

§ 1.1502-34

structure changes occurring in consolidated return years beginning on or after January 1, 1995.

(ii) *Prior period group structure changes.* If there was a group structure change in a consolidated return year beginning before January 1, 1995, and earnings and profits were not determined under §1.1502-33T(a) as contained in the 26 CFR part 1 edition revised as of April 1, 1994, a distribution in a tax year ending after September 7, 1988, of earnings and profits that are not reflected in the earnings and profits of the distributee member, but would have been so reflected if §1.1502-33T(a) as contained in the 26 CFR part 1 edition revised as of April 1, 1994 had applied, the negative adjustment under paragraph (b) of this section for distributions does not apply (and there is therefore no offset to the increase in the earnings and profits of the distributee).

(4) *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.

(5) *Prior law.* For prior determinations, see prior regulations under section 1502 as in effect with respect to the determination. See, e.g., §§1.1502-33 and 1.1502-33T as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

[T.D. 8560, 59 FR 41695, Aug. 15, 1994, as amended by T.D. 8597, 60 FR 36710, July 18, 1995]

§ 1.1502-34 Special aggregate stock ownership rules.

For purposes of §§1.1502-1 through 1.1502-80, in determining the stock ownership of a member of a group in another corporation (the "issuing corporation") for purposes of determining the application of section 165(g)(3)(A), 332(b)(1), 333(b), 351(a), 732(f), or 904(f), in a consolidated return year, there shall be included stock owned by all other members of the group in the issuing corporation. Thus, assume that

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members A, B, and C each own 33⅓ percent of the stock issued by D. In such case, A, B, and C shall each be treated as meeting the 80-percent stock ownership requirement for purposes of section 332, and no member can elect to have section 333 apply. Furthermore, the special rule for minority shareholders in section 337(d) cannot apply with respect to amounts received by A, B, or C in liquidation of D.

[T.D. 6894, 31 FR 11794, Sept. 8, 1966, as amended by T.D. 8949, 66 FR 32902, June 19, 2001]

§ 1.1502-35T Transfers of subsidiary member stock and deconsolidations of subsidiary members (temporary).

(a) *Purpose.* The purpose of this section is to prevent a group from obtaining more than one tax benefit from a single economic loss. The provisions of this section shall be construed in a manner consistent with that purpose and in a manner that reasonably carries out that purpose.

(b) *Redetermination of basis on certain nondeconsolidating transfers of subsidiary member stock and on certain deconsolidations of subsidiary members—*

(1) *Redetermination of basis on certain nondeconsolidating transfers of subsidiary member stock.* Except as provided in paragraph (b)(3)(i) of this section, if, immediately after a transfer of stock of a subsidiary member that has a basis that exceeds its value, the subsidiary member remains a member of the group, then the basis in each share of subsidiary member stock owned by each member of the group shall be redetermined in accordance with the provisions of this paragraph (b)(1) immediately before such transfer. All of the members' bases in the shares of subsidiary member stock immediately before such transfer shall be aggregated. Such aggregated basis shall be allocated first to the shares of the subsidiary member's preferred stock that are owned by the members of the group immediately before such transfer, in proportion to, but not in excess of, the value of those shares at such time. After allocation of the aggregated basis to all shares of the preferred stock of the subsidiary member pursuant to the preceding sentence, any remaining

basis shall be allocated among all common shares of subsidiary member stock held by members of the group immediately before the transfer, in proportion to the value of such shares at such time.

