

sells S's stock after the effective date. If S sells the remaining 20% of T's stock after the effective date, S's stock basis adjustments with respect to that T stock are also not redetermined because T became a nonmember before the effective date. However, if T and U continue to file a consolidated return with each other and T sells U's stock after the effective date, T's stock basis adjustments with respect to U's stock are redetermined (even though some of those adjustments may have been taken into account by S in its prior sale of T's stock before the effective date).

(iii) *Deferred amounts.* For purposes of this paragraph (h)(2), a disposition does not include a transaction to which §1.1502-13, §1.1502-13T, §1.1502-14, or §1.1502-14T applies. Instead, the transaction is deemed to occur as the income, gain, deduction, or loss (if any) is taken into account.

(3) *Distributions—(i) Deemed dividend elections.* If there is a deemed distribution and recontribution pursuant to §1.1502-32(f)(2) as contained in the 26 CFR part 1 edition revised as of April 1, 1994 in a consolidated return year beginning before January 1, 1995, the deemed distribution and recontribution under the election are treated as an actual distribution by S and recontribution by P as provided under the election.

(ii) *Affiliated earnings and profits.* This section does not apply to reduce the basis in S's stock as a result of a distribution of earnings and profits accumulated in separate return years, if the distribution is made in a consolidated return year beginning before January 1, 1995, and the distribution does not cause a negative adjustment under the investment adjustment rules in effect at the time of the distribution. See paragraph (h)(5) of this section for the rules in effect with respect to the distribution.

(4) *Expiring loss carryovers.* If S became a member of a consolidated group in a consolidated return year beginning before January 1, 1995, and S had a loss carryover from a separate return limitation year at that time, the group does not treat any expiration of the loss carryover (even if in a tax year beginning on or after January 1, 1995) as

a noncapital, nondeductible expense resulting in a negative adjustment under this section. If S becomes a member of a consolidated group in a consolidated return year beginning on or after January 1, 1995, and S has a loss carryover from a separate return limitation year at that time, adjustments with respect to the expiration are determined under this section.

(5) *Prior law—(i) In general.* For prior determinations, see prior regulations under section 1502 as in effect with respect to the determination. See, e.g., §§1.1502-32 and 1.1502-32T as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

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

(6) [Reserved]. For further guidance, see §1.1502-32T(h)(6).

(7) [Reserved]. For further guidance, see §1.1502-32T(h)(7).

[T.D. 8560, 59 FR 41685, Aug. 15, 1994, as amended by T.D. 8677, 61 FR 33323, June 27, 1996; T.D. 8560, 62 FR 12098, Mar. 14, 1997; T.D. 8823, 64 FR 36099, July 2, 1999; T.D. 8984, 67 FR 11040, Mar. 12, 2002; T.D. 9048, 68 FR 12291, Mar. 14, 2003; T.D. 9089, 68 FR 52495, Sept. 4, 2003]

#### § 1.1502-32T Investment adjustments (temporary).

(a) and (a)(1) [Reserved]. For further guidance, see §1.1502-32(a) and (a)(1).

(a)(2) *Application of other rules of law.* The rules of this section are in addition to other rules of law. See, e.g., section 358 (basis determinations for

distributees), section 1016 (adjustments to basis), §1.1502-11(b) (limitations on the use of losses), §1.1502-19 (treatment of excess loss accounts), §1.1502-31 (basis after a group structure change), and §1.1502-35T (additional rules relating to stock loss, including losses attributable to worthlessness and certain dispositions not followed by a separate return year). P's basis in S's stock must not be adjusted under this section and other rules of law in a manner that has the effect of duplicating an adjustment. For example, if pursuant to §1.1502-35T(c)(3) and paragraph (b)(3)(iii)(C) of this section the basis in stock is reduced to take into account a loss suspended under §1.1502-35T(c)(1), such basis shall not be further reduced to take into account such loss, or a portion of such loss, if any, that is later allowed pursuant to §1.1502-35T(c)(5). See also paragraph (h)(5) of this section for basis reductions applicable to certain former subsidiaries.

(b) through (b)(3)(ii)(B) [Reserved]. For further guidance, see §1.1502-32(b) through (b)(3)(ii)(B).

(C) *Discharge of indebtedness income—(I) In general.* Discharge of indebtedness income of S that is excluded from gross income under section 108 is treated as tax-exempt income only to the extent the discharge is applied to reduce tax attributes attributable to any member of the group under section 108, section 1017, or §1.1502-28T. If S is treated as realizing discharge of indebtedness income that is excluded from gross income pursuant to §1.1502-28T(a)(3), S shall not be treated as realizing excluded COD income for purposes of the preceding sentence.

