 + $40), reduced by T's loss actually absorbed by the group in Year 3 ($60). The SRLY limitation for Year 4 is $40.

(iv) Under paragraph (c) of this section and the principles of section 172(b), $40 of T's $100 net operating loss carryover from Year 1 is included in the CNOL deduction under paragraph (a) of this section in Year 4.

Example 5. Dual SRLY registers and accounting for SRLY losses actually absorbed. (i) In Year 1, T sustains a $ 100 net operating loss and a $50 net capital loss. At the beginning of Year 2, T becomes a member of the P group in a transaction that does not result in an ownership change under section 382(g). Both of T's carryovers from Year 1 are subject to SRLY limits under this paragraph (c) and §1.1502–22(c). The members of the P group contribute the following to the consolidated taxable income for Years 2 and 3 (computed without regard to T's CNOL deduction under this section or net capital loss carryover under §1.1502–22):

	P	T
Year 1 (SRLY)		
Ordinary		(100)
Capital		(50)
Year 2		
Ordinary	30	60
Capital	0	(20)
Year 3		
Ordinary	10	40
Capital	0	30

(ii) For Year 2, the group computes separate SRLY limits for each of T's SRLY carryovers from Year 1. The group determines its ability to use its capital loss carryover before it determines its ability

to use its ordinary loss carryover. Under section 1212, because the group has no Year 2 capital gain, it cannot absorb any capital losses in Year 2. T's Year 1 net capital loss and the group's Year 2 consolidated net capital loss (all of which is attributable to T) are carried over to Year 3.

(iii) Under this section, the aggregate amount of T's $100 net operating loss carryover from Year 1 that may be included in the CNOL deduction of the group for Year 2 may not exceed $60 — the amount of the consolidated taxable income computed by reference only to T's items, including losses and deductions to the extent actually absorbed (i.e., $60 of T's ordinary income for Year 2). Thus, the group may include $60 of T's ordinary loss carryover from Year 1 in its Year 2 CNOL deduction. T carries over its remaining $40 of its Year 1 loss to Year 3.

(iv) For Year 3, the group again computes separate SRLY limits for each of T's SRLY carryovers from Year 1. The group has consolidated net capital gain (without taking into account a net capital loss carryover deduction) of $30. Under §1.1502–22(c), the aggregate amount of T's $50 capital loss carryover from Year 1 that may be included in computing the group's consolidated net capital gain for all years of the group (here Years 2 and 3) may not exceed $30 (the aggregate consolidated net capital gain computed by reference only to T's items, including losses and deductions actually absorbed (i.e., $30 of capital gain in Year 3)). Thus, the group may include $30 of T's Year 1 capital loss carryover in its computation of consolidated net capital gain for Year 3, which offsets the group's capital gains for Year 3. T carries over its remaining $20 of its Year 1 loss to Year 4. The group carries over the Year 2 consolidated net capital loss to Year 4.

(v) Under this section, the aggregate amount of T's net operating loss carryover from Year 1 that may be included in the CNOL deduction of the group for Years 2 and 3 may not exceed $100, which is the amount of the aggregate consolidated taxable income for Years 2 and 3 determined by reference only to T's items, including losses and deductions actually absorbed (i.e., $60 of ordinary income in Year 2 plus $40 of ordinary income, $30 of capital gain, and $30 of SRLY capital losses actually absorbed in Year 3). The group included $60 of T's ordinary loss carryover in its Year 2 CNOL deduction. It may include the remaining $40 of the carryover in its Year 3 CNOL deduction.

(2) *SRLY subgroup limitation.* In the case of a net operating loss carryover or carryback for which there is a SRLY subgroup, the principles of paragraph (c)(1) of this section apply to the SRLY subgroup, and not separately to its members. Thus, the contribution to consolidated taxable income and the net operating loss carryovers and carrybacks arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group under paragraph (a) of this section are based on the aggregate amounts of income, gain, deduction, and loss of the members of the SRLY subgroup for the relevant consolidated return years (as provided in paragraph (c)(1)(i)(C) of this section). For an illustration of aggregate amounts during the relevant consolidated return years following the year in which a member of a SRLY subgroup ceases to be a member of the group, see paragraph (c)(2)(viii) *Example 4* of this section. A SRLY subgroup may exist only for a carryover or carryback arising in a year that is not a SRLY (and is not treated as a SRLY under paragraph (c)(1)(ii) of this section) with respect to another group (the former group), or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502–15(g) with respect to another group (the former group). A separate SRLY subgroup is determined for each such carryover or carryback. A consolidated group may include more than one SRLY subgroup and a member may be a member of more than one SRLY subgroup. Solely for purposes of determining the members of a SRLY subgroup with respect to a loss:

(i) *Carryovers.* In the case of a carryover, the SRLY subgroup is composed of the member carrying over the loss (the loss member) and each other member that was a member of the former group that becomes a member of the group at the same time as the loss member. A member remains a member of the SRLY subgroup until it ceases to be affiliated with the loss member. The aggregate determination described in paragraph (c)(1) of this section and this paragraph (c)(2) includes the amounts of income, gain, deduction, and loss of each member of the SRLY subgroup for the consolidated return years during which it remains a member of the SRLY subgroup. For an illustration of the aggregate determination of a SRLY subgroup, see paragraph (c)(2)(viii) *Example 2* of this section.

(ii) *Carrybacks.* In the case of a carryback, the SRLY subgroup is composed of the member carrying back the loss (the loss member) and each other member of the group from which the loss is carried back that has been continuously affiliated with the loss member from the year to which the loss is carried through the year in which the loss arises.

(iii) *Built-in losses.* In the case of a built-in loss, the SRLY subgroup is composed of the member recognizing the loss (the loss member) and each other member that was part of the subgroup with respect to the loss determined under §1.1502–15(c)(2) immediately before the members became members of the group. The principles of paragraphs (c)(2)(i) and (ii) of this section apply to determine the SRLY subgroup for the built-in loss that is, under paragraph (c)(1)(ii) of this section, treated as arising in a SRLY with respect to the group in which the loss is recognized. For this purpose and as the context requires, a reference in paragraphs (c)(2)(i) and (ii) of this section to a group or former group is a reference to the subgroup determined under §1.1502–15(c)(2).

(iv) *Principal purpose of avoiding or increasing a SRLY limitation.* The members composing a SRLY subgroup are not treated as a SRLY subgroup if any of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, this paragraph (c). Any member excluded from a SRLY subgroup, if excluded with a principal purpose of so avoiding or increasing any SRLY limitation, is treated as included in the SRLY subgroup.

(v) *Coordination with other limitations.* This paragraph (c)(2) does not allow a net operating loss to offset income to the extent inconsistent with other limitations or restrictions on the use of losses, such as a limitation based on the nature or activities of members. For example, any dual consolidated loss may not reduce the taxable income to an extent greater than that allowed under section 1503(d) and §1.1503–2. See also §1.1502–47(q) (relating to preemption of rules for life-nonlife groups).

(vi) *Anti-duplication.* If the same item of income or deduction could be taken into account more than once in determining a limitation under this paragraph (c), or in a manner inconsistent with any other provision of the Internal Revenue Code or regulations incorporating this paragraph (c), the item of income or deduction is taken into account only once and in such manner that losses are absorbed in accordance with the ordering rules in paragraph (b) of this section and the underlying purposes of this section.

(vii) *Corporations that leave a SRLY subgroup.* If a loss member ceases to be affiliated with a SRLY subgroup, the

amount of the member's remaining SRLY loss from a specific year is determined by multiplying the aggregate of the unabsorbed net operating loss carryovers of the SRLY subgroup from that year by a fraction, the numerator of which is the net operating loss carryover for that year that the member leaving the subgroup had when it became a member of the group, and the denominator of which is the aggregate of the net operating loss carryovers of the members of the SRLY subgroup for that year when they joined the group. The unabsorbed net operating loss carryovers of the SRLY subgroup are those carryovers that have not been absorbed by the group as of the end of the taxable year in which the loss member leaves the group.

(viii) *Examples.* The principles of this paragraph (c)(2) are illustrated by the following examples:

Example 1. Members of SRLY subgroups. (i) Individual A owns all of the stock of P, S, T and M. P and M are each common parents of a consolidated group. During Year 1, P sustains a $50 net operating loss. At the beginning of Year 2, P acquires all the stock of S at a time when the aggregate basis of S's assets exceeds their aggregate value by $70 and S becomes a member of the P group. At the beginning of Year 3, P acquires all the stock of T, T has a $60 net operating loss carryover at the time of the acquisition, and T becomes a member of the P group. During Year 4, S forms S1 and T forms T1, each by contributing assets with built-in gains which are, in the aggregate, material. S1 and T1 become members of the P group. During Year 7, M acquires all of the stock of P, and the members of the P group become members of the M group for the balance of Year 7. The $50 and $60 loss carryovers of P and T are carried to Year 7 of the M group, and the value and basis of S's assets did not change after it became a member of the former P group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) Under paragraph (c)(2) of this section, a separate SRLY subgroup is determined for each loss carryover and built-in loss. In the P group, P's $50 loss carryover is not treated as arising in a SRLY. See §1.1502–1(f). Consequently, the carryover is not subject to limitation under paragraph (c) of this section in the P group.

(iii) In the M group, P's $50 loss carryover is treated as arising in a SRLY and is subject to the limitation under paragraph (c) of this section. A SRLY subgroup with respect to that loss is composed of members which were members of the P group, the group as to which the loss was not a SRLY. The SRLY subgroup is composed of P, the member carrying over the loss, and each other member of the P group that became a member of the M group at the same time as P. A member of the SRLY subgroup remains a member until it ceases to be affiliated with P. For Year 7, the SRLY subgroup is composed of P, S, T, S1, and T1.

(iv) In the P group, S's $70 unrealized loss, if recognized within the 5-year recognition period after S becomes a member of the P group, is subject to limitation under paragraph (c) of this section. See §1.1502–15 and paragraph (c)(1)(ii) of this section. Because S was not continuously affiliated with P, T, or T1 for 60 consecutive months prior to joining the P group, these corporations cannot be included in a SRLY subgroup with respect to S's unrealized loss in the P group. See paragraph (c)(2)(iii) of this section. As a successor to S, S1 is included in a subgroup with S in the P group, and because 100 percent of S1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the P group, its net positive income is not excluded from the consolidated taxable income of the P group that may be offset by the built-in loss. See paragraph (f) of this section.

(v) In the M group, S's $70 unrealized loss, if recognized within the 5-year recognition period after S becomes a member of the M group, is subject to limitation under paragraph (c) of this section. Prior to becoming a member of the M group, S had been continuously affiliated with P (but not T or T1) for 60 consecutive months and S1 is a successor that has remained continuously affiliated with S. Those members had a net unrealized built-in loss immediately before they became members of the group under §1.1502–15(c). Consequently, in Year 7, S, S1, and P compose a subgroup in the M group with respect to S's unrealized loss. Because S1 was a member of the SRLY subgroup when it became a member of the M group and also because 100 percent of S1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the M group its net positive income is not excluded from the consolidated taxable income of the M group that may be offset by the recognized built-in loss. See paragraph (f) of this section.

(vi) In the P group, T's $60 loss carryover arose in a SRLY and is subject to limitation under paragraph (c) of this section. P, S, and S1 were not members of the group in which T's loss arose and T's loss carryover was not subject to the overlap rule described in paragraph (g) of this section with respect to the P group (the former group). Thus, P, S, and S1 are not members of a SRLY subgroup with respect to the T carryover in the P group. See paragraph (c)(2)(i) of this section. As a successor to T, T1 is included in a SRLY subgroup with T in the P group; and, because 100 percent of T1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the P group, its net positive income is not excluded from the consolidated taxable income of the P group that may be offset by the carryover. See paragraph (f) of this section.

(vii) In the M group, T's $60 loss carryover arose in a SRLY and is subject to limitation under paragraph (c) of this section. T and T1 remain the only members of a SRLY subgroup with respect to the carryover. Because T1 was a member of the SRLY subgroup when it became a member of the M group and also because 100 percent of T1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the M group, its net positive income is not excluded from the consolidated taxable income of the M group that may be offset by the carryover. See paragraph (f) of this section.

Example 2. Computation of SRLY subgroup limitation. (i) Individual A owns all of the stock of S, T, P and M. P and M are each common parents of a consolidated group. In Year 2, P acquires all the stock of S and T from Individual A, and S and T become members of the P group. For Year 3, the P group has a $45 CNOL, which is attributable to P, and which P carries forward. M is the common parent of another group. At the beginning of Year 4, M acquires all of the stock of P and the former members of the P group become members of the M group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) P's year to which the loss is attributable, Year 3, is a SRLY with respect to the M group. See §1.1502–1(f)(1). However, P, S, and T compose a SRLY subgroup with respect to the Year 3 loss under paragraph (c)(2)(i) of this section because Year 3 is not a SRLY (and is not treated as a SRLY) with respect to the P group. P's loss is carried over to the M group's Year 4 and is therefore subject to the SRLY subgroup limitation in paragraph (c)(2) of this section.

(iii) In Year 4, the M group has $10 of consolidated taxable income (computed without regard to the CNOL deduction for Year 4). Such consolidated taxable income would be $45 if determined by reference to only the items of P, S, and T, the members included in the SRLY subgroup with respect to P's loss carryover. Therefore, the SRLY subgroup limitation under paragraph (c)(2) of this section for P's net operating loss carryover from Year 3 is $45. Because the M group has only $10 of consolidated taxable income in Year 4, however, only $10 of P's net operating loss carryover is included in the CNOL deduction under paragraph (a) of this section in Year 4.

(iv) In Year 5, the M group has $100 of consolidated taxable income (computed without regard to the CNOL deduction for Year 5). Neither P, S, nor T has any items of income, gain, deduction, or loss in Year 5. Although the members of the SRLY subgroup do not contribute to the $100 of consolidated taxable income in Year 5, the SRLY subgroup limitation for Year 5 is $35 (the sum of SRLY subgroup consolidated taxable income of $45 in Year 4 and $0 in Year 5, less the $10 net operating loss carryover actually absorbed by the M group in Year 4). Therefore, $35 of P's net operating loss carryover is included in the CNOL deduction under paragraph (a) of this section in Year 5.

Example 3. Inclusion in more than one SRLY subgroup. (i) Individual A owns all of the stock of S, T, P and M. S, P and M are each common parents of a consolidated group. At the beginning of Year 1, S acquires all the stock of T from Individual A, and T becomes a member of the S group. For Year 1, the S group has a CNOL of $10, all of which is attributable to S and is carried over to Year 2. At the beginning of Year 2, P acquires all the stock of S, and S and T become members of the P group. For Year 2, the P group has a CNOL of $35, all of which is attributable to P and is carried over to Year 3. At the beginning of Year 3, M acquires all of the stock of P and the former members of the P group become members of the M group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) P's and S's net operating losses arising in SRLYs with respect to the M group are subject to limitation under paragraph (c) of this section. P, S, and T compose a SRLY subgroup for purposes of determining the limitation for P's $35 net operating loss carryover arising in Year 2 because, under paragraph (c)(2)(i) of this section, Year 2 is not a SRLY with respect to the P group. Similarly, S and T compose a SRLY subgroup for purposes of determining the limitation for S's $10 net operating loss carryover arising in Year 1 because Year 1 is not a SRLY with respect to the S group.

(iii) S and T are members of both the SRLY subgroup with respect to P's losses and the SRLY subgroup with respect to S's losses. Under paragraph (c)(2) of this section, S's and T's items cannot be included in the determination of the SRLY subgroup limitation for both SRLY subgroups for the same consolidated return year; paragraph (c)(2)(vi) of this section requires the M group to consider the items of S and T only once so that the losses are absorbed in the order of the taxable years in which they were sustained. Because S's loss was incurred in Year 1, while P's loss was incurred in Year 2, the items will be added in the determination of the consolidated taxable income of the S and T SRLY subgroup to enable S's loss to be absorbed first. The taxable income of the P, S, and T SRLY subgroup is then computed by including the consolidated taxable income for the S and T SRLY subgroup less the amount of any net operating loss carryover of S that is absorbed after applying this section to the S subgroup for the year.

Example 4. Corporation ceases to be affiliated with a SRLY subgroup. (i) Individual A owns all of the stock of P and M. P and S are members of the P group and the P group has a CNOL of $30 in Year 1, all of which is attributable to P and carried over to Year 2. At the beginning of Year 2, M acquires all of the stock of P, and P and S become members of the M group. P and S compose a SRLY subgroup with respect to P's net operating loss carryover. For Year 2, consolidated taxable income of the M group determined by reference to only the items of P (and without regard to the CNOL deduction for Year 2) is $40. However, such consolidated taxable income of the M group determined by reference to the items of both P and S is a loss of $20. Thus, the SRLY subgroup limitation under paragraph (c)(2) of this section prevents the M group from including any of P's net operating loss carryover in the CNOL deduction under paragraph (a) of this section in Year 2, and P carries the Year 1 loss to Year 3.

(ii) At the end of Year 2, P sells all of the S stock and S ceases to be a member of the M group and the P subgroup. For Year 3, consolidated taxable income of the M group is $50 (determined without regard to the CNOL deduction for Year 3), and such consolidated taxable income would be $10 if determined by reference to only items of P. However, the limitation under paragraph (c) of this section for Year 3 for P's net operating loss carryover still prevents the M group from including any of P's loss in the CNOL deduction under paragraph (a) of this section. The limitation results from the inclusion of S's items for Year 2 in the determination of the SRLY subgroup limitation for Year 3 even though S ceased to be a member of the M group (and the P subgroup) at the end of Year 2. Thus, the M group's consolidated taxable income determined by reference to only the SRLY subgroup members' items for all consolidated return years of the group through Year 3 (determined without regard to the CNOL deduction) is not a positive amount.

(ix) *Application to other than loss carryovers.* Paragraph (g) of this section and the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502-15(g) with respect to another group (the former group)" in paragraph (c)(2) of this section apply only to net operating loss carryovers and net capital loss carryovers, and not with respect to other tax attributes, such as credits. Accordingly, as the context may require, if another regulation references this section and such other regulation does not concern net operating loss carryovers or net capital loss carryovers, then such reference does not include a reference to such paragraph or phrase.

(d) *Coordination with consolidated return change of ownership limitation and transactions subject to old section 382*—(1) *Consolidated return changes of ownership.* If a consolidated return change of ownership occurred before January 1, 1997, the principles of §1.1502–21A(d) apply to determine the amount of the aggregate of the net operating losses attributable to old members of the group that may be included in the consolidated net operating loss deduction under paragraph (a) of this section. For this purpose, §1.1502–1(g) is applied by treating that date as the end of the year of change.

(2) *Old section 382.* The principles of §1.1502–21A(e) apply to disallow or reduce the amount of a net operating loss carryover of a member as a result of a transaction subject to old section 382.

(e) *Consolidated net operating loss.* Any excess of deductions over gross income, as determined under §1.1502–11(a) (without regard to any consolidated net operating loss deduction), is also referred to as the consolidated net operating loss (or CNOL).

(f) *Predecessors and successors*—(1) *In general.* For purposes of this section, any reference to a corporation, member, common parent, or subsidiary, includes, as the context may require, a reference to a successor or predecessor, as defined in §1.1502–1(f)(4).

(2) *Limitation on SRLY subgroups*—(i) *General rule.* Except as provided in paragraph (f)(2)(ii) of this section, if a successor's items of income and gain exceed the successor's items of deduction and loss (net positive income), then the net positive income attributable to the successor is excluded from the computation of the consolidated taxable income of a SRLY subgroup.

(ii) *Exceptions.* A successor's net positive income is not excluded from the consolidated taxable income of a SRLY subgroup if—

(A) The successor acquires substantially all the assets and liabilities of its predecessor and the predecessor ceases to exist;

(B) The successor was a member of the SRLY subgroup when the SRLY subgroup members became members of the group;

(C) 100 percent of the stock of the successor is owned directly by corporations that were members of the SRLY subgroup when the SRLY subgroup members became members of the group; or

(D) The Commissioner so determines.

(g) *Overlap with section 382*—(1) *General rule.* The limitation provided in paragraph (c) of this section does not apply to net operating loss carryovers (other than a hypothetical carryover described in paragraph (c)(1)(i)(D) of this section and a carryover described in paragraph (c)(1)(ii) of this section) when the application of paragraph (c) of this section results in an overlap with the application of section 382. For a similar rule applying in the case of net operating loss carryovers described in paragraphs (c)(1)(i)(D) and (c)(1)(ii) of this section, see §1.1502–15(g).

(2) *Definitions*—(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in section 382, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap*—(A) An overlap of the application of paragraph (c) of this section and the application of section 382 with respect to a net operating loss carryover occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382(a) limitation with respect to that carryover (the section 382 event).

(B) If an overlap described in paragraph (g)(2)(ii)(A) of this section occurs

with respect to net operating loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 382 event, then an overlap is treated as also occurring with respect to that corporation's net operating loss carryover that arises within the period beginning with the section 382 event and ending with the SRLY event.

(C) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(1) with respect to a carryover, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 382 event before SRLY event.* If a SRLY event occurs on the same date as a section 382 event or within the six month period beginning on the date of the section 382 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event.

(ii) *SRLY event before section 382 event*. If a section 382 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 382 event.

(4) *Subgroup rules.* In general, in the case of a net operating loss carryover for which there is a SRLY subgroup and a loss subgroup (as defined in §1.1502–91(d)(1)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies—

(i) With respect to a carryover described in paragraph (g)(2)(ii)(A) of this section only if—

(A) All members of the SRLY subgroup with respect to that carryover are also included in a loss subgroup with respect to that carryover; and

(B) All members of a loss subgroup with respect to that carryover are also members of a SRLY subgroup with respect to that carryover; and

(ii) With respect to a carryover described in paragraph (g)(2)(ii)(B) of this section only if all members of the SRLY subgroup for that carryover are also members of a SRLY subgroup that has net operating loss carryovers described in paragraph (g)(2)(ii)(A) of this section that are subject to the overlap rule of paragraph (g)(1) of this section.

(5) *Examples.* The principles of this paragraph (g) are illustrated by the following examples:

Example 1. Overlap—Simultaneous Acquisition. (i) Individual A owns all of the stock of P, which in turn owns all of the stock of S. P and S file a consolidated return. In Year 2, B, an individual unrelated to Individual A, forms T which incurs a $100 net operating loss for that year. At the beginning of Year 3, S acquires T.

(ii) S's acquisition of T results in T becoming a member of the P group (the SRLY event) and also results in an ownership change of T, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event) with respect to the T carryover.

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382.

(iv) Consequently, under this paragraph (g), in Year 3 the SRLY limitation does not apply to the Year 2 $100 net operating loss.

Example 2. Overlap—Section 382 event before SRLY event. (i) Individual A owns all of the stock of P, which in turn owns all of the stock of S. P and S file a consolidated return. In Year 1, B, an individual unrelated to Individual A, forms T which incurs a $100 net operating loss for that year. On February 28 of Year 2, S purchases 55% of T from Individual B. On June 30, of Year 2, S purchases an additional 35% of T from Individual B.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover. The June 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382.

(iv) Consequently, under paragraph (g) of this section, in Year 2 the SRLY limitation does not apply to the Year 1 $100 net operating loss.

Example 3. No overlap—Section 382 event before SRLY event. (i) The facts are the same as in *Example 2* except that Individual B does not sell the additional 35% of T to S until September 30, Year 2.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover. The September 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event did not occur within six months of the change date of the section 382 event, there is no overlap of the application of the SRLY rules and the application of section 382. Consequently, the Year 1 net operating loss is subject to a SRLY limitation and a section 382 limitation.

Example 4. Overlap—SRLY event before section 382 event. (i) P and S file a consolidated return. S has owned 40% of T for 6 years. For Year 6, T has an net operating loss of $500 that is carried forward. On March 31, Year 7, S acquires an additional 40% of T, and on August 31, Year 7, S acquires the remaining 20% of T.

(ii) The March 31 purchase of 40% of T results in T becoming a member of the P group and is therefore a SRLY event. The August 31 purchase of 20% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of this paragraph (g).

(iv) Under this paragraph (g), the SRLY rules of paragraph (c) of this section will apply to the Year 7 tax year. Beginning in Year 8 (the year after the section 382 event), any unabsorbed portion of the Year 6 net operating loss will not be subject to a SRLY limitation.

Example 5. Overlap—Coextensive subgroups. (i) Individual A owns all of the stock of S, which in turn owns all of the stock of T. S and T file a consolidated return beginning in Year 1. B, an individual unrelated to A, owns all of the stock of P, the common parent of a consolidated group. In Year 2, the S group has a $200 consolidated net operating loss which is carried forward, of which $100 is attributable to S, and $100 is attributable to T. At the beginning of Year 3, the P group acquires all of the stock of S from Individual A.

(ii) P's acquisition of S results in S and T becoming members of the P group (the SRLY event). With respect to the Year 2 net operating loss carryover, S and T compose a SRLY subgroup under paragraph (c)(2) of this section.

(iii) S and T also compose a loss subgroup under §1.1502-91(d)(1) with respect to the Year 2 net operating loss carryover. P's acquisition also results in an ownership change of S, the subgroup parent, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event) with respect to the Year 2 carryover.

(iv) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section. Because the SRLY subgroup and the loss subgroup are coextensive, under paragraph (g) of this section, the SRLY limitation does not apply to the Year 2 $200 net operating loss.

Example 6. No Overlap—Different subgroups. (i) Individual B owns all of the stock of P, the common parent of a consolidated group. P owns all of the stock of S and all of the stock of T. Individual A owns all of the stock of X, the common parent of another consolidated group. In Year 1, the P group has a $200 consolidated net operating loss, of which $100 is attributable to S and $100 is attributable to T. At the beginning of Year 3, the X group acquires all of the stock of S and T from P and does not make an election under §1.1502–91(d)(4) (concerning an election to treat the loss subgroup parent requirement as having been satisfied).

(ii) X's acquisition of S and T results in S and T becoming members of the X group (the SRLY event). With respect to the Year 1 net operating loss,

S and T compose a SRLY subgroup under paragraph (c)(2) of this section.

(iii) S and T do not bear (and are not treated as bearing) a section 1504(a)(1) relationship. Therefore S and T do not qualify as a loss subgroup under §1.1502–91(d)(1). X's acquisition of S and T results in separate ownership changes of S and T, that give rise to separate limitations under section 382(a) (the section 382 events) with respect to each of S and T's Year 1 net operating loss carryovers. See §1.1502–94.

(iv) The SRLY event and the change dates of the section 382 events occur on the same date. However, paragraph (g)(1) of this section does not apply because the SRLY subgroup (composed of S and T) is not coextensive with a loss subgroup with respect to the Year 1 carryovers. Consequently, the Year 1 net operating loss is subject to both a SRLY subgroup limitation and also separate section 382 limitations for each of S and T.

Example 7. No Overlap—Different subgroups. (i) Individual A owns all of the stock of T and all of the stock of S, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of P, the common parent of another consolidated group. In Year 1, T has a net operating loss of $100 that is carried forward. At the end of Year 2, S acquires all of the stock of T from Individual A. In Year 3, the S group sustains a $200 consolidated net operating loss that is carried forward. In Year 8, the P group acquires all of the stock of S from Individual A.

(ii) S's acquisition of T in Year 1 results in T becoming a member of the S group. The acquisition, however, did not result in an ownership change under section 382(g). As a result, T's Year 1 net operating loss is subject to SRLY within the S group. At the end of Year 7, §1.1502–96(a) treats T's Year 1 net operating loss as not having arisen in a SRLY with respect to the S group. Section 1.1502–96(a), however, applies only for purposes of §§1.1502–91 through 1.1502–96 and §1.1502–98 but not for purposes of this section. See §1.1502–96(a)(5).

(iii) P's acquisition of S in Year 8 results in S and T becoming members of the P group (the SRLY event). With respect to the Year 1 net operating loss, S and T do not compose a SRLY subgroup under paragraph (c)(2) of this section.

(iv) S and T compose a loss subgroup under §1.1502–91(d)(1) with respect to the Year 1 net operating loss carryover. P's acquisition of S results in an ownership change of the loss subgroup, within the meaning of section 382(g), that gives rise to a subgroup limitation under section 382(a) (the section 382 event) with respect to that carryover.

(v) The SRLY event and the change date of the section 382 event occur on the same date. However, under paragraph (g)(4) of this section, because the SRLY subgroup and the loss subgroup are not coextensive, T's Year 1 net operating loss carryover is subject to a SRLY limitation.

(vi) With respect to the Year 3 net operating loss carryover, S and T compose both a SRLY subgroup and a loss subgroup under §1.1502–91(d)(1). Thus, paragraph (g)(1) of this section applies and the S group's Year 3 net operating loss carryover is not subject to a SRLY limitation.

Example 8. SRLY after overlap. (i) Individual A owns all of the stock of R and M, each the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of D. In Year 1, D incurs a $100 net operating loss that is carried forward. At the beginning of Year 3, R acquires all of the stock of D. In Year 5, M acquires all of the stock of R in a transaction that did not result in an ownership change of R.

(ii) R's Year 3 acquisition of D results in D becoming a member of the R group (the SRLY event) and also results in an ownership change of D, that gives rise to a limitation under section 382(a) (the section 382 event) with respect to D's net operating loss carryover.

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of paragraph (c) of this section and section 382 with respect to D's net operating loss. Consequently, under this paragraph (g), D's Year 1 $100 net operating loss is not subject to a SRLY limitation in the R group.

(iv) M's Year 5 acquisition of R results in R and D becoming members of the M group (the SRLY event), but does not result in an ownership change of R or D that gives rise to a limitation under section 382(a). Because there is no section 382 event, the application of the SRLY rules and section 382 do not overlap. Consequently, D's Year 1 $100 net operating loss is subject to a SRLY limitation in the M group.

(v) Because D's Year 1 net operating loss carryover was subject to the overlap rule of paragraph (g) of this section when it joined the R group, under §1.1502-21(c)(2) the SRLY subgroup with respect to that carryover includes all of the members of the R group that joined the M group at the same time as D.

Example 9. Overlap—Interim losses. (i) Individual A owns all of the stock of P and S, each the common parent of a consolidated group. S owns all of the stock of T, its only subsidiary. B, an individual unrelated to Individual A, owns all of the stock of M, the common parent of a consolidated group. In Year 1, the S group has a $100 consolidated net operating loss. On January 1 of Year 2, P acquires all of the stock of S from Individual A. On January 1 of Year 3, M acquires 51% of the stock of P from Individual A. On May 31 of Year 3, M acquires the remaining 49% of the stock of P from Individual A. The P group, for the Year 3 period prior to June 1 had a $50 consolidated net operating loss, and under paragraph (b)(2)(iv) of this section, the loss is attributable entirely to S. Other than the losses described above, the P group does not have any other consolidated net operating losses.

(ii) In the P group, S's $100 loss carryover is treated as arising in a SRLY and is subject to the limitation under paragraph (c) of this section. A SRLY subgroup with respect to that loss is composed of S and T, the members which were members of the S group as to which the loss was not a SRLY.

(iii) M's January 1 purchase of 51% of P is a section 382 event because it results in an ownership change of S and T that gives rise to a section 382(a) limitation (the section 382 event) with respect to the Year 1 net operating loss carryover. The purchase, however, does not result in an ownership change of P because it is not a loss corporation under section 382(k)(1). M's May 31 purchase of 49% of P results in P, S, and T becoming members of the M group and is therefore a SRLY event.

(iv) With respect to the Year 1 net operating loss, S and T compose a SRLY subgroup under paragraph (c)(2) of this section and a loss subgroup under §1.1502–91(d)(1). The loss subgroup does not include P because the only loss at the time of the section 382 event was subject to SRLY with respect to the P group. See §1.1502–91(d)(1).

(v) Because the SRLY event and the change date of the section 382 event occur on the same date and the SRLY subgroup and loss subgroup are coextensive with respect to the Year 1 net operating loss carryover, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section. Thus, the SRLY limitation does not apply to that carryover.

(vi) The Year 3 net operating loss, which arose between the section 382 event and the SRLY event, is a net operating loss described in paragraph (g)(2)(ii)(B) of this section because it is the net operating loss of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 382 event.

(vii) With respect to the Year 3 net operating loss, P, S, and T compose a SRLY subgroup under paragraph (c)(2) of this section. Because P, a member of the SRLY subgroup for the Year 3 carryover, is not also a member of a SRLY subgroup that has net operating loss carryovers described in paragraph (g)(2)(ii)(A) of this section (the Year 1 net operating loss), the Year 3 carryover is subject to a SRLY limitation in the M group. See paragraph (g)(4)(ii) of this section.

(h) *Effective date*—(1) *In general.* This section generally applies to taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraph (g)(1) of this section does not apply to a particular net operating loss carryover in the current group, then solely for purposes of applying paragraph (c) of this section to determine a limitation with respect to that carryover and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's or subgroup's items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), paragraph (c)(2) of this section shall be applied without regard to the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502–15(g) with respect to another group (the former group)"; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 382(a), as amended by the Tax Reform Act of 1986, applies shall constitute a section 382 event.

(2) *SRLY limitation.* Except in the case of those members (including members of a SRLY subgroup) described in paragraph (h)(3) of this section, a group does not

take into account a consolidated taxable year beginning before January 1, 1997, in determining the aggregate of the consolidated taxable income under paragraph (c)(1) of this section (including for purposes of §1.1502–15 and §1.1502–22(c)) for the members (or SRLY subgroups).

(3) *Prior retroactive election.* A consolidated group that applied the rules of §1.1502–21T(g)(3) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, to all consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997, does not take into account a consolidated taxable year beginning before January 29, 1991, in determining the aggregate of the consolidated taxable income under paragraph (c)(1) of this section (including for purposes of §1.1502–15 and §1.1502–22(c)) for the members (or SRLY subgroups).

(4) *Offspring rule.* Paragraph (b)(2)(ii)-(B) of this section applies to net operating losses arising in taxable years ending on or after June 25, 1999.

(5) *Waiver of carrybacks.* Paragraph (b)(3)(ii)(B) of this section (relating to the waiver of carrybacks for acquired members) applies to acquisitions occurring after August 24, 1999.

(6) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502–21T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

§1.1502–21T [Removed]

Par. 7. Section 1.1502–21T is removed.

Par. 8. Section 1.1502–22 is added to read as follows:

§1.1502–22 Consolidated capital gain and loss.

(a) *Capital gain.* The determinations under section 1222, including capital gain net income, net long-term capital gain, and net capital gain, with respect to members during consolidated return years are not made separately. Instead, consolidated amounts are determined for the group as a whole. The consolidated capital gain net income for any consolidated return year is determined by reference to—

(1) The aggregate gains and losses of members from sales or exchanges of capital assets for the year (other than gains and losses to which section 1231 applies);

(2) The consolidated net section 1231 gain for the year (determined under §1.1502–23); and

(3) The net capital loss carryovers or carrybacks to the year.

(b) *Net capital loss carryovers and carrybacks*—(1) *In general.* The determinations under section 1222, including net capital loss and net short-term capital loss, with respect to members during consolidated return years are not made separately. Instead, consolidated amounts are determined for the group as a whole. Losses included in the consolidated net capital loss may be carried to consolidated return years, and, after apportionment, may be carried to separate return years. The net capital loss carryovers and carrybacks consist of—

(i) Any consolidated net capital losses of the group; and

(ii) Any net capital losses of the members arising in separate return years.

(2) *Carryovers and carrybacks generally.* The net capital loss carryovers and carrybacks to a taxable year are determined under the principles of section 1212 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they were sustained, and losses carried from taxable years ending on the same date, and which are available to offset consolidated capital gain net income, generally are absorbed on a pro rata basis. Additional rules provided under the Internal Revenue Code or regulations also apply, as well as the SRLY limitation under paragraph (c) of this section. See, e.g., section 382(l)(2)(B).

(3) *Carryovers and carrybacks of consolidated net capital losses to separate return years.* If any consolidated net capital loss that is attributable to a member may be carried to a separate return year under the principles of §1.1502–21(b)(2), the amount of the consolidated net capital loss that is attributable to the member is apportioned and carried to the separate return year (apportioned loss).

(4) *Special rules*—(i) *Short years in connection with transactions to which section 381(a) applies.* If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transaction does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a net capital loss may be carried.

(ii) *Special status losses.* [Reserved]

(c) *Limitations on net capital loss carryovers and carrybacks from separate return limitation years.* The aggregate of the net capital losses of a member arising (or treated as arising) in SRLYs that are included in the determination of consolidated capital gain net income for all consolidated return years of the group under paragraph (a) of this section may not exceed the aggregate of the consolidated capital gain net income for all consolidated return years of the group determined by reference to only the member's items of gain and loss from capital assets as defined in section 1221 and trade or business assets defined in section 1231(b), including the member's losses actually absorbed by the group in the taxable year (whether or not absorbed by the member). The principles of §1.1502–21(c) (including the SRLY subgroup principles under §1.1502–21(c)(2)) apply with appropriate adjustments for purposes of applying this paragraph (c).

(d) *Coordination with respect to consolidated return change of ownership limitation occurring in consolidated return years beginning before January 1, 1997.* If a consolidated return change of ownership occurred before January 1, 1997, the principles of §1.1502–22A(d) apply to determine the amount of the aggregate of the net capital loss attributable to old members of the group (as those terms are defined in §1.1502–1(g)), that may be included in the net capital loss carryover under paragraph (b) of this section. For this purpose, §1.1502–1(g) is applied by treating that date as the end of the year of change.

(e) *Consolidated net capital loss.* Any excess of losses over gains, as determined under paragraph (a) of this section (without regard to any carryovers or carrybacks), is also referred to as the consolidated net capital loss.

(f) *Predecessors and successors.* For purposes of this section, the principles of §1.1502–21(f) apply with appropriate adjustments.

(g) *Overlap with section 383*—(1) *General rule.* The limitation provided in paragraph (c) of this section does not apply to net capital loss carryovers ((other than a hypothetical carryover like those described in §1.1502–21(c)(1)(i)(D) and a carryover like those described in §1.1502–21(c)(1)(ii)) when the application of paragraph (c) of this section results in an overlap with the application of section 383. For a similar rule applying in the case of net capital loss carryovers like those described in §§1.1502–21(c)(1)(i)-(D) and (c)(1)(ii), see §1.1502–15(g).

(2) *Definitions*—(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in sections 382 and 383, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap.* (A) An overlap of the application of paragraph (c) of this section and the application of section 383 with respect to a net capital loss carryover occurs if a corporation becomes a member of the consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382 limitation with respect to that carryover (the section 383 event).

(B) If an overlap described in paragraph (g)(2)(ii)(A) of this section occurs with respect to net capital loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 383 event, then an overlap is treated as also occurring with respect to that corporation's net capital loss carryover that arises within the period beginning with the section 383 event and ending with the SRLY event.

(C) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(1) with respect to a carryover, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 383 event before SRLY event.* If a SRLY event occurs on the same date as a section 383 event or within the six month period beginning on the date of the section 383 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event.

(ii) *SRLY event before section 383 event.* If a section 383 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 383 event.

(4) *Subgroup rules.* In general, in the case of a net capital loss carryover for which there is a SRLY subgroup and a loss subgroup (as defined in §1.1502–91(d)(1)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies—

(i) With respect to a carryover described in paragraph (g)(2)(ii)(A) of this section only if—

(A) All members of the SRLY subgroup with respect to that carryover are also included in a loss subgroup with respect to that carryover; and

(B) All members of a loss subgroup with respect to that carryover are also members of a SRLY subgroup with respect to that carryover; and

(ii) With respect to a carryover described in paragraph (g)(2)(ii)(B) of this section only if all members of the SRLY subgroup for that carryover are also members of a SRLY subgroup that has net capital loss carryovers described in paragraph (g)(2)(ii)(A) of this section that are subject to the overlap rule of paragraph (g)(1) of this section.

(h) *Effective date*—(1) *In general.* This section generally applies to taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraph (g)(1) of this section does not apply to a particular net capital loss carryover in the current group, then solely for purposes of applying paragraph (c) of this section to determine a limitation with respect to that carryover and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's or subgroup's items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), the principles of §1.1502–21(c)(2) shall be applied without regard to the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502–15(g) with respect to another group (the former group)"; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 383, as amended by the Tax Reform Act of 1986, applies and which results in a section 382 limitation shall constitute a section 383 event.