(2) *Redetermination of basis on certain deconsolidations of subsidiary members—*

(i) *Allocation of reallocable basis amount.*

Except as provided in paragraph (b)(3)(ii) of this section, if, immediately before a deconsolidation of a subsidiary member, any share of stock of such subsidiary owned by a member of the group has a basis that exceeds its value, then the basis in each share of the subsidiary member's stock owned by each member of the group shall be redetermined in accordance with the provisions of this paragraph (b)(2) immediately before such deconsolidation. The basis in each share of the subsidiary member's stock held by members of the group immediately before the deconsolidation that has a basis in excess of value at such time shall be reduced, but not below such share's value, in a manner that, to the greatest extent possible, causes the ratio of the basis to the value of each such share to be the same; provided, however, that the aggregate amount of such reduction shall not exceed the reallocable basis amount (as computed pursuant to paragraph (b)(2)(ii) of this section). Then, to the extent of the reallocable basis amount, the basis of each share of the preferred stock of the subsidiary member that are held by members of the group immediately before the deconsolidation shall be increased, but not above such share's value, in a manner that, to the greatest extent possible, causes the ratio of the basis to the value of each such share to be the same. Then, to the extent that the reallocable basis amount does not increase the basis of shares of preferred stock of the subsidiary member pursuant to the third sentence of this paragraph (b)(2)(i), such amount shall increase the basis of all common shares of the subsidiary member's stock held by members of the group immediately before the deconsolidation in a manner that, to the greatest extent possible, causes the ratio of the basis to the value of each such share to be the same.

(ii) *Calculation of reallocable basis amount.* The reallocable basis amount shall equal the lesser of—

(A) The aggregate of all amounts by which, immediately before the deconsolidation, the basis exceeds the value of a share of subsidiary member stock owned by any member of the group at such time; and

(B) The total of the subsidiary member's (and any predecessor's) items of deduction and loss, and the subsidiary member's (and any predecessor's) allocable share of items of deduction and loss of all lower-tier subsidiary members, that were taken into account in computing the adjustment under §1.1502-32 to the bases of shares of stock of the subsidiary member (and any predecessor) held by members of the group immediately before the deconsolidation, other than shares that have bases in excess of value immediately before the deconsolidation.

(3) *Exceptions to application of redetermination rules.* (i) Paragraph (b)(1) of this section shall not apply to a transfer of subsidiary member stock if—

(A) During the taxable year of such transfer, in one or more fully taxable transactions, the members of the group dispose of all of the shares of the subsidiary member stock that they own immediately before the transfer, other than the shares the transfer of which would otherwise trigger the application of paragraph (b)(1) of this section, to a person or persons that are not members of the group;

(B) During the taxable year of such transfer, the members of the group are allowed a worthless stock loss under section 165(g) (taking into account the provisions of §1.1502-80(c)) with respect to all of the shares of subsidiary member stock that they own immediately before the transfer, other than the shares the transfer of which would otherwise trigger the application of paragraph (b)(1) of this section; or

(C) Such transfer is to a member of the group and section 332 (provided the stock is transferred to an 80-percent distributee), section 351, section 354, or section 361 applies to such transfer.

(ii) Paragraph (b)(2) of this section shall not apply to a deconsolidation of a subsidiary member if—

(A) During the taxable year of such deconsolidation, in one or more fully taxable transactions, the members of the group dispose of all of the shares of the subsidiary member stock that they own immediately before the deconsolidation to a person or persons that are not members of the group;

(B) Such deconsolidation results from a fully taxable disposition, to a person or persons that are not members of the group, of some of the shares of the subsidiary member, and, during the taxable year of such deconsolidation, the members of the group are allowed a worthless stock loss under section 165(g) with respect to all of the shares of the subsidiary member stock that they own immediately after the deconsolidation;

(C) The members of the group are allowed a worthless stock loss under section 165(g) with respect to all of the shares of the subsidiary member stock that they own immediately before the deconsolidation;

(D) The deconsolidation of the subsidiary member results from the deconsolidation of a higher-tier subsidiary member and, immediately after the deconsolidation of the subsidiary member, none of the stock of the subsidiary member is owned by a group member; or

(E) The deconsolidation of the subsidiary member results from a termination of the group.

