

market value instead of \$30 cash. The basis is adjusted in the same manner as in paragraph (b) of this *Example 2*. In addition, because *S* recognizes a \$10 gain from the asset under section 1001, *P*'s basis in its *S* stock is increased under § 1.1502-32(b) by *S*'s \$10 gain. Consequently, as a result of the reorganization, *P* has an excess loss account of \$5 in its *S* stock. (The results would be the same if the appreciated asset provided by *S* was *P* stock with respect to which *S* recognized gain. See § 1.1032-2(c).)

*Example 3. Reverse triangular merger.* (a) *Facts.* *T* has assets with an aggregate basis of \$60 and fair market value of \$100. *T*'s assets are subject to \$70 of liabilities. *P* owns all of the only class of *S* stock. *P* has a \$5 basis in its *S* stock. Pursuant to a plan, *S* merges into *T* with *T* surviving. In the merger, the *T* shareholders exchange their *T* stock for \$2 cash from *P* and \$28 worth of *P* stock provided by *P* pursuant to the plan. The transaction is a reorganization to which sections 368 (a)(1)(A) and (a)(2)(E) apply.

(b) *Basis adjustment.* Under § 1.358-6, *P*'s basis in the *T* stock acquired equals its \$5 basis in its *S* stock immediately before the transaction adjusted by the \$60 basis in the *T* assets deemed transferred, and the \$70 of liabilities to which the *T* assets are subject. Under the rules of this section, the limitation described in § 1.358-6(c)(1)(ii) does not apply. Consequently, *P* has an excess loss account of \$5 in its *T* stock as a result of the transaction.

(c) *Effective date.* This section applies to reorganizations occurring on or after December 21, 1995.

[T.D. 8648, 60 FR 66082, Dec. 21, 1995]

#### § 1.1502-31 Stock basis after a group structure change.

(a) *In general—(1) Overview.* If one corporation (*P*) succeeds another corporation (*T*) under the principles of § 1.1502-75(d) (2) or (3) as the common parent of a consolidated group in a group structure change, the basis of members in the stock of the former common parent (or the stock of a successor) is adjusted or determined under this section. See § 1.1502-33(f)(1) for the definition of group structure change. For example, if *P* owns all of the stock of another corporation (*S*), and *T* merges into *S* in a group structure change that is a reorganization described in section 368(a)(2)(D) in which *P* becomes the common parent of the *T* group, *P*'s basis in *S*'s stock must be adjusted to reflect the change in *S*'s assets and liabilities. The rules of this

section coordinate with the earnings and profits adjustments required under § 1.1502-33(f)(1), generally conforming the results of transactions in which the *T* group continues under § 1.1502-75 with *P* as the common parent. By preserving in *P* the relationship between *T*'s earnings and profits and asset basis, these adjustments limit possible distortions under section 1502 (e.g., in the deconsolidation rules for earnings and profits under § 1.1502-33(e), and the continued filing requirements under § 1.1502-75(a)). This section applies whether or not *T* continues to exist after the group structure change.

(2) *Application of other rules of law.* The rules of this section are in addition to other rules of law. The provisions of this section and other rules of law must not have the effect of duplicating an amount in *P*'s basis in *S*'s stock.

(b) *General rules.* Except as otherwise provided in this section—

(1) *Asset acquisitions.* If a corporation acquires the former common parent's assets (and any liabilities assumed or to which the assets are subject) in a group structure change, the basis of members in the stock of the acquiring corporation is adjusted immediately after the group structure change to reflect the acquiring corporation's allocable share of the former common parent's net asset basis as determined under paragraph (c) of this section. For example, if *S* acquires all of *T*'s assets in a group structure change that is a reorganization described in section 368(a)(2)(D), *P*'s basis in *S*'s stock is adjusted to reflect *T*'s net asset basis. If *P* owned some of *T*'s stock before the group structure change, the results would be the same because *P*'s basis in the *T* stock is not taken into account in determining *P*'s basis in *S*'s stock. If *T*'s net asset basis is a negative amount, it reduces *P*'s basis in *S*'s stock and, if the reduction exceeds *P*'s basis in *S*'s stock, the excess is *P*'s excess loss account in *S*'s stock. See § 1.1502-19 for rules treating *P*'s excess loss account as negative basis, and treating a reference to *P*'s basis in *S*'s stock as including an excess loss account.