(2) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502–22T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

§1.1502–22T [Removed]

Par. 9. Section 1.1502–22T is removed.

Par. 10. Section 1.1502–23 is added to read as follows:

§1.1502–23 Consolidated net section 1231 gain or loss.

(a) *In general.* Net section 1231 gains and losses of members arising during consolidated return years are not determined separately. Instead, the consolidated net section 1231 gain or loss is determined under this section for the group as a whole.

(b) *Example.* The following example illustrates the provisions of this section:

Example. Use of SRLY registers with net gains and net losses under section 1231. (i) In Year 1, T sustains a $20 net capital loss. At the beginning of Year 2, T becomes a member of the P group. T's capital loss carryover from Year 1 is subject to SRLY limits under §1.1502–22(c). The members of the P group contribute the following to the consolidated taxable income for Year 2 (computed without regard to T's net capital loss carryover under §1.1502–22):

	P	T
	Year 1 (SRLY)	
Ordinary		
Capital		(20)
	Year 2	
Ordinary	10	20
Capital	70	0
§1231	(60)	30

(ii) Under section 1231, if the section 1231 losses for any taxable year exceed the section 1231 gains for such taxable year, such gains and losses are treated as ordinary gains or losses. Because the P group's section 1231 losses, $(60), exceed the section 1231 gains, $30, the P group's net loss is treated as an ordinary loss. T's net section 1231 gain has the same character as the P group's consolidated net section 1231 loss, so T's $30 of section 1231 income is treated as ordinary income for purposes of applying §1.1502–22(c). Under §1.1502–22(c), the group's consolidated net capital gain determined by reference only to T's items is $0. None of T's capital loss carryover from Year 1 may be taken into account in Year 2.

(c) *Recapture of ordinary loss.* [Reserved]

(d) *Effective date*—(1) *In general.* This section applies to gains and losses arising in the determination of consolidated net section 1231 gain or loss for taxable years for which the due date (without extensions) of the consolidated return is taxable years is after June 25, 1999.

(2) *Application to prior periods.* See §1.1502–21(h)(3) for rules applicable to groups that applied the rules of this section to consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997.

§1.1502–23T [Removed]

Par. 11. Section 1.1502–23T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 12. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 13. In §602.101, paragraph (b) is amended by removing the entry for §1.1502–21T from the table and adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–21	1545–1237
* * * * *	

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved June 18, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 25, 1999, 1:27 p.m., and published in the issue of the Federal Register for July 2, 1999, 64 F.R. 36091)

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26 CFR 1.1502–91A: Application of Section 382 with respect to a consolidated group generally applicable for testing dates before June 25, 1999.

T.D. 8824

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

Regulations Under Section 1502 of the Internal Revenue Code of 1986; Limitations on Net Operating Loss Carryforwards and Certain Built-in Losses and Credits Following an Ownership Change of a Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding the operation of sections 382 and 383 of the Internal Revenue Code of 1986 (relating to limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change) with respect to consolidated groups. The regulations include rules for determining whether a loss group or a loss subgroup has an ownership change, for computing a consolidated section 382 limitation or subgroup section 382 limitation, and for applying sections 382 and 383 to corporations that join or leave a group. The rules are necessary to provide guidance to such groups on the use of certain of their tax attributes.

DATES: *Effective Dates:* These regulations are effective June 25, 1999.

Applicability Dates: For dates of application and special effective date rules, see Effective Dates under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Lee A. Kelley at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in these final regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1218.

The collections of information in this regulation are in §§1.1502–20(g)(4), 1.1502–95(e)(8), 1.1502–95(f), and 1.1502–96(e). This information is required to assure that a section 382 limitation is properly determined and applied in cases of corporations that become or cease to be members of a consolidated group. The collection of information in §1.1502–98(e)(8) is mandatory. The other collections of information are required to obtain a benefit. The likely respondents are business or other for-profit institutions.

Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by August 31, 1999. Comments are specifically requested concerning:

Whether the collection[s] of information is necessary for the proper performance of the functions of the **Internal Revenue Service,** including whether the information will have practical utility;

The accuracy of the estimated burden associated with the collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the collection[s] of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Estimated total annual reporting burden: 662 hours.

The estimated annual burden per respondent varies from 15 to 25 minutes, depending on individual circumstances, with an estimated average of 20 minutes.

Estimated number of respondents: 12,054

Estimated annual frequency of responses: On occasion

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On February 4, 1991, the IRS and Treasury issued three notices of proposed rulemaking, CO–132–87 (56 F.R. 4194 [1991–1 C.B. 728]), CO– 077–90 (56 F.R. 4183 [1991–1 C.B. 749]), and CO–078–90 (56 F.R. 4228 [1991–1 C.B. 757]), setting forth rules regarding the application of sections 382 and 383 by consolidated groups and by controlled groups, and regarding the use of built-in deductions and net operating losses and capital losses, including the carryover and carryback of separate return limitation year (SRLY) losses of members of consolidated groups. A public hearing regarding the three sets of proposed regulations was held on April 8, 1991.

On June 27, 1996, the IRS and Treasury published temporary regulations (T.D. 8678, 61 F.R. 33335 [1996–2 C.B. 134]) setting forth rules regarding the application of section 382 to affiliated groups of corporations filing consolidated returns. These regulations were substantially identical to the proposed regulations. A notice of proposed rulemaking cross-referencing the temporary regulations was published in the **Federal Register** on the same day (CO–026–96, 61 F.R. 33391 [1996–2 C.B. 440]) and the proposed regulations published in 1991 were withdrawn. The IRS and Treasury also published temporary regulations regarding the SRLY limitation (T.D. 8677, 61 F.R. 33321 [1996–2 C.B. 119]), and controlled group losses (T.D. 8679, 61 F.R. 33313 [1996–2 C.B. 25]). Notices of proposed rulemaking cross-referencing these temporary regulations were published on the same day (CO–025–96, 61 F.R. 33395 [1996–2 C.B. 439] and CO–024–96, 61 F.R. 33393 [1996–2 C.B. 437]) and the proposed regulations published in 1991 were withdrawn.

This Treasury decision adopts the 1996 proposed regulations regarding the application of section 382 to affiliated groups of corporations filing consolidated returns. The principal changes to those proposed regulations are described below.

As companions to this Treasury decision, the IRS and Treasury also are issuing final regulations relating to the application of sections 382 and 383 by members of controlled groups, and relating to the SRLY limitation. See T.D. 8823 on page 34 and T.D. 8825, 1999–28 I.R.B. 19.

Explanation of Provisions

A. Overview

1. Sections 382 and 383

Under section 382, if an ownership change occurs with respect to a loss corporation (as defined in section 382 and the regulations thereunder), the amount of the loss corporation's taxable income for a post-change year that may be offset by the net operating losses of the loss corporation arising before the ownership change is limited by an amount known as the section 382 limitation. The section 382 limitation for a taxable year of a loss corporation after an ownership change generally is equal to the fair market value of the corporation's stock immediately before the ownership change multiplied by the long-term tax exempt rate (a rate of return published periodically in the Internal Revenue Bulletin). See generally sections 382(b), (e), and (f). This limitation for a taxable year may be increased by certain items, such as an unused limitation from a prior taxable year and certain built-in gains recognized during the taxable year. See section 382(b)(2) and (h).

In general, an ownership change involves an increase of more than 50 percentage points in stock ownership by 5-percent shareholders during the testing period (usually the 3-year period ending on the date on which a loss corporation must make a determination whether it has had an ownership change). In determining whether an ownership change has occurred, all transactions occurring during the testing period that affect the stock ownership of any 5-percent shareholder whose percentage of stock ownership has increased as of the close of the testing date are taken into account. The determination of the percentage ownership interest of any shareholder is made on the basis of the ratio of the fair market value of the loss corporation stock owned by the shareholder to the total fair market value of the loss corporation's outstanding stock. Ordinarily, all stock of the loss corporation, except certain preferred stock described in section 1504(a)(4), is taken into account. These rules are contained in §§1.382–2 and 1.382–2T and relate to ownership changes of corporations without regard to whether the corporations file a separate return or join in filing a consolidated return.

2. General Description of Final Regulations

This document contains two sets of rules. The first set of rules, set forth in §§1.1502–91 through 1.1502–93, provide the tax treatment for net operating losses that arise in (and net unrealized built-in losses with respect to) years that are not separate return limitation years with respect to a consolidated group. (A separate return limitation year, or SRLY, generally is a taxable year of a subsidiary in which the subsidiary was not a member of the group). In general, these rules adopt a single entity approach to determine ownership changes and the section 382 limitations with respect to such losses.

These final regulations also extend the single entity approach to loss subgroups within consolidated groups. A loss subgroup generally consists of two or more corporations that continue to be affiliated with each other after leaving one group and joining another where at least one of the corporations carries over losses from the first group to the second group. Thus, the single entity approach under the final regulations can apply, for example, to a consolidated group's acquisition of another consolidated group or of a chain of subsidiaries from another group.

The second set of rules, set forth in §§1.1502–94 and 1.1502–95, applies to corporations that join or leave a consolidated group with respect to certain attributes (e.g., attributes other than those arising in a consolidated return year). In general, section 382 is applied separately with respect to those attributes because the attributes cannot be used by other members. Section 1.1502–96 contains miscellaneous rules.

In general, §1.1502–98 provides that the rules contained in §§1.1502–91

through 1.1502–96 also apply for purposes of section 383, with adjustments to reflect that section 383 applies to credits and net capital losses.

B. *Amendments to the Proposed Regulations*

1. Definition of a Loss Subgroup, §1.1502–91(d)

Under the proposed regulations, a loss subgroup is composed of members of one group (the former group) that become members of another consolidated group. In the case of a net operating loss carryover, the members of a group compose a loss subgroup if (i) they were affiliated with each other in another group, (ii) they bear a relationship to each other described in section 1504(a)(1) immediately after they become members of the group (the subgroup parent requirement), and (iii) at least one of the members carries over a net operating loss arising in a year that is not a SRLY (and is not treated as a SRLY under proposed §1.1502–21(c)) with respect to the former group. In the case of a net unrealized built-in loss (NUBIL), the members of a group compose a loss subgroup if they (i) have been continuously affiliated with each other for the 5 consecutive year period ending immediately before they become members of the group (the five-year affiliation requirement), (ii) meet the subgroup parent requirement, and (iii) have, in the aggregate, a NUBIL. A member ceases to be included in a loss subgroup when it files a separate return, or when a member breaks the relationship described in section 1504(a)(1) to the loss subgroup parent, regardless of whether that member leaves the current group or remains in the consolidated group.

Retention of the subgroup parent requirement in general

Commentators suggested that the final regulations should eliminate the subgroup parent requirement in order to provide a single subgroup definition for the SRLY limitation and for the section 382 limitation. Other commentators recommended eliminating the requirement following an ownership change of the loss subgroup.

Like a loss group, a loss subgroup has an ownership change if the loss subgroup parent has an ownership change (the parent change method). The parent change method, adopted for its administrative simplicity, looks only to ownership shifts of the parent corporation in determining whether the consolidated group (or loss subgroup) has an ownership change. Owner shifts of minority stock of subsidiary members are not taken into account. Application of the parent change method to loss subgroups eliminates the administrative burdens associated with a rule that would mandate separate tracking of the minority stock of each subgroup member for determining whether an ownership change of the loss subgroup has occurred.

The IRS and the Treasury have determined that, in circumstances where owner shifts of a loss subgroup must continue to be tracked, the parent change method should continue to apply for determining whether a subgroup has an ownership change. Accordingly, in general, these final regulations retain the subgroup parent requirement. Also, these final regulations retain the general rule that a member ceases to be a member of the loss subgroup on the first day that it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent. The final regulations, however, provide an election to treat the subgroup parent requirement as satisfied, and provide certain exceptions for ceasing to be a member of a loss subgroup when a member breaks the relationship described in section 1504(a)(1) to the loss subgroup parent, but remains within the current consolidated group.

Election to treat subgroup parent requirement as satisfied

The subgroup parent requirement may preclude subgroup treatment in instances where single entity principles make such treatment conceptually appropriate. For example, brother-sister corporations with net operating loss carryovers that are not SRLY losses with respect to the former group are not a loss subgroup even if the same acquirer acquires both corporations at the same time. However, single entity principles support treating the brother-sister corporations as a subgroup because they were affiliated with each other in the former group and remain affiliated in the current group.

To extend single entity treatment in such cases would require a mechanism other than the parent change method to track owner shifts of the loss subgroup. Some commentators suggested permitting the parent of the current group to designate the subgroup parent. Under this approach, such designation would be respected unless the designation is made with a principal purpose of avoiding an ownership change.

The IRS and the Treasury believe that the ability to designate the subgroup parent presents opportunities for avoiding or lessening the impact of section 382. Also, a principal purpose standard is not an effective mechanism for preventing inappropriate designations because the *only* purpose of such designation is to apply the ownership change rules of section 382.

The IRS and Treasury recognize, however, that it is appropriate to extend subgroup treatment to the extent that single entity principles support such treatment, and to the extent that subgroup treatment does not compromise the determination whether a subgroup has an ownership change. Also, the IRS and Treasury recognize that, in certain circumstances, taxpayers may prefer more stringent ownership change rules if they can obtain the benefit of subgroup treatment. Finally, the IRS and Treasury recognize that the ability of brother-sister corporations to constitute a section 382 subgroup may be necessary in order for section 382 subgroups to conform with SRLY subgroups, thus permitting application of the rule that eliminates a separate SRLY limitation where the application of SRLY and section 382 overlap. See §§1.1502–15(g), 1.1502–21(g) and 1.1502–22(g).

Accordingly, these final regulations provide that two or more corporations that become members of a consolidated group at the same time and that were affiliated with each other immediately before becoming members of the group are deemed to meet the subgroup parent requirement immediately after they become members of the group if the common parent of the acquiring group makes an election under §1.1502–91(d)(4) with respect to those members. An election includes all corporations that become members of the current group at the same time and that were affiliated with each other immediately before they become members of the current

group. The election applies solely for purposes of satisfying the subgroup parent requirement, and does not apply in determining whether members meet the other requirements for inclusion in a loss subgroup. Although the election applies solely for purposes of §§1.1502–91 through 1.1502–96 and §1.1502–98, the election may affect whether a SRLY limitation overlaps with application of section 382.

If the common parent makes an election under §1.1502–91(d)(4), each of the members with respect to which the election is made (and that is included in the loss subgroup) is treated as the loss subgroup parent for purposes of determining if the loss subgroup has an ownership change on, or after, becoming members of the current group. If, however, a member with respect to which the election is made has an ownership change upon (or after) ceasing to be a member of the current group, that ownership change does not cause an ownership change of a loss subgroup comprised of one or more of its members that remain members of the current group.

Exceptions for ceasing to be a member of a loss subgroup when a member breaks the section 1504(a)(1) relationship with the loss subgroup parent, §1.1502–95(d)(1)

In general, under §1.1502–95(d)(1)(ii), these final regulations provide that a member ceases to be a member of the loss subgroup on the first day that it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent. Continued affiliation through a loss subgroup parent is central to the operation of the parent change method to loss subgroups.

Under certain circumstances, however, separate tracking of the loss subgroup parent terminates, eliminating the need for members to maintain a section 1504(a)(1) relationship through a loss subgroup parent. Section 1.1502–96(a) provides, in part, that ownership shifts of a loss subgroup cease to be separately tracked if there is an ownership change of the loss subgroup within six months before, on, or after becoming members of the group, or if a period of five years elapses after becoming members of group during which time the loss subgroup does not have an ownership change (a fold-in event).

Also, an election under §1.1502–91(d)(4) obviates the need for a section 1504(a)(1) relationship through a loss subgroup common parent because each member is separately tracked as if it were the loss subgroup parent.

In circumstances where the necessity of a section 1504(a)(1) relationship through a loss subgroup parent is eliminated, the IRS and the Treasury believe that a subgroup member should not cease to be a member of the subgroup solely because it ceases to bear such a relationship. Accordingly, these final regulations provide two exceptions to the general rule of §1.1502–95(d)(1)(ii). The first exception applies to the members of the loss subgroup if an election under §1.1502–91(d)(4) applies to them. The second exception applies to loss subgroup members following a fold-in event.

Members excluded or included from a subgroup with a principal purpose of avoiding a limitation, §1.1502–91(d)(5)

Proposed §1.1502–91(d)(5) provides that corporations do not compose a loss subgroup if any one of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, section 382. This rule does not apply solely because, in connection with becoming members of the group, the members of a group are rearranged to satisfy the subgroup parent requirement. The final regulations retain these provisions, and, in conformity with the anti-abuse rule for SRLY subgroups, provide that any member excluded from a loss subgroup, if excluded with a principal purpose of avoiding or increasing a section 382 limitation, is treated as included in the loss subgroup. This rule does not apply solely because a group does not rearrange members of a group to satisfy the subgroup parent requirement.

2. Definition of Loss Subgroup with a NUBIL, §1.1502–91(d)(2)

Commentators criticized the five-year affiliation requirement for adding complexity to the regulations. For instance, the five-year affiliation requirement can cause application of section 382 and SRLY on a single entity basis with respect to members of a loss subgroup with a net operating loss carryover that arose within the former group (because an NOL loss subgroup does not require five years of affiliation), but on a separate entity basis for those same members with respect to built-in losses.

The IRS and Treasury have determined, however, that the five-year affiliation requirement is a necessary feature of the NUBIL subgroup rules. Just as the NOL subgroup rules apply only to loss carryovers that arise in (or have folded into) the former group, so should the NUBIL subgroup rules apply only to built-in losses that accrue within (or have folded into) the former group. Because an accurate method of determining economic accrual *(e.g.,* tracing) would present significant problems for tax administration and for compliance by taxpayers, the IRS and Treasury believe that the five-year affiliation requirement is the best available proxy for determining when built-in attributes arise.

Absent a five-year affiliation requirement, taxpayers could effectively traffic in net unrealized built-in losses without being subject to any limitation (other than one imposed under an applicable "principal purpose" anti-abuse rule). A selling group could acquire a new member with a NUBIG and sell both that recently-acquired NUBIG member and the member containing the desired NUBIL to the prospective buyer. To the extent that the NUBIG offset the NUBIL and the corporations were structured to satisfy the requirements for subgroup treatment, recognized built-in losses would escape any limitation and could be freely absorbed by the acquiring group.

Furthermore, the absence of a five-year affiliation requirement could be used to circumvent a SRLY limitation applicable to a NUBIL if built-in losses are recognized. For instance, if a member comes into a group with a NUBIL and without an ownership change, recognition of that NUBIL would be subject to a SRLY limitation during the following five years and the loss could not be freely absorbed by the income of the other members of the group. However, if all the members of the group were included in a NUBIL subgroup upon being acquired by a second group two years into that five-year period,

that member's recognized built-in losses immediately thereafter would be subject either to a SRLY or section 382 limitation computed with respect to all the members of the former group (thus increasing the rate at which such losses can be utilized) or, in the event that the acquired corporations have an aggregate NUBIG, to no limitation whatsoever.

Some commentators contended that the five-year affiliation requirement (and the time period required for a fold-in event under §1.1502–96(a)) should be reduced to three years, based on the duration of the testing period for an ownership change under section 382.

However, a five-year (rather than a three-year) affiliation requirement is necessary to ensure that taxpayers cannot shorten the five-year recognition period for the SRLY limitation, as described above. Also, the IRS and Treasury believe that the five-year recognition period for the SRLY limitation should be maintained because it mirrors the statutorily-mandated five-year recognition period of section 382(h)(7). In general, Treasury and the IRS believe that it is important to conform the application of section 382 and the SRLY rules where possible, particularly in the light of the rule eliminating application of SRLY where its application overlaps with that of section 382.

Moreover, the five-year affiliation requirement is consistent with Congress' indication in section 384(a) of the point at which it is appropriate for built-in attributes of a member to be treated as attributes of the group. Under certain circumstances, section 384(a) prevents the recognized built-in gain of one corporation from offsetting preacquisition losses of another corporation, if such gain is recognized within a five-year period following the acquisition date. Similarly, section 384(b) provides that section 384(a) does not apply to prevent the recognized built-in gain of one corporation from offsetting the preacquisition losses of another corporation if the gain corporation and the loss corporation were members of the same controlled group (as defined in section 384(b)(2)) for the five-year period ending on the acquisition date.

For these reasons, the final regulations do not reduce the duration of the affiliation requirement from five years to three years.

Commentators requested clarification that an acquiring group takes into account application of the fold-in rules of §1.1502–96(a) in the former group in determining which members are included in a loss subgroup. A new example under §1.1502–96(a)(3), and a cross-reference in a new §1.1502–91(g)(3) to the fold-in rules, clarifies this treatment. Thus, a corporation whose NUBIL folded in to a former group is deemed to have a five-year affiliation with the common parent of that group (and is deemed to have affiliation histories with other group members). A special rule provides that the corporation is not deemed to have been previously affiliated with another corporation that joined the former group at the same time, but was not taken into account in determining a NUBIL limitation, even if in fact the two corporations were previously affiliated.

3. Members Included—Determination Whether a Consolidated Group Has a NUBIL, §1.1502–91(g)(2)(ii)

Proposed §1.1502–91(g)(2)(i) provides, in part, that the members included in the determination whether a consolidated group has a NUBIG or NUBIL are all members of the group on the day the determination is made, other than a new loss member with a NUBIL, and members included in a NUBIL subgroup.

The IRS and Treasury have determined that the reasons for applying a five-year affiliation requirement to subgroups are equally relevant to groups. Accordingly, these final regulations provide that the members included in the determination whether a consolidated group has a NUBIL are the common parent and all other members that have been affiliated with the common parent for the five consecutive year period ending on the day that the determination is made.

In certain cases, a member (or loss subgroup) can join a consolidated group with a NUBIG, but have a NUBIL on the date the consolidated group determines whether it has a NUBIL. The IRS and Treasury have determined that, in such cases, it is appropriate for the built-in attribute of the member to be included in the group's determination because it is clear that such NUBIL arose when it was a group member. Accordingly, the final regulations include in the determination whether a group has a NUBIL any member that has a NUBIL on the date the determination is made, and that is neither a new loss member with a NUBIL nor a member of a NUBIL loss subgroup. The final regulations also include members in the group's determination whether the group has a NUBIL if such member(s) joined the consolidated group with a NUBIL, and, in the aggregate, have a NUBIG on the day that such determination is made.

4. Included—Determination Whether a Consolidated Group (or Loss Subgroup) with a Net Operating Loss Has a NUBIG, §1.1502–91(g)(2)(i)

Proposed §1.1502–93(c) provides that if a loss group (or loss subgroup) has a NUBIG, *any* recognized built-in gain of the loss group (or loss subgroup) is taken into account under section 382(h) in determining the consolidated section 382 limitation (or subgroup section 382 limitation)(emphasis added).

Commentators suggested that this provision, considered together with the five-year affiliation requirement, makes it unclear whether an NOL loss subgroup with members that do not satisfy the five-year affiliation requirement can use a NUBIG, if recognized, to increase the loss subgroup's section 382 limitation.

The IRS and Treasury have determined that the concerns forming the basis of the five-year affiliation requirement for determining whether a loss subgroup has a NUBIL do not extend to the determination whether a net operating loss carryover group (or loss subgroup) has a NUBIG. For example, unlike a NUBIL that can be eliminated by a NUBIG without an immediate tax cost, recognized built-in gains exact such a cost and, therefore, do not present the same planning opportunities. Accordingly, these final regulations provide that the members included in the determination whether an NOL loss group (or loss subgroup) has a NUBIG are all members of the group (or loss subgroup) on the day that the determination is made.

Section 1.1502–91(g)(2)(v) provides, in part, that in determining whether an NOL loss group has a NUBIG which, if recognized, increases the consolidated

section 382 limitation, the group includes all of its members on the day the determination is made. However, for purposes of determining whether a group has a net unrealized built-in loss, not all members of the consolidated group may be included. Thus, a consolidated group may have recognized built-in gains that increase the amount of consolidated taxable income that may be offset by its pre-change net operating loss carryovers that did not arise (and are not treated as arising) in a SRLY, and also may have recognized built-in losses the absorption of which is limited. Similar results may obtain for loss subgroups. In such cases, §1.1502–93(c)(2) prohibits the use of recognized built-in gains to increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

5. Recognized Built-in Gain or Loss on the Disposition of an Intercompany Obligation of a Member, §1.1502–91(h)(2)

Proposed §1.1502–91(h)(2) provides that gain or loss recognized by a member on the disposition of stock of another member or of an intercompany obligation is treated as recognized built-in gain or loss under section 382(h)(2)(unless disallowed under §1.1502–20 or otherwise), even though gain or loss on such stock or obligation is not included in the determination of the group's NUBIG or NUBIL immediately before the ownership change. The IRS and Treasury have determined that such treatment may lead to inappropriate results. For instance, if a bad debt deduction is treated as a recognized built-in loss, application of a section 382 limitation to that loss may prevent the proper offset of cancellation of indebtedness income against the bad debt deduction. Accordingly, §1.1502–91(h)-(2) of the final regulations treats gain or loss recognized on the disposition of an intercompany obligation as recognized built-in gain or loss only to the extent that the transaction gives rise to aggregate income or loss within the consolidated group.

6. Ownership Change Determination—The Parent Change Method, §1.1502–92

Proposed §1.1502–92 provides rules for determining an ownership change of a loss group (or a loss subgroup). A loss group (or loss subgroup) has an ownership change only if the common parent has an ownership change under the parent change method. Out of concern that taxpayers could exploit the parent change method's failure to account for minority shifts of stock, the proposed regulations adopted a supplemental change method that does take into account minority shifts of stock under certain circumstances.

Under the proposed regulations, the supplemental method applies if a person who is a 5-percent shareholder of the common parent (including any person acting pursuant to a plan or arrangement with such 5-percent shareholder) increases its percentage ownership both in the common parent and in any subsidiary of the group within the same testing period. In that event, the loss group (or loss subgroup) must also determine whether it had an ownership change under the rules for the parent change method by treating the common parent as though it had issued to the person who acquires (or is deemed to acquire) the subsidiary stock an amount of its own stock (by value) that equals the value of the subsidiary stock represented by the percentage increase in that person's ownership of the subsidiary (determined on a separate entity basis).

Section 1.1502–92(c), *Example 2* of the proposed regulations illustrates application of the supplemental change method. In *Example 2*, A owns all the stock of L, a loss group parent, and L owns all of the stock of L1. As part of a plan, A sells 49 percent of the L stock to B on October 7, Year 2, and L1 issues new stock representing a 20 percent ownership interest in L1 to the public on November 6, Year 2. The example concludes that "because the issuance of L1 stock to the public occurs in connection with B's acquisition of L stock pursuant to a plan," the supplemental change method applies to the public offering of L1 stock.

Commentators suggest that the "plan or arrangement" language sweeps too broadly, and that only plans to avoid section 382 should be subject to this rule. Commentators also contend that *Example 2* is beyond the scope of the operative rule because the facts do not demonstrate a plan or arrangement with a 5-percent shareholder.

The IRS and Treasury believe that it is appropriate to apply the supplemental change method to certain acquisitions of a loss group in which the plan is not between the 5-percent shareholder of the loss group parent and another person to increase their interests in the loss group. For example, if an individual buys 50 percent or less of the stock of a loss group parent, and as part of the same plan, causes a public offering out of a subsidiary, the supplemental change method should apply to that offering. (Conversely, the supplemental change method should not apply unless the 5-percent shareholder's increase in the stock of parent or subsidiary is related to the increase by another person because those increases are pursuant to the same plan.)

Accordingly, these final regulations provide that a 5-percent shareholder of the common parent (or loss subgroup parent) is treated as increasing its ownership interest in the stock of a subsidiary to the extent, if any, that the percentage ownership interest of another person or persons in the stock of the subsidiary is increased pursuant to a plan or arrangement under which the 5-percent shareholder increases its percentage ownership interest in the common parent (or loss subgroup parent).

To alleviate concerns that the supplemental change method is overly broad, the final regulations limit the scope of the supplemental change method through application of the rules of §1.382–2T(k). The final regulations provide that the supplemental change method will apply if the common parent (or loss subgroup parent) has actual knowledge of the increase in the 5-percent shareholder's ownership interest in the stock of the subsidiary (or has actual knowledge of the plan or arrangement) before the date that the group's income tax return is filed for the taxable year that includes the date of that increase or, if, at any time during the testing period, the 5-percent shareholder of the common parent is also a 5-percent shareholder of the subsidiary (determined without regard to a deemed acquisition of subsidiary stock under the plan or arrangement rule) whose percentage increase in the ownership of the stock of the subsidiary would be taken into account in determining if the subsidiary has an ownership change. For purposes of determining the 5-percent shareholders of the sub-

sidiary, the principles of §1.382–2T(k), including the duty to inquire, apply to the common parent (or loss subgroup parent).

Several additional changes to the supplemental change method were made in response to comments. Section 1.1502–92(c)(4)(iii) clarifies that stock treated as issued under the supplemental change method is not treated as issued in testing periods that do not include the testing date on which the parent stock is deemed to be issued. Section 1.1502–92(c)(4)(ii) provides that stock is not treated as issued if a deemed issuance of parent stock would not cause the loss group (or loss subgroup) to have an ownership change before the day on which the subsidiary leaves the loss group (or loss subgroup).

To avoid retroactive changes in ownership, §1.1502–92(c)(4)(v) provides that if the supplemental change method applies to an acquisition of subsidiary stock before the first date that the 5-percent shareholder increases its percentage ownership interest in the stock of the common parent (or loss subgroup parent), then the deemed issuance of stock is treated as occurring on the first such date. However, the value of the subsidiary stock is the value of such stock on the date it was acquired. In addition, §1.1502–92(c)(4)(vi) provides that if two or more 5-percent shareholders are treated as increasing their percentage ownership interests pursuant to a single plan or arrangement described above, appropriate adjustments must be made so that the amount of stock treated as issued is not taken into account more than one time.

Commentators also requested that the supplemental change method apply only if the acquisitions of parent stock and subsidiary stock are with a principal purpose of avoiding or lessening the impact of section 382. The IRS and Treasury believe that if the same 5-percent shareholder increases in the stock of both a subsidiary and the common parent within the same testing period, the supplemental change method should apply without further evidence of an avoidance purpose. Similarly, a plan or arrangement under which a 5-percent shareholder and another person both increase their interests in the loss group is sufficient proof of an avoidance purpose that the supplemental change method properly applies without further inquiry.

7. Consolidated Section 382 Limitation, §1.1502–93

Proposed §1.1502–93 provides rules for computing the consolidated section 382 limitation following an ownership change of a loss group. The value of the loss group is the value, immediately before the ownership change, of the stock (including stock described in section 1504(a)(4)) of each member of the loss group, other than stock that is owned directly or indirectly by a member. Section 1.1502–93(b)(2) provides that this value is adjusted under any rule in section 382 (such as section 382(l)(1), relating to certain capital contributions) requiring an adjustment to value for purposes of computing the section 382 limitation. The section 382 limitation, as so determined, is further adjusted as required by section 382 and the regulations thereunder (such as section 382(m)(2), relating to a short taxable year). Similar rules apply in determining the section 382 limitation for a loss subgroup.

In response to comments, the final regulations make several clarifications with respect to circumstances that require an adjustment to the value of a loss group or loss subgroup.

Section 1.1502–93(b)(2)(i) provides that, for purposes of section 382(e)(2), redemptions and corporate contractions that do not effect a transfer of value outside of the loss group (or loss subgroup) are disregarded. For purposes of section 382(l)(1), capital contributions between members of the loss group (or loss subgroup)(or a contribution of stock to a member made solely to satisfy the loss subgroup parent requirement of §§1.1502–91(d)(1)(ii) or 1.1502–91(d)-(2)(ii)), are not taken into account. Also, the substantial nonbusiness asset test of section 382(l)(4) is applied on a group (or subgroup) basis, and is not applied separately to its members.

Section 1.1502–93(b)(2)(ii) provides rules that apply to prevent duplication of value of the group (or loss subgroup) and to prevent duplication of the section 382 limitation. This section provides that appropriate adjustments must be made to the extent necessary to prevent any duplication of the value of the stock of a member, even though corporations that do not file consolidated returns may not be required to make such an adjustment. In making these adjustments, the group (or loss subgroup) may apply the principles of §1.382–8 (relating to controlled groups of corporations) in determining the value of a loss group (or loss subgroup) even if that section would not apply if separate returns were filed. Also, the principles of §1.382–5(d)(relating to successive ownership changes and absorption of a section 382 limitation) may apply to adjust the consolidated section 382 limitation (or subgroup section 382 limitation) of a loss group (or loss subgroup) to avoid a duplication of value if there are simultaneous (rather than successive) ownership changes.

One commentator suggested that contributions of assets by the selling group to a departing member or loss subgroup generally should not be subject to section 382(l)(1). The IRS and Treasury have determined that, unlike transfers of stock or assets that do not effect a transfer of value into a loss subgroup, capital contributions that constitute a transfer of value into a loss group or to a departing member should continue to be subject to section 382(l)(1).

A new §1.1502–93(c)(2) provides that appropriate adjustments must be made so that any recognized built-in gain of a member that increases more than one section 382 limitation (whether consolidated, subgroup, or separate) does not effect a duplication in the amount of consolidated taxable income that can be offset by prechange net operating losses. In addition, recognized built-in gains may not increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

8. Ceasing to Be a Member of a Consolidated Group (or Loss Subgroup), §1.1502–95

Elective apportionment of NUBIG

In general, the common parent of a consolidated group may elect to apportion all or part of each element (the value element and the adjustment element) of a consolidated section 382 limitation to a former member or loss subgroup. The proposed regulations do not provide that the common parent may elect to apportion all or part of a loss group's NUBIG.

Under section 382(h)(1)(A), if a consolidated group has a NUBIG immediately before an ownership change, the

section 382 limitation for any recognition period taxable year is increased by the recognized built-in gain for such taxable year. This increase cannot exceed the NUBIG, reduced by recognized built-in gains for prior years ending in the recognition period.

Commentators suggest that, like the value element and the adjustment element of the consolidated section 382 limitation, the common parent should be able to apportion any part or all of the group's NUBIG to a departing member (or loss subgroup). The final regulations adopt this recommendation.

In general, §1.1502–95(c)(2)(ii) provides that the amount of the loss group's NUBIG that may be apportioned to one or more former members that cease to be members during the same consolidated return year cannot exceed the loss group's excess, immediately after the close of that year, of net unrealized built-in gain over recognized built-in gain, determined under section 382(h)(1)(A)(ii) (relating to a limitation on recognized built-in gain). In general, NUBIG apportioned to a former member reduces the amount of NUBIG that the group can avail itself of in subsequent taxable years.

For purposes of determining the extent to which the former member's section 382 limitation can be increased by recognized built-in gains, the amount of NUBIG apportioned is treated as if it were an amount determined under section 382(h) with respect to the former member. The former member's five-year recognition period begins on the group's (or loss subgroup's) change date.

Default apportionment of zero section 382 limitation and NUBIG when a member ceases to be a member of a group (or loss subgroup), §1.1502–95(c)(2)(ii)

Section 1.1502–95(c)(1) provides that the common parent may elect to apportion all or any part of a consolidated section 382 limitation to a former member (or a loss subgroup) when the member or loss subgroup leaves the group. If the common parent does not make an apportionment of the applicable section 382 limitation(s) or of a NUBIG that the member recognizes during the recognition period, the former member or loss subgroup has a consolidated section 382 limitation of zero with respect to pre-change attributes (the zero default rule).

Commentators suggested that the zero default rule may be a trap for the unwary. For instance, under the proposed regulations, a subgroup member that ceases to bear a section 1504(a)(1) to the subgroup parent is subject to the zero default rule, even if that member remains within the current consolidated group.

The IRS and Treasury recognize that any default rule will benefit some taxpayers while operating to the detriment of others. For example, a default apportionment of a section 382 limitation or NUBIG based on the departing member's contribution to the group's net operating loss carryover could cause some apportioned limitation to go unused if that member becomes subject to a new section 382 limitation upon departing the group. By contrast, a rule providing that the default limitation is capped by the amount of any subsequent section 382 limitation, would be difficult to administer. Because the consequences of applying any default rule depend on the particular facts of a transaction, including the relative income generation of the departing and remaining members, the IRS and Treasury believe that the simplicity of the zero default rule makes the rule preferable to other alternatives.

Also, the IRS and the Treasury believe that the new exceptions to ceasing to be a member of a loss subgroup substantially reduce the likelihood that the zero default rule will yield unexpected results. For example, an acquisition of a loss subgroup typically will cause an ownership change of the loss subgroup. Following that ownership change, a member that remains within the current group now can break the section 1504(a)(1) relationship to the loss subgroup parent without ceasing to be a member of the loss subgroup. Accordingly, these final regulations retain the zero default rule when a member ceases to be a member of a group (or loss subgroup). The zero default rule also applies to a NUBIG.

Mandatory apportionment of a group's NUBIL to a departing member, §1.1502–95(e)

In general, a group has a NUBIL if the adjusted bases of the assets of members included in such determination under §1.1502–91(g) exceed their fair market value immediately before the change date. Similar rules apply to loss subgroups. Subject to the limitations of section 382(h)(2)(B), NUBILs recognized within the five year period beginning on the change date are subject to the consolidated section 382 limitation. The proposed regulations do not provide rules for apportioning a group's NUBIL to a former member (or loss subgroup). The IRS and Treasury believe that a mandatory apportionment of the group's NUBIL is necessary to ensure that the group's NUBIL, if recognized by the former member (or loss subgroup) during the recognition period, remains subject to the consolidated section 382 limitation. One commentator suggests that a former member (or loss group) should be apportioned a group's NUBIL only if and when a former member that had a separately computed NUBIL that contributed to the group's NUBIL departs the group, and the contributed built-in loss has not fully been recognized. Adjustments would reflect intragroup transfers of assets occurring between the change date and the date that the former member departs.

The IRS and Treasury believe that the suggested approach overemphasizes the location of assets with a NUBIG. For example, if a former member has a NUBIG determined on a separate entity basis, a recognized built-in loss of that member will not be limited, even if the former member is the first corporation to dispose of a built-in loss asset. The IRS and Treasury believe that subjecting the sale of built-in loss assets to the consolidated section 382 limitation, regardless of the location of built-in gain assets, more accurately reflects the NUBIL as a group attribute. Similarly, consistent with treatment of the NUBIL as a group attribute, the approach permits built-in gain to be sheltered by built-in loss only after the excess of built-in losses over built-in gains has been recognized. Accordingly, these final regulations adopt a model that apportions NUBIL based on the gross amount of built-in loss that the departing member contributed to the determination of the group's NUBIL.

In general, §1.1502–95(f) provides that a departing member is allocated a portion of the group's (or loss subgroup's)

NUBIL if, immediately after the close of the consolidated return year in which the departing member ceases to be a member, the amount of the loss group's (or loss subgroup's) excess of net unrealized built-in loss over recognized built-in loss (the remaining NUBIL balance) is greater than zero. In general, NUBIL apportioned to former members in prior taxable years is treated as recognized built-in loss in those years.

The amount of NUBIL allocated to a departing member is equal to the remaining NUBIL balance multiplied by a fraction. The numerator of the fraction is the amount of the built-in loss, taken into account on the change date, in the assets held by the departing member immediately after the member ceases to be a member of the loss group (or loss subgroup). The denominator of the fraction is the sum of the numerator, plus the amount of the built-in loss, taken into account on the change date, in the assets held by the group immediately after the close of the taxable year in which the departing member ceases to be a member. (Fluctuations in value of the assets between the change date and the date that the member ceases to be a member of the group (or loss subgroup), or the close of the taxable year in which the member ceases to be a member of the loss group, are disregarded.) In general, adjustments are made for gain or loss that has been recognized during the recognition period, and for assets that are transferred basis property. The amount of the NUBIL allocated to a former member generally is treated as previously recognized built-in loss for purposes of applying the limitation of section 382(h)(1)(B)(ii) to a loss group's taxable years beginning after the year in which the former member ceases to be a member.