(4) *Special rule for lower-tier subsidiaries.* If, immediately after a transfer of subsidiary member stock or a deconsolidation of a subsidiary member, a lower-tier subsidiary member some of the stock of which is owned by the subsidiary member is a member of the group, then, for purposes of applying paragraph (b) of this section, the subsidiary member shall be treated as having transferred its stock of the lower-tier subsidiary member. This principle shall apply to stock of subsidiary members that are owned by such lower-tier subsidiary member.

(5) *Stock basis adjustments for higher-tier stock.* The basis adjustments required under this paragraph (b) result in basis adjustments to higher-tier member stock. The adjustments are applied in the order of the tiers, from the lowest to highest. For example, if a

common parent owns stock of a subsidiary member that owns stock of a lower-tier subsidiary member and the subsidiary member recognizes a loss on the disposition of a portion of its shares of the lower-tier subsidiary member stock, the common parent must adjust its basis in its subsidiary member stock under the principles of § 1.1502-32 to reflect the adjustments that the subsidiary member must make to its basis in its stock of the lower-tier subsidiary member.

(6) *Ordering rules.* (i) The rules of this paragraph (b) apply after the rules of § 1.1502-32 are applied.

(ii) The rules of this paragraph (b) apply before the rules of § 1.337(d)-2T and paragraphs (c) and (f) of this section are applied.

(iii) Paragraph (b) of this section (and any resulting basis adjustments to higher-tier member stock made pursuant to paragraph (b)(5) of this section) applies to redetermine the basis of stock of a lower-tier subsidiary member before paragraph (b) of this section applies to a higher-tier member of such lower-tier subsidiary member.

(c) *Loss suspension—(1) General rule.* Any loss recognized by a member of a consolidated group with respect to the disposition of a share of subsidiary member stock shall be suspended to the extent of the duplicated loss with respect to such share of stock if, immediately after the disposition, the subsidiary is a member of the consolidated group of which it was a member immediately prior to the disposition (or any successor group).

(2) *Special rule for lower-tier subsidiaries.* This paragraph (c)(2) applies if neither paragraph (c)(1) nor (f) of this section applies to a member's disposition of a share of stock of a subsidiary member (the departing member), a loss is recognized on the disposition of such share, and the departing member owns stock of one or more other subsidiary members (a remaining member) that is a member of such group immediately after the disposition. In that case, such loss shall be suspended to the extent the duplicated loss with respect to the departing member stock disposed of is attributable to the remaining member or members.

(3) *Treatment of suspended loss.* For purposes of the rules of § 1.1502-32, any loss suspended pursuant to paragraph (c)(1) or (c)(2) of this section is treated as a noncapital, nondeductible expense of the member that disposes of subsidiary member stock, incurred during the taxable year that includes the date of the disposition of stock to which paragraph (c)(1) or (c)(2) of this section applies. See § 1.1502-32T(b)(3)(iii)(C). Consequently, the basis of a higher-tier member's stock of the member that disposes of subsidiary member stock is reduced by the suspended loss in the year it is suspended.

(4) *Reduction of suspended loss—(i) General rule.* The amount of any loss suspended pursuant to paragraphs (c)(1) and (c)(2) of this section shall be reduced, but not below zero, by the subsidiary member's (and any successor's) items of deduction and loss, and the subsidiary member's (and any successor's) allocable share of items of deduction and loss of all lower-tier subsidiary members, that are allocable to the period beginning on the date of the disposition that gave rise to the suspended loss and ending on the day before the first date on which the subsidiary member (or any successor) is not a member of the group of which it was a member immediately prior to the disposition (or any successor group), and that are taken into account in determining consolidated taxable income (or loss) of such group for any taxable year that includes any date on or after the date of the disposition and before the first date on which the subsidiary member (or any successor) is not a member of such group; provided, however, that such reduction shall not exceed the excess of the amount of such items over the amount of such items that are taken into account in determining the basis adjustments made under § 1.1502-32 to stock of the subsidiary member (or any successor) owned by members of the group. The preceding sentence shall not apply to items of deduction and loss to the extent that the group can establish that all or a portion of such items was not reflected in the computation of the duplicated loss with respect to the subsidiary member on the

date of the disposition of stock that gave rise to the suspended loss.