(2) *Stock acquisitions.* If a corporation acquires stock of the former common parent in a group structure change, the

basis of the members in the former common parent's stock immediately after the group structure change (including any stock of the former common parent owned before the group structure change) is redetermined in accordance with the results for an asset acquisition described in paragraph (b)(1) of this section. For example, if all of T's stock is contributed to P in a group structure change to which section 351 applies, P's basis in T's stock is T's net asset basis, rather than the amount determined under section 362. Similarly, if S merges into T in a group structure change described in section 368(a)(2)(E), P's basis in T's stock is the basis that P would have in S's stock under paragraph (b)(1) of this section if T had merged into S in a group structure change described in section 368(a)(2)(D).

(c) *Net asset basis.* The former common parent's net asset basis is the basis it would have in the stock of a newly formed subsidiary, if—

(1) The former common parent transferred its assets (and any liabilities assumed or to which the assets are subject) to the subsidiary in a transaction to which section 351 applies;

(2) The former common parent and the subsidiary were members of the same consolidated group (see § 1.1502-80(d) for the non-application of section 357(c) to the transfer); and

(3) The asset basis taken into account is each asset's basis immediately after the group structure change (e.g., taking into account any income or gain recognized in the group structure change and reflected in the asset's basis).

(d) *Additional adjustments.* In addition to the adjustments in paragraph (b) of this section, the following adjustments are made:

(1) *Consideration not provided by P.* The basis is reduced to reflect the fair market value of any consideration not provided by the member. For example, if S acquires T's assets in a group structure change described in section 368(a)(2)(D), and S provides an appreciated asset (e.g., stock of P) as partial consideration in the transaction, P's basis in S's stock is reduced by the fair market value of the asset.

(2) *Allocable share*—(i) *Asset acquisitions.* If a corporation receives less than all of the former common parent's assets and liabilities in the group structure change, the former common parent's net asset basis taken into account under paragraph (b)(1) of this section is adjusted accordingly.

(ii) *Stock acquisitions.* If a corporation owns less than all of the former common parent's stock immediately after a group structure change described in paragraph (b)(2) of this section, the percentage of the former common parent's net asset basis taken into account equals the percentage (by fair market value) of the former common parent's stock owned immediately after the group structure change. For example, if P owns less than all of the former common parent's stock immediately after the group structure change, only an allocable part of the basis determined under this section is reflected in the shares owned by P (and the amount allocable to shares owned by nonmembers has no effect on the basis of their shares).

(3) *Allocation among shares of stock.* The basis determined under this section is allocated among shares under the principles of section 358. For example, if P owns multiple classes of the former common parent's stock immediately after the group structure change, only an allocable part of the basis determined under this section is reflected in the basis of each share. See § 1.1502-19(d), for special allocations with respect to excess loss accounts.

(4) *Higher-tier members.* To the extent that the former common parent is owned by members other than the new common parent, the basis of members in the stock of all subsidiaries owning, directly or indirectly, in whole or in part, an interest in the former common parent's assets or liabilities is adjusted in accordance with the principles of this section. The adjustments are applied in the order of the tiers, from the lowest to the highest.

(e) *Waiver of loss carryovers of former common parent*—(1) *General rule.* An irrevocable election may be made to treat all or any portion of a loss carryover attributable to the common parent as expiring for all Federal income tax purposes immediately before the

group structure change. Thus, if the loss carryover is treated as expiring under the election, it will not result in a negative adjustment to the basis of P's stock under § 1.1502-32(b).

(2) *Election.* The election described in this paragraph (e) must be made in a separate statement entitled "ELECTION TO TREAT LOSS CARRYOVER AS EXPIRING UNDER § 1.1502-31(e)." The statement must be filed with the consolidated group's return for the year that includes the group structure change, and it must be signed by the former and the new common parent. The statement must identify the amount of each loss carryover deemed to expire (or the amount of each loss carryover deemed not to expire, with any balance of any loss carryovers being deemed to expire).

(f) *Predecessors and successors.* For purposes of this section, any reference to a corporation includes a reference to a successor or predecessor as the context may require. See § 1.1502-32(f) for definitions of predecessor and successor.