For purposes of determining the amount of the former member's recognized built-in losses in any taxable year beginning after the former member ceases to be a member, the amount of the loss group's (or loss subgroup's) net unrealized built-in loss that is apportioned to the former member is treated as if it were an amount of net unrealized built-in loss determined under section 382(h)(1)(B)(i) with respect to such member, and that amount is not reduced under section 382(h)(1)(B)(ii) by the loss group's (or loss subgroup's) recognized built-in losses.

Subgroup principles apply to the allocation of a NUBIL. For example, if two or more members leave a loss group, and are members of a consolidated group, any allocation of the loss group's NUBIL is made on a subgroup basis. In general, the common parent may apportion all or any part of a consolidated section 382 limitation (or subgroup section 382 limitation) under §1.1502–95(c) to a former member to which the group's NUBIL is allocated (or to a loss subgroup that includes that member).

9. Miscellaneous Rules, §1.1502–96

Fold-in rules do not apply to NUBIGs, §1.1502–96(a)

Proposed §1.1502–96(a)(2) provides in part that, following a fold-in event described in §1.1502–96(a)(1), the member's separately computed NUBIG or NUBIL is included in the determination whether the group has a NUBIG or NUBIL.

The IRS and Treasury believe that the "fold-in" of a member's NUBIG can lead to inappropriate results. For example, a consolidated group that acquires a corporation with a small net operating loss carryover and a large NUBIG can immediately offset the group's NUBIL with the NUBIG, if the member is acquired with an ownership change. Accordingly, the fold-in rules of §1.1502–96(a) do not apply to include a member's separately computed NUBIG in determining whether a group has a NUBIL. A member's NUBIG is only included in such determination if the member is included under §1.1502–91(g)(2).

Net operating loss carryovers reattributed under §1.1502–20(g)

Section 1.1502–20 of the regulations disallows a deduction for certain losses on the disposition of stock of a subsidiary. In general, under §1.1502–20(g), the common parent can reattribute to itself net operating loss carryovers or capital loss carryovers attributable to the subsidiary in an amount not to exceed the disallowed loss. Section 1.1502–20(g) further provides that the common parent succeeds to the reattributed losses as if the losses were succeeded to in a transaction described in section 381(a). Also, any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3)) in connection with the disposition is not taken into account under section 382 with respect to the reattributed losses. (§1.1502–20(g)(1)). The preamble to T.D. 8364 (56 F.R. 47379, September 19, 1991)(which added §1.1502–20), states that clarification regarding the application of section 382 to reattributed losses would be provided in connection with finalizing §§1.1502–91 through 1.1502–99. The preamble states that, for example, it is anticipated that proposed §1.1502–95 would be modified to permit the common parent to elect to retain all or part of a section 382 limitation that applies to reattributed SRLY losses.

A new §1.1502–96(d) provides rules relating to reattributed losses. This section generally provides that §§1.1502–91 through 1.1502–96 and §1.1502–98 apply to reattributed losses consistent with the provision of §1.1502–20(g) that treats the common parent as succeeding to the losses in a transaction to which section 381(a) applies. For example, if the reattributed loss is a pre-change attribute subject to a section 382 limitation, it remains subject to that limitation following the reattribution. Section 1.1502–96(d)(4) provides rules that allow the common parent to elect to apportion to itself all or part of any separate section 382 limitation or subgroup section 382 limitation to which the reattributed loss is subject. The apportionment is made under the principles of the rules of §1.1502–95(c), relating to the apportionment of a consolidated section 382 limitation to a member that leaves the group. In certain cases, the section 382 limitation applicable to the reattributed loss is zero unless an apportionment of such limitation is made to the common parent. The election to apportion a section 382 limitation is made as part of the election to reapportion the loss. See §1.1502–20(g)(4), as amended by this document.

As previously set forth in §1.1502–20(g), §1.1502–96(d) adopts the general rule that any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3))in connection with the disposition of the subsidiary's stock) is not taken

into account under section 382 with respect to the reattributed losses. The final regulations, however, modify the general rule to provide that any owner shift with respect to the successor corporation that is treated as continuing in existence under §1.382–2(a)(1)(ii) must be taken into account for such purpose if such owner shift is effected by the reattribution and any owner shift of the stock of the subsidiary not held directly or indirectly by the common parent would have been taken into account if such shift had occurred immediately before the reattribution. Such an owner shift may occur if the subsidiary has minority shareholders that, under §1.382–2(a)(1)(ii), are treated as decreasing their ownership in the reattributed loss, while the shareholders of the common parent increase their ownership interests in that loss.

The final regulations provide that, in general, the value of the stock of the common parent is used to establish a section 382 limitation for the reattributed loss with respect to an ownership change upon, or after, the reattribution. These rules coordinate the determination of the value of that stock with the capital contribution rules of section 382(l)(1), and also require appropriate adjustments so that value is not improperly omitted or duplicated as a result of the reattribution.

Effective Dates

Sections 1.1502–91 through 1.1502–96 and 1.1502–98

Except as set forth below, §§1.1502–91 through 1.1502–96 and 1.1502–98 apply to testing dates that occur on or after June 25, 1999. Sections 1.1502–94 through 1.1502–96 also apply on any date on or after June 25, 1999 on which a corporation becomes a member of a group or on which a corporation ceases to be a member of a loss group (or a loss subgroup).

A transition rule for net unrealized built-in loss provides that a consolidated group may apply §1.1502–91A(g) for the period ending on the day before June 25, 1999 to determine the earliest date that its testing period begins (treating the day before June 25, 1999 as the end of a taxable year.)

The election under §1.1502–91(d)(4) to treat the subgroup parent requirement as satisfied is effective for corporations that become members of a consolidated group in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999. Section 1.1502–95(d)(2)(ii)(relating to exceptions to ceasing to be a member of loss subgroup) applies to corporations that cease to bear a section 1504(a)(1) relationship to a loss subgroup parent in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999.

The third sentence of §1.1502–91(d)-(5)(relating to members excluded from a loss subgroup) applies to corporations that become members of a consolidated group on or after June 25, 1999.

In the case of corporations that cease to be members of a loss group (or loss subgroup) before June 25, 1999, in a taxable year for which the due date of the income tax return (without extensions) is after June 25, 1999, §§1.1502–95(a), (b), (c) and (f) apply to those corporations if the common parent makes the election described in the second sentence of (c)(1) of that section in the time and manner prescribed in paragraph (f) of that section.

Section 1.1502–96(d) applies to reattributions of net operating losses or net capital losses in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999; except that the election under §1.1502– 96(d)(5) (relating to an election to reattribute section 382 limitation) can be made with any election under §1.1502–20(g)(4) to reattribute to the common parent a net operating loss or net capital loss that is timely filed on or after June 25, 1999.

Sections 1.1502–91A through 1.1502–96A and 1.1502–98A apply to any testing date on or after January 1, 1997, and before June 25, 1999. Sections 1.1502–94A through 1.1502–96A also apply on any date on or after January 1, 1997, and before June 25, 1999, on which a corporation becomes a member of a group or on which a corporation ceases to be a member of a loss group (or a loss subgroup). For periods before January 1, 1997, the transition rules in §1.1502–99A(c) continue to apply.

The transition rules in §1.1502–99A for periods ending before January 1, 1997 also are clarified to provide that a member that ceases to be a member of a group does not have a zero section 382 limitation with respect to pre-change net operating losses allocated to that member.

Need For Immediate Guidance

Because the temporary regulations are not applicable for taxable years ending after June 26, 1999, it is necessary to implement these final regulations without delay to ensure continuity of treatment of certain attributes and to ensure that there is no period within which the treatment of such attributes is inconsistent with the temporary regulations and these final regulations. See section 7805(e)(2). Accordingly, it is impracticable and contrary to the public interest to issue this Treasury decision subject to the effective date limitation of section 553(d) of title 5 of the United States Code (if applicable).

SPECIAL ANALYSIS

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect corporations filing consolidated federal income tax returns that have net operating losses or other attributes that are subject to section 382. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have net operating losses or other attributes subject to section 382. Moreover, many of these corporations will not have ownership changes. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was sent to the Small Business Administration for comment on its impact on small business.

DRAFTING INFORMATION

The principal author of the final regulations is Lee A. Kelley of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the IRS and Treasury participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 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 sections 1.1502–91T, 1.1502–92T, 1.1502–93T, 1.1502–94T, 1.1502–95T, 1.1502–96T, 1.1502–98T, and 1.1502–99T, and adding entries in numerical order to read in part as follows:

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

Section 1.1502–91 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–92 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–93 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–94 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–95 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–96 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–98 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–99 also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502. * * *

Section 1.1502–91A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–92A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–93A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–94A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–95A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–96A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–98A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502.

Section 1.1502–99A also issued under 26 U.S.C. 382(m) and 26 U.S.C. 1502. * * *

Par. 2. In the list below, for each section indicated in the left column, remove the wording indicated in the middle column, and add the wording indicated in the right column.

Affected Section	*Remove*	*Add*
1.1502–91T(a)(1), first sentence	§§ 1.1502–92T and 1.1502–93T	§§ 1.1502–92A and 1.1502–93A
1.1502–91T(a)(1), third sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–91T(a)(1), third sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–91T(a)(3)	§§ 1.1502–94T and 1.1502–95T	§§ 1.1502–94A and 1.1502–95A
1.1502–91T(b) introductory text	§§ 1.1502–92T through 1.1502–99T	§§ 1.1502–92A through 1.1502–99A
1.1502–91T(b)(1)	§§ 1.1502–92T through 1.1502–99T	§§ 1.1502–92A through 1.1502–99A
1.1502–91T(c)(2), second sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(c)(3), Example(b), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–91T(d)(4), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–91T(d)(5), first sentence	§ 1.1502–95T(d)	§ 1.1502–95A(d)
1.1502–91T(d)(5), second sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(e)(2), Example(b), third sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–91T(f)(2), Example(b)(2), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(f)(2), Example(b)(2), third sentence	§ 1.1502–92T(a)(2)	§ 1.1502–92A(a)(2)
1.1502–91T(f)(2), Example(b)(2), fourth sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–91T(f)(2), Example(c), second sentence	§ 1.1502–96T(c)	§ 1.1502–96A(c)
1.1502–91T(g)(1), last sentence	§1.1502–94T(c)	§ 1.1502–94A(c)
1.1502–91T(g)(1), last sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–91T(g)(2)(i)(A)	§ 1.1502–94T(a)(1)(ii)	§ 1.1502–94A(a)(1)(ii)
1.1502–91T(g)(2)(i)(B)	§ 1.1502–91T(d)(2)	§ 1.1502–91A(d)(2)
1.1502–91T(j), first sentence	§§ 1.1502–92T through 1.1502–99T	§§ 1.1502–92A through 1.1502–99A

1.1502–92T(a), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–92T(a), second sentence	§1.1502–96T(b)	§ 1.1502–96A(b)
1.1502–92T(b)(1)(i)(A)	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–92T(b)(1)(i)(B)	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–92T(b)(1)(ii), second sentence	§ 1.1502–95T(b)	§ 1.1502–95A(b)
1.1502–92T(b)(1)(ii)(A)	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–92T(b)(1)(ii)(C)	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–92T(b)(2) Example 1(a), sixth sentence	§ 1.1502–91T(c)(1)	§ 1.1502–91A(c)(1)
1.1502–92T(b)(2) Example 3(b), first sentence	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–92T(b)(2) Example 4(b), first sentence	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–92T(b)(3)(iii) Example 2(d), fourth sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–92T(b)(3)(iii) Example 3(a), seventh sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–92T(b)(4), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–92T(b)(4), first sentence	§ 1.1502–96T(a)(2)	§ 1.1502–96A(a)(2)
1.1502–92T(b)(4), first sentence	§ 1.1502–96T(b)	§ 1.1502–96A(b)
1.1502–92T(b)(4), second sentence	§ 1.1502–96T(a) applies, see § 1.1502–96T(c)	§1.1502–96A(a) applies, see § 1.1502–96A(c)
1.1502–92T(e)(1)(ii)	§ 1.1502–96T(b)	§ 1.1502–96A(b)
1.1502–92T(e)(2), fifth sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–92T(e)(2), fifth sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–93T(a)(2)	§ 1.1502–95T(c)	§ 1.1502–95A(c)
1.1502–93T(b)(2), last sentence	§ 1.382–8T	§ 1.382-8
1.1502–93T(b)(2), fourth sentence	§ 1.1502–91T(g)(2)	§ 1.1502–91A(g)(2)
1.1502–94T(a)(1)(i)	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–94T(a)(1)(ii)	§ 1.1502–91T(d)(2)	§ 1.1502–91A(d)(2)
1.1502–94T(a)(3)	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–94T(a)(3)	§§ 1.1502–92T and 1.1502–93T	§§ 1.1502–92A and 1.1502–93A
1.1502–94T(a)(4), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–94T(a)(4), first sentence	§, 1.1502–96T(a)(2)	§1.1502–96A(a)(2)
1.1502–94T(a)(4), first sentence	§ 1.1502–92T(b)(1)(i)	§1.1502–92A(b)(1)(i)
1.1502–94T(a)(4), first sentence	§1.1502–96T(b)	§§1.1502–96A(b)
1.1502–94T(a)(4), second sentence	§ 1.1502–96T(a) applies, see § 1.1502–96T(c)	§ 1.1502–96A(a) applies, see § 1.1502–96A(c)
1.1502–94T(a)(5)	§ 1.1502–96T(c)	§ 1.1502–96A(c)
1.1502–94T(b)(4) Example 1(b), first sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)

1.1502–94T(b)(4) Example 2(b),	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–94T(b)(4) Example 2(d), first sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–94T(b)(4) Example 2(d), third sentence	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–94T(b)(4) Example 3(b), first sentence	§ 1.1502–91T(d)(1)	§ 1.1502–91A(d)(1)
1.1502–94T(b)(4) Example 3(c), second sentence	§§ 1.1502–96T(a) and 1.1502–91T(c)(2)	§§ 1.1502–96A(a) and 1.1502–91A(c)(2)
1.1502–94T(c), first sentence	§§ 1.1502–91T(g) and (h)	§§ 1.1502–91A(g) and (h) and 1.1502–93A(c)
1.1502–94T(c), second sentence	§ 1.1502–91T(g)(3)	§ 1.1502–91A(g)(3)
1.1502–94T(d), fifth sentence	§ 1.1502–96T(a)	§ 1.1502–96A(a)
1.1502–94T(d),sixth sentence	§ 1.1502–92T(e)(1)	§ 1.1502–92A(e)(1)
1.1502–95T(a)(3), paragraph heading	*§§ 1.1502–91T through 1.1502–93T*	*§§ 1.1502–91A through 1.1502–93A*
1.1502–95T(a)(3)	§§ 1.1502–91T through 1.1502–93T	§§ 1.1502–91A through 1.1502–93A
1.1502–95T(b)(1) introductory text, first sentence	§§ 1.1502–91T through 1.1502–93T	§§ 1.1502–91A through 1.1502–93A
1.1502–95T(b)(2) introductory text	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(b)(4) Example(2)(a), second sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(c)(2) introductory text	§ 1.1502–93T	§ 1.1502–93A
1.1502–95T(c)(7) Example(1)(a), third sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(d)(2) Example(1)(a), fifth sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–95T(d)(2) Example(3)(a), fourth sentence	§ 1.1502–92T(b)(1)(ii)	§ 1.1502– 92A(b)(1)(ii)
1.1502–95T(e)(1) introductory text	§ 1.1502–95T	§ 1.1502–95A
1.1502–96T(a)(2) introductory text, first sentence	§ 1.1502–91T(c)(1)(i)	§ 1.1502–91A(c)(1)(i)
1.1502–96T(a)(2)(ii)	§ 1.1502–91T(c)	§ 1.1502–91A(c)
1.1502–96T(a)(3), second sentence	§ 1.1502–91T(f)(2)	§ 1.1502–91A(f)(2)
1.1502–96T(a)(5), first sentence	§§ 1.1502–91T through 1.1502–95T	§§ 1.1502–91A through 1.1502–95A
1.1502–96T(a)(5) introductory text, first sentence	§ 1.1502–98T	§ 1.1502–98A
1.1502–96T(b)(1) introductory text, first sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–96T(b)(1) introductory text, first sentence	§ 1.1502–91T(c)(1)	§ 1.1502–91A(c)(1)
1.1502–96T(b)(1) introductory text, first sentence	§ 1.1502–91T(d)	§ 1.1502–91A(d)
1.1502–96T(b)(1) introductory text, second sentence	§ 1.1502–95T(b)	§ 1.1502–95A(b)

1.1502–96T(b)(3), paragraph heading	*§§ 1.1502–91T, 1.1502–92T, and 1.1502–94T*	*§§1.1502–91A, 1.1502–92A, and 1.1502–94A*
1.1502–96T(b)(3), first sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–96T(b)(3), first sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–96T(b)(3), second sentence	§ 1.1502–94T	§ 1.1502–94A
1.1502–96(c), last sentence	§ 1.382–5T(d)	§ 1.382–5(d)
1.1502–98T, first sentence	§§ 1.1502–91T through 1.1502–96T	§§ 1.1502–91A through 1.1502–96A
1.1502–98T, second sentence	§§ 1.1502–91T through 1.1502–96T	§§ 1.1502–91A through 1.1502–96A
1.1502–98T, third sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–98T, third sentence	§ 1.1502–93T	§ 1.1502–93A
1.1502–99T(a), first sentence	Sections 1.1502–91T through 1.1502–96T and 1.1502–98T	Sections 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(a), second sentence	Sections 1.1502–94T through 1.1502–96T	Sections 1.1502–94A through 1.1502–96A
1.1502–99T(b), first sentence	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(b), second sentence	§ 1.1502–92T(b)(1)(i)	§ 1.1502–92A(b)(1)(i)
1.1502–99T(b), third sentence	§ 1.1502–92T(b)(1)	§ 1.1502–92A(b)(1)
1.1502–99T(c)(1)(ii)	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(c)(1)(iii), first sentence	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(c)(1)(iii), second sentence	§ 1.1502–92T	§ 1.1502–92A
1.1502–99T(c)(2)(i), first sentence	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A
1.1502–99T(c)(2)(i), first sentence	§ 1.1502–95T(c)	§ 1.1502–95A(c)
1.1502–99T(c)(2)(i), fifth sentence	§ 1.1502–91T(d)(2)(i)	§ 1.1502–91A(d)(2)(i)
1.1502–99T(c)(2)(ii)	§ 1.382–8T	§ 1.382–8
1.1502–99T(c)(2)(ii)	§ 1.382–8T(h)	§ 1.382–8(h)
1.1502–99T(d)(1)	§ 1.1502–92T	§ 1.1502–92A
1.1502–99T(d)(3)	§§ 1.1502–91T through 1.1502–96T and 1.1502–98T	§§ 1.1502–91A through 1.1502–96A and 1.1502–98A

Par. 3. Section 1.1502–20 is amended as follows:

1. Adding a sentence to the end of paragraph (g)(1).
2. Redesignating paragraph (g)(5) as paragraph (g)(4).
3. Paragraph (g)(4)(i)(A) is amended by removing ", and" and adding ";" in its place.
4. Paragraph (g)(4)(i)(B) is amended by removing the period at the end of the paragraph and adding "; and" in its place.
5. Adding a new paragraph (g)(4)(i)(C) immediately after paragraph (g)(4)(i)(B) and before paragraph (g)(4)(i) concluding text.
6. Redesignating paragraph (g)(4)(ii) as paragraph (g)(4)(iii).
7. Adding a new paragraph (g)(4)(ii).

The revisions and additions read as follows:

§1.1502–20 Disposition or deconsolidation of subsidiary stock.

* * * * *

(g) * * *

(1) * * * See §1.1502–96(d) for rules relating to section 382 and the reattribution of losses under this paragraph (g).

* * * * *

(4)

(i) * * *

(C) If the common parent is reattributing to itself all or any part of a section 382 limitation pursuant to §1.1502–96(d)(5), the information required by paragraph (g)(4)(ii) of this section.

* * * * *

(ii) *Reattribution of section 382 limitation.* The information required by this paragraph (g)(4)(ii) is a separate list for each subsidiary (or a separate list for two or more subsidiaries that are members of a loss subgroup whose pre-change sub-

group losses are being reattributed) with respect to which an apportionment of a separate section 382 limitation or subgroup section 382 limitation is being made, setting forth—

(A) The name and E.I.N. of the subsidiary (or subsidiaries that were members of a loss subgroup);

(B) A statement entitled "THIS IS AN ELECTION UNDER §1.1502–96(d)(5) TO APPORTION ALL OR PART OF [insert A SEPARATE or A SUBGROUP or BOTH A SEPARATE AND A SUBGROUP] SECTION 382 LIMITATION TO [insert name and E.I.N. of the common parent]";

(C) The date of the ownership change giving rise to the separate section 382 limitation or subgroup section 382 limitation that is being apportioned;

(D) The amount of the separate (or subgroup) section 382 limitation for the taxable year in which the reattribution occurs (determined without reference to any apportionment under this section or §1.1502–95(c));

(E) The amount of each net operating loss carryover or capital loss carryover, and the year in which it arose, of the subsidiary (or subsidiaries) that is subject to the separate section 382 limitation or subgroup section 382 limitation that is being apportioned to the common parent, and the amount of the value element and adjustment element of that limitation that is apportioned to the common parent.

* * * * *

Par. 3a. Immediately following §1.1502–79A, an undesignated centerheading is added to read as follows:

REGULATIONS APPLYING SECTION 382 WITH RESPECT TO TESTING DATES (AND CORPORATIONS JOINING OR LEAVING CONSOLIDATED GROUPS) BEFORE June 25, 1999.

Par. 4. Section §1.1502–90T is amended as follows:

1. Redesignating §1.1502–90T as §1.1502–90A [newly redesignated §1.1502–90A will appear after the centerheading added in Par. 3a.]

2. Revising the section heading and the introductory text of newly designated §1.1502–90A.

3. Redesignating the entries for §1.1502–91T through §1.1502–99T as §1.1502–91A through §1.1502–99A and revising the section headings.

4. Revising the entries for paragraph (a) of newly designated §1.1502–99A.

The revisions read as follows:

§1.1502–90A Table of contents.

The following list contains the major headings in §§1.1502–91A through 1.1502–99A:

§1.1502–91A Application of section 382 with respect to a consolidated group generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–92A Ownership change of a loss group or a loss subgroup generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–93A Consolidated section 382 limitation (or subgroup section 382 limitation) generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–94A Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group generally applicable for corporations becoming members of a group before June 25, 1999.

* * * * *

§1.1502–95A Rules on ceasing to be a member of a consolidated group (or loss subgroup) generally applicable for corporations ceasing to be members before June 25, 1999.

* * * * *

§1.1502–96A Miscellaneous rules generally applicable for testing dates before June 25, 1999.

* * * * *

§1.1502–97A Special rules under section 382 for members under the jursidiction of a court in a title 11 or similar case. [Reserved].

§1.1502–98A Coordination with section 383 generally applicable for testing dates (or members joining or leaving a group) before June 25, 1999.

§1.1502–99A Effective dates.

(a) Effective date.
(1) In general.
(2) Anti-duplication rules for recognized built-in gain.

* * * * *

Par. 5. Section 1.1502–91T is amended as follows:

1. Redesignating §1.1502–91T as §1.1502–91A.

2. Revising the section heading of newly designated §1.1502–91A.

3. Amending paragraph (h)(2) by removing the words "or an intercompany obligation" and replacing them with "(or an intercompany obligation disposed of before June 25, 1999)".

The revision reads as follows:

§1.1502–91A Application of section 382 with respect to a consolidated group generally applicable for testing dates before June 25, 1999.

* * * * *

Par. 6. Section 1.1502–92T is revised as §1.1502–92A, and the section heading is amended to read as follows:

§1.1502–92A Ownership change of a loss group or a loss subgroup generally applicable for testing dates before June 25, 1999.

* * * * *

Par 6a. Section 1.1502–93T is amended as follows:

1. Redesignating §1.1502–93T as §1.1502–93A.

2. Revising the section heading of newly redesignated §1.1502–93A.

3. Adding a sentence at the end of paragraph (c).

The additions and revisions read as follows:

§1.1502–93A Consolidated section 382 limitation (or subgroup section 382 limitation)generally applicable for testing dates before June 25, 1999.

* * * * *

(c)* * * See §1.1502–99A(a)(2) for a special rule relating to the application of

§1.502–93(c)(2) to consolidated return years for which the due date of the return is after June 25, 1999.

* * * * *

Par. 7. Section 1.1502–94T is amended as follows:

1. Redesignating §1.1502–94T as §1.1502–94A.
2. Revising the section heading of newly redesignated §1.1502–94A.
3. Revising the last sentence of paragraph (b)(4), Example 3(b).

The revision reads as follows:

§1.1502–94A Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group) generally applicable for corporations becoming members of a group before June 25, 1999.

* * * * *

(b) * * *

(4) * * *

Example 3. * * *

(b) * * * See also §1.1502–21T in effect prior to June 25, 1999, contained in 26 CFR Part 1, revised April 1, 1999, or §1.1502–21, as applicable.

* * * * *

Par. 8. Redesignate §1.1502–95T as §1.1502–95A and revise the section heading to read as follows:

§1.1502–95A Rules on ceasing to be a member of a consolidated group generally applicable for corporations ceasing to be members before June 25, 1999.

* * * * *

Par. 9. Redesignate §1.1502–96T as §1.1502–96A and revise the section heading to read as follows:

§1.1502–96A. Miscellaneous rules generally applicable for testing dates before June 25, 1999.

* * * * *

Par. 10. Redesignate §1.1502–97T as §1.1502–97A and revise the section heading to read as follows:

§1.1502–97A Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case. [Reserved].

* * * * *

Par. 11. Redesignate §1.1502–98T as §1.1502–98A and revise the section heading to read as follows:

§1.1502–98A Coordination with section 383 generally applicable for testing dates (or members joining or leaving a group) before June 25, 1999.

* * * * *

Par. 12. Section 1.1502–99T is amended as follows:

1. Redesignating §1.1502–99T as §1.1502–99A.
2. Revising the section heading.
3. Revising paragraph (a).
4. Amending paragraph (c)(2)(i) by removing the language "(relating to the apportionment" in the first sentence and adding "and (b)(2)(ii)(relating to the apportionment".

The revisions read as follows:

§1.1502–99A Effective dates.

(a) *Effective date*—(1) *In general.* Except as provided in §1.1502–99(b), §§1.1502–91A through 1.1502–96A and 1.1502–98A apply to any testing date on or after January 1, 1997, and before June 25, 1999. Sections 1.1502–94A through 1.1502–96A also apply on any date on or after January 1, 1997, and before June 25, 1999, on which a corporation becomes a member of a group or on which a corporation ceases to be a member of a loss group (or a loss subgroup).

(2) *Anti-duplication rules for recognized built-in gain.* Section 1.1502–93(c)(2)(relating to recognized built-in gain of a loss group or loss subgroup) applies to taxable years for which the due date for income tax returns (without extensions) is after June 25, 1999.

* * * * *

Par. 13. Sections 1.1502–90 through 1.1502–99 are added to read as follows:

§1.1502–90 Table of contents.

The following list contains the major headings in §§1.1502–91 through 1.1502–99:

§1.1502–91 Application of section 382 with respect to a consolidated group.

a. Determination and effect of an ownership change.
(1) In general.
(2) Special rule for post-change year that includes the change date.
(3) Cross-reference.
(b) Definitions and nomenclature.
(c) Loss group.
(1) Defined.
(2) Coordination with rule that ends separate tracking.
(3) Example.
(d) Loss subgroup.
(1) Net operating loss carryovers.
(2) Net unrealized built-in loss.
(3) Loss subgroup parent.
(4) Election to treat loss subgroup parent requirement as satisfied.
(5) Principal purpose of avoiding a limitation.
(6) Special rules.
(7) Examples.
(e) Pre-change consolidated attribute.
(1) Defined.
(2) Example.
(f) Pre-change subgroup attribute.
(1) Defined.
(2) Example.
(g) Net unrealized built-in gain and loss.
(1) In general.
(2) Members included.
(i) Consolidated group with a net operating loss.
(ii) Determination whether a consolidated group has a net unrealized built-in loss.
(iii) Loss subgroup with net operating loss carryovers.
(iv) Determination whether subgroup has a net unrealized built-in loss.
(v) Separate determination of section 382 limitation for recognized built-in losses and net operating losses.
(3) Coordination with rule that ends separate tracking.
(4) Acquisitions of built-in gain or loss assets.

(5) Indirect ownership.
2. Common parent not common parent for five years.
(h) Recognized built-in gain or loss.
(1) In general. [Reserved]
(2) Disposition of stock or an intercompany obligation of a member.
(3) Intercompany transactions.
(4) Exchanged basis property.
(i) [Reserved]
(j) Predecessor and successor corporations.

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

(a) Scope.
(b) Determination of an ownership change.
(1) Parent change method.
(i) Loss group.
(ii) Loss subgroup.
(iii) Special rule if election regarding section 1504(a)(1) relationship is made.
(2) Examples.
(3) Special adjustments.
(i) Common parent succeeded by a new common parent.
(ii) Newly created loss subgroup parent.
(iii) Examples.
(4) End of separate tracking of certain losses.
(c) Supplemental rules for determining ownership change.
(1) Scope.
(2) Cause for applying supplemental rule.
(3) Operating rules.
(4) Supplemental ownership change rules.
(i) Additional testing dates for the common parent (or loss subgroup parent).
(ii) Treatment of subsidiary stock as stock of the common parent (or loss subgroup parent).
(iii) Different testing periods.
(iv) Disaffiliation of a subsidiary.
(v) Subsidiary stock acquired first.
(vi) Anti-duplication rule.
(5) Examples.
(d) Testing period following ownership change under this section.
(e) Information statements.
(1) Common parent of a loss group.
(2) Abbreviated statement with respect to loss subgroups.

§1.1502–93 Consolidated section 382 limitation (or subgroup section 382 limitation).

(a) Determination of the consolidated section 382 limitation (or subgroup section 382 limitation).
(1) In general.
(2) Coordination with apportionment rule.
(b) Value of the loss group (or loss subgroup).
(1) Stock value immediately before ownership change.
(2) Adjustment to value.
(i) In general.
(ii) Anti-duplication.
(3) Examples.
(c) Recognized built-in gain of a loss group or loss subgroup.
(1) In general.
(2) Adjustments.
(d) Continuity of business.
(1) In general.
(2) Example.
(e) Limitations of losses under other rules.

§1.1502–94 Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group.

(a) Scope.
(1) In general.
(2) Successor corporation as new loss member.
(3) Coordination in the case of a loss subgroup.
(4) End of separate tracking of certain losses.
(5) Cross-reference.
(b) Application of section 382 to a new loss member.
(1) In general.
(2) Adjustment to value.
(3) Pre-change separate attribute defined.
(4) Examples.
(c) Built-in gains and losses.
(d) Information statements.

§1.1502–95 Rules on ceasing to be a member of a consolidated group (or loss subgroup).

(a) In general.
(1) Consolidated group.
(2) Election by common parent.
(3) Coordination with §§1.1502–91 through 1.1502–93.
(b) Separate application of section 382 when a member leaves a consolidated group.
(1) In general.
(2) Effect of a prior ownership change of the group.
(3) Application in the case of a loss subgroup.
(4) Examples.
(c) Apportionment of a consolidated section 382 limitation.
(1) In general.
(2) Amount which may be apportioned.
(i) Consolidated section 382 limitation.
(ii) Net unrealized built-in gain.
(3) Effect of apportionment on the consolidated group.
(i) Consolidated section 382 limitation.
(ii) Net unrealized built-in gain.
(4) Effect on corporations to which an apportionment is made.
(i) Consolidated section 382 limitation.
(ii) Net unrealized built-in gain.
(5) Deemed apportionment when loss group terminates.
(6) Appropriate adjustments when former member leaves during the year.
(7) Examples.
(d) Rules pertaining to ceasing to be a member of a loss subgroup.
(1) In general.
(2) Exceptions.
(3) Examples.
(e) Allocation of net unrealized built-in loss.
(1) In general.
(2) Amount of allocation.
(i) In general.
(ii) Transferred basis property and deferred gain or loss.
(iii) Assets for which gain or loss has been recognized.
(iv) Exchanged basis property.
(v) Two or more members depart during the same year.
(vi) Anti-abuse rule.
(3) Effect of the allocation on the consolidated group.
(4) Effect on corporations to which the allocation is made.
(5) Subgroup principles.
(6) Apportionment of consolidated section 382 limitation (or subgroup section 382 limitation).
(i) In general.
(ii) Special rule for former members that become members of the same consolidated group.

(7) Examples.
(8) Reporting requirement.
(f) Filing the election to apportion the section 382 limitation and net unrealized built-in gain.
(1) Form of the election to apportion.
(2) Signing of the election.
(3) Filing of the election.
(4) Revocation of election.

§1.1502–96 Miscellaneous rules.

c. End of separate tracking of losses.
(1) Application.
(2) Effect of end of separate tracking.
(i) Net operating loss carryovers.
(ii) Net unrealized built-in losses.
(iii) Common parent not common parent for five years.
(3) Continuing effect of end of separate tracking.
(i) In general.
(ii) Example.
(4) Special rule for testing period.
(5) Limits on effects of end of separate tracking.
(b) Ownership change of subsidiary.
(1) Ownership change of a subsidiary because of options or plan or arrangement.
(2) Effect of the ownership change.
(i) In general.
(ii) Pre-change losses.
(3) Coordination with §§1.1502–91, 1.1502–92, and 1.1502–94.
(4) Example.
(c) Continuing effect of an ownership change.
(d) Losses reattributed under §1.1502–20(g).
(1) In general.
(2) Deemed section 381(a) transaction.
(3) Rules relating to owner shifts.
(i) In general.
(ii) Examples.
(4) Rules relating to the section 382 limitation.
(i) Reattributed loss is a pre-change separate attribute of a new loss member.
(ii) Reattributed loss is a pre-change subgroup attribute.
(iii) Potential application of section 382(l)(1).
(iv) Duplication or omission of value.
(v) Special rule for continuity of business requirement.
(5) Election to reattribute section 382 limitation.
(i) Effect of election.
(ii) Examples.
(e) Time and manner of making election under §1.1502–91(d)(4).
(1) In general.
(2) Election statement.

§1.1502–97 Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case.[Reserved].

§1.1502–98 Coordination with section 383.

§1.1502–99 Effective dates.

(a) Effective date.
(b) Special rules.
(1) Election to treat subgroup parent requirement as satisfied.
4. Principal purpose of avoiding a limitation.
(3) Ceasing to be a member of a loss subgroup.
(i) Ownership change of a loss subgroup.
(ii) Expiration of 5-year period.
(4) Reattribution of net operating loss carryovers under §1.1502–20(g).
(5) Election to apportion net unrealized built-in gain.
(c) Testing period may include a period beginning before June 25, 1999.
(1) In general.
(2) Transition rule for net unrealized built-in losses.

§1.1502–91 Application of section 382 with respect to a consolidated group.

(a) *Determination and effect of an ownership change*—(1) *In general.* This section and §§1.1502–92 and 1.1502–93 set forth the rules for determining an ownership change under section 382 for members of consolidated groups and the section 382 limitations with respect to attributes described in paragraphs (e) and (f) of this section. These rules generally provide that an ownership change and the section 382 limitation are determined with respect to these attributes for the group (or loss subgroup) on a single entity basis and not for its members separately. Following an ownership change of a loss group (or a loss subgroup) under §1.1502–92, the amount of consolidated taxable income for any post-change year which may be offset by pre-change consolidated attributes (or pre-change subgroup attributes) shall not exceed the consolidated section 382 limitation (or subgroup section 382 limitation) for such year as determined under §1.1502–93.

(2) *Special rule for post-change year that includes the change date.* If the post-change year includes the change date, section 382(b)(3)(A) is applied so that the consolidated section 382 limitation (or subgroup section 382 limitation) does not apply to the portion of consolidated taxable income that is allocable to the period in the year on or before the change date. See generally §1.382–6 (relating to the allocation of income and loss). The allocation of consolidated taxable income for the post-change year that includes the change date must be made before taking into account any consolidated net operating loss deduction (as defined in §1.1502–21(a)).

(3) *Cross-reference.* See §§1.1502–94 and 1.1502–95 for rules that apply section 382 to a corporation that becomes or ceases to be a member of a group or loss subgroup.

(b) *Definitions and nomenclature.* For purposes of this section and §§1.1502–92 through 1.1502–99, unless otherwise stated:

(1) The definitions and nomenclature contained in section 382 and the regulations thereunder (including the nomenclature and assumptions relating to the examples in §1.382-2T(b)) and this section and §§1.1502–92 through 1.1502–99 apply.

(2) In all examples, all groups file consolidated returns, all corporations file their income tax returns on a calendar year basis, the only 5-percent shareholder of a corporation is a public group, the facts set forth the only owner shifts during the testing period, no election is made under paragraph (d)(4) of this section, and each asset of a corporation has a value equal to its adjusted basis.

(3) As the context requires, references to §§1.1502–91 through 1.1502–96 include references to corresponding provisions of §§1.1502–91A through 1.1502–96A. For example, a reference to an ownership change under §1.1502–92 in §1.1502–95(b) can include a reference to an ownership change under §1.1502–92A.

(c) *Loss group*—(1) *Defined.* A loss group is a consolidated group that—

(i) Is entitled to use a net operating loss carryover to the taxable year that did not arise (and is not treated under §1.1502–21(c) as arising) in a SRLY;

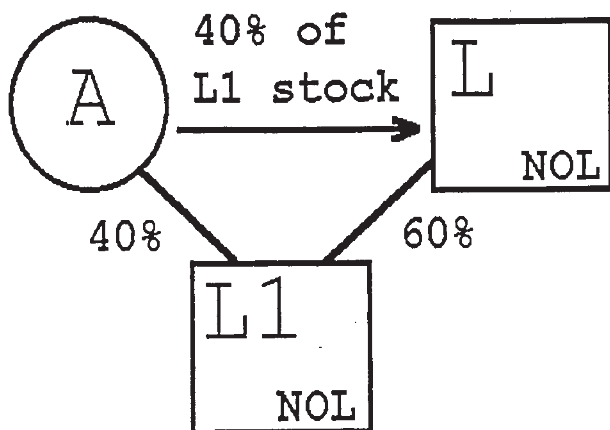
(ii) Has a consolidated net operating loss for the taxable year in which a testing date of the common parent occurs (determined by treating the common parent as a loss corporation); or

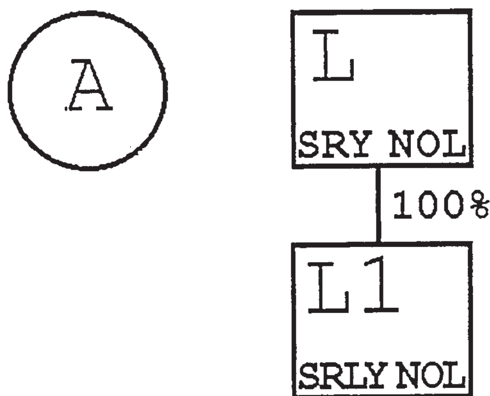
(iii) Has a net unrealized built-in loss (determined under paragraph (g) of this section by treating the date on which the determination is made as though it were a change date).

(2) *Coordination with rule that ends separate tracking.* A consolidated group may be a loss group because a member's losses that arose in (or are treated as arising in) a SRLY are treated as described in paragraph (c)(1)(i) of this section. See §1.1502–96(a).

(3) *Example.* The following example illustrates the principles of this paragraph (c):

Example. Loss group. (i) L and L1 file separate returns and each has a net operating loss carryover arising in Year 1 that is carried over to Year 2. A owns 40 shares and L owns 60 shares of the 100 outstanding shares of L1 stock. At the close of Year 1, L buys the 40 shares of L1 stock from A. For Year 2, L and L1 file a consolidated return. The following is a graphic illustration of these facts:





(ii) L and L1 become a loss group at the beginning of Year 2 because the group is entitled to use the Year 1 net operating loss carryover of L, the common parent, which did not arise (and is not treated under §1.1502–21(c) as arising) in a SRLY. See §1.1502–94 for rules relating to the application of section 382 with respect to L1's net operating loss carryover from Year 1 which did arise in a SRLY.