(ii) *Operating rules—(A) Year in which deduction or loss is taken into account.* For purposes of paragraph (c)(4)(i) of this section, a subsidiary member's (or any successor's) deductions and losses are treated as taken into account when and to the extent they are absorbed by the subsidiary member (or any successor) or any other member. To the extent that the subsidiary member's (or any successor's) deduction or loss is absorbed in the year it arises or is carried forward and absorbed in a subsequent year (e.g., under section 172, 465, or 1212), the deduction is treated as taken into account in the year in which it is absorbed. To the extent that a subsidiary member's (or any successor's) deduction or loss is carried back and absorbed in a prior year (whether consolidated or separate), the deduction or loss is treated as taken into account in the year in which it arises and not in the year in which it is absorbed.

(B) *Determination of items that are allocable to the post-disposition, pre-deconsolidation period.* For purposes of paragraph (c)(4)(i) of this section, the determination of whether a subsidiary member's (or any successor's) items of deduction and loss and allocable share of items of deduction and loss of all lower-tier subsidiary members are allocable to the period beginning on the date of the disposition of subsidiary stock that gave rise to the suspended loss and ending on the day before the first date on which the subsidiary member (or any successor) is not a member of the consolidated group of which it was a member immediately prior to the disposition (or any successor group) is determined pursuant to the rules of § 1.1502-76(b)(2), without regard to § 1.1502-76(b)(2)(ii)(D), as if the subsidiary member ceased to be a member of the group at the end of the day before the disposition and filed separate returns for the period beginning on the date of the disposition and ending on the day before the first date on which it is not a member of such group.

(5) *Allowable loss—(i) General rule.* To the extent not reduced under paragraph (c)(4) of this section, any loss

suspended pursuant to paragraph (c)(1) or (c)(2) of this section shall be allowed, to the extent otherwise allowable under applicable provisions of the Internal Revenue Code and regulations thereunder, on a return filed by the group of which the subsidiary was a member on the date of the disposition of subsidiary stock that gave rise to the suspended loss (or any successor group) for the taxable year that includes the day before the first date on which the subsidiary (and any successor) is not a member of such group or the date the group is allowed a worthless stock loss under section 165(g) (taking into account the provisions of § 1.1502-80(c)) with respect to all of the subsidiary member stock owned by members.

(ii) *No tiering up of certain adjustments.* No adjustments shall be made to a member's basis of stock of a subsidiary member (or any successor) for a suspended loss that is taken into account under paragraph (c)(5)(i) of this section. See § 1.1502-32T(a)(2).

(iii) *Statement of allowed loss.* Paragraph (c)(5)(i) of this section applies only if the separate statement required under this paragraph (c)(5)(iii) is filed with, or as part of, the taxpayer's return for the year in which the loss is allowable. The statement must be entitled "ALLOWED LOSS UNDER § 1.1502-35T(c)(5)" and must contain the name and employer identification number of the subsidiary the stock of which gave rise to the loss.

(6) *Special rule for dispositions of certain carryover basis assets.* If—

(i) A member of a group recognizes a loss on the disposition of an asset other than stock of a subsidiary member;

(ii) Such member's basis in the asset disposed of was determined, directly or indirectly, in whole or in part, by reference to the basis of stock of a subsidiary member and, at the time of the determination of the member's basis in the asset disposed of, there was a duplicated loss with respect to such stock of the subsidiary member; and

(iii) Immediately after the disposition, the subsidiary member is a member of such group, then such loss shall be suspended pursuant to the principles of paragraphs (c)(1) and (c)(2) of this section to the extent of the duplicated

loss with respect to such stock at the time of the determination of basis of the asset disposed of. Principles similar to those set forth in paragraphs (c)(3), (c)(4), and (c)(5) of this section shall apply to a loss suspended pursuant to this paragraph (c)(6).