(g) *Examples.* For purposes of the examples in this section, unless otherwise stated, all corporations have only one class of stock outstanding, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, all transactions are between unrelated persons, and tax liabilities are disregarded. The principles of this section are illustrated by the following examples.

*Example 1. Forward triangular merger.* (a) *Facts.* P is the common parent of one group and T is the common parent of another. T has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. T's shareholders have an aggregate basis of \$50 in T's stock. In Year 1, pursuant to a plan, P forms S and T merges into S with the T shareholders receiving \$100 of P stock in exchange for their T stock. The transaction is a reorganization described in section 368(a)(2)(D). The transaction is also a reverse acquisition under § 1.1502-75(d)(3) because the T shareholders, as a result of owning T's stock, own more than 50% of the value of P's stock immediately after the transaction. Thus, the transaction is a group structure change under § 1.1502-33(f)(1), and P's earnings and profits are adjusted to reflect T's earnings and profits immediately before T

ceases to be the common parent of the T group.

(b) *Analysis.* Under paragraph (b)(1) of this section, P's basis in S's stock is adjusted to reflect T's net asset basis. Under paragraph (c) of this section, T's net asset basis is \$60, the basis T would have in the stock of a subsidiary under section 358 if T had transferred all of its assets and liabilities to the subsidiary in a transaction to which section 351 applies. Thus, P has a \$60 basis in S's stock.

(c) *Pre-existing S.* The facts are the same as in paragraph (a) of this *Example 1*, except that P has owned the stock of S for several years and P has a \$50 basis in the S stock before the merger with T. Under paragraph (b)(1) of this section, P's \$50 basis in S's stock is adjusted to reflect T's net asset basis. Thus, P's basis in S's stock is \$110 (\$50 plus \$60).

(d) *Excess loss account included in former common parent's net asset basis.* The facts are the same as in paragraph (a) of this *Example 1*, except that T has two assets, an operating asset with an \$80 basis and \$90 fair market value, and stock of a subsidiary with a \$20 excess loss account and \$10 fair market value. Under paragraph (c) of this section, T's net asset basis is \$60 (\$80 minus \$20). See sections 351 and 358, and § 1.1502-19. Consequently, P has a \$60 basis in S's stock. Under section 362 and § 1.1502-19, S has an \$80 basis in the operating asset and a \$20 excess loss account in the stock of the subsidiary.

(e) *Liabilities in excess of basis.* The facts are the same as in paragraph (a) of this *Example 1*, except that T's assets have a fair market value of \$170 (and \$60 basis) and are subject to \$70 of liabilities. Under paragraph (c) of this section, T's net asset basis is (\$10) (\$60 minus \$70). See sections 351 and 358, and §§ 1.1502-19 and 1.1502-80(d). Thus, P has a \$10 excess loss account in S's stock. Under section 362, S has a \$60 basis in its assets (which are subject to \$70 of liabilities). (Under paragraph (a)(2) of this section, because the liabilities are taken into account in determining net asset basis under paragraph (c) of this section, the liabilities are not also taken into account as consideration not provided by P under paragraph (d)(1) of this section.)

(f) *Consideration provided by S.* The facts are the same as in paragraph (a) of this *Example 1*, except that P forms S with a \$100 contribution at the beginning of Year 1, and during Year 6, pursuant to a plan, S purchases \$100 of P stock and T merges into S with the T shareholders receiving P stock in exchange for their T stock. Under paragraph (b)(1) of this section, P's \$100 basis in S's stock is increased by \$60 to reflect T's net asset basis. Under paragraph (d)(1) of this section, P's basis in S's stock is decreased by \$100 (the fair market value of the P stock) because the P stock purchased by S and used in the

transaction is consideration not provided by P.

(g) *Appreciated asset provided by S.* The facts are the same as in paragraph (a) of this *Example 1*, except that P has owned the stock of S for several years, and the shareholders of T receive \$60 of P stock and an asset of S with a \$30 adjusted basis and \$40 fair market value. S recognizes a \$10 gain from the asset under section 1001. Under paragraph (b)(1) of this section, P's basis in S's stock is increased by \$60 to reflect T's net asset basis. Under paragraph (d)(1) of this section, P's basis in S's stock is decreased by \$40 (the fair market value of the asset provided by S). In addition, P's basis in S's stock is increased under § 1.1502-32(b) by S's \$10 gain.