(d) *Loss subgroup*—(1) *Net operating loss carryovers.* Two or more corporations that become members of a consolidated group (the current group) compose a loss subgroup if—

(i) They were affiliated with each other in another group (the former group), whether or not the group was a consolidated group;

(ii) They bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the current group (or are deemed to bear that relationship as a result of an election described in paragraph (d)(4) of this section); and

(iii) At least one of the members carries over a net operating loss that did not arise (and is not treated under §1.1502–21(c) as arising) in a SRLY with respect to the former group.

(2) *Net unrealized built-in loss.* Two or more corporations that become members of a consolidated group compose a loss subgroup if they—

(i) Have been continuously affiliated with each other for the 5 consecutive year period ending immediately before they become members of the group;

(ii) Bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the current group (or are deemed to bear that relationship as a result of an election described in paragraph (d)(4) of this section); and

(iii) Have a net unrealized built-in loss (determined under paragraph (g) of this section on the day they become members of the group by treating that day as though it were a change date).

(3) *Loss subgroup parent.* A loss subgroup parent is the corporation that bears the same relationship to the other members of the loss subgroup as a common parent bears to the members of a group.

(4) *Election to treat loss subgroup parent requirement as satisfied*—(i) *In general.* Solely for purposes of paragraphs (d)(1)(i) and (2)(ii) of this section, two or more corporations that become members of a consolidated group at the same time and that were affiliated with each other immediately before becoming members of the group are deemed to bear a section 1504(a)(1) relationship to each other immediately after they become members of the group if the common parent of that group makes an election under this paragraph (d)(4) with respect to those members. See §1.1502–96(e) for the time and manner of making the election.

(ii) *Members included.* An election under this paragraph (d)(4) includes all corporations that become members of the

current group at the same time and that were affiliated with each other immediately before they become members of the current group.

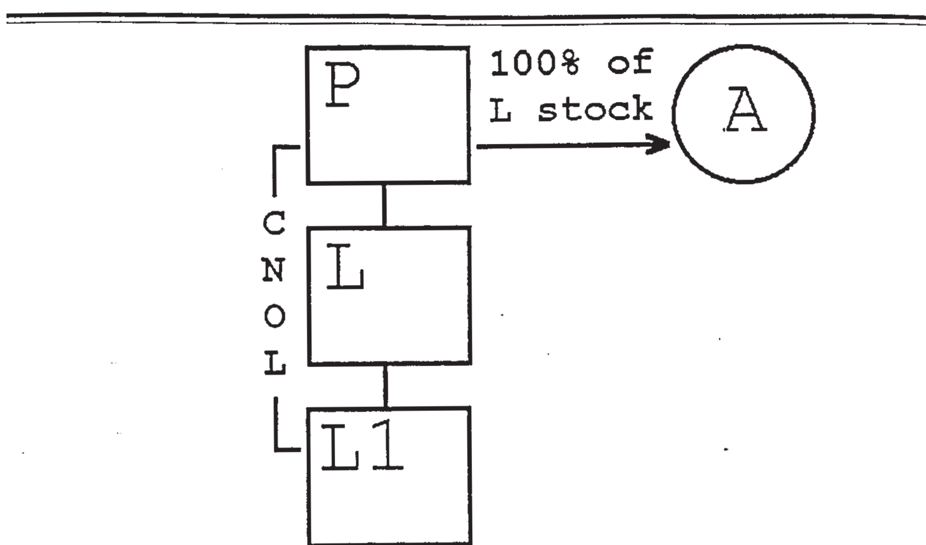
(iii) *Each member included treated as loss subgroup parent.* If the members to which this election applies are a loss subgroup described in paragraph (d)(1) or (2) of this section, then each member is treated as a loss subgroup parent. See §1.1502–92(b)(1)(iii) for special rules relating to an ownership change of a loss subgroup if the election under this paragraph (d)(4) is made.

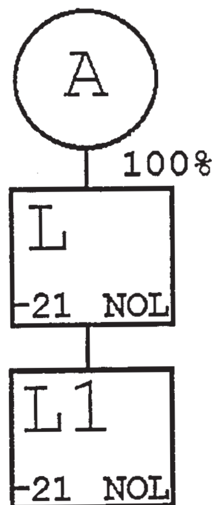
(5) *Principal purpose of avoiding a limitation.* The corporations described in paragraphs (d)(1) or (2) of this section do not compose a loss subgroup if any one of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, section 382. Instead, §1.1502–94 applies with respect to the attributes of each such corporation. Any member excluded from a loss subgroup, if excluded with a principal purpose of so avoiding or increasing any section 382 limitation, is treated as included in the loss subgroup. This paragraph (d)(5) does not apply solely because, in connection with becoming members of the group, the members of a group (or loss subgroup) are rearranged (or, in the case of the preceding sentence, are not rearranged) to bear a relationship to the other members described in section 1504(a)(1).

(6) *Special rules.* See §1.1502–95(d) for rules concerning when a corporation ceases to be a member of a loss subgroup, and for certain exceptions that may apply if a member does not continue to satisfy the loss subgroup parent requirement within the current group. See also §1.1502–96(a) for a special rule regarding the end of separate tracking of SRLY losses of a member that has an ownership change or that has been a member of a group for at least 5 consecutive years.

(7) *Examples.* The following examples illustrate the principles of this paragraph (d):

Example 1. Loss subgroup. (i) P owns all the L stock and L owns all the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried to Year 2. On May 2, Year 2, P sells all the stock of L to A, and L and L1 thereafter file consolidated returns. A portion of the Year 1 consolidated net operating loss is apportioned under §1.1502–21(b) to each of L and L1, which they carry over to Year 2. The following is a graphic illustration of these facts:





(ii) (a) L and L1 compose a loss subgroup within the meaning of paragraph (d)(1) of this section because—

(A) They were affiliated with each other in the P group (the former group);

(B) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they became members of the L group; and

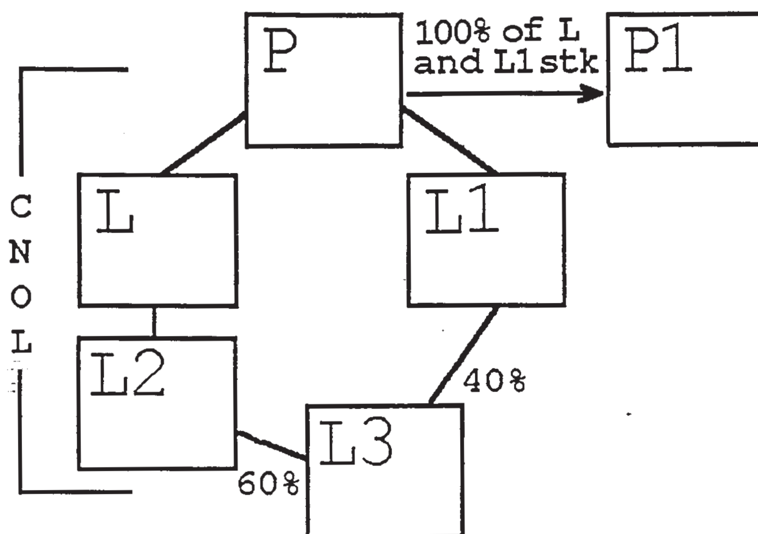
(C) At least one of the members (here, both L and L1) carries over a net operating loss to the L group (the current group) that did not arise in a SRLY with respect to the P group.

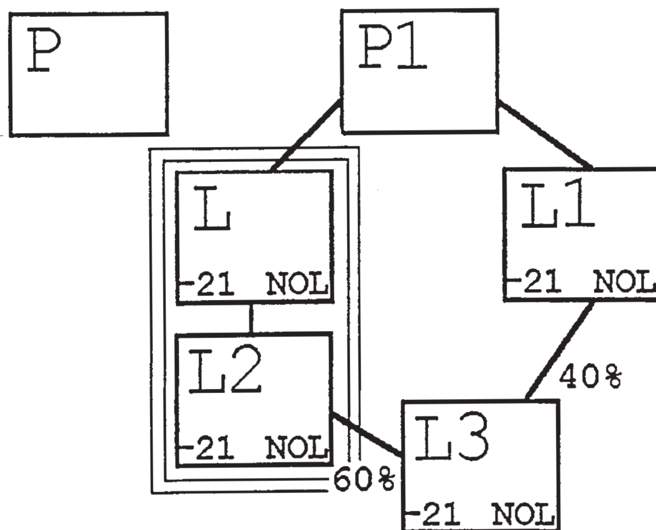
(b) Under paragraph (d)(3) of this section, L is the loss subgroup parent of the L loss subgroup.

Example 2. Loss subgroup—section 1504(a)(1) relationship. (i) P owns all the stock of L and L1. L owns all the stock of L2. L1 and L2 own 40 percent and 60 percent of the stock of L3, respectively. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On May 22, Year 2, P sells all the stock of L and L1 to P1, the common parent of another consolidated group. The Year 1 consolidated net operating loss is apportioned under §1.1502–21(b), and each of L, L1, L2, and L3 carries over a portion of such loss to the first consolidated return year of the P1 group ending after the acquisition. The following is a graphic illustration of these facts:

(ii) L and L2 compose a loss subgroup within the meaning of paragraph (d)(1) of this section. Neither L1 nor L3 is included in a loss subgroup because neither bears a relationship described in section 1504(a)(1) through a loss subgroup parent to any other member of the former group immediately after becoming members of the P1 group.

Example 3. Loss subgroup—section 1504(a)(1) relationship. The facts are the same as in *Example 2,* except that the stock of L1 is transferred to L in





connection with the sale of the L stock to P1. L, L1, L2, and L3 compose a loss subgroup within the meaning of paragraph (d)(1) of this section because—

(i) They were affiliated with each other in the P group (the former group);

(ii) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they become members of the P1 group; and

(iii) At least one of the members (here, each of L, L1, L2, and L3) carries over a net operating loss to the P1 group (the current group).

Example 4. Loss subgroup—elective section 1504(a)(1) relationship. The facts are the same as in Example 2, except that P1 makes the election under paragraph (d)(4) of this section. The election includes L, L1, L2, and L3 (even though L and L2 would compose a loss subgroup without regard to the election) because they become members of the current group (the P1 group) at the same time and were affiliated with each other in the P group immediately before they became members of the P1 group. As a result of the election, L, L1, L2, and L3 are treated as satisfying the requirement that they bear the relationship described in section 1504(a)(1) to each other through a loss subgroup parent immediately after they become members of the P1 group. L, L1, L2, and L3 compose a loss subgroup within the meaning of paragraph (d)(1) of this section.

(e) *Pre-change consolidated attribute*—(1) *Defined.* A pre-change consolidated attribute of a loss group is—

(i) Any loss described in paragraph (c)(1)(i) or (ii) of this section (relating to the definition of loss group) that is allocable to the period ending on or before the change date; and

(ii) Any recognized built-in loss of the loss group.

(2) *Example.* The following example illustrates the principle of this paragraph (e):

Example. Pre-change consolidated attribute. (i) The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. The L loss group has an ownership change at the beginning of Year 2.

(ii) The net operating loss carryover of the L loss group from Year 1 is a pre-change consolidated attribute because the L group was entitled to use the loss in Year 2 and therefore the loss was described in paragraph (c)(1)(i) of this section. Under paragraph (a)(2)(i) of this section, the amount of consolidated taxable income of the L group for Year 2 that may be offset by this loss carryover may not exceed the consolidated section 382 limitation of the L group for that year. See §1.1502–93 for rules relating to the computation of the consolidated section 382 limitation.

(f) *Pre-change subgroup attribute*—(1) *Defined.* A pre- change subgroup attribute of a loss subgroup is—

(i) Any net operating loss carryover described in paragraph (d)(1)(iii) of this section (relating to the definition of loss subgroup); and

(ii) Any recognized built-in loss of the loss subgroup.

(2) *Example.* The following example illustrates the principle of this paragraph (f):

Pre-change subgroup attribute. (i) P is the common parent of a consolidated group. P owns all the stock of L, and L owns all the stock of L1. L2 is not a member of an affiliated group, and has a net operating loss arising in Year 1 that is carried over to Year 2. On December 11, Year 2, L1 acquires all the stock of L2, causing an ownership change of L2. During Year 2, the P group has a consolidated net operating loss that is carried over to Year 3. On November 2, Year 3, M acquires all the L stock from P. M, L, L1, and L2 thereafter file consolidated returns. All of the P group Year 2 consolidated net operating loss is apportioned under §1.1502–21(b) to L and L2, which they carry over to the M group.

(ii)(a) L, L1, and L2 compose a loss subgroup because—

(1) They were affiliated with each other in the P group (the former group);

(2) They bear a relationship described in section 1504(a)(1) to each other through a loss subgroup parent (L) immediately after they became members of the L group; and

(3) At least one of the members (here, both L and L2) carries over a net operating loss to the M group (the current group) that is described in paragraph (d)(1)(iii) of this section.

(b) For this purpose, L2's loss from Year 1 that was a SRLY loss with respect to the P group (the former group) is described in paragraph (d)(1)(iii) of this section because L2 had an ownership change on becoming a member of the P group (see §1.1502–96(a)) on December 11, Year 2. Starting on December 12, Year 2, the P group no longer separately tracked owner shifts of the stock of L1 with respect to the Year 1 loss. M's acquisition results in an ownership change of L, and therefore the L loss subgroup under §1.1502–92(a)(2). See §1.1502–93

for rules governing the computation of the subgroup section 382 limitation.

(iii) In the M group, L2's Year 1 loss continues to be subject to a section 382 limitation resulting from the ownership change that occurred on December 11, Year 2. See §1.1502–96(c).

(g) *Net unrealized built-in gain and loss*—(1) *In general.* The determination whether a consolidated group (or loss subgroup) has a net unrealized built-in gain or loss under section 382(h)(3) is based on the aggregate amount of the separately computed net unrealized built-in gains or losses of each member that is included in the group (or loss subgroup) under paragraph (g)(2) of this section, including items of built-in income and deduction described in section 382(h)(6). Thus, for example, amounts deferred under section 267, or under §1.1502–13 (other than amounts deferred with respect to the stock of a member (or an intercompany obligation) included in the group (or loss subgroup) under paragraph (g)(2) of this section) are built-in items. The threshold requirement under section 382(h)(3)(B) applies on an aggregate basis and not on a member-by-member basis. The separately computed amount of a member included in a group or loss subgroup does not include any unrealized built-in gain or loss on stock (including stock described in section 1504(a)(4) and §1.382–2T(f)(18)(ii) and (iii)) of another member included in the group or loss subgroup (or an intercompany obligation). However, a member of a group or loss subgroup includes in its separately computed amount the unrealized built-in gain or loss on stock (but not on an intercompany obligation) of another member not included in the group or loss subgroup. If a member is not included in the determination whether a group (or subgroup) has a net unrealized built-in loss under paragraph (g)(2)(ii) or (iv) of this section, that member is not included in the loss group or loss subgroup. See §1.1502–94(c) (relating to built-in gain or loss of a new loss member) and §1.1502–96(a) (relating to the end of separate tracking of certain losses).

(2) *Members included*—(i) *Consolidated group with a net operating loss.* The members included in the determination whether a consolidated group described in paragraph (c)(1)(i) or (ii) of this section (relating to loss groups with net operating losses) has a net unrealized built-in gain are all members of the consolidated group on the day that the determination is made.

(ii) *Determination whether a consolidated group has a net unrealized built-in loss.* The members included in the determination whether a consolidated group is a loss group described in paragraph (c)(1)(iii) of this section are—

(A) The common parent and all other members that have been affiliated with the common parent for the 5 consecutive year period ending on the day that the determination is made;

(B) Any other member that has a net unrealized built-in loss determined under paragraph (g)(1) of this section on the date that the determination is made, and that is neither a new loss member described in §1.1502–94(a)(1)(ii) nor a member of a loss subgroup described in paragraph (d)(2) of this section;

(C) Any new loss member described in §1.1502–94(a)(1)(ii) that has a net unrealized built-in gain determined under paragraph (g)(1) of this section on the day that the determination is made; and

(D) The members of a loss subgroup described in paragraph (d)(2) of this section if the members of the subgroup have, in the aggregate, a net unrealized built-in gain on the day that the determination is made.

(iii) *Loss subgroup with net operating loss carryovers.* The members included in the determination whether a loss subgroup described in paragraph (d)(1) of this section (relating to loss subgroups with net operating loss carryovers) has a net unrealized built-in gain are all members of the loss subgroup on the day that the determination is made.

(iv) *Determination whether subgroup has a net unrealized built-in loss.* The members included in the determination whether a subgroup has a net unrealized built-in loss are those members described in paragraphs (d)(2)(i) and (ii) of this section.

(v) *Separate determination of section 382 limitation for recognized built-in losses and net operating losses.* In determining whether a loss group described in paragraph (c)(1)(i) or (ii) of this section (relating to loss groups that have net operating loss carryovers) has a net unrealized built-in gain which, if recognized, increases the consolidated section 382 limitation, the group includes, under paragraph (g)(2)(i) of this section, all of its members on the day the determination is made. Under paragraph (g)(2)(ii) of this section, however, for purposes of determining whether a group has a net unrealized built-in loss described in paragraph (c)(1)(iii) of this section, not all members of the consolidated group may be included. Thus, a consolidated group may have recognized built-in gains that increase the amount of consolidated taxable income that may be offset by its prechange net operating loss carryovers that did not arise (and are not treated as arising) in a SRLY, and also may have recognized built-in losses the absorption of which is limited. Similar results may obtain for loss subgroups under paragraphs (g)(2)(iii) and (iv) of this section. See §1.1502–93(c)(2) for rules prohibiting the use of recognized built-in gains to increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

(3) *Coordination with rule that ends separate tracking.* See §1.1502–96(a) for special rules relating to members (or loss subgroups) that have an ownership change within six months before, on, or after becoming a member of the group.

(4) *Acquisitions of built-in gain or loss assets.* A member of a consolidated group (or loss subgroup) may not, in determining its separately computed net unrealized built-in gain or loss, include any gain or loss with respect to assets acquired with a principal purpose to affect the amount of its net unrealized built-in gain or loss. A group (or loss subgroup) may not, in determining its net unrealized built-in gain or loss, include any gain or loss of a member acquired with a principal purpose to affect the amount of its net unrealized built-in gain or loss.

(5) *Indirect ownership.* A member's separately computed net unrealized built-in gain or loss is adjusted to the extent necessary to prevent any duplication of unrealized gain or loss attributable to the member's indirect ownership interest in another member through a nonmember if the member has a 5-percent or greater ownership interest in the nonmember.

(6) *Common parent not common parent for five years.* If the common parent has become the common parent of an existing

group within the previous 5 year period in a transaction described in §1.1502–75(d)(2)(ii) or (3), appropriate adjustments must be made in applying paragraph (g)(2)(ii)(A) of this section so that corporations that have not been members of the group for five years are not included. In such a case, references to the common parent in paragraph (g)(2)(ii)(A) of this section are to the former common parent. Thus, members of the group remaining in existence (including the new common parent) that have not been affiliated with the former common parent (or that have not been members of that group) for the five consecutive year period ending on the day that the determination is made are not included under paragraph (g)(2)(ii)(A) of this section. See, however, §1.1502–96(a)(2) for special rules relating to members (or loss subgroups) that have an ownership change within six months before, on, or after the time that the member becomes a member of the group.

(h) *Recognized built-in gain or loss*—(1) *In general.* [Reserved].

(2) *Disposition of stock or an intercompany obligation of a member.* Gain or loss recognized by a member on the disposition of stock (including stock described in section 1504(a)(4) and §1.382–2T(f)(18)(ii) and (iii)) of another member is treated as a recognized gain or loss for purposes of section 382(h)(2) (unless disallowed under §1.1502–20 or otherwise), even though gain or loss on such stock was not included in the determination of a net unrealized built-in gain or loss under paragraph (g)(1) of this section. Gain or loss recognized by a member with respect to an intercompany obligation is treated as recognized gain or loss only to the extent (if any) the transaction gives rise to aggregate income or loss within the consolidated group.

(3) *Intercompany transactions.* Gain or loss that is deferred under provisions such as section 267 and §1.1502–13 is treated as recognized built-in gain or loss only to the extent taken into account by the group during the recognition period. See also §1.1502–13(c)(7) *Example 10.*

(4) *Exchanged basis property.* If the adjusted basis of any asset is determined, directly or indirectly, in whole or in part, by reference to the adjusted basis of another asset held by the member at the beginning of the recognition period, the asset is treated, with appropriate adjustments, as held by the member at the beginning of the recognition period.

(i) [Reserved]

(j) *Predecessor and successor corporations.* A reference in this section and §§1.1502–92 through 1.1502–99 to a corporation, member, common parent, loss subgroup parent, or subsidiary includes, as the context may require, a reference to a predecessor or successor corporation as defined in §1.1502–1(f)(4). For example, the determination whether a successor satisfies the continuous affiliation requirement of paragraph (d)(2)(i) or (g)(2)(ii) of this section is made by reference to its predecessor.

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

(a) *Scope.* This section provides rules for determining if there is an ownership change for purposes of section 382 with respect to a loss group or a loss subgroup. See §1.1502–94 for special rules for determining if there is an ownership change with respect to a new loss member and §1.1502–96(b) for special rules for determining if there is an ownership change of a subsidiary.

(b) *Determination of an ownership change*—(1) *Parent change method*—(i) *Loss group.* A loss group has an ownership change if the loss group's common parent has an ownership change under section 382 and the regulations thereunder. Solely for purposes of determining whether the common parent has an ownership change—

(A) The losses described in §1.1502–91(c) are treated as net operating losses (or a net unrealized built-in loss) of the common parent; and

(B) The common parent determines the earliest day that its testing period can begin by reference to only the attributes that make the group a loss group under §1.1502–91(c).

(ii) *Loss subgroup.* A loss subgroup has an ownership change if the loss subgroup parent has an ownership change under section 382 and the regulations thereunder. The principles of §1.1502–95(b) (relating to ceasing to be a member of a consolidated group) apply in determining whether the loss subgroup parent has an ownership change. Solely for purposes of determining whether the loss subgroup parent has an ownership change—

(A) The losses described in §1.1502–91(d) are treated as net operating losses (or a net unrealized built-in loss) of the loss subgroup parent;

(B) The day that the members of the loss subgroup become members of the group (or a loss subgroup) is treated as a testing date within the meaning of §1.382–2(a)(4); and

(C) The loss subgroup parent determines the earliest day that its testing period can begin under §1.382–2T(d)(3) by reference to only the attributes that make the members a loss subgroup under §1.1502–91(d).

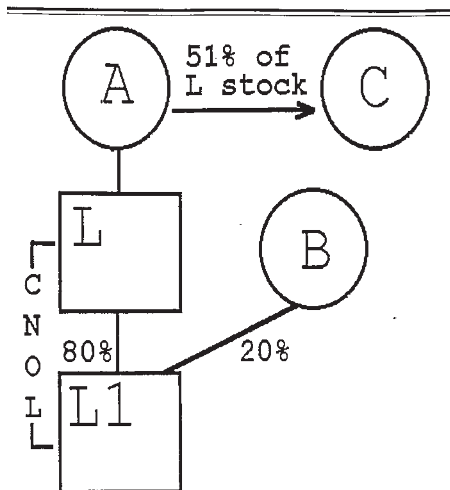
(iii) *Special rule if election regarding section 1504(a)(1) relationship is made*—(A) *Ownership change of deemed loss subgroup parent is an ownership change of loss subgroup.* If the common parent makes an election under §1.1502–91(d)(4), each of the members in the loss subgroup is treated as the loss subgroup parent for purposes of determining whether the loss subgroup has an ownership change under section 382 and the regulations thereunder on or after the day the members become members of the group.

(B) *Exception.* Paragraph (b)(1)(iii)(A) of this section does not apply to cause an ownership change of a loss subgroup if a deemed loss subgroup parent has an ownership change upon (or after) ceasing to be a member of the current group.

(2) *Examples.* The following examples illustrate the principles of this paragraph (b):

Example 1. Loss group—ownership change of the common parent. (i) A owns all the L stock. L owns 80 percent and B owns 20 percent of the L1 stock. For Year 1, the L group has a consolidated net operating loss that resulted from the operations of L1 and that is carried over to Year 2. The value of the L stock is $1000. The total value of the L1 stock is $600 and the value of the L1 stock held by B is $120. The L group is a loss group under §1.1502–91(c)(1) because it is entitled to use its net operating loss carryover from Year 1. On August 15, Year 2, A sells 51 percent of the L stock to C. The following is a graphic illustration of these facts:

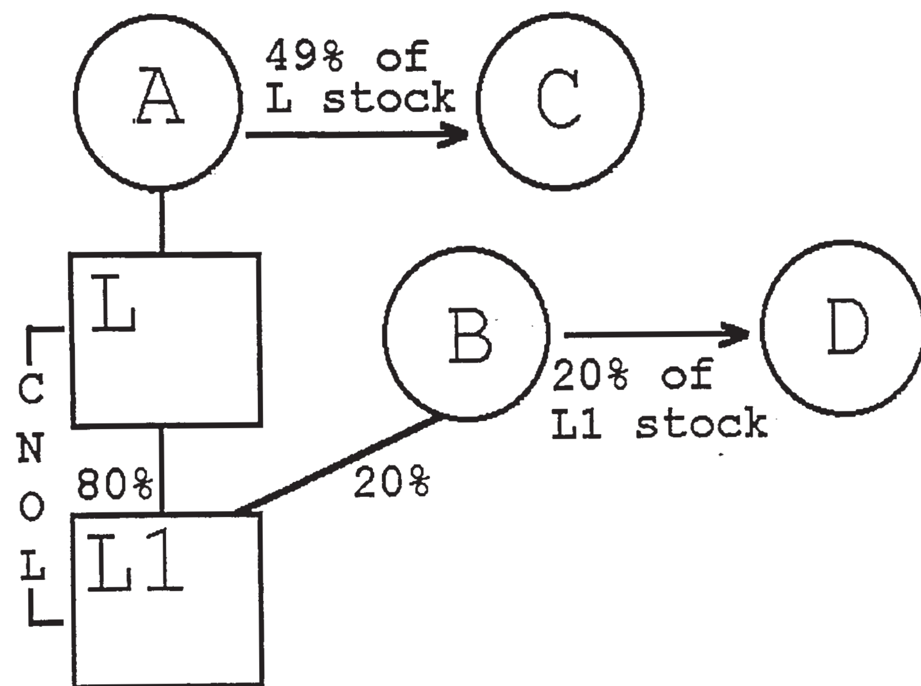
(ii) Under paragraph (b)(1)(i) of this section, section 382 and the regulations thereunder are applied to L to determine whether it (and therefore the L loss group) has an ownership change with respect to its net operating loss carryover from Year 1 attrib-



utable to L1 on August 15, Year 2. The sale of the L stock to C causes an ownership change of L under §1.382–2T and of the L loss group under paragraph (b)(1)(i) of this section. The amount of consolidated taxable income of the L loss group for any post-change taxable year that may be offset by its pre-change consolidated attributes (that is, the net operating loss carryover from Year 1 attributable to L1) may not exceed the consolidated section 382 limitation for the L loss group for the taxable year.

Example 2. Loss group—owner shifts of subsidiaries disregarded. (i) The facts are the same as in *Example 1,* except that on August 15, Year 2, A sells only 49 percent of the L stock to C and, on December 12, Year 3, in an unrelated transaction, B sells the 20 percent of the L1 stock to D. A's sale of the L stock to C does not cause an ownership change of L under §1.382–2T nor of the L loss group under paragraph (b)(1)(i) of this section. The following is a graphic illustration of these facts:

(ii) B's subsequent sale of L1 stock is not taken into account for purposes of determining whether the L loss group has an ownership change under paragraph (b)(1)(i) of this section, and, accordingly, there is no ownership change of the L loss group. See paragraph (c) of this section, however, for a supplemental ownership change method that would apply to cause an ownership change if the purchases by C and D were pursuant to a plan or arrangement and certain other conditions are satisfied.



Example 3. Loss subgroup—ownership change of loss subgroup parent controls. (i) P owns all the L stock. L owns 80 percent and A owns 20 percent of the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On September 9, Year 2, P sells 51 percent of the L stock to B, and L1 is apportioned a portion of the Year 1 consolidated net operating loss under §1.1502–21(b), which it carries over to its next taxable year. L and L1 file a consolidated return for their first taxable year ending after the sale to B. The following is a graphic illustration of these facts:

(ii) Under §1.1502–91(d)(1), L and L1 compose a loss subgroup on September 9, Year 2, the day that they become members of the L group. Under paragraph (b)(1)(ii) of this section, section 382 and the regulations thereunder are applied to L to determine whether it (and therefore the L loss subgroup) has an ownership change with respect to the portion of the Year 1 consolidated net operating loss that is apportioned to L1 on September 9, Year 2. L has an ownership change resulting from P's sale of 51 percent of the L stock to A. Therefore, the L loss subgroup has an ownership change with respect to that loss.

Example 4. Loss group and loss subgroup—contemporaneous ownership changes. (i) A owns all the stock of corporation M, M owns 35 percent and B owns 65 percent of the L stock, and L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On May 19, Year 2, B sells 45 percent of the L stock to M for cash. M, L, and L1 thereafter file consolidated returns. L and L1 are each apportioned a portion of the Year 1 consolidated net operating loss, which they carry over to the M group's Year 2 and Year 3 consolidated return years. The M group has a consolidated net operating loss arising in Year 2 that is carried over to Year 3. On June 9, Year 3, A sells 70 percent of the M stock to C. The following is a graphic illustration of these facts:

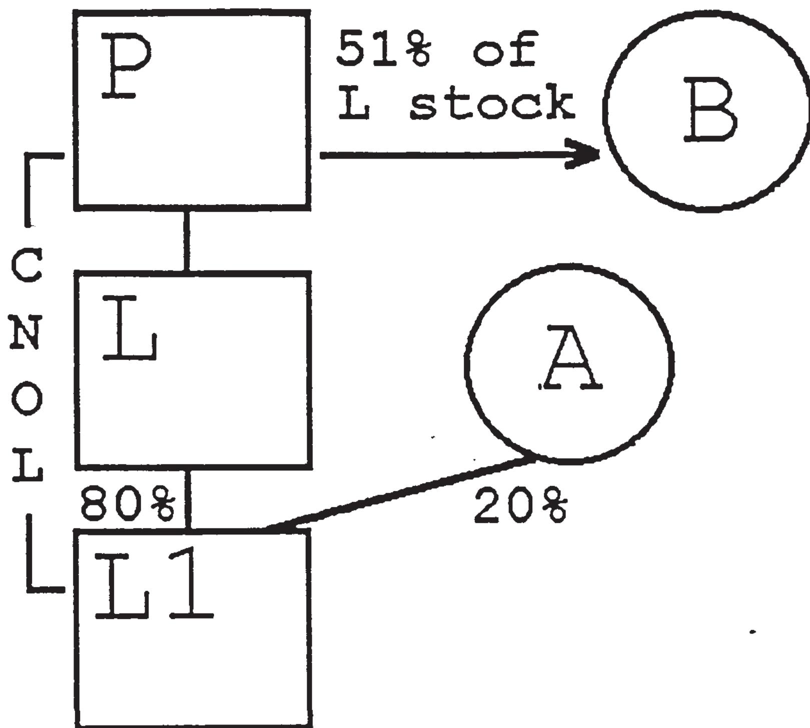
(ii) Under §1.1502–91(d)(1), L and L1 compose a loss subgroup on May 19, Year 2, the day they become members of the M group. Under paragraph (b)(1)(ii) of this section, section 382 and the regulations thereunder are applied to L to determine whether L (and therefore the L loss subgroup) has an ownership change with respect to the loss carryovers from Year 1 on May 19, Year 2, a testing date because of B's sale of L stock to M. The sale of L stock to M results in only a 45 percentage point increase in A's ownership of L stock. Thus, there is no ownership change of L (or the L loss subgroup) with respect to those loss carryovers under paragraph (b)(1)(ii) of this section on that day.

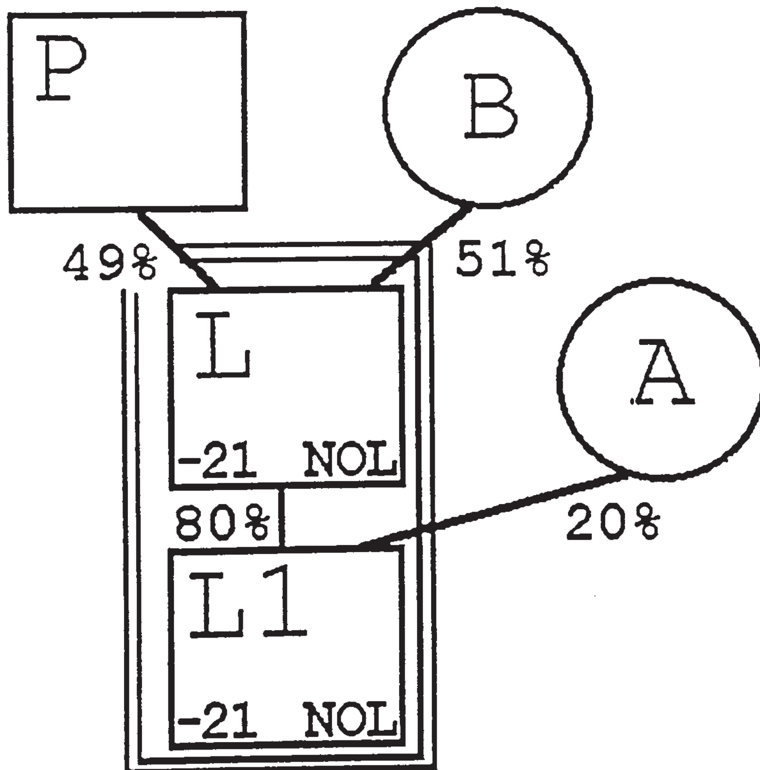
(iii) June 9, Year 3, is also a testing date with respect to the L loss subgroup because of A's sale of M stock to C. The sale results in a 56 percentage point increase in C's ownership of L stock, and L has an ownership change. Therefore, the L loss subgroup has an ownership change on that day with respect to the loss carryovers from Year 1.

(iv) Paragraph (b)(1)(i) of this section requires that section 382 and the regulations thereunder be applied to M to determine whether M (and therefore the M loss group) has an ownership change with respect to the net operating loss carryover from Year 2 on June 9, Year 3, a testing date because of A's sale of M stock to C. The sale results in a 70 percentage point increase in C's ownership of M stock, and M has an ownership change. Therefore, the M loss group has an ownership change on that day with respect to that loss carryover.

Example 5—Deemed subgroup parent. (i) P owns all the stock of L and L1 and 80 percent of the stock of T. A owns the remaining 20 percent of the stock of T. L1 owns all the stock of L2. P1, which owns 60 percent of the stock of P, acquires, at the beginning of Year 2, the T, L, and L1 stock owned by P, and T, L, L1, and L2 become members of the P1 group. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. L, L1, and L2 are each apportioned a portion of the Year 1 consolidated net operating loss under §1.1502–21(b), which they carry over to the P1 group's Year 2 and Year 3 consolidated return years. P1 makes the election described in §1.1502–91(d)(4) to treat T, L, L1 and L2 as meeting the section 1504(a)(1) requirement of §1.1502–91(d)(1)(ii). As a result of the election, T, L, L1 and L2 compose a loss subgroup and T, L, L1, and L2 are each treated as the loss subgroup parent for purposes of this paragraph (b). Because of P1's indirect ownership of T, L, L1, and L2 prior to P1's acquisition of the T, L, and L1 stock, P1's acquisition does not cause an ownership change of the loss subgroup.

(ii) On February 2, Year 3, L1 sells all of the stock of L2 to B. Although L2 is treated as a loss subgroup parent, the determination whether the loss subgroup comprised of T, L, and L1 has an ownership change under this paragraph (b) is made without regard to the sale of L2 because L2's ownership change occurred upon ceasing to be a member of the P1 group. See §1.1502–95(b) to determine the ap-





plication of section 382 to L2 when L2 ceases to be a member of the P1 group and the T, L, L1 and L2 loss subgroup.

(iii) On March 26, Year 3, A sells her 20 percent minority stock interest in T to C . C's purchase, together with the 32 percentage point owner shift effected by P1's acquisition of the T stock at the beginning of Year 2, causes an ownership change of T, and therefore of the loss subgroup comprised of T, L, and L1.

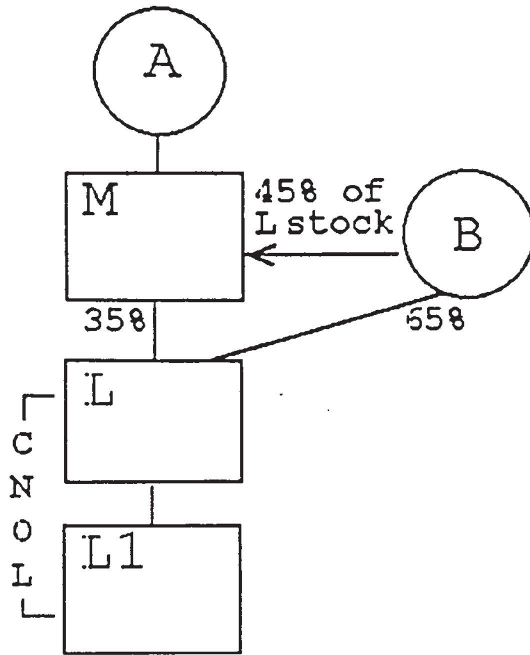
(3) *Special adjustments*—(i) Common parent succeeded by a new common parent. For purposes of determining if a loss group has an ownership change, if the common parent of a loss group is succeeded or acquired by a new common parent and the loss group remains in existence, the new common parent is treated as a continuation of the former common parent with appropriate adjustments to take into account shifts in ownership of the former common parent during the testing period (including shifts that occur incident to the common parent's becoming the former common parent). A new common parent may be a continuation of the former common parent even if, under §1.1502–91(g)(2)(ii), the new common parent is not included in determining whether the group has a net unrealized built-in loss.

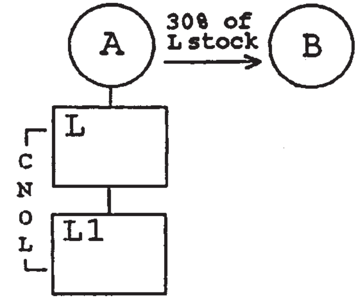
(ii) *Newly created loss subgroup parent.* For purposes of determining if a loss subgroup has an ownership change, if the member that is the loss subgroup parent has not been the loss subgroup parent for at least 3 years as of a testing date, appropriate adjustments must be made to take into account owner shifts of members of the loss subgroup so that the structure of the loss subgroup does not have the effect of avoiding an ownership change under section 382. (See paragraph (b)(3)(iii), *Example 3* of this section.)