(7) *Coordination with loss deferral, loss disallowance, and other rules—(i) In general.* Loss recognized on the disposition of subsidiary member stock or another asset is subject to redetermination, deferral, or disallowance under other applicable provisions of the Internal Revenue Code and regulations thereunder, including sections 267(f) and 482. Paragraphs (c)(1), (c)(2), and (c)(6) of this section do not apply to a loss that is disallowed under any other provision. If loss is deferred under any other provision, paragraphs (c)(1), (c)(2), and (c)(6) of this section apply when the loss would otherwise be taken into account under such other provision. However, if an overriding event described in paragraph (c)(7)(ii) of this section occurs before the deferred loss is taken into account, paragraphs (c)(1), (c)(2), and (c)(6) of this section apply to the loss immediately before the event occurs, even though the loss may not be taken into account until a later time.

(ii) *Overriding events.* For purposes of paragraph (c)(7)(i) of this section, the following are overriding events—

(A) The stock ceases to be owned by a member of the consolidated group;

(B) The stock is canceled or redeemed (regardless of whether it is retired or held as treasury stock); or

(C) The stock is treated as disposed of under § 1.1502-19(c)(1)(ii)(B) or (c)(1)(iii).

(8) *Application.* This paragraph (c) shall not be applied in a manner that permanently disallows a deduction for an economic loss, provided that such deduction is otherwise allowable. If the application of any provision of this paragraph (c) results in such a disallowance, proper adjustment may be made to prevent such a disallowance. Whether a provision of this paragraph (c) has resulted in such a disallowance is determined on the date on which the subsidiary (or any successor) the disposition of the stock of which gave rise to a suspended stock loss is not a member of the group or the date the group

is allowed a worthless stock loss under section 165(g) (taking into account the provisions of §1.1502-80(c)) with respect to all of such subsidiary member stock owned by members. Proper adjustment in such cases shall be made by restoring the suspended stock loss immediately before the subsidiary ceases to be a member of the group or the group is allowed a worthless stock loss under section 165(g) (taking into account the provisions of §1.1502-80(c)) with respect to all of such subsidiary member stock owned by members, to the extent that its reduction pursuant to paragraph (c)(4) of this section had the result of permanently disallowing a deduction for an economic loss.

(9) *Ordering rule.* The rules of this paragraph (c) apply after the rules of paragraph (b) of this section and §1.337(d)-2T are applied.

(d) *Definitions*—(1) *Disposition.* *Disposition* means any event in which gain or loss is recognized, in whole or in part.

(2) *Deconsolidation.* *Deconsolidation* means any event that causes a subsidiary member to no longer be a member of the consolidated group.

(3) *Value.* *Value* means fair market value.

(4) *Duplicated loss*—(i) *In general.* Duplicated loss is determined immediately after a disposition and equals the excess, if any, of—

(A) The sum of—

(1) The aggregate adjusted basis of the subsidiary member's assets other than any stock that subsidiary member owns in another subsidiary member; and

(2) Any losses attributable to the subsidiary member and carried to the subsidiary member's first taxable year following the disposition; and

(3) Any deductions of the subsidiary member that have been recognized but are deferred under a provision of the Internal Revenue Code (such as deductions deferred under section 469); over

(B) The sum of—

(1) The value of the subsidiary member's stock; and

(2) Any liabilities of the subsidiary member that have been taken account for tax purposes.