(h) *Depreciated asset provided by S.* The facts are the same as in paragraph (a) of this *Example 1*, except that P has owned the stock of S for several years, and the shareholders of T receive \$60 of P stock and an asset of S with a \$50 adjusted basis and \$40 fair market value. S recognizes a \$10 loss from the asset under section 1001. Under paragraph (b)(1) of this section, P's basis in S's stock is increased by \$60 to reflect T's net asset basis. Under paragraph (d)(1) of this section, P's basis in S's stock is decreased by \$40 (the fair market value of the asset provided by S). In addition, S's \$10 loss is taken into account under § 1.1502-32(b) in determining P's basis adjustments under that section.

*Example 2. Stock acquisition.* (a) *Facts.* P is the common parent of one group and T is the common parent of another. T has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. T's shareholders have an aggregate basis of \$50 in T's stock. Pursuant to a plan, P forms S and S acquires all of T's stock in exchange for P stock in a transaction described in section 368(a)(1)(B). The transaction is also a reverse acquisition under § 1.1502-75(d)(3). Thus, the transaction is a group structure change under § 1.1502-33(f)(1), and the earnings and profits of P and S are adjusted to reflect T's earnings and profits immediately before T ceases to be the common parent of the T group.

(b) *Analysis.* Under paragraph (d)(4) of this section, although S is not the new common parent of the T group, adjustments must be made to S's basis in T's stock in accordance with the principles of this section. Although S's basis in T's stock would ordinarily be determined under section 362 by reference to the basis of T's shareholders in T's stock immediately before the group structure change, under the principles of paragraph (b)(2) of this section, S's basis in T's stock is determined by reference to T's net asset basis. Thus, S's basis in T's stock is \$60.

(c) *Higher-tier adjustments.* Under paragraph (d)(4) of this section, P's basis in S's stock is adjusted to \$60 (to be consistent with the adjustment to S's basis in T's stock).

(d) *Cross ownership.* The facts are the same as in paragraph (a) of this *Example 2*, except that S has owned 10% of T's stock for several years and, pursuant to the plan, S acquires the remaining 90% of T's stock in exchange for P stock. The results are the same as in paragraphs (b) and (c) of this *Example 2*, because S's basis in the initial 10% of T's stock is redetermined under this section.

(e) *Allocable share.* The facts are the same as in paragraph (a) of this *Example 2*, except that P owns only 90% of S's stock immediately after the group structure change. S's basis in T's stock is the same as in paragraph (b) of this *Example 2*. Under paragraph (d)(2) of this section, P's basis in its S stock is adjusted to \$54 (90% of S's \$60 adjustment).

*Example 3. Taxable stock acquisition.* (a) *Facts.* P is the common parent of one group and T is the common parent of another. T has assets with an aggregate basis of \$60 and fair market value of \$100 and no liabilities. T's shareholders have an aggregate basis of \$50 in T's stock. Pursuant to a plan, P acquires all of T's stock in exchange for \$70 of P's stock and \$30 in a transaction that is a group structure change under § 1.1502-33(f)(1). P's acquisition of T's stock is a taxable transaction. (Because of P's use of cash, the acquisition is not a transaction described in section 368(a)(1)(B).)

(b) *Analysis.* Under paragraph (b)(2) of this section, P's basis in T's stock is adjusted to reflect T's net asset basis. Thus, although P's basis in T's stock would ordinarily be a cost basis of \$100, P's basis in T's stock under this section is \$60.

(h) *Effective date—(1) General rule.* This section applies to group structure changes occurring in consolidated return years beginning on or after January 1, 1995.

(2) *Prior law.* For prior years, see prior regulations under section 1502 as in effect with respect to the transaction. See, e.g., § 1.1502-31T as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

[T.D. 8560, 59 FR 41683, Aug. 15, 1994]

### § 1.1502-32 Investment adjustments.

(a) *In general—(1) Purpose.* This section provides rules for adjusting the basis of the stock of a subsidiary (S) owned by another member (P). These rules modify the determination of P's basis in S's stock under applicable rules of law by adjusting P's basis to reflect S's distributions and S's items of income, gain, deduction, and loss taken into account for the period that S is a member of the consolidated