(b)(3)(ii)(C)(2) through (b)(3)(ii)(D) [Reserved]. For further guidance, see §1.1502-32(b)(3)(ii)(C)(2) through (b)(3)(ii)(D).

(iii) *Noncapital, nondeductible expenses—(A) In general.* S's noncapital, nondeductible expenses are its deductions and losses that are taken into account but permanently disallowed or eliminated under applicable law in determining its taxable income or loss, and that decrease, directly or indirectly, the basis of its assets (or an equivalent amount). For example, S's Federal taxes described in section 275 and loss not recognized under section

311(a) are noncapital, nondeductible expenses. Similarly, if a loss carryover (e.g., under section 172 or 1212) attributable to S expires or is reduced under section 108(b) and §1.1502-28T, it becomes a noncapital, nondeductible expense at the close of the last tax year to which it may be carried. However, when a tax attribute attributable to S is reduced as required pursuant to §1.1502-28T(a)(3), the reduction of the tax attribute is not treated as a noncapital, nondeductible expense of S. Finally, if S sells and repurchases a security subject to section 1091, the disallowed loss is not a noncapital, nondeductible expense because the corresponding basis adjustments under section 1091(d) prevent the disallowance from being permanent.

(b)(3)(iii)(B) [Reserved]. For further guidance, see §1.1502-32(b)(3)(iii)(B).

(b)(3)(iii)(C) *Loss suspended under §1.1502-35T(c).* Any loss suspended pursuant to §1.1502-35T(c) is treated as a noncapital, nondeductible expense incurred during the taxable year that includes the date of the disposition to which such section applies. See §1.1502-35T(c)(3). Consequently, the basis of a higher-tier member's stock of P is reduced by the suspended loss in the year it is suspended.

(D) *Loss disallowed under §1.1502-35T(g)(3)(iii).* Any loss or deduction the use of which is disallowed pursuant to §1.1502-35T(g)(3)(iii) (other than a loss or deduction described in §1.1502-35T(g)(3)(i)(B)(I)), and with respect to which no waiver described in paragraph (b)(4) of this section is filed, is treated as a noncapital, nondeductible expense incurred during the taxable year that such loss would otherwise be absorbed. See §1.1502-35T(g)(3)(iv).

(b)(3)(iv) through (b)(4)(iv) [Reserved]. For further guidance, see §1.1502-32(b)(3)(iv) through (b)(4)(iv).

(b)(4)(v) *Special rule for loss carryovers of a subsidiary acquired in a transaction for which an election under §1.1502-20T(i)(2) is made—(A) Expired losses.* Notwithstanding §1.1502-32(b)(4)(iv), to the extent that S's loss carryovers are increased by reason of an election under §1.1502-20T(i)(2) and such loss carryovers expire or would have been properly used to offset income in a taxable year for which the refund of an

overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which S receives the notification described in §1.1502-20T(i)(3)(iv) and at all times thereafter, the group will be deemed to have made an election under §1.1502-32(b)(4) to treat all of such expired loss carryovers as expiring for all Federal income tax purposes immediately before S became a member of the consolidated group.

(B) *Available losses.* Notwithstanding §1.1502-32(b)(4)(iv), to the extent that S's loss carryovers are increased by reason of an election under §1.1502-20T(i)(2) and such loss carryovers have not expired and would not have been properly used to offset income in a taxable year for which the refund of an overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which S receives the notification described in §1.1502-20T(i)(3)(iv) and at all times thereafter, the group may make an election under §1.1502-32(b)(4) to treat all or a portion of such loss carryovers as expiring for all Federal income tax purposes immediately before S became a member of the consolidated group. Such election must be filed with the group's original return for the taxable year in which S receives the notification described in §1.1502-20T(i)(3)(iv).

(C) *Effective date.* This paragraph (b)(4)(v) is applicable on and after March 7, 2002.