(ii) *Special rules.* (A) The amounts determined under paragraph (d)(4)(i) (other than amounts described in para-

graph (d)(4)(i)(B)(1)) of this section with respect to a subsidiary member include its allocable share of corresponding amounts with respect to all lower-tier subsidiary members. If 80 percent or more in value of the stock of a subsidiary member is acquired by purchase in a single transaction (or in a series of related transactions during any 12-month period), the value of the subsidiary member's stock may not exceed the purchase price of the stock divided by the percentage of the stock (by value) so purchased. For this purpose, stock is acquired by purchase if the transferee is not related to the transferor within the meaning of sections 267(b) and 707(b)(1), using the language "10 percent" instead of "50 percent" each place that it appears, and the transferee's basis in the stock is determined wholly by reference to the consideration paid for such stock.

(B) The amounts determined under paragraph (d)(4)(i) of this section are not applied more than once to suspend a loss under this section.

(5) *Predecessor and Successor.* A predecessor is a transferor of assets to a transferee (the successor) in a transaction—

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

(ii) In which substantially all of the assets of the transferor are transferred to members in a complete liquidation;

(iii) In which the successor's basis in assets is determined (directly or indirectly, in whole or in part) by reference to the transferor's basis in such assets, but the transferee is a successor only with respect to the assets the basis of which is so determined; or

(iv) Which is an intercompany transaction, but only with respect to assets that are being accounted for by the transferor in a prior intercompany transaction.

(6) *Successor group.* A surviving group is treated as a successor group of a consolidated group (the terminating group) that ceases to exist as a result of—

(i) The acquisition by a member of another consolidated group of either the assets of the common parent of the terminating group in a reorganization described in section 381(a)(2), or the stock of the common parent of the terminating group; or

(ii) The application of the principles of § 1.1502-75(d)(2) or (3).

(7) *Preferred stock, common stock.* Preferred stock and common stock shall have the meanings set forth in § 1.1502-32(d)(2) and (3), respectively.

(8) *Higher-tier.* A subsidiary member is *higher-tier* with respect to a member if or to the extent investment basis adjustments under § 1.1502-32 with respect to the stock of the latter member would affect investment basis adjustments with respect to the stock of the former member.

(9) *Lower-tier.* A subsidiary member is *lower-tier* with respect to a member if or to the extent investment basis adjustments under § 1.1502-32 with respect to the stock of the former member would affect investment basis adjustments with respect to the stock of the latter member.

(e) *Examples.* For purposes of the examples in this section, unless otherwise stated, all groups file consolidated returns on a calendar-year basis, the facts set forth the only corporate activity, all transactions are between unrelated persons, and tax liabilities are disregarded. The principles of paragraphs (a) through (d) of this section are illustrated by the following examples:

Example 1. Nondeconsolidating sale of preferred stock of lower-tier subsidiary member. (i) *Facts.* P owns 100 percent of the common stock of each of S1 and S2. S1 and S2 each have only one class of stock outstanding. P's basis in the stock of S1 is \$100 and the value of such stock is \$130. P's basis in the stock of S2 is \$120 and the value of such stock is \$90. P, S1, and S2 are all members of the P group. S1 and S2 form S3. In Year 1, in transfers to which section 351 applies, S1 contributes \$100 to S3 in exchange for all of the common stock of S3 and S2 contributes an asset with a basis of \$50 and a value of \$20 to S3 in exchange for all of the preferred stock of S3. S3 becomes a member of the P group. In Year 3, in a transaction that is not part of the plan that includes the contributions to S3, S2 sells the preferred stock of S3 for \$20. Immediately after the sale, S3 is a member of the P group.

(ii) *Application of basis redetermination rule.* Because S2's basis in the preferred stock of S3 exceeds its value immediately prior to the sale and S3 is a member of the P group immediately after the sale, all of the P group members' bases in the stock of S3 is redetermined pursuant to paragraph (b)(1) of this section. Of the group members' total basis of

\$150 in the S3 stock, \$20 is allocated to the preferred stock, the fair market value of the preferred stock on the date of the sale, and \$130 is allocated to the common stock. S2's sale of the preferred stock results in the recognition of \$0 of gain/loss. Pursuant to paragraph (b)(5) of this section, the redetermination of S1's and S2's bases in the stock of S3 results in adjustments to P's basis in the stock of S1 and S2. In particular, P's basis in the stock of S1 is increased by \$30 to \$130 and its basis in the stock of S2 is decreased by \$30 to \$90.