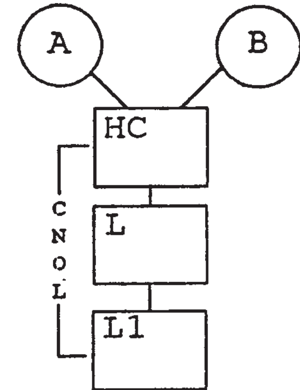
(iii) *Examples.* The following examples illustrate the principles of this paragraph (b)(3):

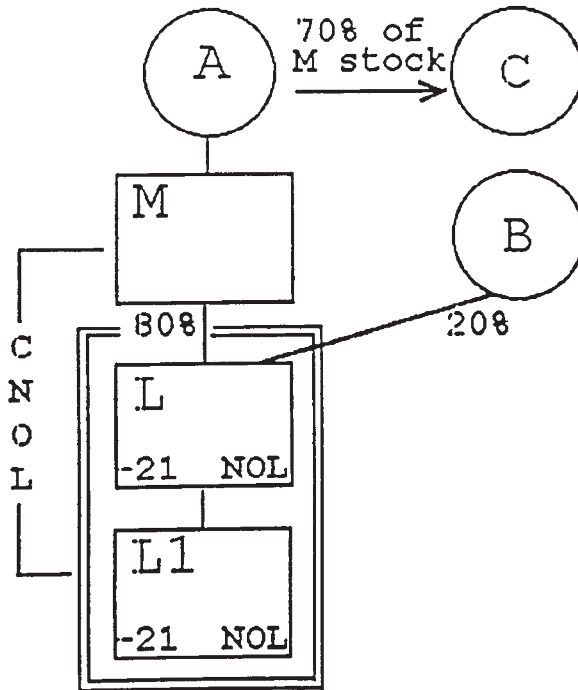
Example 1. New common parent acquires old common parent. (i) A, who owns all the L stock, sells 30 percent of the L stock to B on August 26, Year 1. L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On July 16, Year 2, A and B transfer their L stock to a newly created holding company, HC, in exchange for 70 percent and 30 percent, respectively, of the HC stock. HC, L, and L1 thereafter file consolidated returns. Under the principles of §1.1502– 75(d), the L loss group is treated as remaining in existence, with HC taking the place of L as the new common parent of the loss group. The following is a graphic illustration of these facts:

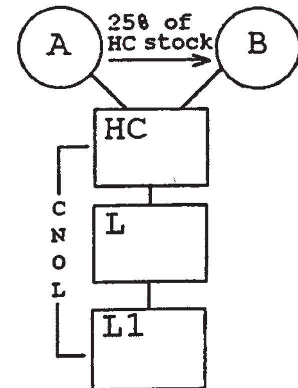
(ii) On November 11, Year 3, A sells 25 percent of the HC stock to B. For purposes of determining if the L loss group has an ownership change under paragraph (b)(1)(i) of this section on November 11, Year 3, HC is treated as a continuation of L under paragraph (b)(4)(i) of this section because it acquired L and became the common parent without terminating the L loss group. Accordingly, HC's testing period commences on January 1, Year 1, the









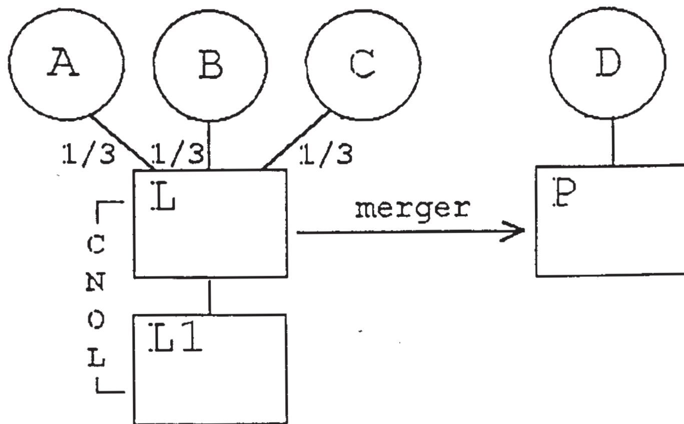


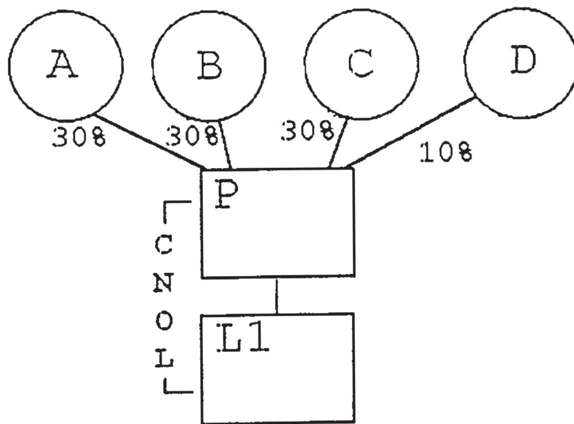
first day of the taxable year of the L loss group in which the consolidated net operating loss that is carried over to Year 3 arose (see §1.382–2T(d)(3)(i)). Immediately after the close of November 11, Year 3, B's percentage ownership interest in the common parent of the loss group (HC) has increased by 55 percentage points over its lowest percentage ownership during the testing period (zero percent). Accordingly, HC and the L loss group have an ownership change on that day.

Example 2. New common parent in case in which common parent ceases to exist. (i) A, B, and C each own one-third of the L stock. L owns all the L1 stock. The L group has a consolidated net operating loss arising in Year 2 that is carried over to Year 3. On November 22, Year 3, L is merged into P, a corporation owned by D, and L1 thereafter files consolidated returns with P. A, B, and C, as a result of owning stock of L, own 90 percent of P's stock after the merger. D owns the remaining 10 percent of P's stock. The merger of L into P qualifies as a reverse acquisition of the L group under §1.1502–75(d)(3)(i), and the L loss group is treated as remaining in existence, with P taking the place of L as the new common parent of the L group. The following is a graphic illustration of these facts:

(ii) 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 his ownership interest in P during the testing period (from zero to 10 percentage points).

(iii) The facts are the same as in paragraph (i) of this *Example 2,* except that A has held 23 1/3 shares (23 1/3 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 6 2/3 percentage points over A's lowest percentage ownership during the testing period (23 1/3 percent to 30 percent).

(iv) The facts are the same as in (i) of this *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.

Example 3. Newly acquired loss subgroup parent. (i) P owns all the L stock and L owns all the L1 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On January 19, Year 2, L issues a 20 percent stock interest to B. On February 5, Year 3, P contributes its L stock to a newly formed subsidiary, HC, in exchange for all the HC stock, and distributes the HC stock to its sole shareholder A. HC, L, and L1 thereafter file consolidated returns. A portion of the P group's Year 1 consolidated net operating loss is apportioned to L and L1 under §1.1502–21(b) and is carried over to the HC group's year ending after February 5, Year 3. HC, L, and L1 compose a loss subgroup within the meaning of §1.1502–91(d) with respect to the net operating loss carryovers from Year 1. The following is a graphic illustration of these facts:

(ii) February 5, Year 3, is a testing date for HC as the loss subgroup parent with respect to the net operating loss carryovers of L and L1 from Year 1. See paragraph (b)(1)(ii)(B) of this section. For purposes of determining whether HC has an ownership change on the testing date, appropriate adjustments must be made with respect to the changes in the percentage ownership of the stock of HC because HC was not the loss subgroup parent for at least 3 years prior to the day on which it became a member of the HC loss subgroup (a testing date). The appropriate adjustments include adjustments so that HC succeeds to the owner shifts of other members of the former group. Thus, HC succeeds to the owner shift of L that resulted from the sale of the 20 percent interest to B in determining whether the HC loss subgroup has an ownership change on February 5, Year 3, and on any subsequent testing date that includes January 19, Year 2.

(4) *End of separate tracking of certain losses.* If §1.1502–96(a) (relating to the end of separate tracking of attributes) applies to a loss subgroup, then, while one or more members that were included in the loss subgroup remain members of the consolidated group, there is an ownership change with respect to their attributes described in §1.1502–96(a)(2) only if the consolidated group is a loss group and has an ownership change under paragraph (b)(1)(i) of this section (or such a member has an ownership change under §1.1502–96(b) (relating to ownership changes of subsidiaries)). If, however, the loss subgroup has had an ownership change before §1.1502–96(a) applies, see §1.1502–96(c) for the continuing application of the subgroup's section 382 limitation with respect to its pre-change subgroup attributes.

(c) *Supplemental rules for determining ownership change*—(1) *Scope.* This paragraph (c) contains a supplemental rule for determining whether there is an ownership change of a loss group (or loss subgroup). It applies in addition to, and not instead of, the rules of paragraph (b) of this section. Thus, for example, if the common parent of the loss group has an ownership change under paragraph (b) of this section, the loss group has an ownership change even if, by applying this paragraph (c), the common parent would not have an ownership change. This paragraph (c) does not apply in determining an ownership change of a loss subgroup for which an election under §1.1502–1(d)(4) is made.

(2) *Cause for applying supplemental rule.* This paragraph (c) applies to a loss group (or loss subgroup) if—

(i) Any 5-percent shareholder of the common parent (or loss subgroup parent) increases its percentage ownership interest in the stock of both—

(A) A subsidiary of the loss group (or loss subgroup) other than by a direct or indirect acquisition of stock of the common parent (or loss subgroup parent); and

(B) The common parent (or loss subgroup parent);

(ii) Those increases occur within a 3 year period ending on any day of a consolidated return year or, if shorter, the pe-

riod beginning on the first day following the most recent ownership change of the loss group (or loss subgroup); and

(iii) Either—

(A) The common parent (or loss subgroup parent) has actual knowledge of the increase in the 5-percent shareholder's ownership interest in the stock of the subsidiary (or has actual knowledge of the plan or arrangement described in paragraph (c) (3)(i) of this section) before the date that the group's income tax return is filed for the taxable year that includes the date of that increase; or

(B) At any time during the period described in paragraph (c)(2)(ii) of this section, the 5-percent shareholder of the common parent is also a 5-percent shareholder of the subsidiary (determined without regard to paragraph (c)(3)(i) of this section) whose percentage increase in the ownership of the stock of the subsidiary would be taken into account in determining if the subsidiary has an ownership change (determined as if the subsidiary was a loss corporation and applying the principles of §1.382–2T(k), including the principles relating to duty to inquire).

(3) *Operating rules.* Solely for purposes of this paragraph (c)—

(i) A 5-percent shareholder of the common parent (or loss subgroup parent) is treated as increasing its ownership interest in the stock of a subsidiary to the extent, if any, that another person or persons increases its percentage ownership interest in the stock of a subsidiary pursuant to a plan or arrangement under which the 5-percent shareholder increases its percentage ownership interest in the common parent (or loss subgroup parent);

(ii) The rules in section 382(l)(3) and §§1.382–2T(h) and 1.382–4(d) (relating to constructive ownership) apply with respect to the stock of the subsidiary by treating such stock as stock of a loss corporation; and

(iii) In the case of a loss subgroup, a subsidiary includes any member of the loss subgroup other than the loss subgroup parent. (A loss subgroup parent is, however, a subsidiary of the loss group of which it is a member.)

(4) *Supplemental ownership change rules.* The determination whether the common parent (or loss subgroup parent) has an ownership change is made by applying paragraph (b)(1) of this section as modified by the following additional rules:

(i) *Additional testing dates for the common parent (or loss subgroup parent).* A testing date for the common parent (or loss subgroup parent) also includes—

(A) Each day on which there is an increase in the percentage ownership of stock of a subsidiary as described in paragraph (c)(2) of this section; and

(B) The first day of the first consolidated return year for which the group is a loss group (or the members compose a loss subgroup).

(ii) *Treatment of subsidiary stock as stock of the common parent (or loss subgroup parent).* The common parent (or loss subgroup parent) is treated as though it had issued to the person acquiring (or deemed to acquire) the subsidiary stock an amount of its own stock (by value) that equals the value of the subsidiary stock represented by the percentage increase in that person's ownership of the subsidiary (determined on a separate entity basis). Similar principles apply if the increase in percentage ownership interest is effected by a redemption or similar transaction.

(iii) *Different testing periods.* Stock treated as issued under paragraph (c)(4)(ii) of this section on a testing date is not treated as so issued for purposes of applying the ownership change rules of this paragraph (c) and paragraph (b) (1) of this section in a testing period that does not include that testing date.

(iv) *Disaffiliation of a subsidiary.* If a deemed issuance of stock under paragraph (c)(4)(ii) of this section would not cause the loss group (or loss subgroup) to have an ownership change before the day (if any) on which the subsidiary ceases to be a member of the loss group (or subgroup), then paragraph (c)(4) of this section shall not apply.

(v) *Subsidiary stock acquired first.* If an increase of subsidiary stock described in paragraph (c)(2)(i)(A) of this section occurs before the date that the 5-percent shareholder increases its percentage ownership interest in the stock of the common parent (or loss subgroup parent), then the deemed issuance of stock is treated as occurring on that later date, but in an amount equal to the value of the subsidiary stock on the date it was acquired.

(vi) *Anti-duplication rule.* If two or more 5-percent shareholders are treated as increasing their percentage ownership interests pursuant to the same plan or arrangement described in paragraph (c)(3)(i) of this section, appropriate adjustments must be made so that the amount of stock treated as issued is not taken into account more than once.

(5) *Examples.* The following examples illustrate the principles of this paragraph (c):

Example 1. Stock of the common parent under supplemental rules. (i) A owns all the L stock. L is not a member of an affiliated group and has a net operating loss carryover arising in Year 1 that is carried over to Year 6. On September 20, Year 6, L transfers all of its assets and liabilities to a newly created subsidiary, S, in exchange for S stock. L and S thereafter file consolidated returns. On November 23, Year 6, B contributes cash to L in exchange for a 45 percent ownership interest in L and contributes cash to S for a 20 percent ownership interest in S.

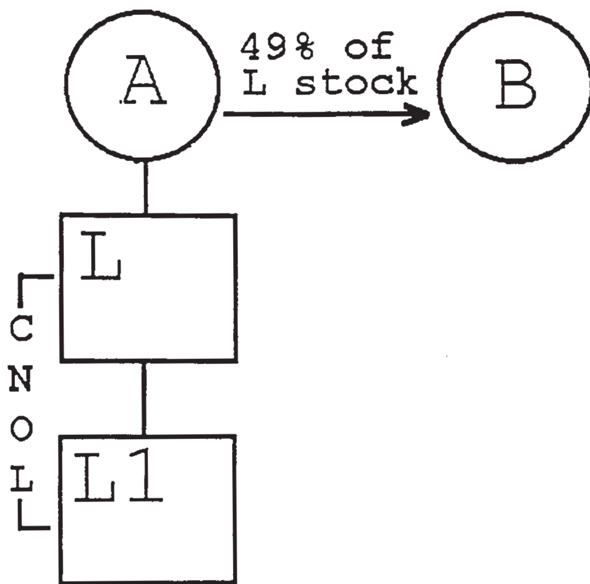
(ii) During the 3 year period ending on November 23, Year 6, B is a 5% shareholder of L and of S that increases its ownership interest in L and S during that period. Under paragraph (c)(4)(ii) of this section, the determination whether L (the common parent of a loss group) has an ownership change on November 23, Year 6 (or, subject to paragraph (c)(4)(iv) of this section, on any testing date in the testing period which includes November 23, Year 6), is made by applying paragraph (b)(1)(i) of this section and by treating the value of B's 20 percent ownership interest in S as if it were L stock issued to B. Because B is a 5% shareholder of both L and S during the 3 year period ending on November 23, Year 6, and B's increase in its percentage ownership in the stock of S would be taken into account in determining if S (if it were a loss corporation) had an ownership change, it is not relevant whether L has actual knowledge of B's acquisition of S stock.

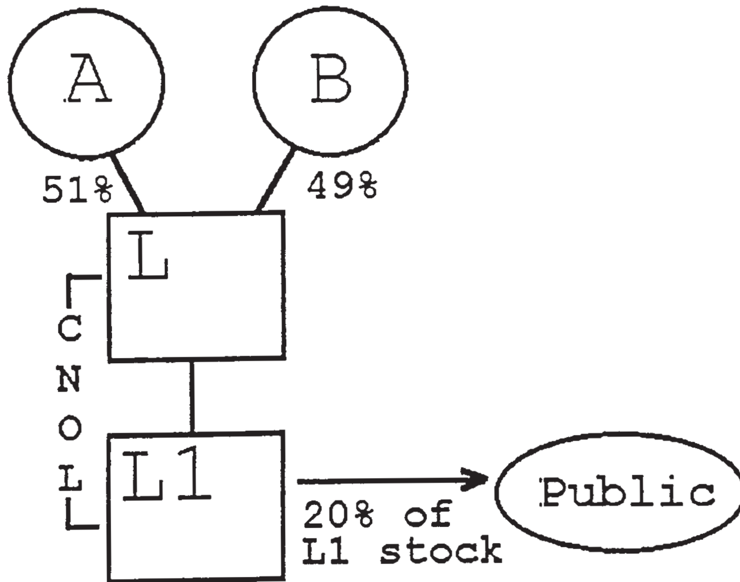
Example 2. Plan or arrangement—public offering of subsidiary stock. (i) A owns all the stock of L and L owns all the stock of L1. The L group has a consolidated net operating loss arising in Year 1 that resulted from the operations of L1 and that is carried over to Year 2. On October 7, Year 2, A sells 49 percent of the L stock to B. As part of a plan that includes the sale of L stock, A causes a public offering of L1 stock on November 6, Year 2. L has actual knowledge of the plan. The following is a graphic illustration of these facts:

(ii) A's sale of the L stock to B does not cause an ownership change of the L loss group on October 7, Year 2, under the rules of §1.382–2T and paragraph (b)(1)(i) of this section.

(iii) Because the issuance of L1 stock to the public occurs as part of the same plan as B's acquisition of L stock, and L has knowledge of the plan, paragraph (c)(4) of this section applies to determine whether the L loss group has an ownership change on November 6, Year 2 (or, subject to paragraph (c)(4)(iv) of this section, on any testing date for which the testing period includes November 6, Year 2).

(d) *Testing period following ownership change under this section.* If a loss group (or a loss subgroup) has had an ownership





change under this section, the testing period for determining a subsequent ownership change with respect to pre-change consolidated attributes (or pre-change subgroup attributes) begins no earlier than the first day following the loss group's (or loss subgroup's) most recent change date.

(e) *Information statements*—(1) *Common parent of a loss group.* The common parent of a loss group must file the information statement required by §1.382–2T(a)(2)(ii) for a consolidated return year because of any owner shift, equity structure shift, or other transaction described in §1.382–2T(a)(2)(i)—

(i) With respect to the common parent and with respect to any subsidiary stock subject to paragraph (c) of this section; and

(ii) With respect to an ownership change described in §1.1502–96(b) (relating to ownership changes of subsidiaries).

(2) *Abbreviated statement with respect to loss subgroups.* The common parent of a consolidated group that has a loss subgroup during a consolidated return year must file the information statement required by §1.382–2T(a)(2)(ii) because of any owner shift, equity structure shift, or other transaction described in §1.382–2T(a)(2)(i) with respect to the loss subgroup parent and with respect to any subsidiary stock subject to paragraph (c) of this section. Instead of filing a separate statement for each loss subgroup parent, the common parent (which is treated as a loss corporation) may file the single statement described in paragraph (e)(1) of this section. In addition to the information concerning stock ownership of the common parent, the single statement must identify each loss subgroup parent and state which loss subgroups, if any, have had ownership changes during the consolidated return year. The loss subgroup parent is, however, still required to maintain the records necessary to determine if the loss subgroup has an ownership change. This paragraph (e)(2) applies with respect to the attributes of a loss subgroup until, under §1.1502–96(a), the attributes are no longer treated as described in §1.1502–91(d) (relating to the definition of loss subgroup). After that time, the information statement described in paragraph (e)(1) of this section must be filed with respect to those attributes.

§1.1502–93 Consolidated section 382 limitation (or subgroup section 382 limitation).

(a) *Determination of the consolidated section 382 limitation (or subgroup section 382 limitation*—(1) *In general.* Following an ownership change, the consolidated section 382 limitation (or subgroup section 382 limitation) for any post-change year is an amount equal to the value of the loss group (or loss subgroup), as defined in paragraph (b) of this section, multiplied by the long-term tax-exempt rate that applies with respect to the ownership change, and adjusted as required by section 382 and the regulations thereunder. See, for example, section 382(b)(2) (relating to the carryforward of unused section 382 limitation), section 382(b)-(3)(B) (relating to the section 382 limitation for the post-change year that includes the change date), section 382(h) (relating to recognized built-in gains and section 338 gains), and section 382(m)(2) (relating to short taxable years). For special rules relating to the recognized built-in gains of a loss group (or loss subgroup), see paragraph (c)(2) of this section.

(2) *Coordination with apportionment rule.* For special rules relating to apportionment of a consolidated section 382 limitation (or a subgroup section 382 limitation) or net unrealized built-in gain when one or more corporations cease to

be members of a loss group (or a loss subgroup) and to aggregation of amounts so apportioned, see §1.1502–95(c).

(b) *Value of the loss group (or loss subgroup)*—(1) *Stock value immediately before ownership change.* Subject to any adjustment under paragraph (b)(2) of this section, the value of the loss group (or loss subgroup) is the value, immediately before the ownership change, of the stock of each member, other than stock that is owned directly or indirectly by another member. For this purpose—

(i) Ownership is determined under §1.382–2T;

(ii) A member is considered to indirectly own stock of another member through a nonmember only if the member has a 5-percent or greater ownership interest in the nonmember; and

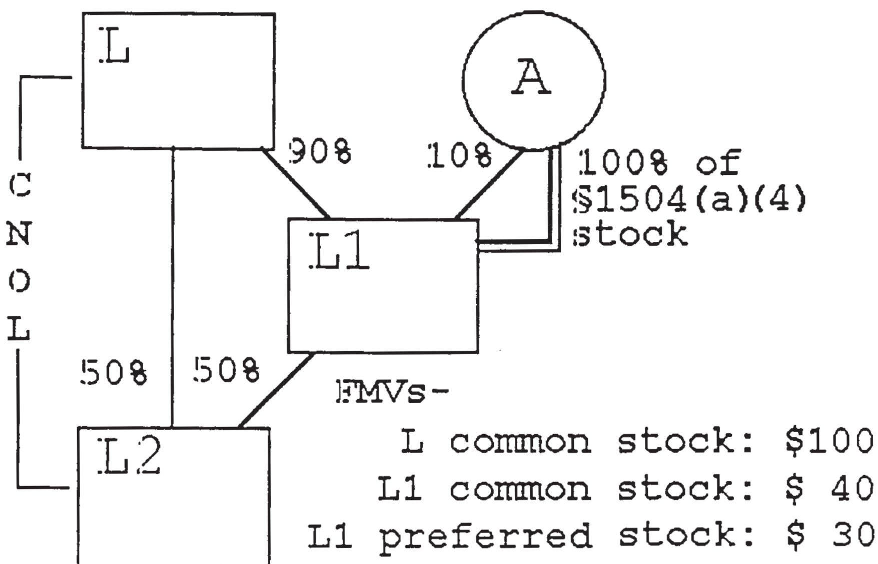
(iii) Stock includes stock described in section 1504(a)(4) and §1.382–2T(f)(18)(ii) and (iii).

(2) *Adjustment to value*—(i) *In general.* The value of the loss group (or loss subgroup), as determined under paragraph (b)(1) of this section, is adjusted under any rule in section 382 or the regulations thereunder requiring an adjustment to such value for purposes of computing the amount of the section 382 limitation. See, for example, section 382(e)(2) (redemptions and corporate contractions), section 382(l)(1) (certain capital contributions) and section 382(l)(4) (ownership of substantial nonbusiness assets). For purposes of section 382(e)(2), redemptions and corporate contractions that do not effect a transfer of value outside of the loss group (or loss subgroup) are disregarded. For purposes of section 382(l)(1), capital contributions between members of the loss group (or loss subgroup)(or a contribution of stock to a member made solely to satisfy the loss subgroup parent requirement of paragraph (d)(1)(ii) or (2)(ii) of this section), are not taken into account. Also, the substantial nonbusiness asset test of section 382(l)(4) is applied on a group (or subgroup) basis, and is not applied separately to its members.

(ii) *Anti-duplication.* Appropriate adjustments must be made to the extent necessary to prevent any duplication of the value of the stock of a member, even though corporations that do not file consolidated returns may not be required to make such an adjustment. In making these adjustments, the group (or loss subgroup) may apply the principles of §1.382–8 (relating to controlled groups of corporations) in determining the value of a loss group (or loss subgroup) even if that section would not apply if separate returns were filed. Also, the principles of §1.382–5(d)(relating to successive ownership changes and absorption of a section 382 limitation) may apply to adjust the consolidated section 382 limitation (or subgroup section 382 limitation) of a loss group (or loss subgroup) to avoid a duplication of value if there are simultaneous (rather than successive) ownership changes.

(3) *Examples.* The following examples illustrate the principles of this paragraph (b):

Example 1. Basic case. (i) L, L1, and L2 compose a loss group. L has outstanding common stock, the value of which is $100. L1 has outstanding common stock and preferred stock that is described in section 1504(a)(4). L owns 90 percent of the L1 common stock, and A owns the remaining 10 percent of the L1 common stock plus all the preferred stock. The value of the L1 common stock is $40, and the value of the L1 preferred stock is $30. L2 has outstanding common stock, 50 percent of which is owned by L and 50 percent by L1. The L group has an ownership change. The following is a graphic illustration of these facts:



(ii) Under paragraph (b)(1) of this section, the L group does not include the value of the stock of any member that is owned directly or indirectly by another member in computing its consolidated section 382 limitation. Accordingly, the value of the stock of the loss group is $134, the sum of the value of—

(a) The common stock of L ($100);

(b) The 10 percent of the L1 common stock ($4) owned by A; and

(c) The L1 preferred stock ($30) owned by A.

Example 2—Indirect ownership. (i) L and L1 compose a consolidated group. L's stock has a value of $100. L owns 80 shares (worth $80) and corporation M owns 20 shares (worth $20) of the L1 stock. L also owns 79 percent of the stock of corporation M. The L group has an ownership change. The following is a graphic illustration of these facts:

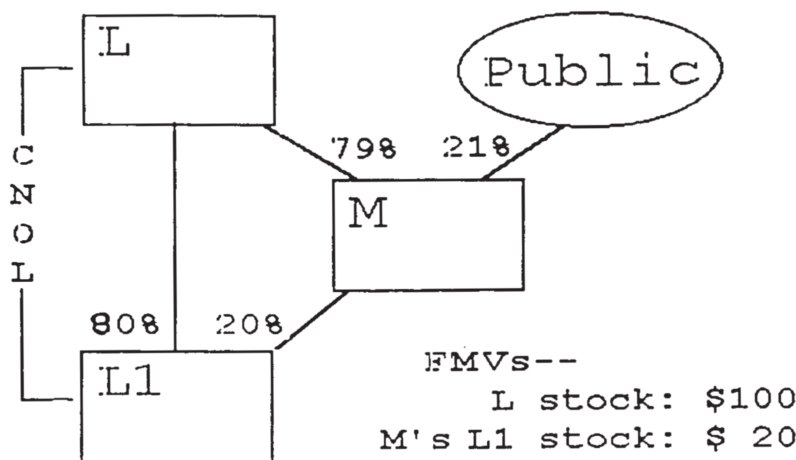
(ii) Under paragraph (b)(1) of this section, because of L's more than 5 percent ownership interest in M, a nonmember, L is considered to indirectly own 15.8 shares of the L1 stock held by M (79% x 20 shares). The value of the L loss group is $104.20, the sum of the values of—

(a) The L stock ($100); and

(b) The L1 stock not owned directly or indirectly by L (21% × $20, or $4.20).

(c) *Recognized built-in gain of a loss group or loss subgroup*—(1) *In general.* If a loss group (or loss subgroup) has a net unrealized built-in gain, any recognized built-in gain of the loss group (or loss subgroup) is taken into account under section 382(h) in determining the consolidated section 382 limitation (or subgroup section 382 limitation).

(2) *Adjustments.* Appropriate adjustments must be made so that any recognized built-in gain of a member that increases more than one section 382 limitation (whether consolidated, subgroup, or separate) does not effect a duplication in the amount of consolidated taxable income that can be offset by pre-change net operating losses. For example, a consolidated section 382 limitation that is increased by recognized built-in gains is reduced to the extent that pre-change net operating losses of a loss subgroup absorb additional consolidated taxable income because the same recog-



nized built-in gains caused an increase in that loss subgroup's section 382 limitation. In addition, recognized built-in gain may not increase the amount of consolidated taxable income that can be offset by recognized built-in losses.

(d) *Continuity of business*—(1) *In general.* A loss group (or a loss subgroup) is treated as a single entity for purposes of determining whether it satisfies the continuity of business enterprise requirement of section 382(c)(1).

(2) *Example.* The following example illustrates the principle of this paragraph (d):

Example. Continuity of business enterprise. L owns all the stock of two subsidiaries, L1 and L2. The L group has an ownership change. It has pre-change consolidated attributes attributable to L2. Each of the members has historically conducted a separate line of business. Each line of business is approximately equal in value. One year after the ownership change, L discontinues its separate business and the business of L2. The separate business of L1 is continued for the remainder of the 2 year period following the ownership change. The continuity of business enterprise requirement of section 382(c)(1) is met even though the separate businesses of L and L2 are discontinued.

(e) *Limitations of losses under other rules.* If a section 382 limitation for a post-change year exceeds the consolidated taxable income that may be offset by pre-change attributes for any reason, including the application of the limitation of §1.1502–21(c), the amount of the excess is carried forward under section 382(b)(2) (relating to the carryforward of unused section 382 limitation).

§1.1502–94 Coordination with section 382 and the regulations thereunder when a corporation becomes a member of a consolidated group.

(a) *Scope*—(1) *In general.* This section applies section 382 and the regulations thereunder to a corporation that is a new loss member of a consolidated group. A corporation is a new loss member if it—

(i) Carries over a net operating loss that arose (or is treated under §1.1502–21(c) as arising) in a SRLY with respect to the current group, and that is not described in §1.1502–91(d)(1); or

(ii) Has a net unrealized built-in loss (determined under paragraph (c) of this section immediately before it becomes a member of the current group by treating that day as a change date) that is not taken into account under §1.1502–91(d)(2) in determining whether two or more corporations compose a loss subgroup.

(2) *Successor corporation as new loss member.* A new loss member also includes any successor to a corporation that has a net operating loss carryover arising in a SRLY and that is treated as remaining in existence under §1.382–2(a)(1)(ii) following a transaction described in section 381(a).

(3) *Coordination in the case of a loss subgroup.* For rules regarding the determination of whether there is an ownership change of a loss subgroup with respect to a net operating loss or a net unrealized built-in loss described in §1.1502–91(d) (relating to the definition of loss subgroup) and the computation of a subgroup section 382 limitation following such an ownership change, see §§1.1502–92 and 1.1502–93.

(4) *End of separate tracking of certain losses.* If §1.1502–96(a) (relating to the end of separate tracking of attributes) applies to a new loss member, then, while that member remains a member of the consolidated group, there is an ownership change with respect to its attributes described in §1.1502–96(a)(2) only if the consolidated group is a loss group and has an ownership change under §1.1502–92(b)(1)(i) (or that member has an ownership change under §1.1502–96(b) (relating to ownership changes of subsidiaries)). If, however, the new loss member has had an ownership change before §1.1502–96(a) applies, see §1.1502–96(c) for the continuing application of the section 382 limitation with respect to the member's pre-change losses.

(5) *Cross-reference.* See section 382(a) and §1.1502–96(c) for the continuing effect of an ownership change after a corporation becomes or ceases to be a member.

(b) *Application of section 382 to a new loss member*—(1) *In general.* Section 382 and the regulations thereunder apply to a new loss member to determine, on a separate entity basis, whether and to what extent a section 382 limitation applies to limit the amount of consolidated taxable income that may be offset by the new loss member's pre-change separate attributes. For example, if an ownership change with respect to the new loss member occurs under section 382 and the regulations thereunder, the amount of consolidated taxable income for any post-change year that may be offset by the new loss member's pre-change separate attributes shall not exceed the section 382 limitation as determined separately under section 382(b) with respect to that member for such year. If the post-change year includes the change date, section 382(b)-(3)(A) is applied so that the section 382 limitation of the new loss member does not apply to the portion of the taxable income for such year that is allocable to the

period in such year on or before the change date. See generally §1.382-6 (relating to the allocation of income and loss).

(2) *Adjustment to value.* Appropriate adjustments must be made to the extent necessary to prevent any duplication of the value of the stock of a member, even though corporations that do not file consolidated returns may not be required to make such an adjustment. For example, the principles of §1.1502–93(b)(2)(ii) (relating to adjustments to value) apply in determining the value of a new loss member.

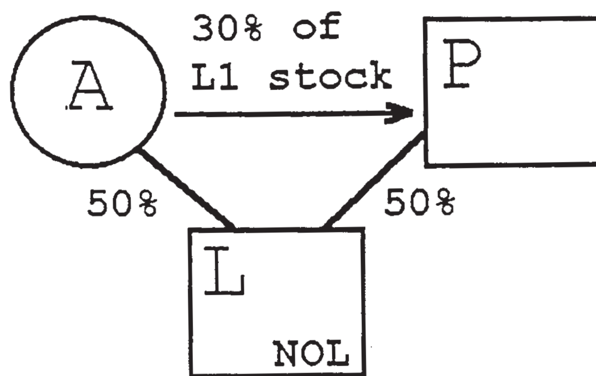
(3) *Pre-change separate attribute defined.* A pre-change separate attribute of a new loss member is—

(i) Any net operating loss carryover of the new loss member described in paragraph (a)(1) of this section; and

(ii) Any recognized built-in loss of the new loss member.

(4) *Examples.* The following examples illustrate the principles of this paragraph (b):

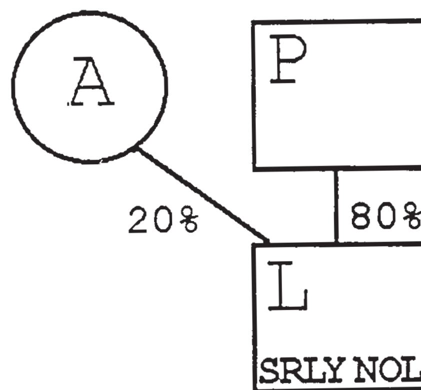
Example 1. Basic case. (i) A and P each own 50 percent of the L stock. On December 19, Year 6, P purchases 30 percent of the L stock from A for cash. L has net operating losses arising in Year 1 and Year 2 that it carries over to Year 6 and Year 7. The following is a graphic illustration of these facts:



(ii) L is a new loss member because it has net operating loss carryovers that arose in a SRLY with respect to the P group and L is not a member of a loss subgroup under §1.1502–91(d). Under section 382 and the regulations thereunder, L is a loss corporation on December 19, Year 6, that day is a testing date for L, and the testing period for L commences on December 20, Year 3.

(iii) P's purchase of L stock does not cause an ownership change of L on December 19, Year 6, with respect to the net operating loss carryovers from Year 1 and Year 2 under section 382 and §1.382-2T. The use of the loss carryovers, however, is subject to limitation under §1.1502–21(c).

Example 2. Multiple new loss members. (i) The facts are the same as in Example 1, and, on December 31, Year 6, L purchases all the stock of L1 from B for cash. L1 has a net operating loss of $40 arising in Year 3 that it carries over to Year 7. The following is a graphic illustration of these facts:



(ii) L1 is a new loss member because it has a net operating loss carryover from Year 3 that arose in a SRLY with respect to the P group and L1 is not a member of a loss subgroup under §1.1502–91(d)(1).

(iii) L's purchase of all the stock of L1 causes an ownership change of L1 on December 31, Year 6, under section 382 and §1.382-2T. Accordingly, a section 382 limitation based on the value of the L1 stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L1's loss from Year 3.

(iv) L1's ownership change upon becoming a member of the P group is an ownership change described in §1.1502–96(a). Thus, starting on January 1, Year 7, the P group no longer separately tracks owner shifts of the stock of L1 with respect to L1's loss from Year 3, and the P group is a loss group because L1's Year 3 loss is treated as a loss described in §1.1502–91(c).

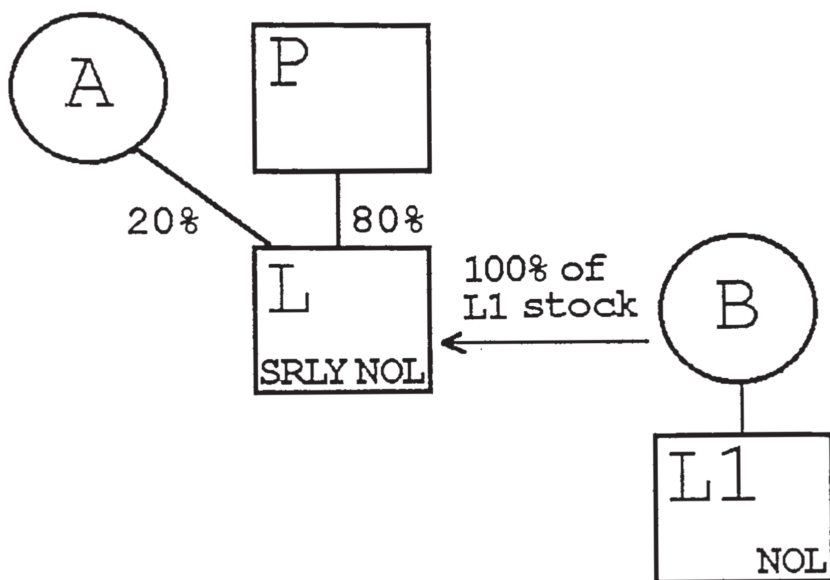
Example 3. Ownership changes of new loss members. (i) The facts are the same as in *Example 2,* and, on July 30, Year 7, C purchases all the stock of P for cash.

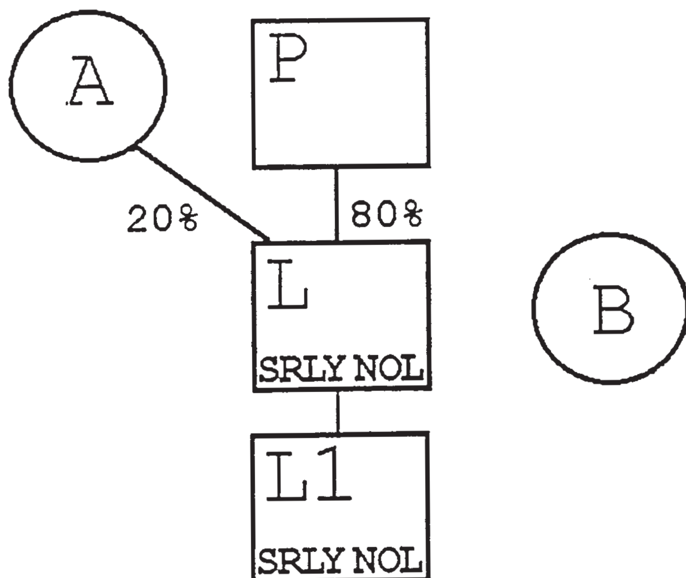
(ii) L is a new loss member on July 30, Year 7, because its Year 1 and Year 2 losses arose in SRLYs with respect to the P group and it is not a member of a loss subgroup under §1.1502–91(d)(1). The testing period for L commences on August 1, Year 4. C's purchase of all the P stock causes an ownership change of L on July 30, Year 7, under section 382 and §1.382–2T with respect to its Year 1 and Year 2 losses. Accordingly, a section 382 limitation based on the value of the L stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L's Year 1 and Year 2 losses. See §1.1502–21(c) for rules relating to an additional limitation.

(iii) The P group is a loss group on July 30, Year 7, because it is entitled to use L1's loss from Year 3, and such loss is no longer treated as a loss of a new loss member starting the day after L1's ownership change on December 31, Year 6. See §§1.1502–96(a) and 1.1502–91(c)(2). C's purchase of all the P stock causes an ownership change of P, and therefore the P loss group, on July 30, Year 7, with respect to L1's Year 3 loss. Accordingly, a consolidated section 382 limitation based on the value of the P stock immediately before the ownership change limits the amount of consolidated taxable income of the P group for any post-change year that may be offset by L1's Year 3 loss.

(c) *Built-in gains and losses.* As the context may require, the principles of §§1.1502–91(g) and (h) and 1.1502–93(c) (relating to built-in gains and losses) apply to a new loss member on a separate entity basis. See §1.1502–91(g)(4). See §1.1502–13 (including Example 10 of §1.1502–13(c)(7)) for rules relating to the treatment of intercompany transactions.

(d) *Information statements.* The common parent of a consolidated group that has a new loss member subject to paragraph (b)(1) of this section during a consolidated return year must file the information statement required by §1.382–2T(a)(2)(ii) because of any owner shift, equity structure shift, or other trans-





action described in §1.382–2T(a)(2)(i). Instead of filing a separate statement for each new loss member, the common parent may file a single statement described in §1.382–2T(a)(2)(ii) with respect to the stock ownership of the common parent (which is treated as a loss corporation). In addition to the information concerning stock ownership of the common parent, the single statement must identify each new loss member and state which new loss members, if any, have had ownership changes during the consolidated return year. The new loss member is, however, required to maintain the records necessary to determine if it has an ownership change. This paragraph (d) applies with respect to the attributes of a new loss member until an event occurs which ends separate tracking under §1.1502–96(a). After that time, the information statement described in §1.1502–92(e)(1) must be filed with respect to these attributes.

§1.1502–95 Rules on ceasing to be a member of a consolidated group (or loss subgroup).