(b)(4)(vi) *Special rules in the case of certain transactions subject to §1.1502-35T.* If a member of a consolidated group transfers stock of a subsidiary member and such stock has a basis that exceeds its value immediately before such transfer or a subsidiary member is deconsolidated and any stock of such subsidiary member owned by members of the group immediately before such deconsolidation has a basis that exceeds its value, all members of the group are subject to the provisions of §1.1502-35T(b), which generally require a redetermination of members' basis in all shares of subsidiary stock. In addition, if stock of a subsidiary member is treated as worthless under section 165 (taking into account the provisions of §1.1502-80(c)), or if a mem-

ber of a group disposes of subsidiary member stock and on the following day the subsidiary is not a member of the group and does not have a separate return year, and the common parent makes an election under §1.1502-35T(f)(2) to reattribute to itself the losses treated as attributable to such subsidiary member, §1.1502-35T(f)(2) requires a reduction of members' basis in shares of subsidiary stock.

(vii) *Special rules for amending waiver of loss carryovers from separate return limitation year—(A) Waivers that increased allowable loss or reduced basis reduction required.* If, in connection with the acquisition of S, the group made an election pursuant to §1.1502-32(b)(4) to treat all or any portion of S's loss carryovers as expiring, and the prior group elected to determine the amount of the allowable loss or the basis reduction required with respect to the stock of S or a higher-tier corporation of S by applying the provisions described in §1.1502-20T(i)(2)(i) or (ii), then the group may reduce the amount of any loss carryover deemed to expire (or increase the amount of any loss carryover deemed not to expire) as a result of the election made pursuant to §1.1502-32(b)(4). The aggregate amount of loss carryovers that may be treated as not expiring as a result of amendments made pursuant to this paragraph (b)(4)(vii)(A) with respect to S and any higher- and lower-tier corporation of S may not exceed the amount described in §1.1502-20(c)(1)(iii) with respect to the acquired stock (computed without regard to the effect of the group's election or elections pursuant to §1.1502-32(b)(4), but with regard to the effect of the prior group's election pursuant to §1.1502-20(g), if any, prior to the application of §1.1502-20T(i)(3)). For purposes of determining the aggregate amount of loss carryovers that may be treated as not expiring as a result of amendments made pursuant to this paragraph (b)(4)(vii)(A) with respect to S and any higher- and lower-tier corporation of S, the group may rely on a written notification provided by the prior group. Nothing in this paragraph shall be construed as permitting a group to increase the amount of any loss carryover deemed to expire (or reduce the amount of any loss carryover

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deemed not to expire) as a result of the election made pursuant to § 1.1502-32(b)(4).

(B) *Inadvertent waivers of loss carryovers previously subject to an election described in § 1.1502-20(g)*. If, in connection with the acquisition of S, the group made an election pursuant to § 1.1502-32(b)(4) to waive loss carryovers of S by identifying the amount of each loss carryover deemed not to expire, the prior group elected to determine the amount of the allowable loss or the basis reduction required with respect to the stock of S or a higher-tier corporation of S by applying the provisions described in § 1.1502-20T(i)(2)(i) or (ii), and the amount of S's loss carryovers treated as reattributed to the prior group pursuant to the election described in § 1.1502-20(g) is reduced pursuant to § 1.1502-20T(i)(3), then the group may amend its election made pursuant to § 1.1502-32(b)(4) to provide that all or a portion of the loss carryovers of S that are treated as loss carryovers of S as a result of the prior group's election to apply the provisions described in § 1.1502-20T(i)(2)(i) or (ii) are deemed not to expire. This paragraph (b)(4)(vii)(B), however, does not permit a group to reduce the amount of any loss carryover deemed not to expire as a result of the election made pursuant to § 1.1502-32(b)(4).

(C) *Time and manner of amending an election under § 1.1502-32(b)(4)*. The amendment of an election made pursuant to § 1.1502-32(b)(4) must be made in a statement entitled *Amendment of Election to Treat Loss Carryover as Expiring Under § 1.1502-32(b)(4) Pursuant to § 1.1502-32T(b)(4)(vii)*. The statement must be filed with or as part of any timely filed (including extensions) original return for the taxable year that includes May 7, 2003 or with or as part of an amended return filed before the date the original return for the taxable year that includes May 7, 2003 is due (with regard to extensions). A separate statement shall be filed for each election made pursuant to § 1.1502-32(b)(4) that is being amended pursuant to this paragraph (b)(4)(vii). For purposes of making this statement, the group may rely on the statements set forth in a written notification provided by the prior group. The statement filed

under this paragraph must include the following—

(1) The name and employer identification number (E.I.N.) of S;

(2) In the case of an amendment made pursuant to paragraph (b)(4)(vii)(A), a statement that the group has received a written notification from the prior group confirming that the group's prior election or elections pursuant to § 1.1502-32(b)(4) had the effect of either increasing the prior group's allowable loss on the disposition of subsidiary stock or reducing the prior group's amount of basis reduction required;