Example 2. Deconsolidating sale of common stock. (i) *Facts.* In Year 1, in a transfer to which section 351 applies, P contributes Asset A with a basis of \$900 and a value of \$200 to S in exchange for one share of S common stock (CS1). In Years 2 and 3, in successive but unrelated transfers to which section 351 applies, P transfers \$200 to S in exchange for one share of S common stock (CS2), Asset B with a basis of \$300 and a value of \$200 in exchange for one share of S common stock (CS3), and Asset C with a basis of \$1000 and a value of \$200 in exchange for one share of S common stock (CS4). In Year 4, S sells Asset A for \$200, recognizing \$700 of loss that is used to offset income of P recognized during Year 4. As a result of the sale of Asset A, the basis of each of P's four shares of S common stock is reduced by \$175. Therefore, the basis of CS1 is \$725. The basis of CS2 is \$25. The basis of CS3 is \$125, and the basis of CS4 is \$825. In Year 5 in a transaction that is not part of a plan that includes the Year 1 contribution, P sells CS4 for \$200. Immediately after the sale of CS4, S is not a member of the P group.

(ii) *Application of basis redetermination rule.* Because P's basis in each of CS1 and CS4 exceeds its value immediately prior to the deconsolidation of S, P's basis in its shares of S common stock is redetermined pursuant to paragraph (b)(2) of this section. Pursuant to paragraph (b)(2)(ii) of this section, the reallocable basis amount is \$350 (the lesser of \$1150, the gross loss inherent in the stock of S owned by P immediately before the sale, and \$350, the aggregate amount of S's items of deduction and loss that were previously taken into account in the computation of the adjustment to the basis of the stock of S that P did not hold at a loss immediately before the deconsolidation). Pursuant to paragraph (b)(2)(i) of this section, first, P's basis in CS1 is reduced from \$725 to \$600 and P's basis in CS4 is reduced from \$825 to \$600. Then, the reallocable basis amount increases P's basis in CS2 from \$25 to \$250 and P's basis in CS3 from \$125 to \$250. P recognizes \$400 of loss on the sale of CS4. The loss suspension rule does not apply because S is no longer a member of the P group. Thus, the loss is allowable at that time.

Example 3. Nondeconsolidating sale of common stock. (i) *Facts.* In Year 1, P forms S with a contribution of \$80 in exchange for 80 shares of the common stock of S, which at that time represents all of the outstanding stock of S. S becomes a member of the P group. In Year 2, P contributes Asset A with a basis of \$50 and a value of \$20 in exchange for 20 shares of the common stock of S in a transfer to which section 351 applies. In Year 3, in a transaction that is not part of the plan that includes the Year 2 contribution, P sells the 20 shares of the common stock of S that it acquired in Year 2 for \$20. Immediately after the Year 3 stock sale, S is a member of the P group. At the time of the Year 3 stock sale, S has \$80 and Asset A. In Year 4, S sells Asset A, the basis and value of which have not changed since its contribution to S. On the sale of Asset A for \$20, S recognizes a \$30 loss. The P group cannot establish that all or a portion of the \$30 loss was not reflected in the calculation of the duplicated loss of S on the date of the Year 3 stock sale. The \$30 loss is used on the P group return to offset income of P. In Year 5, P sells its remaining S common stock for \$80.