(a) *In general*—(1) *Consolidated group.* This section provides rules for applying section 382 on or after the day that a member ceases to be a member of a consolidated group (or loss subgroup). The rules concern how to determine whether an ownership change occurs with respect to losses of the member, and how a consolidated section 382 limitation (or subgroup section 382 limitation) and a loss group's (or loss subgroup's) net unrealized built-in gain or loss is apportioned to the member. As the context requires, a reference in this section to a loss group, a member, or a corporation also includes a reference to a loss subgroup, and a reference to a consolidated section 382 limitation also includes a reference to a subgroup section 382 limitation.

(2) *Election by common parent.* Only the common parent (not the loss subgroup parent) may make the election under paragraph (c) of this section to apportion a consolidated section 382 limitation (or subgroup section 382 limitation) or a loss group's (or loss subgroup's) net unrealized built-in gain.

(3) *Coordination with §§1.1502–91 through 1.1502–93.* For rules regarding the determination of whether there is an ownership change of a loss subgroup and the computation of a subgroup section 382 limitation following such an ownership change, see §§1.1502–91 through 1.1502–93.

(b) *Separate application of section 382 when a member leaves a consolidated group*—(1) *In general.* Except as provided in §§1.1502–91 through 1.1502–93 (relating to rules applicable to loss groups and loss subgroups), section 382 and the regulations thereunder apply to a corporation on a separate entity basis after it ceases to be a member of a consolidated group (or loss subgroup). Solely for purposes of determining whether a corporation has an ownership change—

(i) Any portion of a consolidated net operating loss that is apportioned to the corporation under §1.1502–21(b) is treated as a net operating loss of the corporation beginning on the first day of the taxable year in which the loss arose;

(ii) The testing period may include the period during which (or before which) the corporation was a member of the group (or loss subgroup); and

(iii) Except to the extent provided in §1.1502–96(d) (relating to reattributed losses), the day it ceases to be a member of a consolidated group is treated as a

testing date of the corporation within the meaning of §1.382-2(a)(4).

(2) *Effect of a prior ownership change of the group.* If a loss group has had an ownership change under §1.1502–92 before a corporation ceases to be a member of a consolidated group (the former member)—

(i) Any pre-change consolidated attribute that is subject to a consolidated section 382 limitation continues to be treated as a pre-change loss with respect to the former member after it is apportioned to the former member and, if any net unrealized built-in loss is allocated to the former member under paragraph (e) of this section, any recognized built-in loss of the former member is a pre-change loss of the member;

(ii) The section 382 limitation with respect to such pre-change attribute is zero unless the common parent, under paragraph (c) of this section, apportions to the former member all or part of the consolidated section 382 limitation applicable to such attribute. The limitation applicable to a pre-change attribute other than a recognized built-in loss may be increased to the extent that the common parent has apportioned all or part of the loss group's net unrealized built-in gain to the former member, and the former member recognizes built-in gain during the recognition period;

(iii) The testing period for determining a subsequent ownership change with respect to such pre-change attribute (or such net unrealized built-in loss, if any) begins no earlier than the first day following the loss group's most recent change date; and

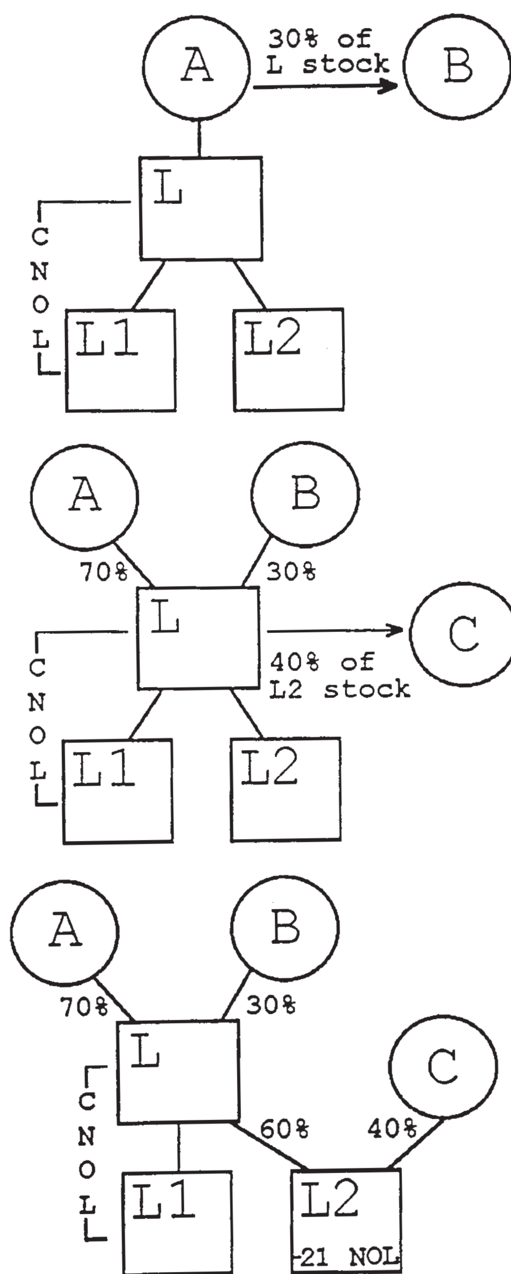
(iv) As generally provided under section 382, an ownership change of the former member that occurs on or after the day it ceases to be a member of a loss group may result in an additional, lesser limitation amount with respect to such losses.

(3) *Application in the case of a loss subgroup.* If two or more former members are included in the same loss subgroup immediately after they cease to be members of a consolidated group, the principles of paragraphs (b), (c) and (e) of this section apply to the loss subgroup. Therefore, for example, an apportionment by the common parent under paragraph (c) of this section is made to the loss subgroup rather than separately to its members. If the common parent of the consolidated group apportions all or part of a limitation (or net unrealized built-in gain) separately to one or more former members that are included in a loss subgroup because the common parent of the acquiring group makes an election under §1.1502–91(d)(4) with respect to those members, the aggregate of those separate amounts is treated as the amount apportioned to the loss subgroup. Such separate apportionment may occur, for example, because the election under §1.1502–91(d)(4) has not been filed at the time that the election of apportionment is made under paragraph (f) of this section.

(4) *Examples.* The following examples illustrate the principles of this paragraph (b):

Example 1. Treatment of departing member as a separate corporation throughout the testing period. (i) A owns all the L stock. L owns all the stock of L1 and L2. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3. On January 12, Year 2, A sells 30 percent of the L stock to B. On February 7, Year 3, L sells 40 percent of the L2 stock to C, and L2 ceases to be a member of the group. A portion of the Year 1 consolidated net operating loss is apportioned to L2 under §1.1502–21(b) and is carried to L2's first separate return year, which ends December 31, Year 3. The following is a graphic illustration of these facts:

(ii) Under paragraph (b)(1) of this section, L2 is a loss corporation on February 7, Year 3. Under



paragraph (b)(1)(iii) of this section, February 7, Year 3, is a testing date. Under paragraph (b)(1)(ii) of this section, the testing period for L2 with respect to this testing date commences on January 1, Year 1, the first day of the taxable year in which the portion of the consolidated net operating loss apportioned to L2 arose. Therefore, in determining whether L2 has an ownership change on February 7, Year 3, B's purchase of 30 percent of the L stock and C's purchase of 40 percent of the L2 stock are each owner shifts. L2 has an ownership change under section 382(g) and §1.382–2T because B and C have increased their ownership interests in L2 by 18 and 40 percentage points, respectively, during the testing period.

Example 2. Effect of prior ownership change of loss group. (i) L owns all the L1 stock and L1 owns all the L2 stock. The L loss group had an ownership change under §1.1502–92 in Year 2 with respect to a consolidated net operating loss arising in Year 1 and carried over to Year 2 and Year 3. The consolidated section 382 limitation computed solely on the basis of the value of the stock of L is $100. On December 31, Year 2, L1 sells 25 percent of the stock of L2 to B. L2 is apportioned a portion of the Year 1 consolidated net operating loss which it carries over to its first separate return year ending after December 31, Year 2. L2's separate section 382 limitation with respect to this loss is zero unless L elects to apportion all or a part of the consolidated section 382 limitation to L2. (See paragraph (c) of this section for rules regarding the apportionment of a consolidated section 382 limitation.) L apportions $50 of the consolidated section 382 limitation to L2, and the remaining $50 of the consolidated section 382 limitation stays with the loss group composed of L and L1.

(ii) On December 31, Year 3, L1 sells its remaining 75 percent stock interest in L2 to C, resulting in an ownership change of L2. L2's section 382 limitation computed on the change date with respect to the value of its stock is $30. Accordingly, L2's section 382 limitation for post-change years ending after December 31, Year 3, with respect to its pre-change losses, including the consolidated net operating losses apportioned to it from the L group, is $30, adjusted for a short taxable year, carryforward of unused limitation, or any other adjustment required under section 382.

(c) *Apportionment of a consolidated section 382 limitation*—(1) *In general.* The common parent may elect to apportion all or any part of a consolidated section 382 limitation to a former member (or loss subgroup). The common parent also may elect to apportion all or any part of the loss group's net unrealized built-in gain to a former member (or loss subgroup).

(2) *Amount which may be apportioned*—(i) *Consolidated section 382 limitation.* The common parent may apportion all or part of each element of the consolidated section 382 limitation determined under §1.1502–93. For this purpose, the consolidated section 382 limitation consists of two elements—

(A) The value element, which is the element of the limitation determined under section 382(b)(1) (relating to value multiplied by the long-term tax-exempt rate) without regard to such adjustments as those described in section 382(b)(2) (relating to the carryforward of unused section 382 limitation), section 382(b)(3)(B)(relating to the section 382 limitation for the post-change year that includes the change date), section 382(h)(relating to built-in gains and section 338 gains), and section 382(m)(2)(relating to short taxable years); and

(B) The adjustment element, which is so much (if any) of the limitation for the taxable year during which the former member ceases to be a member of the consolidated group that is attributable to a carryover of unused limitation under section 382(b)(2) or to recognized built-in gains under 382(h).

(ii) *Net unrealized built-in gain.* The aggregate amount of the loss group's net unrealized built-in gain that may be apportioned to one or more former members that cease to be members during the same consolidated return year cannot exceed the loss group's excess, immediately after the close of that year, of net unrealized built-in gain over recognized built-in gain, determined under section 382(h)(1)(A)(ii) (relating to a limitation on recognized built-in gain). For this purpose, net unrealized built-in gain apportioned to former members in prior consolidated return years is treated as recognized built-in gain in those years.

(3) *Effect of apportionment on the consolidated group*—(i) *Consolidated section 382 limitation.* The value element of the consolidated section 382 limitation for any post-change year ending after the day that a former member (or loss subgroup) ceases to be a member(s) is reduced to the extent that it is apportioned under this paragraph (c). The consolidated section 382 limitation for the post-change year in which the former member (or loss subgroup) ceases to be a member(s) is also reduced to the extent that the adjustment element for that year is apportioned under this paragraph (c).

(ii) *Net unrealized built-in gain.* The amount of the loss group's net unrealized built-in gain that is apportioned to the former member (or loss subgroup) is treated as recognized built-in gain for a prior taxable year ending in the recognition period for purposes of applying the limitation of section 382(h)(1)(A)(ii) to the loss group's recognition period taxable years beginning after the consolidated return year in which the former member (or loss subgroup) ceases to be a member.

(4) *Effect on corporations to which an apportionment is made*—(i) *Consolidated section 382 limitation.* The amount of the value element that is apportioned to a former member (or loss subgroup) is treated as the amount determined under section 382(b)(1) for purposes of determining the amount of that corporation's (or loss subgroup's) section 382 limitation for any taxable year ending after the former member (or loss subgroup) ceases to be a member(s). Appropriate adjustments must be made to the limitation based on the value element so apportioned for a short taxable year, carryforward of unused limitation, or any other adjustment required under section 382. The adjustment element apportioned to a former member (or loss subgroup) is treated as an adjustment under section 382(b)(2) or section 382(h), as appropriate, for the first taxable year after the member (or members) ceases to be a member (or members).

(ii) *Net unrealized built-in gain.* For purposes of determining the amount by which the former member's (or loss subgroup's) section 382 limitation for any taxable year beginning after the former member (or loss subgroup) ceases to be a member(s) is increased by its recognized built-in gain—

(A) The amount of net unrealized built-in gain apportioned to a former member (or loss subgroup) is treated as if it were an amount of net unrealized built-in gain determined under section 382(h)(1)(A)(i)(without regard to the threshold of section 382(h)(3)(B)) with respect to such member or loss subgroup, and that amount is not reduced under section 382(h)(1)(A)(ii) by the loss group's recognized built-in gain;

(B) The former member's (or loss subgroup's) 5 year recognition period begins on the loss group's change date;

(C) In applying section 382(h)(1)(A)(ii), the former member (or loss subgroup) takes into account only its prior taxable years that begin after it ceases to be a member of the loss group; and

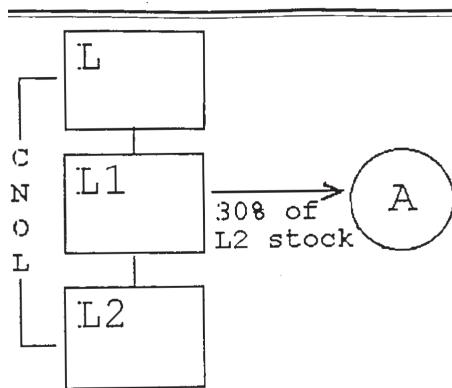
(D) The former member's (or loss subgroup's) recognized built-in gain on the disposition of an asset is determined under section 382(h)(2)(A), treating references to the change date in that section as references to the loss group's change date.

(5) *Deemed apportionment when loss group terminates.* If a loss group terminates, to the extent the consolidated section 382 limitation or net unrealized built-in gain is not apportioned under paragraph (c)(1) of this section, the consolidated section 382 limitation or net unrealized built-in gain is deemed to be apportioned to the loss subgroup that includes the common parent, or, if there is no loss subgroup that includes the common parent immediately after the loss group terminates, to the common parent. A loss group terminates on the first day of the first taxable year that is a separate return year with respect to each member of the former loss group.

(6) *Appropriate adjustments when former member leaves during the year.* Appropriate adjustments are made to the consolidated section 382 limitation for the consolidated return year during which the former member (or loss subgroup) ceases to be a member(s) to reflect the inclusion of the former member in the loss group for a portion of that year.

(7) *Examples.* The following examples illustrate the principles of this paragraph (c):

Example 1. Consequence of apportionment. (i) L owns all the L1 stock and L1 owns all the L2 stock. The L group has a $200 consolidated net operating loss arising in Year 1 that is carried over to Year 2. At the close of December 31, Year 1, the group has an ownership change under §1.1502–92. The ownership change results in a consolidated section 382 limitation of $10 based on the value of the stock of the group. On August 29, Year 2, L1 sells 30 percent of the stock of L2 to A. L2 is apportioned $90 of the group's $200 consolidated net operating loss under §1.1502–21(b). L, the common parent, elects to apportion $6 of the consolidated section 382 limitation to L2. The following is a graphic illustration of these facts:



(ii) For its separate return years ending after December 31, Year 2, L2's section 382 limitation with respect to the $90 of the group's net operating loss apportioned to it is $6, adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment. For its consolidated return year ending December 31, Year 2 the L group's consolidated section 382 limitation with respect to the remaining $110 of pre-change consolidated attribute is $4 ($10 minus the $6 value element apportioned to L2), adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment.

(iii) For the L group's consolidated return year ending December 31, Year 2, the value element of its consolidated section 382 limitation is increased by $4 (rounded to the nearest dollar), to account for the period during which L2 was a member of the L group ($6, the consolidated section 382 limitation apportioned to L2, times 241/365, the ratio of the number of days during Year 2 that L2 is a member of the group to the number of days in the group's consolidated return year). See paragraph (c)(6) of this section. Therefore, the value element of the consolidated section 382 limitation for Year 2 of the L group is $8 (rounded to the nearest dollar).

(iv) The section 382 limitation for L2's short taxable year ending December 31, Year 2, is $2 (rounded to the nearest dollar), which is the amount that bears the same relationship to $6, the value element of the consolidated section 382 limitation apportioned to L2, as the number of days during that short taxable year, 124 days, bears to 365. See §1.382–5(c).

Example 2. Consequence of no apportionment. The facts are the same as in *Example 1,* except that L does not elect to apportion any portion of the consolidated section 382 limitation to L2. For its separate return years ending after August 29, Year 2, L2's section 382 limitation with respect to the $90 of the group's pre-change consolidated attribute apportioned to L2 is zero under paragraph (b)(2)(ii) of this section. Thus, the $90 consolidated net operating loss apportioned to L2 cannot offset L2's taxable income in any of its separate return years ending after August 29, Year 2. For its consolidated return years ending after August 29, Year 2, the L group's consolidated section 382 limitation with respect to the remaining $110 of pre-change consolidated attribute is $10, adjusted, as appropriate, for any short taxable year, unused section 382 limitation, or other adjustment.

Example 3. Apportionment of adjustment element. The facts are the same as in *Example 1*, except that L2 ceases to be a member of the L group on August 29, Year 3, and the L group has a $4 carryforward of an unused consolidated section 382 limitation (under section 382(b)(2)) to the Year 3 consolidated return year. The carryover of unused limitation increases the consolidated section 382 limitation for the Year 3 consolidated return year from $10 to $14. L may elect to apportion all or any portion of the $10 value element and all or any portion of the $4 adjustment element to L2.

(d) *Rules pertaining to ceasing to be a member of a loss subgroup*—(1) *In general.* A corporation ceases to be a member of a loss subgroup on the earlier of—

(i) The first day of the first taxable year for which it files a separate return; or

(ii) The first day that it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent (treating for this purpose the loss subgroup parent as the common parent described in section 1504(a)(1)(A)).

(2) *Exceptions.* Paragraph (d)(1)(ii) of this section does not apply to a member of a loss subgroup while that member remains a member of the current group—

(i) If an election under §1.1502–91(d)(4)(relating to treating the subgroup parent requirement as satisfied) applies to the members of the loss subgroup;

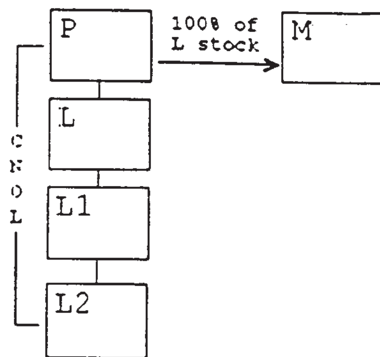
(ii) Starting on the day after the change date (but not earlier than the date the loss subgroup becomes a member of the group), if there is an ownership change of the loss subgroup within six months before, on, or after becoming members of the group; or

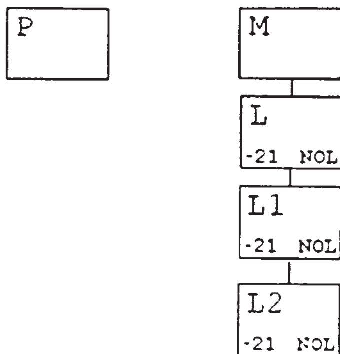
(iii) Starting the day after the period of 5 consecutive years following the day that the loss subgroup become members of the group during which the loss subgroup has not had an ownership change.

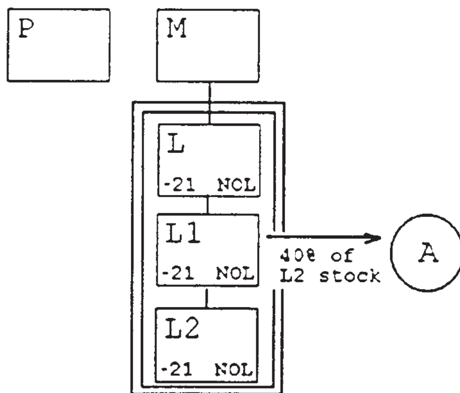
(3) *Examples.* The principles of this paragraph (d) are illustrated by the following examples:

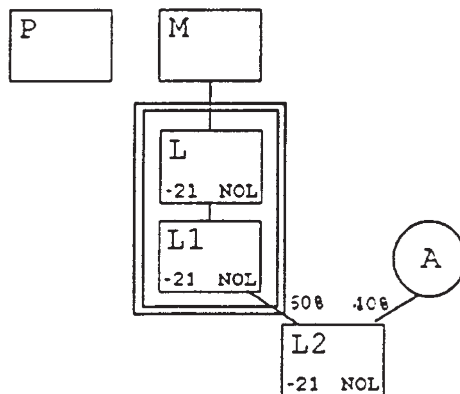
Example 1. Basic case. (i) P owns all the L stock, L owns all the L1 stock and L1 owns all the L2 stock. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. On December 11, Year 2, P sells all the stock of L to corporation M. Each of L, L1, and L2 is apportioned a portion of the Year 1 consolidated net operating loss, and thereafter each joins with M in filing consolidated returns. Under §1.1502–92, the L loss subgroup has an ownership change on December 11, Year 2. The L loss subgroup has a subgroup section 382 limitation of $100. The following is a graphic illustration of these facts:

(ii) On May 22, Year 3, L1 sells 40 percent of the L2 stock to A. L2 carries over a portion of the P group's net operating loss from Year 1 to its separate return year ending December 31, Year 3. Under paragraph (d)(1) of this section, L2 ceases to be a member of the L loss subgroup on May 22, Year 3, which is both (1) the first day of the first taxable year for which it files a separate return and (2) the day it ceases to bear a relationship described in section 1504(a)(1) to the loss subgroup parent, L. The net operating loss of L2 that is carried over from the P group is treated as a pre-change loss of L2 for its separate return years ending after May 22, Year 3. Under paragraphs (a)(2) and (b)(2) of this section, the separate section 382 limitation with respect to this loss is zero unless M elects to apportion all or a









part of the subgroup section 382 limitation of the L loss subgroup to L2.

Example 2. Formation of a new loss subgroup. The facts are the same as in *Example 1,* except that A purchases 40 percent of the L1 stock from L rather than purchasing L2 stock from L1. L1 and L2 file a consolidated return for their first taxable year ending after May 22, Year 3, and each of L1 and L2 carries over a part of the net operating loss of the P group that arose in Year 1. Under paragraph (d)(1) of this section, L1 and L2 cease to be members of the L loss subgroup on May 22, Year 3. The net operating losses carried over from the P group are treated as pre-change subgroup attributes of the loss subgroup composed of L1 and L2. The subgroup section 382 limitation with respect to those losses is zero unless M elects to apportion all or part of the subgroup section 382 limitation of the L loss subgroup to the L1 loss subgroup. The following is a graphic illustration of these facts:

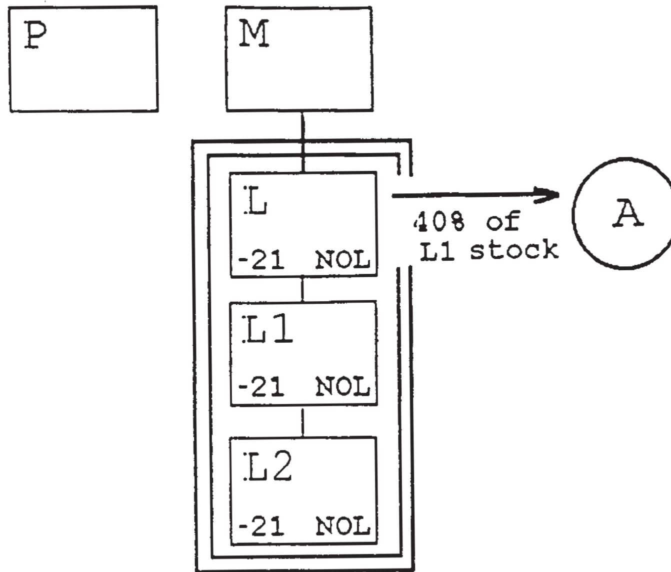
Example 3. Ownership change upon becoming members of the group. (i) A owns all the stock of P, and P owns all the stock of L1 and L2. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 3 and Year 4. Corporation M acquires all the stock of P on November 11, Year 3, and P, L1, and L2 thereafter file consolidated returns with M. M's acquisition results in an ownership change of the P loss subgroup under §1.1502–92(b)(1)(ii).

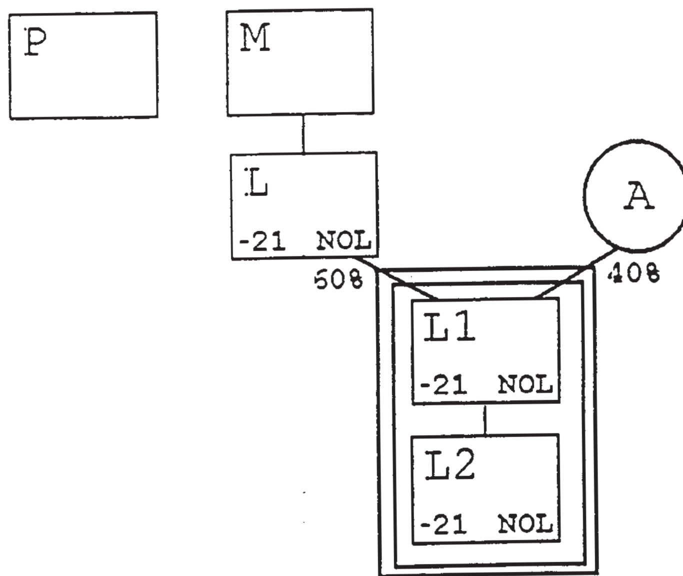
(ii) P distributes the L2 stock to M on October 7, Year 4, and L2 ceases to bear the relationship described in section 1504(a)(1) to P, the P loss subgroup parent. However, under paragraph (d)(2) of this section, L2 does not cease to be a member of the P loss subgroup because the P loss subgroup had an ownership change upon becoming members of the M group and L2 remains in the M group.

Example 4. Ceasing to bear a section 1504 (a)(1) to the loss subgroup parent. (i) A owns all the stock of P, and P owns all the stock of L1 and L2. The P group has a consolidated net operating loss arising in Year 1 that is carried over to Year 7. At the close of Year 2, X acquires all of the stock of P, causing an ownership change of the loss subgroup composed of P, L1 and L2 under §1.1502–92(b)(1)(ii). In Year 4, M, which is owned by the same person that owns X, acquires all of the stock of P, and the M acquisition does not cause a second ownership change of the P loss subgroup.

(ii) P distributes the L2 stock to M on February 3, Year 6 (less than 5 years after the P loss subgroup became members of the M group) and L2 ceases to bear the relationship described in section 1504(a)(1) to P, the loss subgroup parent. Thus, the section 382 limitation from the Year 2 ownership change that applies with respect to the pre-change attributes attributable to L2 is zero except to the extent M elects to apportion all or part of the P loss subgroup section 382 limitation to L2.

Example 5. Relationship through a successor. The facts are the same as in *Example 3,* except that M's acquisition of the P stock does not result in an ownership change of the P loss subgroup, and, instead of P's distributing the stock of L2, L2 merges into L1 on October 7, Year 4. L1 (as successor to L2 in the merger within the meaning of §1.1502–1(f)(4)) continues to bear a relationship described in





section 1504(a)(1) to P, the loss subgroup parent. Thus, L2 does not cease to be a member of the P loss subgroup as a result of the merger.

Example 6. Reattribution of net operating loss carryover under §1.1502–20(g). The facts are the same as in *Example 3,* except that, instead of distributing the L2 stock to M, P sells that stock to B, and, under §1.1502–20(g), M reattributes $10 of L2's net operating loss carryover to itself. Under §1.1502–20(g), M succeeds to the reattributed loss as if the loss were succeeded to in a transaction described in section 381(a). M, as successor to L2, does not cease to be a member of the P loss subgroup.

(e) *Allocation of net unrealized built-in loss*—(1) *In general.* This paragraph (e) provides rules for the allocation of a loss group's (or loss subgroup's) net unrealized built-in loss if a member ceases to be a member of a loss group (or loss subgroup). This paragraph (e) applies if—

(i) A loss group (or loss subgroup) has a net unrealized built-in loss on a change date; and

(ii) Immediately after the close of the consolidated return year in which the departing member ceases to be a member, the amount of the loss group's (or loss subgroup's) excess of net unrealized built-in loss over recognized built-in loss, determined under section 382(h)(1)(B)(ii) (relating to a limitation on recognized built-in loss), is greater than zero. (The amount of such excess is referred to as the remaining NUBIL balance.) In applying section 382(h)(1)(B)(ii) for this purpose, net unrealized built-in loss allocated to departing members in prior consolidated return years is treated as recognized built-in loss in those years.

(2) *Amount of allocation*—(i) *In general.* The amount of net unrealized built-in loss allocated to a departing member is equal to the remaining NUBIL balance, multiplied by a fraction. The numerator of the fraction is the amount of the built-in loss, taken into account on the change date under §1.1502–91(g), in the assets held by the departing member immediately after the member ceases to be a member of the loss group (or loss subgroup). The denominator of the fraction is the sum of the numerator, plus the amount of the built-in loss, taken into account under §1.1502–91(g) on the change date, in the assets held by the loss group (or loss subgroup) immediately after the close of the taxable year in which the departing member ceases to be a member. (Fluctuations in value of the assets between the change date and the date that the member ceases to be a member of the group (or loss subgroup), or the close of the taxable year in which the member ceases to be a member of the loss group, are disregarded.) Because the amount of built-in loss on the change date with respect to a departing member's assets is taken into account (rather than that member's separately computed net unrealized built-in loss on the change date), a departing member can be apportioned all or part of the loss group's net unrealized built-in loss, even if the departing member had a separately computed net unrealized built-in gain on the change date. Amounts taken into account under section 382(h)(6)(C) (relating to certain deduction items) are treated as if they were assets in determining the numerator and denominator of the fraction.

(ii) *Transferred basis property and deferred gain or loss.* For purposes of paragraph (b)(2)(i) of this section, assets held by the departing member immediately after it ceases to be a member of the group (or by other members immediately after the close of the taxable year) include—

(A) Assets held at that time that are transferred basis property that was held

by any member of the group (or loss subgroup) on the change date; and

(B) Assets held at that time by any member of the consolidated group with respect to which gain or loss of the group member or loss subgroup member at issue has been deferred in an intercompany transaction and has not been taken into account.

(iii) *Assets for which gain or loss has been recognized.* For purposes of paragraph (b)(2)(i) of this section, assets held by the departing member immediately after it ceases to be a member of the group (or by other members immediately after the close of the taxable year) do not include assets with respect to which gain or loss has previously been recognized and taken into account during the recognition period (including gain or loss recognized in an intercompany transaction and taken into account immediately before the member leaves the group). Appropriate adjustments must be made if gain or loss on an asset has been only partially recognized and taken into account.

(iv) *Exchanged basis property.* The rules of §1.1502–91(h) apply for purposes of this paragraph (e) (disregarding stock received from the departing member or another member that is a member immediately after the close of the taxable year).

(v) *Two or more members depart during the same year.* If two or more members cease to be members during the same consolidated return year, appropriate adjustments must be made to the denominator of the fraction for each departing member by treating the other departing members as if they had not ceased to be members during that year and as if the assets held by those other departing members immediately after they cease to be members of the group (or loss subgroup) are assets held by the group immediately after the close of the taxable year.

(vi) *Anti-abuse rule.* If assets are transferred between members or a member ceases to be a member with a principal purpose of causing or affecting the allocation of amounts under this paragraph (e), appropriate adjustments must be made to eliminate any benefit of such acquisition, disposition, or allocation.

(3) *Effect of allocation on the consolidated group.* The amount of the net unrealized built-in loss that is allocated to the former member is treated as recognized built-in loss for a prior taxable year ending in the recognition period for purposes applying the limitation of section 382(h)(1)(B)(ii) to a loss group's (or loss subgroup's) recognition period taxable years beginning after the consolidated return year in which the former member ceases to be a member.

(4) *Effect on corporations to which the allocation is made.* For purposes of determining the amount of the former member's recognized built-in losses in any taxable year beginning after the former member ceases to be a member—

(i) The amount of the loss group's (or loss subgroup's) net unrealized built-in loss that is allocated to the former member is treated as if it were an amount of net unrealized built-in loss determined under section 382(h)(1)(B)(i)(without regard to the threshold of section 382(h)(3)(B)) with respect to such member or loss subgroup, and that amount is not reduced under section 382(h)(1)(B)(ii) by the loss group's (or loss subgroup's) recognized built-in losses;

(ii) The former member's 5 year recognition period begins on the loss group's (or loss subgroup's) change date;

(iii) In applying section 382(h)(1)(B)(ii), the former member takes into account only its prior taxable years that begin after it ceases to be a member of the loss group (or loss subgroup); and

(iv) The former member's recognized built-in loss on the disposition of an asset is determined under section 382(h)(2)(B), treating references to the change date in that section as references to the loss group's (or loss subgroup's) change date.

(5) *Subgroup principles.* If two or more former members are members of the same consolidated group (the second group) immediately after they cease to be members of the current group, the principles of paragraphs (e)(1), (2) and (4) of this section apply to those former members on an aggregate basis. Thus, for example, the amount of net unrealized built-in loss allocated to those members is based on the assets held by those members immediately after they cease to be members of the current group and the limitation of section 382(h)(1)(B)(ii) on recognized built-in losses is applied by taking into account the aggregate amount of net unrealized built-in loss allocated to the former members and the aggregate recognized losses of those members in taxable years beginning after they cease to be members of the current group. If one or more of such members cease to be members of the second group, the principles of this paragraph (e) are applied with respect to those members to allocate to them all or part of any remaining unrecognized amount of net unrealized built-in loss allocated to the members that became members of the second group.

(6) *Apportionment of consolidated section 382 limitation (or subgroup section 382 limitation)*—(i) *In general.* For rules relating to the apportionment of a consolidated section 382 limitation (or subgroup section 382 limitation) to a former member, see paragraph (c) of this section.

(ii) *Special rule for former members that become members of the same consolidated group.* If recognized built-in losses of one or more former members would be subject to a consolidated section 382 limitation (or subgroup section 382 limitation) if recognized immediately before the member (or members) cease to be members of the group, an apportionment of that limitation may be made, under paragraph (c) of this section, to a loss subgroup that includes such member (or members), and the recognized built-in losses (if any) of that member (or members) will be subject to that apportioned limitation. If two or more of such former members are not included in a loss subgroup immediately after they cease to be members of the group (for example, because they do not have net operating loss carryovers or, in the aggregate, a net unrealized built-in loss), but are members of the same consolidated group, an apportionment of the consolidated section 382 limitation (or subgroup section 382 limitation) may be made to them as if they were a loss subgroup.

(7) *Examples.* The following examples illustrate the principles of this paragraph (e):

Example 1. Basic allocation case. (i) P owns all of the stock of L1 and L2. On September 4, Year 1, A purchases all of the P stock, causing an ownership change of the P group. On that date P has two assets (other than the L1 and L2 stock), asset 1 with an adjusted basis of $40 and a fair market value of $15 and asset 2 with an adjusted basis of $50 and a fair market value of $100. L1 has two assets, asset 3 , with a fair market value of $50 and an adjusted basis of $100, and asset 4, with an adjusted basis of $125 and a fair market value of $75. L2 has two assets,

asset 5, with a fair market value of $150 and an adjusted basis of $100, and asset 6, with an adjusted basis of $90 and a fair market value of $40. Thus, the P loss group has a net unrealized built-in loss of $75.

(ii) On March 19, Year 3, P sells all of the L2 stock to M. At that time, asset 5, which has appreciated in value, has a fair market value of $250 and an adjusted basis of $100. Asset 6, which has declined in value, has an adjusted basis of $90 and a fair market value of $10.

(iii) On April 8, Year 3, P sells asset 1, and has a recognized built-in loss of $25 that is subject to the P group's section 382 limitation. On November 11, Year 4, L2 sells asset 6 for its then fair market value, $10, recognizing a loss of $80. On June 3, Year 5, L1 sells asset 4, recognizing a loss of $50.

(iv) Immediately after the close of Year 3, the P loss group's remaining NUBIL balance is $50 ($75 net unrealized built-in loss reduced by the $25 recognized built-in loss of P). The portion of the remaining NUBIL balance that is allocated to L2 is $17 (rounded to the nearest dollar). Seventeen dollars is the product obtained by multiplying $50 (the remaining NUBIL balance) by $50/$150. The numerator of the fraction ($50) is the amount of built-in loss in asset 6, taken into account on the change date under §1.1502–91(g). The denominator ($150) is the sum of the numerator ($50) and the amount of built-in loss in assets 3 and 4, taken into account on the change date under §1.1502–91(g) ($100). The built-in loss in asset 1 is not included in the denominator of the fraction because it is not held by the P group immediately after the close of Year 3.

(v) Seventeen dollars of L2's $80 loss on the sale of asset 6 is a recognized built-in loss and subject to a section 382 limitation of zero, unless P apportions some or all of the P group's consolidated section 382 limitation to L2 (adjusted for a short taxable year, carryover of unused limitation, or any other adjustment required under section 382).

(vi) Thirty-three dollars of L1's $50 loss on the sale of asset 4 is subject to the P group's consolidated section 382 limitation, reduced by the amount of such limitation apportioned to L2, and adjusted for any short taxable year, a carryforward of unused limitation, or other adjustment. (In applying section 382(h)(1)(B)(ii) with respect to Year 5, the P group's net unrealized built-in loss is reduced by P's $25 recognized built-in loss in Year 3 and the $17 of net unrealized built-in loss allocated to L2, thus limiting the P group's recognized built-in loss in Year 5 to $33.)

Example 2. Two members depart in the same year. The facts are the same as in *Example 1,* except that P sells all of the stock of L1 to C on November 1, Year 3. The amount of net unrealized built-in loss apportioned to L2 (rounded to the nearest dollar) is $17 ($50 remaining NUBIL balance × $50/$150). The amount of net unrealized built-in loss apportioned to L1 (rounded to the nearest dollar) is $33 ($50 remaining NUBIL balance × $100/$150).

(8) *Reporting requirement.* If a net unrealized built-in loss is allocated under this paragraph (e), the common parent must file a statement with its income tax return for the taxable year in which the former member(s) (or a new loss subgroup that includes that member) ceases to be a member. The statement must provide the name and employer identification number (E.I.N.) of the departing member, the amount of remaining NUBIL balance for the taxable year in which the member departs, and the amount of the net unrealized built-in loss allocated to the departing member. The common parent must also deliver a copy of the statement to the former member on or before the day the group files its income tax return for the consolidated return year that the former member ceases to be a member. A copy of the statement must be attached to the first income tax return of the former member (or the first return in which the former member joins) that is filed after the close of the consolidated return year of the group of which the former member (or a new loss subgroup that includes that member) cease to be a member. This paragraph (e)(8) does not apply if the required information (other than the amount of remaining NUBIL balance) is included in a statement of election under paragraph (f) of this section (relating to apportioning a section 382 limitation).

(f) *Filing the election to apportion the section 382 limitation and net unrealized built-in gain*—(1) *Form of the election to apportion.* An election under paragraph (c) of this section must be made by the common parent. The election must be made in the form of the following statement: "THIS IS AN ELECTION UNDER §1.1502–95 OF THE INCOME TAX REGULATIONS TO APPORTION ALL OR PART OF THE [insert THE CONSOLIDATED SECTION 382 LIMITATION, THE SUBGROUP SECTION 382 LIMITATION, THE LOSS GROUP'S NET UNREALIZED BUILT-IN GAIN, THE LOSS SUBGROUP'S NET UNREALIZED BUILT-IN GAIN, as appropriate] TO [insert name and E.I.N. of the corporation (or the corporations that compose a new loss subgroup) to which allocation is made]". The declaration must also include the following information, as appropriate—

(i) The date of the ownership change that resulted in the consolidated section 382 limitation (or subgroup section 382 limitation) or the loss group's (or loss subgroup's) net unrealized built-in gain;

(ii) The amount of the departing member's (or loss subgroup's) pre-change net operating loss carryovers and the taxable years in which they arose that will be subject to the limitation that is being apportioned to that member (or loss subgroup);

(iii) The amount of any net unrealized built-in loss allocated to the departing member (or loss subgroup) under paragraph (e) of this section, which, if recognized, can be a pre-change attribute subject to the limitation that is being apportioned;

(iv) If a consolidated section 382 limitation (or subgroup section 382 limitation) is being apportioned, the amount of the consolidated section 382 limitation (or subgroup section 382 limitation) for the taxable year during which the former member (or new loss subgroup) ceases to be a member of the consolidated group (determined without regard to any apportionment under this section);

(v) If any net unrealized built-in gain is being apportioned, the amount of the loss group's (or loss subgroup's) net unrealized built-in gain (as determined under paragraph (c) (2)(ii) of this section) that may be apportioned to members that ceased to be members during the consolidated return year;

(vi) The amount of the value element and adjustment element of the consolidated section 382 limitation (or subgroup section 382 limitation) that is apportioned to the former member (or new loss subgroup) pursuant to paragraph (c) of this section;

(vii) The amount of the loss group's (or loss subgroup's) net unrealized built-in gain that is apportioned to the former member (or new loss subgroup) pursuant to paragraph (c) of this section;

(viii) If the former member is allocated any net unrealized built-in loss under paragraph (e) of this section, the amount of any adjustment element apportioned to the former member that is attributable to recognized built-in gains (determined in a manner that will enable both the group and the former member to apply the principles of §1.1502–93(c));

(ix) The name and E.I.N. of the common parent making the apportionment.