(3) The amount of each loss carryover of S deemed to expire (or the amount of loss carryover deemed not to expire) as set forth in the election made pursuant to § 1.1502-32(b)(4);

(4) The amended amount of each loss carryover of S deemed to expire (or the amended amount of loss carryover deemed not to expire); and

(5) In the case of an amendment made pursuant to paragraph (b)(4)(vii)(A) of this section, a statement that the aggregate amount of loss carryovers of S and any higher- and lower-tier corporation of S that will be treated as not expiring as a result of amendments made pursuant to paragraph (b)(4)(vii)(A) of this section will not exceed the amount described in § 1.1502-20(c)(1)(iii) with respect to the acquired stock (computed without regard to the effect of the group's election or elections pursuant to § 1.1502-32(b)(4), but with regard to the effect of the prior group's election pursuant to § 1.1502-20(g), if any, prior to the application of § 1.1502-20T(i)(3)).

(D) *Items taken into account in open years*. An amendment to an election made pursuant to § 1.1502-32(b)(4) affects the group's items of income, gain, deduction or loss only to the extent that the amendment gives rise, directly or indirectly, to items or amounts that would properly be taken into account in a year for which an assessment of deficiency or a refund for overpayment, as the case may be, is not prevented by any law or rule of law. Under this paragraph, if the year to which a loss previously deemed to expire as a result of an election made pursuant to § 1.1502-32(b)(4) is deemed not to expire as a result of an election made pursuant to this paragraph would

have been carried back or carried forward is a year for which a refund of overpayment is prevented by law, then to the extent that the absorption of such loss in such year would have affected the tax treatment of another item (e.g., another loss that was absorbed in such year) that has an effect in a year for which a refund of overpayment is not prevented by any law or rule of law, the amendment to the election made pursuant to § 1.1502-32(b)(4) will affect the treatment of such other item. Therefore, if the absorption of such loss (the first loss) in a year for which a refund of overpayment is prevented by law would have prevented the absorption of another loss (the second loss) in such year and such second loss would have been carried to and used in a year for which a refund of overpayment is not prevented by any law or rule of law (the other year), the amendment of the election makes the second loss available for use in the other year.

(E) *Higher- and lower-tier corporations of S.* A higher-tier corporation of S is a corporation that was a member of the prior group and, as a result of such higher-tier corporation becoming a member of the group, S became a member of the group. A lower-tier corporation of S is a corporation that was a member of the prior group and became a member of the group as a result of S becoming a member of the group.

(F) *Effective date.* This paragraph (b)(4)(vii) is applicable on and after May 7, 2003.

(b)(5)(i) through (b)(5)(ii), *Example 3* [Reserved]. For further guidance, see § 1.1502-32(b)(5)(i) through (b)(5)(ii), *Example 3*.

*Example 4. Discharge of indebtedness.* (a) *Facts.* P forms S on January 1 of Year 1 and S borrows \$200. During Year 1, S's assets decline in value and the P group has a \$100 consolidated net operating loss. Of that amount, \$10 is attributable to P and \$90 is attributable to S under the principles of § 1.1502-21T(b)(2)(iv). None of the loss is absorbed by the group in Year 1, and S is discharged from \$100 of indebtedness at the close of Year 1. P has a \$0 basis in the S stock. P and S have no attributes other than the consolidated net operating loss. Under section 108(a), S's \$100 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and § 1.1502-28T,

the consolidated net operating loss is reduced to \$0.

(b) *Analysis.* Under § 1.1502-32(b)(3)(iii)(B), the reduction of \$90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense in Year 1 because that loss is permanently disallowed by section 108(b) and § 1.1502-28T. Under paragraph (b)(3)(ii)(C)(I) of this section, all \$100 of S's discharge of indebtedness income is treated as tax-exempt income in Year 1 because the discharge results in a \$100 reduction to the consolidated net operating loss. Consequently, the loss and the cancellation of the indebtedness result in a net positive \$10 adjustment to P's basis in its S stock.