(2) *Signing of the election.* The election statement must be signed by both the common parent and the former member (or, in the case of a loss subgroup, the common parent and the loss subgroup parent) by persons authorized to sign their

respective income tax returns. If the allocation is made to a loss subgroup for which an election under §1.1502–91(d)(4) is made, and not separately to its members, the election statement under this paragraph (e) must be signed by the common parent and any member of the new loss subgroup by persons authorized to sign their respective income tax returns.

(3) *Filing of the election.* The election statement must be filed by the common parent of the group that is apportioning the consolidated section 382 limitation (or the subgroup section 382 limitation) or the loss group's net unrealized built-in gain (or loss subgroup's net unrealized built-in gain) with its income tax return for the taxable year in which the former member (or new loss subgroup) ceases to be a member. The common parent must also deliver a copy of the statement to the former member (or the members of the new loss subgroup) on or before the day the group files its income tax return for the consolidated return year that the former member (or new loss subgroup) ceases to be a member. A copy of the statement must be attached to the first return of the former member (or the first return in which the members of a new loss subgroup join) that is filed after the close of the consolidated return year of the group of which the former member (or the members of a new loss subgroup) ceases to be a member.

(4) *Revocation of election.* An election statement made under paragraph (c) of this section is revocable only with the consent of the Commissioner.

§1.1502–96 Miscellaneous rules.

(a) *End of separate tracking of losses*—(1) *Application.* This paragraph (a) applies to a member (or a loss subgroup) with a net operating loss carryover that arose (or is treated under §1.1502–21(c) as arising) in a SRLY, or a member (or loss subgroup) with a net unrealized built-in loss determined at the time that the member (or loss subgroup) becomes a member of the consolidated group if there is—

(i) An ownership change of the member (or loss subgroup) within six months before, on, or after becoming a member of the group; or

(ii) A period of 5 consecutive years following the day that the member (or loss subgroup) becomes a member of a group during which the member (or loss subgroup) has not had an ownership change.

(2) *Effect of end of separate tracking*—(i) *Net operating loss carryovers.* If this paragraph (a) applies with respect to a member (or loss subgroup) with a net operating loss carryover, then, starting on the day after the earlier of the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the consolidated group) or the last day of the 5 consecutive year period described in paragraph (a)(1)(ii) of this section, such loss carryover is treated as described in §1.1502–91(c)(1)(i). The preceding sentence also applies for purposes of determining whether there is an ownership change with respect to such loss carryover following such change date or 5 consecutive year period. Thus, for example, starting the day after the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the consolidated group) or the end of the 5 consecutive year period—

(A) The consolidated group which includes the new loss member or loss subgroup is no longer required to separately track owner shifts of the stock of the new loss member or subgroup parent to determine if an ownership change occurs with respect to the loss carryover of the new loss member or members included in the loss subgroup;

(B) The group is a loss group because the member's loss carryover is treated as a loss described in §1.1502–91(c)(1)(i);

(C) There is an ownership change with respect to such loss carryover only if the group has an ownership change; and

(D) If the group has an ownership change, such loss carryover is a pre-change consolidated attribute subject to the loss group's consolidated section 382 limitation.

(ii) *Net unrealized built-in losses.* If this paragraph (a) applies with respect to a new loss member described in §1.1502–94 (a)(1)(ii) (or a loss subgroup described in §1.1502–91(d)(2)) then, starting on the day after the earlier of the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the group) or the last day of the 5 consecutive year period described in paragraph (a)(1)(ii) of this section, the member (or members of the loss subgroup) are treated, for purposes of applying §1.1502–91(g)(2)(ii), as if they have been affiliated with the common parent for 5 consecutive years. Starting on that day, the member's (or the members of the loss subgroup's) separately computed net unrealized built-in loss is included in the determination whether the group has a net unrealized built-in loss, and there is an ownership change with respect to the member's separately computed net unrealized built-in loss only if the group (including the member) has a net unrealized built-in loss and has an ownership change. Thus, for example, starting the day after the change date (but not earlier than the day the member (or loss subgroup) becomes a member of the consolidated group), or the end of the 5 consecutive period–

(A) The consolidated group which includes the new loss member or loss subgroup is no longer required to separately track owner shifts of the stock of the new loss member or subgroup parent to determine if an ownership change occurs with respect to the net unrealized built-in loss of the new loss member or members of the loss subgroup;

(B) The group includes the member's (or the loss subgroup members') separately computed net unrealized built-in loss in determining whether it is a loss group under §1.1502–91(c)(1)(iii);

(C) There is an ownership change with respect to such net unrealized built-in loss only if the group is a loss group and has an ownership change; and

(D) If the group has an ownership change, the member's separately computed net unrealized built-in loss and its assets are taken into account in determining the group's pre-change consolidated attributes described in §1.1502–91(e)(1) (relating to recognized built-in losses) that are subject to the group's consolidated section 382 limitation.

(iii) *Common parent not common parent for five years.* If the common parent has become the common parent of an existing group within the previous 5-year period in a transaction described in §1.1502–75(d)(2)(ii) or (3), appropriate adjustments must be made in applying paragraphs (a)(2)(ii) and (3) of this section. In such a case, as the context requires, references to the common parent are to the former common parent.

(3) *Continuing effect of end of separate tracking*—(i) *In general.* As the context may require, a current group determines which of its members are included in a loss subgroup on any testing date by taking into account the application of this section in the former group. See the example in §1.1502–91(f)(2). For this purpose, corporations that are treated under paragraph (a)(2)(ii) of this section as having been affiliated with the common parent of the former group for 5 consecutive years are also treated as having been affiliated with any other members that have been (or are treated as having been) affiliated with the common parent. The corporations are treated as having been affiliated with such other members for the same period of time that those members have been (or are treated as having been) affiliated with the common parent. If two or more corporations become members of the group at the same time, but paragraph (a)(1) of this section does not apply to every such corporation, then immediately after the corporations become members of the group, the corporations to which paragraph (a)(1) of this section applied are treated as not having been previously affiliated, for purposes of applying this paragraph (a)(3), with the corporations to which paragraph (a)(2)(ii) of this section did not apply.

(ii) *Example.* The following example illustrates the principles of this paragraph (a)(3):

Example. (i) L has owned all the stock of L1 for three years. At the close of December 31, Year 1, the M group purchases all the L stock, and L and L1 become members of the M group. Other than the stock of L1, L has one asset (the L loss asset) with a net unrealized built-in loss of $200 on this date. L1 has one asset with a net unrealized built-in gain of $50 (the L1 gain asset). L and L1 do not compose a loss subgroup because they do not meet the five year affiliation requirement of §1.1502–91(d)(2)(i). L is a new loss member, and M's purchase of L causes an ownership change of L. At the close of December 31, Year 4, at a time when L1 has been affiliated with the M group for three years and has been affiliated with L for six years, the S group purchases all the M stock. On this date, the L loss asset has a net unrealized built-in loss of $300, the L1 gain asset has a net unrealized built-in gain of $80, and M, the common parent of the M group, has one asset with a net unrealized built-in gain of $200.

(ii) Paragraph (a)(1) of this section applies to L because L is a new loss member described in §1.1502–94(a)(1)(ii) that has an ownership change upon becoming a member of the M group on December 31, Year 1. Accordingly, L is treated as having been affiliated with M for 5 consecutive years, and the L loss asset with a net unrealized built-in loss of $300 is included in the determination whether the M group has a net unrealized built-in loss.

(iii) The S group determines which of its members are included in a loss subgroup by taking into account application of paragraph (a) of this section in the M group. For this purpose, application of paragraph (a) of this section causes L to be treated as having been affiliated with M (or as having been a member of the M group) for 5 consecutive years as of January 1, Year 2. Therefore, the S group includes L in the determination whether the M subgroup acquired by S on December 31, Year 4, has a net unrealized built-in loss.

(iv) Because paragraph (a)(1) of this section applied to L when L became a member of the M group, but did not apply to L1, L is treated as not having been affiliated with L1 before L and L1 joined the M group. Also, L1 is not included in the determination whether the M subgroup has a net unrealized built-in loss because L1 has not been continuously affiliated with members of the M group for the five consecutive year period ending immediately before they become members of the S group. See §1.1502–91(g)(2).

(4) *Special rule for testing period.* For purposes of determining the beginning of the testing period for a loss group, the member's (or loss subgroup's) net operating loss carryovers (or net unrealized built-in loss) described in paragraph (a)(2) of this section are considered to arise—

(i) In a case described in paragraph (a)(1)(i) of this section, in a taxable year that begins not earlier than the later of the day following the change date or the day that the member becomes a member of the group; and

(ii) In a case described in paragraph (a)(1)(ii) of this section, in a taxable year that begins 3 years before the end of the 5 consecutive year period.

(5) *Limits on effects of end of separate tracking.* The rule contained in this paragraph (a) applies solely for purposes of §§1.1502–91 through 1.1502–95 and this section (other than paragraph (b)(2)(ii)(B) of this section (relating to the definition of pre-change attributes of a subsidiary)) and §1.1502–98, and not for purposes of other provisions of the consolidated return regulations. However, the rule contained in this paragraph (a) does apply in §§1.1502–15(g), 1.1502–21(g) and 1.1502–22(g) for purposes of determining the composition of loss subgroups defined in §1.1502–91(d). See also paragraph (c) of this section for the continuing effect of an ownership change with respect to pre-change attributes.

(b) *Ownership change of subsidiary*—(1) *Ownership change of a subsidiary because of options or plan or arrangement.* Notwithstanding §1.1502–92, a subsidiary may have an ownership change for purposes of section 382 with respect to its attributes which a group or loss subgroup includes in making a determination under §1.1502–91(c)(1) (relating to the definition of loss group) or §1.1502–91(d) (relating to the definition of loss subgroup). The subsidiary has such an ownership change if it has an ownership change under the principles of §1.1502–95(b) and section 382 and the regulations thereunder (determined on a separate entity basis by treating the subsidiary as not being a member of a consolidated group) in the event of—

(i) The deemed exercise under §1.382–4(d) of an option or options (other than an option with respect to stock of the common parent) held by a person (or persons acting pursuant to a plan or arrangement) to acquire more than 20 percent of the stock of the subsidiary; or

(ii) An increase by 1 or more 5-percent shareholders, acting pursuant to a plan or arrangement to avoid an ownership change of a subsidiary, in their percentage ownership interest in the subsidiary by more than 50 percentage points during the testing period of the subsidiary through the acquisition (or deemed acquisition pursuant to §1.382–4(d)) of ownership interests in the subsidiary and in higher-tier members with respect to the subsidiary.

(2) *Effect of the ownership change*—(i) *In general.* If a subsidiary has an ownership change under paragraph (b)(1) of this section, the amount of consolidated taxable income for any post-change year that may be offset by the pre-change losses of the subsidiary shall not exceed the section 382 limitation for the subsidiary. For purposes of this limitation, the value of the subsidiary is determined solely by reference to the value of the subsidiary's stock.

(ii) *Pre-change losses.* The pre-change losses of a subsidiary are—

(A) Its allocable part of any consolidated net operating loss which is attributable to it under §1.1502–21(b) (determined on the last day of the consolidated return year that includes the change date) that is not carried back and absorbed in a taxable year prior to the year including the change date;

(B) Its net operating loss carryovers that arose (or are treated under §1.1502–21(c) as having arisen) in a SRLY; and

(C) Its recognized built-in loss with respect to its separately computed net unrealized built-in loss, if any, determined on the change date.

(3) *Coordination with §§1.1502–91, 1.1502–92, and 1.1502–94.* If an increase in percentage ownership interest causes an ownership change with respect to an attribute under this paragraph (b) and under §1.1502–92 on the same day, the ownership change is considered to occur only under §1.1502–92 and not under this paragraph (b). See §1.1502–94 for anti-duplication rules relating to value.

(4) *Example.* The following example illustrates paragraph (b)(1)(ii) of this section:

Example. Plan to avoid an ownership change of a subsidiary. (i) L owns all the stock of L1, L1 owns all the stock of L2, L2 owns all the stock of L3, and L3 owns all the stock of L4. The L group has a consolidated net operating loss arising in Year 1 that is carried over to Year 2. L has assets other than its L1 stock with a value of $900. L1, L2, and L3 own no assets other than their L2, L3, and L4 stock. L4 has assets with a value of $100. During Year 2, A, B, C, and D, acting pursuant to a plan to avoid an ownership change of L4, acquire the following ownership interests in the members of the L loss group: (A) on September 11, Year 2, A acquires 20 percent of the L1 stock from L and B acquires 20 percent of the L2 stock from L1; and (B) on September 20, Year 2, C acquires 20 percent of the stock of L3 from L2 and D acquires 20 percent of the stock of L4 from L3.

(ii) The acquisitions by A, B, C, and D pursuant to the plan have increased their respective percentage ownership interests in L4 by approximately 10, 13, 16, and 20 percentage points, for a total of approximately 59 percentage points during the testing period. This more than 50 percentage point increase in the percentage ownership interest in L4 causes an ownership change of L4 under paragraph (b)(2) of this section.

(c) *Continuing effect of an ownership change.* A loss corporation (or loss subgroup) that is subject to a limitation under section 382 with respect to its pre-change losses continues to be subject to the limitation regardless of whether it becomes a member or ceases to be a member of a consolidated group. See §1.382–5(d) (relating to successive ownership changes and absorption of a section 382 limitation).

(d) *Losses reattributed under §1.1502–20(g)*—(1) *In general.* This paragraph (d) contains rules relating to net operating carryovers that are reattributed to the common parent under §1.1502–20(g). References in this paragraph (d) to a subsidiary are references to the subsidiary (or lower tier subsidiary) whose net operating loss carryover is reattributed to the common parent.

(2) *Deemed section 381(a) transaction.* Under §1.1502–20 (g)(1), the common parent succeeds to the reattributed losses as if the losses were succeeded to in a transaction described in section 381(a). In general, §§1.1502–91 through 1.1502–95, this section, and §1.1502–98 are applied to the reattributed net operating loss carryovers in accordance with that characterization. See generally, §1.382–2(a)(1)(ii)(relating to distributor or transferor loss corporations in transactions under section 381), §1.1502– (1)(f)(4)(relating to the definition of predecessor and successor) and §1.1502–91(j)(relating to predecessor and successor corporations). For example, if the reattributed net operating loss carryover is a pre-change attribute subject to a section 382 limitation, it remains subject to that limitation following the reattribution. In certain cases, the limitation applicable to the reattributed loss is zero unless the common parent apportions all or part of the limitation to itself. (See paragraph (d)(4) of this section.)

(3) *Rules relating to owner shifts*—(i) *In general.* Any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3)) in connection with the disposition of the stock of the subsidiary is not taken into account in determining whether there is an ownership change with respect to the reattributed net operating loss carryover. However, any owner shift with respect to the successor corporation that is treated as continuing in existence under §1.382–2(a)(1)(ii) must be taken into account for such purpose if such owner shift is effected by the reattribution and an owner shift of the stock of the subsidiary not held directly or indirectly by the common parent would have been taken into account if such shift had occurred immediately before the reattribution. See paragraph (d)(3)(ii) *Example 2* of this section.

(ii) Examples. The following examples illustrate the principles of this paragraph (d)(3):

Example 1. No owner shift for reattributed loss. (i) P, the common parent of a consolidated group, owns 60% of the stock of L, and B owns the remaining 40%. L has a net operating loss carryover of $100 from year 1 that it carries over to Years 2, 3, and 4. At the beginning of Year 2, P purchases 40% of the L stock from B, which does not cause an ownership change of L. On December 31, Year 3, P sells all of the L stock to M. Pursuant to §1.1502–20(g), P reattributes $10 of L's $100 net operating loss carryover to itself, and L carries $90 of its net operating loss carryover to its Year 4.

(ii) The sale of the L stock to M does not cause an owner shift that is taken into account in determining if there is an ownership change with respect to the $10 reattributed loss. Following the reattribution, §1.1502–94(b) continues to apply to determine if there is an ownership change with respect to the $10 reattributed loss, until, under paragraph (a) of this section, the loss is treated as described in §1.1502–91(c)(1)(i). In applying §1.1502–94(b), the 40 percentage point increase by the P shareholders prior to the reattribution is taken into account. The sale of the L stock to M does cause an ownership change of L with respect to the $90 of its net operating loss that it carries over to Year 4.

Example 2. Owner shift for reattributed loss. The facts are the same as in *Example 1,* except that P only purchases 20% of the L stock from B and sells 80% of the L stock to M. L isa new loss member, and, under §1.1502–94(b)(1), an owner shift of the stock of L not held directly or indirectly by the common parent (the 20% of L stock still held by B) would have been taken into account if such shift had occurred immediately before the reattribution. Following the reattribution, §1.1502–94(b) continues to apply to determine if there is an ownership change with respect to the $10 reattributed loss, until, under paragraph (a) of this section, the loss is treated as described in §1.1502–91(c)(1)(i). With respect to the $10 reattributed loss, the P shareholders have increased their percentage ownership interest by 40 percentage points. The P shareholders have increased their ownership interests by 20 percentage points as a result of P's purchase of stock from B, and, under §1.382–2(a)(1)(ii), are treated as increasing their interests by an additional 20 percentage points as a result of the reattribution. (The acquisition of the L stock by M does not, however, effect an owner shift for the $10 of reattributed loss.) The sale of the L stock to M causes an ownership change of L with respect to the $90 of net operating loss that L carries over to Year 4.

(4) *Rules relating to the section 382 limitation*—(i) *Reattributed loss is a pre-change separate attribute of a new loss member.* If the reattributed net operating loss carryover is a pre-change separate attribute of a new loss member that is subject to a separate section 382 limitation prior to the disposition of subsidiary stock, the common parent's limitation with respect to that loss is zero, except to the extent that the common parent apportions to itself, under paragraph (d)(5) of this section, all or part of such limitation. A separate section 382 limitation is the

limitation described in §1.1502–94(b) that applies to a pre-change separate attribute.

(ii) *Reattributed loss is a pre-change subgroup attribute.* If the reattributed net operating loss carryover is a pre-change subgroup attribute subject to a subgroup section 382 limitation prior to the disposition of subsidiary stock, and, immediately after the reattribution, the common parent is not a member of the loss subgroup, the section 382 limitation with respect to that net operating loss carryover is zero, except to the extent that the common parent apportions to itself, under paragraph (d)(5) of this section, all or part of the subgroup section 382 limitation. See, however, §1.1502–95(d)(3) *Example 6,* for an illustration of a case where the common parent, as successor to the subsidiary, is a member of the loss subgroup immediately after the reattribution.

(iii) *Potential application of section 382(l)(1).* In general, the value of the stock of the common parent is used to determine the section 382 limitation for an ownership change with respect to the reattributed net operating loss carryover that occurs at the time of, or after, the reattribution. For example, if the net operating loss carryover is a pre-change consolidated attribute, the value of the stock of the common parent is used to determine the section 382 limitation, and no adjustment to that value is required because of the deemed section 381(a) transaction. However, if the net operating loss carryover is a pre-change separate attribute of a new loss member (or is a pre-change attribute of a loss subgroup member and the common parent was not the loss subgroup parent immediately before the reattribution), the deemed section 381(a) transaction is considered to constitute a capital contribution with respect to the new loss member (or loss subgroup member) for purposes of section 382(l)(1). Accordingly, if that section applies because the deemed capital contribution is (or is considered under section 382(l)(1)(B) to be) part of a plan described in section 382(l)(1)(A), the value of the stock of the common parent after the deemed section 381(a) transaction must be adjusted to reflect the capital contribution. Ordinarily, this will require the value of the stock of the common parent to be reduced to an amount that represents the value of the stock of the subsidiary (or loss subgroup of which the subsidiary was a member) when the reattribution occurred.

(iv) *Duplication or omission of value.* In determining any section 382 limitation with respect to the reattributed net operating loss carryover and with respect to other pre-change losses, appropriate adjustments must be made so that value is not improperly omitted or duplicated as a result of the reattribution. For example, if the subsidiary has an ownership change upon its departure, and the common parent (as successor) has an ownership change with respect to the reattributed pre-change separate attribute upon its reattribution under paragraph (d)(3)(i) of this section, proper adjustments must be made so that the value of the subsidiary is not taken into account more than once in determinining the section 382 limitation for the reattributed loss and the loss that is not reattributed.

(v) *Special rule for continuity of business requirement.* If the reattributed net operating loss carryover is a pre-change attribute of new loss member and the reattribution occurs within the two year period beginning on the change date, then, starting immediately after the reattribution, the continuity of business requirement of section 382(c)(1) is applied with respect to the business enterprise of the common parent. Similar principles apply if the reattributed net operating loss carryover is a pre-change subgroup attribute and, on the day after the reattribution, the common parent is not a member of the loss subgroup.

(5) *Election to reattribute section 382 limitation*—(i) *Effect of election.* The common parent may elect to apportion to itself all or part of any separate section 382 limitation or subgroup section 382 limitation to which the net operating loss carryover is subject immediately before the reattribution. However, no net unrealized built-in gain of the member (or loss subgroup) whose net operating loss carryover is reattributed can be apportioned to the common parent. The principles of §1.1502–95(c) apply to the apportionment, treating, as the context requires, references to the former member as references to the common parent, and references to the consolidated section 382 limitation as references to the separate section 382 limitation (or subgroup section 382 limitation) that is being apportioned. Thus, for example, the common parent can reattribute to itself all or part of the value element or adjustment element of the limitation, and any part of such element that is apportioned requires a corresponding reduction in such element of the separate section 382 limitation of the subsidiary whose net operating loss carryover is reattributed (or in the subgroup section 382 limitation if the reattributed loss is a pre-change subgroup attribute). Appropriate adjustments must be made to the separate section 382 limitation (or subgroup section 382 limitation) for the consolidated return year in which the reattribution is made to reflect that the reattributed net operating loss carryover is an attribute acquired by the common parent during the year in a transaction to which section 381(a) applies. The election is made by the common parent as part of the election to reattribute the net operatingloss carryover. See §1.1502–20(g)-(4) for the time and manner of making the election.

(ii) *Examples.* The following examples illustrate the principles of this paragraph (d)(5):

Example 1. Consequence of apportionment. (i) P, the common parent of a consolidated group, purchases all of the stock of L on December 31, Year 1. L carries over a net operating loss arising in Year 1 to each of the next 5 taxable years. The purchase of the L stock causes an ownership change of L, and results in a separate section 382 limitation of $10 for L's net operating loss carryover based on the value of the L stock. On July 2, Year 3, P sells 30 percent of the L stock to A. Under §1.1502–20(g), P elects to apportion to itself $110 of L's $200 net operating loss carryover. P also elects to apportion to itself $6 of the $10 value element of the separate section 382 limitation.

(ii) For the consolidated return years ending after December 31, Year 3, P's separate section 382 limitation with respect to the reattributed net operating loss carryover is $6, adjusted as appropriate for any short taxable year, unused section 382 limitation, or other adjustment. For the P group's consolidated return year ending December 31, Year 3, the separate section 382 limitation for L's net operating loss carryover is $8, the sum of $5 and $3. Five dollars of the limitation is the amount that bears the same relationship to $10 as the number of days in the period ending with the deemed section 381(a) transaction, 183 days, bears to 365. Three dollars of the limitation is the amount that bears the same relationship to $6 as the number of days in the period between July 3 and December 31, 182, bears to 365.

(iii) For L's taxable years ending after December 31, Year 3, L's separate section 382 limitation for its $90 of net operating loss carryover that was not reattributed to P is $4, adjusted as appropriate for any

short taxable year, unused section 382 limitation, or other adjustment. For L's short taxable year ending December 31, Year 3, the section 382 limitation for its $90 of net operating loss carryover is $2, the amount that bears the same relationship to $4 (the portion of the value element that was not apportioned to P), as the number of days during the short taxable year, 182 days, bears to 365. See §1.382–5(c).

Example 2. No apportionment required for consolidated pre-change attribute. (i) P, the common parent of a consolidated group, forms L. For Year 1, L has an operating loss of $70 that is not absorbed and is included in the group's consolidated net operating loss that is carried over to subsequent years. On January 1 of Year 3, A buys all of the P stock and the P group has an ownership change. The consolidated section 382 limitation based on the value of the P stock is $10.

(ii) On April 13 of Year 4, P sells all of the stock of L to B and, under §1.1502–20(g), elects to reattribute to itself $45 of L's net operating loss carryover. Following the reattribution, the $45 portion of the Year 1 net operating loss carryover retains its character as a pre-change consolidated attribute, and remains subject to so much of the $10 consolidated section 382 limitation as P does not elect to apportion to L under §1.1502–95(c).

(e) *Time and manner of making election under §1.1502–91(d)(4)*—(1) *In general.* This paragraph (e) prescribes the time and manner of making the election under §1.1502–91(d)(4), relating to treating two or more corporations as treating the section 1504(a)(1) requirement of §1.1502–91(d) (1)(ii) and (d) (2)(ii) as satisfied.

(2) *Election statement.* An election under §1.1502–91(d)(4) must be made by the common parent. The election must be made in the form of the following statement: "THIS IS AN ELECTION UNDER §1.1502–91(d)(4) TO TREAT THE FOLLOWING CORPORATIONS AS MEETING THE REQUIREMENTS OF §1.1502–91(d)(1)(ii) AND (d)(2)(ii) IMMEDIATELY AFTER THEY BECAME MEMBERS OF THE GROUP." [List separately the name of each corporation, its E.I.N., and the date that it became a member of the group]. If separate elections are being made for corporations that became members at different times or that were acquired from different affiliated groups, provide a separate statement and list for each election.

(3) The election statement must be filed by the common parent with its income tax return for the consolidated return year in which the members with respect to which the election is made become members of the group. Such election must be filed on or before the due date for such income tax return, including extensions.

(4) An election made under this paragraph (e) is irrevocable.

§1.1502–97 Special rules under section 382 for members under the jurisdiction of a court in a title 11 or similar case. [Reserved]

§1.1502–98 Coordination with section 383.

The rules contained in §§1.1502–91 through 1.1502–96 also apply for purposes of section 383, with appropriate adjustments to reflect that section 383 applies to credits and net capital losses. Similarly, in the case of net capital losses, general business credits, and excess foreign taxes that are pre-change attributes, §1.383–1 applies the principles of §§1.1502–91 through 1.1502–96. For example, if a loss group has an ownership change under §1.1502–92 and has a carryover of unused general business credits from a pre-change consolidated return year to a post-change consolidated return year, the amount of the group's regular tax liability for the post-change year that can be offset by the carryover cannot exceed the consolidated section 383 credit limitation for that post-change year, determined by applying the principles of §§1.383–1(c)(6) and 1.1502–93 (relating to the computation of the consolidated section 382 limitation).

§1.1502–99 Effective dates.

(a) *In general.* Except as provided in paragraphs (b) and (c) of this section, §§1.1502–91 through 1.1502–96 and §1.1502–98 apply to any testing date 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 any date on or after June 25, 1999.

(b) *Special rules*—(1) *Election to treat subgroup parent requirement as satisfied.* Section 1.1502–91(d)(4), §1.1502–91(d)-(7), *Example 4,* §1.1502–92(b)(1)(iii), §1.1502–92(b)(2), *Example 5,* the last two sentences of §1.1502–95(b)(3), §1.1502–95(d)(2)(i), and §1.1502–96(e) (all of which relate to the election under §1.1502–91(d)(4) to treat the loss subgroup parent requirement as satisfied) apply to corporations that become members of a consolidated group in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999.

(2) *Principal purpose of avoiding a limitation.* The third sentence of §1.1502–91(d)(5) (relating to members excluded from a loss subgroup) applies to corporations that become members of a consolidated group on or after June 25, 1999.

(3) *Ceasing to be a member of a loss subgroup*—(i) *Ownership change of a loss subgroup.* Section 1.1502–95(d)(2)-(ii) and §1.1502–95(d)(3), *Example 3* apply to corporations that cease to bear a relationship described in section 1504(a)(1) to a loss subgroup parent in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999.

(ii) *Expiration of 5-year period.* Section 1.1502–95(d)(2) (iii) applies with respect to the day after the last day of any 5 consecutive year period described in that section that ends in a taxable year for which the due date of the income tax return (without extensions) is after June 25, 1999.

(4) *Reattribution of net operating loss carryovers under §1.1502–20(g).* Section 1.1502–96(d) applies to reattributions of net operating loss carryovers (or capital loss carryovers) in taxable years for which the due date of the income tax return (without extensions) is after June 25, 1999; except that the election under §1.1502–96(d)(5)(relating to an election to reattribute section 382 limitation) can be made with any election under §1.1502–20(g)(4) to reattribute to the common parent a net operating loss or net capital loss that is timely filed on or after June 25, 1999.

(5) *Election to apportion net unrealized built-in gain.* In the case of corporations that cease to be members of a loss group (or loss subgroup) before June 25, 1999 in a taxable year for which the due date of the income tax return (without extensions) is after June 25, 1999, §1.1502–95(a),(b), (c), and (f) apply to those corporations if the common parent makes the election described in the second sentence of paragraph (c)(1) of §1.1502–95 in the time and manner prescribed in paragraph (f) of §1.1502–95.

(c) *Testing period may include a period beginning before June 25, 1999*—(1) *In general.* A testing period for purposes of §§1.1502–91 through 1.1502–96 and 1.1502–98 may include a period beginning before June 25, 1999. Thus, for example, in applying §1.1502–92(b)(1)(i) (relating to the determination of an ownership change of a loss group), the determination of the lowest percentage of ownership interest of any 5-percent shareholder of the common parent during a testing period ending on a testing date occurring on or after June 25, 1999 takes into account the period beginning before June 25, 1999, except to the extent that the period is more than 3 years before the testing date or is otherwise before the beginning of the testing period. See §1.1502–92(b)(1).

(2) *Transition rule for net unrealized built-in loss.* A loss group (or loss subgroup) that has a net unrealized built-in loss on a testing date on or after June 25, 1999 may apply §1.1502–91A(g)(and §1.1502–96A(a) as it relates to §1.1502–91A(g)) for the period ending on the day before June 25, 1999 to determine under §1.382–2T(d)(ii)(A) the earliest date that its testing period begins (treating the day before June 25, 1999 as the end of a taxable year.) Thus, for example, if a consolidated group with no net operating losses has a net unrealized built-in loss determined under §1.1502–91(g) on a testing date after June 25, 1999, but, under §1.1502–91A(g), does not have a net unrealized built-in loss for the period ending on the day before June 25, 1999, the group's testing period begins no earlier than June 25, 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 14. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 15. In §602.101, paragraph (b) is amended by removing the entry for §1.1502–95T, revising the entry for §1.1502–20, and adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–20	1545–1160 1545–1218
* * * * *	
1.1502–95	1545–1218
1.1502–96	1545–1218
1.1502–95A	1545–1218
* * * * *	

John M. Dalrymple,
Acting Deputy Commissioner of Internal Revenue.

Approved June 18, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 25, 1999, 1:27 p.m., and published in the issue of the Federal Register for July 2, 1999, 64 F.R. 36116)

Section 1397E.—Credits to Holders of Qualified Zone Academy Bonds

26 CFR 1.1397E–1T: Qualified zone academy bonds.

T.D. 8826

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance to state and local government issuers of qualified zone academy bonds. These temporary regulations change the method of ascertaining the qualified zone academy bond credit rate and provide reimbursement rules. State and local governments that issue qualified zone academy bonds will be affected by these temporary regulations. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–105327–99) on this subject on page 117.

DATES: *Effective Date:* These regulations are effective July 1, 1999.

Applicability Date: For dates of applicability, see §1.1397E–1T(j).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Timothy L. Jones (202) 622-3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 226(a) of the Taxpayer Relief Act of 1997, Public Law 105–34, (111 Stat. 788), amended the Internal Revenue Code by redesignating section 1397E as 1397F and adding a new section 1397E. Section 1397E authorizes a new type of debt instrument known as a qualified zone academy bond. Temporary regulations interpreting section 1397E were published on January 7, 1998 (63 F.R. 671).

Explanation of Provisions

In General

A qualified zone academy bond is a taxable bond issued by a state or local government, the proceeds of which are used to improve certain eligible public schools. In lieu of receiving periodic interest payments from the issuer, an eligible holder of a qualified zone academy bond is generally allowed annual federal income tax credits while the bond is outstanding. These credits compensate the holder for lending money to the issuer and function as payments of interest on the bond.

Credit Rate

Under section 1397E(b)(2), the Secretary shall determine a credit rate for qualified zone academy bonds that the Secretary estimates will permit the bonds to be issued without discount and without interest cost to the issuer. Section 1.1397E–

1T(b) provides that the credit rate for a qualified zone academy bond is equal to 110 percent of the long-term applicable Federal rate (AFR), compounded annually, for the month in which the bond is issued.

Comments have been received that the credit rate established by §1.1397E–1T(b) is generally lower than the rate required to permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuer. Comments have also been received that a single credit rate applicable to obligations issued during a monthly period is too rigid and non-responsive to market interest rate movements.

The revised regulations state that the Secretary will determine monthly (or more often as the Secretary deems necessary) a credit rate that will generally permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuers. The revised regulations also provide that the manner for ascertaining the credit rate determined by the Secretary will be set forth in procedures, notices, forms, and instructions as prescribed by the Commissioner. A notice to be published in the Internal Revenue Bulletin will further provide that, until otherwise provided, the qualified zone academy bond credit rate will be determined daily and will be published on the Internet site for State and Local Government Bonds. The credit rate to be applied to a qualified zone academy bond will be the daily rate for the first day on which there is a binding contract in writing for the sale or exchange of the bond. Treasury and the IRS will monitor the issuance of qualified zone academy bonds to determine if future adjustments in the credit rate may be required.

Coordination with Reimbursement Rules

These temporary regulations provide that the proceeds of a qualified zone academy bond may be used to reimburse a qualified expenditure (including any qualified non-capital expenditure) made prior to the date the bond was issued. The temporary regulations provide that rules similar to the reimbursement rules set forth in §1.150–2 will apply. Comments are solicited about whether these rules provide adequate guidance regarding reimbursement matters for issuers of qualified zone academy bonds.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. See also the Special Analysis Section of the notice of proposed rulemaking on qualified zone academy bonds in the Proposed Rules Section of this issue of the Federal Register. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Timothy L. Jones, Office of Assistant Chief Counsel (Financial Institutions & Products). However, other personnel from IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.1397E–1T is amended as follows:

1. Revising paragraphs (b) and (j);

2. Redesignating paragraph (h) as paragraph (i);

3. Adding new paragraph (h).

The revisions and additions read as follows:

§1.1397E–1T Qualified zone academy bonds (temporary).

* * * * *

(b) *Credit Rate.* The Secretary shall determine monthly (or more often as deemed necessary by the Secretary) the credit rate the Secretary estimates will generally permit the issuance of a qualified zone academy bond without discount and without interest cost to the issuer. The manner for ascertaining the credit rate for a qualified zone academy bond as determined by the Secretary shall be set forth in procedures, notices, forms, or instructions prescribed by the Commissioner.

* * * * *

(h) *Reimbursement.* An expenditure for a qualified purpose may be reimbursed with proceeds of a qualified zone academy bond. For this purpose, rules similar to those in §1.150–2 shall apply.

* * * * *

(j) *Effective dates.* Except as provided in this paragraph (j), this section applies to a qualified zone academy bond issued on or after January 1, 1998. Paragraph (b) and paragraph (h) of this section shall apply to a qualified zone academy bond sold on or after July 1, 1999. Paragraph (b) of this section as in effect on January 7, 1998 (See 26 CFR Part 1 as revised April 1, 1999), shall apply to a qualified zone academy bond sold prior to July 1, 1999. This section shall not apply to a qualified zone academy bond sold after January 5, 2001.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 22, 1999.

Donald C. Lubick,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 30, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 1, 1999, 64 F.R. 35573)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 446, 481, 6213, 6405, 6621, 7121, 7123, 7430; 1.446–1, 1.481–1, 1.481–2, 1.481–4, 301.6213–1, 301.6405–1, 301.6621–1, 301.7121–1, 301.7430–1.)

Rev. Proc. 99–28

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SECTION 1. PURPOSE AND BACKGROUND

This revenue procedure describes the method by which a taxpayer may request an early referral of one or more unresolved issues from the Examination or Collection Division to the Office of Appeals (Appeals). Section 7123 of the Internal Revenue Code (IRC), as added by § 3465 of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub L. No. 105–206, 112 Stat. 685, provides that the Secretary shall prescribe procedures by which any taxpayer may request such an early referral. Early referral is a process to resolve cases more expeditiously through the District and Appeals working simultaneously. This process is optional and may be requested by any taxpayer. This revenue procedure also describes the method by which a taxpayer may request early referral of one or more unagreed issues with respect to an involuntary change in method of accounting, employment tax, employee plans, or exempt organizations.

SECTION 2. EXAMINATION EARLY REFERRAL PROCEDURES

.01 In general. Except as provided in section 2.03 of this revenue procedure, a taxpayer may request early referral to Appeals of any developed, unagreed issue under the jurisdiction of the District Director arising from an audit. The District will continue to develop issues that have not been referred to Appeals. This revenue procedure does not alter the District Director's authority to audit the returns of a taxpayer as to other issues nor limit or expand the District Director's authority to resolve any other issues, including the authority in Delegation Order No. 236 (Rev. 3).

.02 **Appropriate issues for early referral.** Appropriate issues for early referral are limited to those that:

(1) if resolved, can reasonably be expected to result in a quicker resolution of the entire case;

(2) both the taxpayer and the District agree should be referred to Appeals early;

(3) are fully developed; and

(4) are part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.

Industry Specialization Program (ISP) issues can also be referred to Appeals for early resolution under these early referral procedures. ISP issues are listed in Exhibit 8.7.1–1 of the Internal Revenue Manual. For specific procedures for the early referral of issues arising during the examination of the tax-exempt status of a bond issue, see Notice 98–58, 1998–49 I.R.B. 13, or any subsequent procedure.

.03 Issues excluded from early referral. Early referral does not include an issue:

(1) with respect to which a 30-day letter has been issued. Thus, a qualified offer under § 7430(c), may not be made as part of the early referral process because such offers may only be made subsequent to the issuance of a 30-day letter;

(2) that is not fully developed;

(3) when the remaining issues in the case are expected to be completed before Appeals could resolve the early referral issue;

(4) that is designated for litigation by the Office of Chief Counsel;

(5) for which the taxpayer has filed a request for Competent Authority assistance, or issues for which the taxpayer intends to seek Competent Authority assis-

tance. Taxpayers are encouraged to request the simultaneous Appeals/Competent Authority procedure described in section 8 of Rev. Proc. 96–13, 1996–1 C.B. 616, or a subsequent revenue procedure. If a taxpayer enters into a settlement with Appeals (including an Appeals settlement through the early referral process), and then requests Competent Authority assistance, the U.S. competent authority will endeavor only to obtain a correlative adjustment with the treaty country and will not take any actions that would otherwise amend the settlement. *See* section 7.05 of Rev. Proc. 96–13; or

(6) that is part of a whipsaw transaction. (The term "whipsaw" refers to the situation produced when the government is subjected to conflicting claims of taxpayers. A potential whipsaw situation exists whenever there is a transaction between two parties and differing characteristics of transactions will benefit one and hurt the other for tax purposes.)

.04 Initiating the early referral request. A request for early referral must be submitted in writing by the taxpayer to the case/group manager. The case/group manager may suggest that a taxpayer make such a request.

.05 Statement of issues and position. The taxpayer's early referral request must:

(1) identify the taxpayer (and, where applicable, all related persons involved in the issues) and the tax periods to which those issues relate;

(2) state each issue for which early referral is requested; and

(3) describe the taxpayer's position with regard to the relevant early referral issues. This statement must contain a brief discussion of the material facts and an analysis of the facts and law as they apply to each early referral issue.

.06 Perjury Statement. The early referral request, and any supplemental submission (including additional documents), must include a declaration in the following form:

> **Under penalties of perjury, I declare that I have examined this request [or submission], including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete.**

This declaration must be signed by any person currently authorized to sign the taxpayer's federal income tax returns.

.07 Signatures. The early referral request must be signed by the taxpayer or the taxpayer's authorized representative. It is preferred that Form 2848, Power of Attorney and Declaration of Representative, be used to designate an authorized representative, with regard to an early referral request under this revenue procedure.

.08 Notification of action. The case/group manager will, where feasible, notify the taxpayer of the decision to accept or reject an issue in the early referral request within 14 days of receiving the request.

.09 Appeal of denial of early referral request. There is no formal taxpayer appeal if the early referral request is denied in whole or in part; however, the taxpayer can request a conference with the Internal Revenue Service supervisor of the case/group manager who denied the early referral request.

.10 Administrative appeal at a later time. If the case/group manager does not approve the early referral request with respect to any issue, the taxpayer retains the right to pursue the administrative appeal of any proposed deficiency related to that issue at a later time.

.11 Issuance of notice of proposed adjustment or explanation of adjustment. The District will complete a Form 5701, Notice of Proposed Adjustment, or an equivalent form (the Notification Form) for each early referral issue approved pursuant to this revenue procedure. The District will send the Notification Form to the taxpayer generally within 30 days from the date the early referral request was accepted. The Notification Form will describe the issue and explain the District's proposed adjustment. The issuance of the Notification Form for the early referral issue is not treated as the first letter of proposed deficiency for purposes of computing increased interest under § 6621(c), or for the award of administrative costs under § 7430(c).

.12 Taxpayer response to Notification Form. The taxpayer must respond in writing to each of the District's proposed adjustments set forth in the Notification Form. The response must contain an explanation of the taxpayer's position regarding the issues. The response shall be submitted to the case/group manager within 30 days (unless extended by the case/group manager) from the date that the proposed adjustment (the Notification Form) is sent to the taxpayer. The procedural requirements of sections 2.06 and 2.07 of this revenue procedure (perjury statement and signatures) also apply to the taxpayer's response to the Notification Form. If a response is not received for any issue within the time provided, the taxpayer's early referral request will be considered withdrawn regarding that particular issue without prejudice to the taxpayer's right to an administrative appeal at a later date. *See* section 2.18 of this revenue procedure.

.13 Early referral file sent to Appeals. Once the taxpayer has responded to the Notification Form, the District will send the early referral file to Appeals. Appeals will then take jurisdiction over the issues accepted for early referral. All other issues in the case remain in the District's jurisdiction. The early referral file should include copies of:

(1) applicable portions of tax returns and workpapers;

(2) the approved early referral request;

(3) the Notification Form;

(4) the taxpayer's written response to the Notification Form;

(5) the District's response to the taxpayer's position, if any; and

(6) an estimate of the potential tax effect of the proposed adjustment.

.14 Resolving the early referral issues. The taxpayer's written response to the Notification Form generally serves the same purpose as an Appeals protest. Established Appeals procedures, including those governing submissions and taxpayer conferences, apply to early referral issues. *See* section 601.106 *et seq.* of the Statement of Procedural Rules.

.15 Agreement reached. If an agreement is reached with respect to an early referral issue generally, a Form 906, Closing Agreement on Final Determination Covering Specific Matters, is prepared. *See* § 7121 and also Rev. Proc. 68–16, 1968–1 C.B. 770, which describes the preparation of closing agreements. The closing agreement is used to compute the

corrected tax as a partial agreement prior to or concurrently with the resolution of any other issues in the case. If an early referral issue results in a refund or credit requiring a report described in § 6405 that must be submitted to the Joint Committee on Taxation, the report must include a copy of the proposed closing agreement signed by or for the taxpayer, but not signed by or on behalf of the Commissioner. The Service will not sign the proposed agreement until after review by the Joint Committee.

.16 Agreement not reached. If early referral negotiations are unsuccessful and an agreement is not reached with respect to an early referral issue:

(1) Taxpayers may then request mediation for the issue, provided the early referral issue meets the requirements for mediation. See Announcement 98–99, 1998–46 I.R.B. 34, or any subsequent procedure. If mediation is not requested, Appeals will close the early referral file and return jurisdiction over the issue to the District. Appeals will send a copy of the Appeals Case Memorandum for the issue to the case/ group manager.

(2) Appeals will not reconsider an unagreed early referral issue if the entire case is later protested to Appeals, unless there has been a substantial change in the circumstances regarding the early referral issue.

.17 Effect of conclusion of examination.

(1) If the District concludes its examination of any issues not referred as part of the early referral process, it will issue a preliminary notice of deficiency ("30 day letter") with respect to unagreed issues. The letter will include any issues referred under the early referral process that are still pending in Appeals at the time the examination is concluded. The issuance of the 30 day letter generally will constitute the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review for purposes of the increased underpayment rate of interest for large corporations as provided in § 6621(c), or for the award of administrative costs under § 7430(c).

(2) If the only unagreed issues present in the case at the time the examination is concluded are issues that were considered by Appeals under the early referral process and returned to the District unagreed, no 30-day letter will be issued. Instead a statutory notice of deficiency ("90-day letter") will be issued. If a 90-day letter is issued instead of the 30-day letter, the 90-day letter will constitute the first letter of proposed deficiency for purposes of §§ 6621(c) and 7430(c).

.18 Appeals consideration after 30-day letter. If Appeals takes jurisdiction of the remaining issues in the case following the issuance of a 30-day letter, all issues including all early referral issues that have not yet been settled by Appeals will be considered under established Appeals procedures. The only exception is previously considered early referral issues described in section 2.16(2) of this revenue procedure. These issues will not be reconsidered.

.19 Withdrawal from the early referral process. If the taxpayer withdraws an early referral request with respect to one or more of the early referral issues after Appeals has taken jurisdiction over the issues, such withdrawal will be treated in the same manner as if no agreement of those early referral issues was reached. See section 2.16 of this revenue procedure. The withdrawal request must be communicated in writing to the Appeals Officer assigned the early referral.

SECTION 3. INTERNAL REVENUE SERVICE INITIATED CHANGE IN ACCOUNTING METHOD EARLY REFERRAL PROCEDURES

.01 In general. The IRS published a proposed revenue procedure, Notice 98–31, 1998–22 I.R.B. 10, that outlines procedures under § 446(b) for changes in accounting methods initiated by the IRS. Although the early referral procedures in section 2 of this revenue procedure generally apply to all examination issues, section 3.02 of this revenue procedure provides accounting method issues that are appropriate for early referral.

.02 Appropriate issues for early referral. Examples of appropriate issues for early referral include whether :

(1) the taxpayer's practice is a method of accounting;

(2) the IRS is precluded from changing the taxpayer's method of accounting because, for example, the taxpayer obtained audit protection by initiating a voluntary accounting method change;

(3) the taxpayer's present method of accounting clearly reflects income under § 446;

(4) the method of accounting proposed by the IRS clearly reflects income under § 446;

(5) the methodology used by the IRS to compute the § 481(a) adjustment is appropriate; or

(6) the methodology used by the IRS to compute the § 481(b) adjustment is appropriate.

SECTION 4. EMPLOYMENT TAX EARLY REFERRAL PROCEDURES

.01 Background.

(1) In 1996, the Service adopted the classification settlement program (CSP) for worker classification cases for a two-year test period. The Service announced in Notice 98–21, 1998–15 I.R.B. 14, that the CSP would be extended until further notice. The CSP is an optional settlement program that allows businesses and tax examiners to resolve worker classification cases as early in the administrative process as possible, thereby reducing taxpayer burden. In the CSP, examiners can offer a business under audit a worker classification settlement using a standard closing agreement developed for this purpose. The CSP procedures also ensure that the taxpayer relief provisions under § 530 of the Revenue Act of 1978, as amended, are properly applied. When a taxpayer does not agree with the CSP terms offered by the Service or is not eligible for a settlement under the CSP, consideration should be given to requesting early referral to Appeals under these procedures.

(2) Section 530 provides businesses with relief from federal employment tax obligations if certain requirements are met. It terminates the business' employment tax liability under IRC Subtitle C (Federal Insurance Contributions Act and Federal Unemployment Tax Act taxes, federal income tax withholding, and Railroad Retirement Tax Act taxes) and any interest or penalties attributable to such liability for employment taxes (Rev. Proc. 85–18, 1985–1 C.B. 518). Section 530 does not affect the employment tax liability of a worker.

(3) Section 530(e)(3) is generally effective after December 31, 1996 and clar-

ifies that the determination of whether a business is entitled to relief under § 530 is not dependent upon whether the relevant workers are first determined to be employees. As a result, IRS examiners will now consider the taxpayer's eligibility for relief under § 530 before initiating any examination of the relationship between a business and a worker.

(4) Taxpayers that disagree with the District's position regarding the application of § 530 have the option of immediately requesting early referral of the issue from the District to Appeals. In attempting to resolve the § 530 issue, Appeals will follow the procedures set forth in this revenue procedure. If the § 530 issue remains unresolved, or if it is determined that the taxpayer is not eligible for relief under § 530, the case will be returned to the District for consideration of the worker classification issues. If the taxpayer and the District are unable to agree on the worker classification issues, the taxpayer will be encouraged strongly to request early referral of the unagreed issue from the District to Appeals. It is not necessary for a taxpayer to request early referral when the IRS examiner determines that the taxpayer is not entitled to relief under § 530. The taxpayer also may wait until the IRS examiner has determined the § 530 and worker classification issues before requesting early referral of the issues to Appeals.

(5) The Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788, added § 7436 to the Code, which provides new judicial review rights concerning certain employment tax determinations. Generally, § 7436 became effective on August 5, 1997 and applies to employment tax cases in which the Service has determined that at least one worker should be reclassified as an employee and that the taxpayer is not entitled to relief under § 530. The law requires that any employment tax that depends upon such determinations cannot be assessed unless the taxpayer has been given an opportunity to file a petition for United States Tax Court review of the Service's determinations on those two issues. In all cases involving worker classification and § 530 issues, the District will inform taxpayers about the opportunity to seek Tax Court review at the same time as they are informed of their appeal rights. See Notice 98–43, 1998-33 I.R.B. 13.

.02 In general. The early referral procedures in section 2 of this revenue procedure generally apply to employment tax issues. Sections 4.03 through 4.06 of this revenue procedure specifically apply to the early referral of employment tax issues.

.03 Appropriate issues for early referral. Examples of appropriate employment tax issues for early referral include:

(1) Worker classification issues, including whether a worker is an employee or independent contractor under the common law; whether a worker is a statutory employee or statutory non-employee.

(2) Liability issues, including whether § 530 applies; whether § 3509 rates are appropriate; and whether the taxpayer qualifies for an interest-free adjustment.

(3) Other issues, including whether certain payments are excepted from the definition of "wages" (e.g., a fringe benefit that would be excludable from the employee's gross income under § 132); and whether certain services are excepted from the definition of "employment."

.04 Issuance of employment tax report. If an issue is approved for transfer from the District to Appeals, the District will prepare an employment tax report for each early referral issue approved pursuant to this revenue procedure, by following the procedures in section 2.11 of this revenue procedure. The issuance of the employment tax report is not treated as the first letter of proposed assessment of tax for purposes of computing increased interest under § 6621(c), or for the award of administrative costs under § 7430(c).

.05 Agreement reached. If an agreement is reached with respect to an employment tax early referral issue, a Form 2504, Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment — Excise or Employment Tax, or a Form 2504 AD, Excise or Employment Tax — Offer of Agreement to Assessment and Collection of Additional Tax and Offer of Acceptance of Overassessment, should be labeled "Partial Agreement" and may be used for factual or non-complex issues that do not affect subsequent years. Notice 98–43 provides that if a taxpayer settles a § 530 or worker classification issue on an agreed basis, the taxpayer must formally waive the restrictions on assessment contained in §§ 7436(d)(1) and 6213. The following waiver must be included:

> **I understand that by signing this agreement, I am waiving the restrictions on assessment provided in §§ 7436(d) and 6213(a) of the Internal Revenue Code of 1986.**

A closing agreement generally will be prepared for issues where a settlement is complex or affects subsequent years. See § 7121 and also Rev. Proc 68–16, 1968–1 C.B. 770, which describes the preparation of closing agreements. Appeals will coordinate effects on subsequent years with the District and District Counsel.

.06 Agreement not reached.

(1) If one or more of the early referral employment tax issues are unagreed, the case will be returned to the District. The employment tax dependent upon a § 530 or worker classification issue may not be assessed at that time. See § 7436(d)(1) and Notice 98–43. Instead, the District must send the taxpayer, via certified or registered mail, a "Notice of Determination Concerning Worker Classification Under Section 7436."

(2) With respect to any unagreed early referral employment tax issues that do not relate to a § 530 or worker classification issue (so that the unagreed issue(s) is not subject to § 7436), a 30-day letter will not be issued. Rather, the District will process the portion of the case that is not dependent upon a § 530 or worker classification issue for assessment of tax due from the taxpayer that relates to that portion of the case only, which will start the period for the increased underpayment rate for large corporate underpayments under § 6621(c), or for the award of administrative costs under § 7430(c).

SECTION 5. COLLECTION EARLY REFERRAL PROCEDURES

.01 In general. Early referral to Appeals is also available for collection issues. Procedures for utilizing the early referral process are described in Publication 1660, "Collection Appeal Rights." Each taxpayer subject to a lien, levy or seizure will receive a copy of Publication 1660. Early referral of collection issues is a different process than the due process procedures described in § 6320 for liens and § 6330 for levies. Specifically, denial of relief pursuant to the early referral pro-

cedures will not be reviewable in the Tax Court or in a U.S. District Court. In addition, the early referral procedures apply to a broader range of collection issues than the due process procedures.

.02 Appropriate issues for early referral. Appropriate collection issues for early referral include proposed:

(1) notices of federal tax liens;

(2) levies;

(3) seizures; and

(4) denials or terminations of installment agreements.

SECTION 6. EMPLOYEE PLANS/EXEMPT ORGANIZATIONS (EP/EO) EARLY REFERRAL PROCEDURES

.01 In general. The early referral procedures in section 2 of this revenue procedure generally apply to EP/EO issues. Thus, for example, only issues under audit are eligible for early referral. EP/EO issues excluded from the early referral process are identified in sections 6.02 and 6.03 of this revenue procedure.

.02 Employee Plans issues excluded from early referral. Early referral does not apply to:

(1) procedural issues relating to matters that may be eligible for Administrative Policy Regarding Self-Correction, or submitted under VCR, Walk-in CAP, or the Audit Closing Agreement Program. See Rev. Proc. 98–22, 1998–12 I.R.B. 11, or its successors;

(2) issues relating to excise taxes in § 4975; or

(3) issues concerning plan qualification if such issues are not covered by published precedent or are issues for which there may be nonuniformity between offices.

.03 Exempt Organizations issues excluded from early referral. Early referral does not apply to:

(1) issues subject to § 7428, including issues related to exemption or private foundation status;

(2) issues arising in Church tax inquiries and examinations subject to § 7611;

(3) issues relating to excise taxes in § 507 and Chapters 41 and 42 of the IRC; or

(4) issues relating to the revocation of exempt status.

SECTION 7. NO USER FEE

There is no user fee for an early referral request.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 96–9 is superseded.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for requests for early referral filed after July 19, 1999, the date this revenue procedure is published in the Internal Revenue Bulletin.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Thomas Carter Louthan, Director, Office of Alternative Dispute Resolution and Customer Service Programs, and Sandy Cohen from the Office of Alternative Dispute Resolution and Customer Service Programs, National Office Appeals. For further information regarding this revenue procedure, please contact Mr. Louthan at (202) 694-1842, or Mr. Cohen at (202) 694-1818 (not toll-free numbers).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Withdrawal of Notice of Federal Tax Lien in Certain Circumstances

REG–101519–97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the withdrawal of notices of federal tax liens in certain circumstances. The proposed regulations reflect changes made to section 6323 of the Internal Revenue Code of 1986 by the Taxpayer Bill of Rights 2. The proposed regulations affect all taxpayers seeking withdrawals of notices of federal tax liens.

DATES: Written comments and requests for a public hearing must be received by September 27, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–101519–97), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered to: CC:DOM:CORP:R (REG–101519–97), room 5228, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regslist.html.

FOR FURTHER INFORMATION CONTACT: Kevin B. Connelly, (202) 622-3640 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to the withdrawal of notices of federal tax liens under section 6323 of the Internal Revenue Code (Code). Section 501(a) of the Taxpayer Bill of Rights 2 (TBOR2), Public Law 104–168, 110 Stat. 1452 (1996), amended section 6323 to authorize the Secretary to withdraw a notice of federal tax lien in certain limited circumstances. Section 501(a) also requires the Secretary to notify credit reporting agencies, financial institutions and creditors of the withdrawal upon the written request of the taxpayer. These proposed regulations reflect the amendments made by Section 501(a) of TBOR2.

Explanation of Provisions

Section 501(a) of TBOR2 amended section 6323 of the Code by authorizing the Secretary to withdraw a notice of federal tax lien under certain conditions and providing that upon written request of the taxpayer the Secretary will notify any credit reporting agency and any financial institution or creditor identified by the taxpayer. These proposed regulations implement section 501(a).

The proposed regulations provide that a district director, the director of a service center or the Assistant Commissioner (International)(the relevant person being referred to as "the director") may withdraw a notice of federal tax lien if the director determines that one of the conditions enumerated in paragraph (b) of the regulations exists. The notice of federal tax lien is withdrawn by filing a notice of withdrawal in the office in which the notice of federal tax lien is filed and providing the taxpayer with a copy of the notice. Following the withdrawal of a notice of federal tax lien, chapter 64 of subtitle F, relating to collection, is applied as if the IRS had never filed a notice of federal tax lien. The withdrawal of a notice of federal tax lien does not affect the underlying tax lien. The withdrawal simply relinquishes any lien priority the IRS had obtained under section 6323 of the Code when the IRS filed the notice being withdrawn.

The proposed regulations provide that the director has the authority to withdraw a notice of federal tax lien if one of the following conditions exists: (1) the filing of the notice of federal tax lien was premature or otherwise not in accordance with the administrative procedures of the Secretary; (2) the taxpayer has entered into an agreement under section 6159 to satisfy the liability for which the lien was imposed by means of installment payments, unless the agreement by its terms provides that the notice will not be withdrawn; (3) the withdrawal of notice will facilitate collection of the tax liability for which the lien was imposed; or (4) the withdrawal of notice would be in the best interest of the taxpayer, as determined by the National Taxpayer Advocate, and in the best interest of the United States, as determined by the director.

The fourth ground for withdrawal (i.e., withdrawal based on the best interests of the parties) requires that the withdrawal be in the best interests of both the United States and the taxpayer. Therefore, two distinct determinations must be made before a director may withdraw a notice of federal tax lien based on the best interests of the parties. Under the proposed regulations the director alone will determine whether the withdrawal of a notice of federal tax lien is in the United States' best interest. The National Taxpayer Advocate generally will determine whether the withdrawal of a notice is in the taxpayer's best interest; however, if a taxpayer requests the director to withdraw a notice and has not requested the National Taxpayer Advocate to determine the taxpayer's best interest, a finding by the director that the withdrawal is in the taxpayer's, as well as the United States', best interest will be sufficient to support the withdrawal of notice. The director is not authorized to determine that the withdrawal of a notice is not in the taxpayer's best interest. Only the National Taxpayer Advocate is authorized to make that determination.

The proposed regulations provide that a person may request the withdrawal of a notice of federal tax lien by writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice is filed. A written request for withdrawal must include: (1) the name, current address, and taxpayer identification number of the person requesting withdrawal of the notice of federal tax lien; (2) a copy of the notice of federal tax lien affecting the property, if available; (3) the grounds upon which the

withdrawal of notice of federal tax lien is being requested; (4) a list of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien; and (5) a request to disclose information relating to the withdrawal to the persons or entities listed.

The director must consider each taxpayer's request for withdrawal of notice of federal tax lien and determine whether any of the conditions authorizing withdrawal exists and whether to issue a withdrawal. The director also may issue a notice of withdrawal based on information received from a source other than the taxpayer.

If the director grants a withdrawal of notice of federal tax lien, the taxpayer may supplement the list of credit reporting agencies and financial institutions or creditors provided with the request for withdrawal. If no list was submitted with the request to withdraw, a list may be submitted after the notice is withdrawn. A request to supplement the list must be sent in writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice of federal tax lien is filed. The request must contain: (1) the name, current address, and taxpayer identification number of the person requesting the notification; (2) a copy of the notice of withdrawal; (3) the names and addresses of the persons or entities the taxpayer wishes the IRS to contact; and (4) a request to disclose the withdrawal to the persons or entities listed.

The regulations as proposed will be effective when the final regulations are published in the **Federal Register** with respect to withdrawals of any notice of federal tax lien occurring after such date regardless of when the notice was filed.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the collection of information in the regulation is exempt pursuant to 5 U.S.C. 601(7)(B), the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted timely (preferably a signed original and eight (8) copies) to the IRS. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http:// www.irs.ustreas.gov/prod/tax_regslist.html. All comments will be available for public inspection and copying. The IRS and Treasury Department specifically request comments on the clarity of the proposed rule and how it may be made easier to understand. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register.**

Drafting Information

The principal author of these regulations is Kevin B. Connelly, Office of Assistant Chief Counsel (General Litigation) CC:EL:GL, IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, the IRS proposes to amend 26 CFR part 301 as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.6323(j)–1 is added to read as follows:

§301.6323(j)–1 Withdrawal of notice of federal tax lien in certain circumstances.

(a) *In general.* A district director, the Assistant Commissioner (International), or the director of a service center (collectively the director) may withdraw a notice of federal tax lien filed under this section, if the director determines that any of the conditions in paragraph (b) of this section exist. A notice of federal tax lien is withdrawn by the director filing a notice of withdrawal in the office in which the notice of federal tax lien is filed. If a notice of withdrawal is filed, chapter 64 of subtitle F, relating to collection, will be applied as if the withdrawn notice had never been filed. A copy of the notice of withdrawal will be provided to the taxpayer. Upon written request by a taxpayer with respect to whom a notice of federal tax lien has been or will be withdrawn, the director will promptly make reasonable efforts to notify any credit reporting agency and any financial institution or creditor identified by the taxpayer of the withdrawal of such notice. The withdrawal of a notice of federal tax lien will not affect the underlying federal tax lien.

(b) *Conditions authorizing withdrawal.* The director may authorize the withdrawal of a notice of federal tax lien upon determining that one of the following conditions exists:

(1) *Premature or not in accordance with administrative procedures.* The filing of the notice of federal tax lien was premature or otherwise not in accordance with the administrative procedures of the Secretary.

(2) *Installment agreement.* The taxpayer has entered into an agreement under section 6159 to satisfy the liability for which the lien was imposed by means of installment payments. If, however, the agreement specifically provides that a notice of federal tax lien will not be withdrawn, the director may not grant a request for withdrawal of that notice of federal tax lien under this paragraph (b)(2).

(3) *Facilitate collection.* The withdrawal of the notice of federal tax lien will facilitate the collection of the tax liability for which the lien was imposed.

(4) *Best interests of the United States and the taxpayer*—(i) *In general.* The taxpayer or the National Taxpayer Advocate has consented to the withdrawal of the notice of federal tax lien, and withdrawal of the notice would be in the best interest of the taxpayer, as determined by the National Taxpayer Advocate, and the United States, as determined by the director.

(ii) *Best interest of the taxpayer.* The National Taxpayer Advocate generally will determine whether the withdrawal of a notice of federal tax lien is in the best interest of the taxpayer. If, however, a taxpayer requests the director to withdraw a notice and has not specifically requested the National Taxpayer Advocate to determine the taxpayer's best interest, a finding by the director that the withdrawal of notice is in the best interest of the taxpayer will be sufficient to support withdrawal.

(5) *Examples.* The following examples illustrate the provisions of this paragraph (b):

Example 1. A is an employee of X Corporation. A notice of federal tax lien has been filed to secure an outstanding tax liability against A. A, who has no assets and no other secured creditors, has agreed to pay the balance of tax due through payroll deductions at a rate higher than the Internal Revenue Service could obtain through a wage levy in order to get the notice of federal tax lien withdrawn. X Corporation has agreed to allow A to enter into a payroll deduction agreement. In this situation, the director may withdraw the notice of federal tax lien to facilitate collection.

Example 2. A owes $1,000 in federal income taxes. A enters into an agreement to pay the outstanding federal income tax liability in installments. The agreement provides that a notice of federal tax lien may be filed if the taxpayer defaults. A timely pays the installments each month and has not defaulted in any way. Eleven months after entering into the installment agreement, the Internal Revenue Service files a notice of federal tax lien. Noting that there has been no default, the taxpayer asks the Internal Revenue Service to withdraw the notice of federal tax lien. In this situation, the director may withdraw the notice of federal tax lien because the taxpayer has entered into an installment agreement that does not prohibit the withdrawal of the notice.

Example 3. A is the owner of a farm machinery dealership against whom a notice of federal tax lien has been filed to secure an outstanding tax liability. A currently is paying the tax liability by an installment agreement that prohibits the withdrawal of the notice of federal tax lien. X Corporation has agreed to provide A with 100 tractors to increase A's inventory if the notice of federal tax lien is withdrawn. A asks the Internal Revenue Service to withdraw the notice of federal tax lien. The director determines that the withdrawal of the notice of federal tax lien is in the best interest of the United States because it would enable A to generate additional tractor sales, and increased sales would enable A to increase the amount of his installment payments as well as reduce the amount of time needed to satisfy the liability. A, who has no other assets or secured creditors, has agreed to modify his installment agreement. If the National Taxpayer Advocate (or the director in lieu of the National Taxpayer Advocate) determines that the withdrawal is in the best interests of the taxpayer, the director may withdraw the notice of federal tax lien because withdrawal is in the best interest of the taxpayer and the United States. Alternatively, the director may withdraw the notice of federal tax lien to facilitate collection.

(c) *Determinations by the director.* The director must determine whether any of the conditions authorizing the withdrawal of a notice of federal tax lien exist if a taxpayer submits a request for withdrawal in accordance with paragraph (d) of this section. The director also may make this determination based on information received from a source other than the taxpayer. If the director determines that conditions authorizing the withdrawal are not present, the director may not authorize the withdrawal. If the director determines conditions for withdrawal are present, the director may (but is not required to) authorize the withdrawal. If the basis for the withdrawal is the best interests of the taxpayer and the Internal Revenue Service, the taxpayer or the National Taxpayer Advocate must consent to the withdrawal.

(d) *Procedures for request for withdrawal*—(1) *Manner.* A request for the withdrawal of a notice of federal tax lien must be made in writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice of federal tax lien is filed.

(2) *Form.* The written request will include the following information and documents—

(i) Name, current address, and taxpayer identification number of the person requesting the withdrawal of notice of federal tax lien;

(ii) A copy of the notice of federal tax lien affecting the taxpayer's property, if available;

(iii) The grounds upon which the withdrawal of notice of federal tax lien is being requested;

(iv) A list of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien; and

(v) A request to disclose the withdrawal of notice of federal tax lien to the persons listed in paragraph (d)(2)(iv) of this section.

(e) *Supplemental list of credit agencies, financial institutions, and creditors*—(1) *In general.* If the director grants a withdrawal of notice of federal tax lien, the taxpayer may supplement the list in paragraph (d)(2)(iv) of this section. If no list was provided in the request to withdraw the notice of federal tax lien, the list in paragraph (d)(2)(iv) of this section and the request for notification in paragraph (d)(2)(v) of this section may be submitted after the notice is withdrawn

(2) *Manner.* A request to supplement the list of any credit agencies and any financial institutions or creditors that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien must be sent in writing to the director (marked for the attention of the Chief, Special Procedures Function) of the district in which the notice of federal tax lien is filed.

(3) *Form.* The request must include the following information and documents—

(i) Name, current address, and taxpayer identification number of the taxpayer requesting the notification of any credit agency or any financial institution or creditor of the withdrawal of notice of federal tax lien;

(ii) A copy of the notice of withdrawal, if available;

(iii) A supplemental list, identified as such, of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the director to notify of the withdrawal of notice of federal tax lien; and

(iv) A request to disclose the withdrawal of notice of federal tax lien to the persons listed in paragraph (e)(3)(iii) of this section.

(f) *Effective date.* This section applies on or after the date final regulations are published in the Federal Register with respect to a withdrawal of any notice of federal tax lien.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 29, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 1, 1999, 64 F.R. 35102)

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Zone Academy Bonds; Obligations of States and Political Subdivisions

REG–105327–99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: The IRS is issuing temporary regulations providing guidance to holders and issuers of qualified zone academy bonds. These proposed regulations would change the method of ascertaining the qualified zone academy bond credit rate and would provide reimbursement rules. State and local governments that issue qualified zone academy bonds would be affected by these proposed regulations. The text of the temporary regulations, T.D. 8826 on page 107, also serves as the text of these proposed regulations. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by September 28, 1999. Outlines of topics to be discussed at the public hearing scheduled for November 9, 1999, at 10 a.m. must be received by October 19, 1999.

ADDRESSES: Send Submissions to: CC:DOM:CORP:R (REG–105327–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–105327–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/reglist.html. The public hearing will be held in the room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Timothy L. Jones at 202-622-3980; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, Michael Slaughter at 202-622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 226(a) of the Taxpayer Relief Act of 1997, Public Law 105–34, 111 Stat. 788 (1997) amended the Internal Revenue Code by redesignating section 1397E as 1397F and adding a new section 1397E. Section 1397E authorizes a new type of debt instrument known as a qualified zone academy bond. Temporary Regulations (T.D. 8755, 1998–10 I.R.B. 21) interpreting section 1397E were published on January 7, 1998, 63 F.R. 671, as §1.1397E–1T.

Temporary regulations amending §1.1397E–1T are published in T.D. 8826 on page 107. Section 1.1397E– 1T is amended by revising paragraphs (b) and (j), redesignating paragraph (h) as paragraph (i) and adding new paragraph (h). The text of the temporary regulations also serves as the text of these proposed regulations. An explanation of the regulations may be found in the preamble of the temporary regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply. The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because these regulations do not impose a collection of information on small entities. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments (a signed original and eight (8) copies, if written) that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how the regulations may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 9, 1999, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments by September 28, 1999, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 19, 1999. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Timothy L. Jones, Office of Assistant Chief Counsel (Financial Institutions & Products). However, other personnel

from IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.1397E-1 as proposed to be added at 63 F.R .708 is amended by:

1. Revising paragraphs (b) and (j);
2. Redesignating paragraph (h) as paragraph (i);
3. Adding new paragraph (h).

The revisions and addition read as follows:

§1.1397E-1 Qualified zone academy bonds.

[The text of proposed paragraphs (b), (h) and (j) is the same as the text of §1.1397E–1T(b), (h), and (j) published in T.D. 8826.]

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on June 30, 1999, 8:45 a.m., and published in the issue of the Federal Register for July 1, 1999, 64 F.R. 35579)

Foundations Status of Certain Organizations

Announcement 99–70

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

360 Degree Exchange Inc., Washington, DC
Adult and Children Transitional Shelter, Denver, CO
African American Cultural Education Foundation Inc., Washington, DC
Aide in Community Development Incorporated, Hamburg, AR
Alexander Band Boosters, Albany, OH
All Children Count Inc., Los Angeles, CA
Alliance for Lending Assistance to Students, Victoria, TX
American Association for Medical-Legal Education, North Charleston, SC
Animals Protected in Entertainment, Stockton, CA
Art for Kids Sake, Gladstone, OR
Art St. Ballet Society, Galveston, TX
Associate Benevolent Committee, Menomonie, WI
Association for the Support of Intercollegiate Speech Teams, Cheverly, MD
Atlantic Indoor Association, Powhatan, VA
Back Pain Society Inc., Woburn, MA
Baldwin Youth Work Institute, Inc., New York, NY
Ballet Eddy Toussaint USA Inc., Sarasota, FL
Bemidji Centennial Committee, Bemidji, MN
Berdan Support Fund, Mendenhall, PA
Bridgewater Creative Playground Inc., Bridgewater, NJ
Broomstones Curling Foundation, Framingham, MA
Celebrate Life City Wide Virginia Beach, Virginia Beach, VA
Center for African Development International Inc., Richmond Hill, NY
Center for Counseling Training and Development Inc., Tampa, FL
Center for the Applied Study of Prejudice & Ethnoviolence, Inc., Baltimore, MD
Child Health Institute Foundation, Inc., Shawnee Mission, KS
Chippewa Valley Concert Band Inc., Eau Claire, WI
Church Partners Inc., Dallas, TX
Coker Green Productions, Lubbock, TX
Community Help Fund, Redmond, OR
Community Housing Foundation, Penryn, CA
Covenant Life Ministries, Virginia Beach, VA
Cresthill Police Association, Joliet, IL
Crosslake Club Inc., Covington, LA
Crossroads Career Services, Inc., Atlanta, GA
D A R E Davenport Inc., Bettendorf, IA
Double Trouble in Recovery Inc., Brooklyn, NY
Drake School Parent Teacher Organization, Sugar Land, TX
Dunkirk-Fredonia Lions Club Barker Russell C. MRL Scholarship Fund, Dunkirk, NY
Eden Center, Chester, SC
Equestrian Therapy Center Inc., Wolfforth, TX
Ernies Museum of Black Arkansans Hall of Fame and Music Theater, Little Rock, AR
Eyestone Elementary School Parent Teacher Organization, Wellington, CO
Families on the Edge, Riverdale, MD
Florida Jr. Chamber of Commerce Disaster Relief Foundation, Lakeland, FL
For the Defense Ltd., Chicago, IL
Fort Worth Teen Center Inc., Fort Worth, TX
Friends of City Hall, New Orleans, LA
Friends of the Henderson County Library West, Seven Points, TX
Fund for the Advancement of Social Work Practice in New York City, New York, NY
General Care, Inc., Baton Rouge, LA
George Jenkins High School Band Boosters Inc., Lakeland, FL
Good News Ministries, Newport News, VA
Good Sports Inc., Miami, FL
Haparnes Inc., Brooklyn, NY
Hattie Larlham League of Hudson, Hudson, OH
Healthspeak Inc., Durham, NC
Heart of Gold Foundation Inc., Storm Lake, IA
Hickman County Band Boosters, Centerville, TN
Honduran Waves From the Americas Hola Corporation, Silver Spring, MD
International Society for Consciousness and the Arts, New York, NY
Jesus Christ King of Kings—Global Ministries Inc., Houston, TX

Junior Shooting Sports USA Inc., Spotsylvania, VA
Juvenile Educational Travel, Inc., Kernersville, NC
Kansas Academy of Theatrical Arts Inc., Kansas City, KS
Kenny Neighborhood Association, Minneapolis, MN
Kent Bramlett Foundation Inc., Nashville, TN
Laredo Independent School District Educational Foundation, Laredo, TX
The Leadership Trust, Greensboro, NC
Learning Institute for Employability, Elmhurst, NY
Life Bridges Inc., Libertyville,IL
Life Outreach Urban Development Corporation, Baltimore, MD
Maranatha 2 Ministries, Inc., Lakewood, NJ
Massid Al-Mubeen, Inc., Glassboro, NJ
Meals on Wheels of Quince Orchard Inc., Gaithersburg, MD
Meherrin River Arts Council Inc., Emporia, VA
Metropolitan Housing Development Corporation, Kansas City, MO
Midatlantic Credit Counseling Services Inc., Dover, DE
National Book Exchange, Pawtucket, RI
National Museum of Coal Mining Inc., Golf, IL
National Parent Alliance Inc., Jamaica, NY
Network Aiken, Aiken, SC
New American Revolution, New York, NY
North Metro Arts Roundtable Inc., Atlanta, GA
Northeast Fine Arts Boosters, Goose Lake, IA
Northwood Youth Futures Inc., Eagle River, WI
Oelwein Friends of Education Foundation, Oelwein, IA
Oklahoma Judo Development Institute, Norman, OK
Omnificent Ink Productions, Inc., New York, NY
Opera Northeast of New England Inc., Gardner, MA
Organplan Foundation Inc., New York, NY
Padrinos In Education, Irving, TX
Paragon Foundation, Austin, TX
Parents Supporting Parents of Maryland Inc., Kensington, MD
Peach County Partnership Coalition, Fort Valley, GA
Perry Community Development Inc., Perry, IA
Philadelphia Health Care Trust, Philadelphia, PA
Point Men of Fort Worth, Arlington, TX
Powerhouse Productions Inc., Chicago, IL
Power in One Foundation, Drums, PA
Public Integrity Research Corporation, Gilbert, AZ
Public Interest Science Conference, Eugene, OR
Pulaski County Youth Emergency Shelter Inc., Pulaski, VA
Red Sea International Heritage, Inc., New York, NY
Resident Assistance Corporation, St. Louis, MO
Sandia Softball Booster Club, Albuquerque, NM
Sartell Arena Association, Sartell, MN
Sea Rescue Group Inc., Miami, FL
Self Educational Art Institute Inc., Menomonee Falls, WI
Seminole Warhawk Band Aides Boosters Inc., Seminole, FL
Seneca Boosters Club, Louisville, KY
Shelter the Children, Ft. Worth, TX
Society for Jewish Music, Skokie, IL
South Central Oklahoma Christian Broadcasting, Inc., Ada, OK
Special Defenders, Inc., Orlando, FL
Speelyay Inc., Chesterton, IN
Starting Over of New York Inc., New York, NY
Stephens County Veterans Council Incorporated, Duncan, OK
Tal Psycho-Social Research Center Inc., New York, NY
Teens Reaching Out, Detroit, MI
Tennessee Education Support Systems, Millington, TN
The American Sports Academy Inc., Oxon Hill, MD
Through Education and Art Comes Hope, Chicago, IL
Town of Tonawanda Lightning Hockey Association, Buffalo, NY
Tri-Cities Kids at Play Inc., Grand Haven, MI
Tri-State Ecumenical Counsel, Morrisville, PA
Turner Chapel Community Development, Inc., Raleigh, MS
T W Hellman Educational Foundation, Kirkwood, MD
U S Registry of Alcohol Victims & Survivors, Washington, DC
UDT Seal Memorial Park, Virginia Beach, VA
Ohio Education Fund, Columbus, OH
Ultimate Housing Co-Partnership, West Valley City, UT
Under Two Flags, Gettysburg, PA
Union County Genealogical Society, Creston, IA
Union Lancers Youth Soccer Association, Glen Ridge, NJ
Union of Christians Inc., Tulsa, OK
Unite El Paso, El Paso, TX
United Campus Ministry of Pittsburgh, Pittsburgh, PA
United Caring and Sharing, Goshen, OH
United Catholic Development Inc., Overland Park, KS
United Chambers Scholarship Foundation Inc., Sanford, FL
United Children Services, Houston, TX
United Childrens Protection Coalition Inc., Holiday, FL
United Christian Ministries Inc., Port Orange, FL
United Endeavors Inc., New York, NY
United Housing Contractors Association, New Orleans, LA
United Latins of America, Orange, NJ
United Security Institution Academy, Columbus, OH
United Senior Citizens Association of Texas Inc., Houston, TX
United Soccer of Adamsville Club Inc., Adamsville, AL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1999–1 through 1999–26 will be found in Internal Revenue Bulletin 1999–27, dated July 6, 1999.

Finding List of Current Action on Previously Published Items[1]

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[1] A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1999–1 through 1999–26 will be found in Internal Revenue Bulletin 1999–27, dated July 6, 1999.

Notes

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