(c) *Insufficient attributes.* The facts are the same as in paragraph (a) of this *Example 4*, except that S is discharged from \$120 of indebtedness at the close of Year 1. Under section 108(a), S's \$120 of discharge of indebtedness income is excluded from gross income because of insolvency. Under section 108(b) and § 1.1502-28T, the consolidated net operating loss is reduced to \$0 at the close of Year 1. Under § 1.1502-32(b)(3)(iii)(B), the reduction of \$90 of the consolidated net operating loss attributable to S is treated as a noncapital, nondeductible expense. Under paragraph (b)(3)(ii)(C)(I) of this section, only \$100 of the discharge is treated as tax-exempt income because only that amount is applied to reduce tax attributes. The remaining \$20 of discharge income excluded under section 108(a) has no effect on P's basis in S's stock.

(b)(5)(ii), *Example 4*(d) through (h)(5)(ii) [Reserved]. For further guidance, see § 1.1502-32(b)(5)(ii), *Example 4*(d) through (h)(5)(ii).

(h)(6) *Loss suspended under § 1.1502-35T(c) or disallowed under § 1.1502-35T(g)(3)(iii).* Paragraphs (a)(2), (b)(3)(iii)(C), (b)(3)(iii)(D) and (b)(4)(vi) of this section are effective on and after March 7, 2002, and expire on March 11, 2006.

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

and (c), of this section without regard to the references to §1.1502-28T or, alternatively, apply paragraphs (b)(3)(ii)(C)(I), (b)(3)(iii)(A), and (b)(5)(ii), *Example 4*, paragraphs (a), (b), and (c), of §1.1502-32 as contained in 26 CFR part 1 edition revised as of April 1, 2003.

[T.D. 9048, 68 FR 11291, Mar. 14, 2003; 68 FR 16431, Apr. 4, 2003; T.D. 9057, 68 FR 24354, May 7, 2003; T.D. 9089, 68 FR 52495, Sept. 4, 2003]

### § 1.1502-33 Earnings and profits.

(a) *In general*—(1) *Purpose*. This section provides rules for adjusting the earnings and profits of a subsidiary (S) and any member (P) owning S's stock. These rules modify the determination of P's earnings and profits under applicable rules of law, including section 312, by adjusting P's earnings and profits to reflect S's earnings and profits for the period that S is a member of the consolidated group. The purpose for modifying the determination of earnings and profits is to treat P and S as a single entity by reflecting the earnings and profits of lower-tier members in the earnings and profits of higher-tier members and consolidating the group's earnings and profits in the common parent. References in this section to earnings and profits include deficits in earnings and profits.

(2) *Application of other rules of law*. The rules of this section are in addition to other rules of law. For example, the allowance for depreciation is determined in accordance with section 312(k). P's earnings and profits must not be adjusted under this section and other rules of law in a manner that has the effect of duplicating an adjustment. For example, if S's earnings and profits are reflected in P's earnings and profits under paragraph (b) of this section, and S transfers its assets to P in a liquidation to which section 332 applies, S's earnings and profits that P succeeds to under section 381 must be adjusted to prevent duplication.

(b) *Tiering up earnings and profits*—(1) *General rule*. P's earnings and profits are adjusted under this section to reflect changes in S's earnings and profits in accordance with the applicable principles of §1.1502-32, consistently applied, and an adjustment to P's earnings and profits for a tax year under

this paragraph (b)(1) is treated as earnings and profits of P for the tax year in which the adjustment arises. Under these principles, for example, the adjustments are made as of the close of each consolidated return year, and as of any other time if a determination at that time is necessary to determine the earnings and profits of any person. Similarly, S's earnings and profits are allocated under the principles of §1.1502-32(c), and the adjustments are applied in the order of the tiers, from the lowest to the highest. However, modifications to the principles include:

(i) The amount of P's adjustment is determined by reference to S's earnings and profits, rather than S's taxable and tax-exempt items (and therefore, for example, the deferral of a negative adjustment for S's unabsorbed losses does not apply).

(ii) The tax sharing rules under paragraph (d) of this section apply rather than those of §1.1502-32(b)(3)(iv)(D).

(2) *Affiliated earnings and profits*. The reduction in S's earnings and profits under section 312 from a distribution of earnings and profits accumulated in separate return years of S that are not separate return limitation years does not tier up to P's earnings and profits. Thus, the increase in P's earnings and profits under section 312 from receipt of the distribution is not offset by a corresponding reduction.

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

(ii) *Tiering up earnings and profits*. The principles of this paragraph (b) are illustrated by the following examples.

*Example 1. Tier-up and distribution of earnings and profits.* (a) *Facts*. P forms S in Year 1 with a \$100 contribution. S has \$100 of earnings and profits for Year 1 and no earnings and profits for Year 2. During Year 2, S declares and distributes a \$50 dividend to P.