(ii) *Application of basis redetermination and loss suspension rules.* Because P's basis in the common stock sold exceeds its value immediately prior to the sale and S is a member of the P group immediately after the sale, P's basis in all of the stock of S is redetermined pursuant to paragraph (b)(1) of this section. Of P's total basis of \$130 in the S common stock, a proportionate amount is allocated to each of the 100 shares of S common stock. Accordingly, \$26 is allocated to the common stock of S that is sold and \$104 is allocated to the common stock of S that is retained. On P's sale of the 20 shares of the common stock of S for \$20, P recognizes a loss of \$6. Because the sale of the 20 shares of common stock of S does not result in the deconsolidation of S, under paragraph (c)(1) of this section, that loss is suspended to the extent of the duplicated loss with respect to the shares sold. The duplicated loss with respect to the shares sold is \$6. Therefore, the entire \$6 loss is suspended.

(iii) *Effect of subsequent asset sale on stock basis.* Of the \$30 loss recognized on the sale of Asset A, \$24 is taken into account in determining the basis adjustments made under § 1.1502-32 to the stock of S owned by P. Accordingly, P's basis in its S stock is reduced by \$24 from \$104 to \$80.

(iv) *Effect of subsequent asset sale on suspended loss.* Because P cannot establish that all or a portion of the loss recognized on the sale of Asset A was not reflected in the calculation of the duplicated loss of S on the date of the Year 3 stock sale and such loss is allocable to the period beginning on the date of the Year 3 disposition of the S stock and ending on the day before the first date on

which S is not a member of the P group and is taken into account in determining consolidated taxable income (or loss) of the P group for a taxable year that includes a date on or after the date of the Year 3 disposition and before the first date on which S is not a member of the P group, such asset loss reduces the suspended loss pursuant to paragraph (c)(4) of this section. The amount of such reduction, however, cannot exceed \$6, the excess of the amount of such loss, \$30, over the amount of such loss that is taken into account in determining the basis adjustment made to the stock of S owned by P, \$24. Therefore, the suspended loss is reduced to zero.

(v) *Effect of subsequent stock sale.* P recognizes \$0 gain/loss on the Year 5 sale of its remaining S common stock. No amount of suspended loss remains to be allowed under paragraph (c)(5) of this section.

Example 4. Nondeconsolidating sale of common stock of lower-tier subsidiary. (i) *Facts.* In Year 1, P forms S1 with a contribution of \$200 in exchange for all of the common stock of S1, which represents all of the outstanding stock of S1. In the same year, S1 forms S2 with a contribution of \$80 in exchange for 80 shares of the common stock of S2, which at that time represents all of the outstanding stock of S2. S1 and S2 become members of the P group. In the same year, S2 purchases Asset A for \$80. In Year 2, S1 contributes Asset B with a basis of \$50 and a value of \$20 in exchange for 20 shares of the common stock of S2 in a transfer to which section 351 applies. In Year 3, S1 sells the 20 shares of the common stock of S2 that it acquired in Year 2 for \$20. Immediately after the Year 3 stock sale, S2 is a member of the P group. At the time of the Year 3 stock sale, the bases and values of Asset A and Asset B are unchanged. In Year 4, S2 sells Asset B for \$45, recognizing a \$5 loss. The P group cannot establish that all or a portion of the \$5 loss was not reflected in the calculation of the duplicated loss of S2 on the date of the Year 3 stock sale. The \$5 loss is used on the P group return to offset income of P. In Year 5, S1 sells its remaining S2 common stock for \$100.

(ii) *Application of basis redetermination and loss suspension rules.* Because S1's basis in the S2 common stock sold exceeds its value immediately prior to the sale and S2 is a member of the P group immediately after the sale, S1's basis in all of the stock of S2 is redetermined pursuant to paragraph (b)(1) of this section. Of S1's total basis of \$130 in the S2 common stock, a proportionate amount is allocated to each of the 100 shares of S2 common stock. Accordingly, a total of \$26 is allocated to the common stock of S2 that is sold and \$104 is allocated to the common stock of S2 that is retained. On S1's sale of the 20 shares of the common stock of S2 for \$20, S1 recognizes a loss of \$6. Because the sale of the 20 shares of common stock of S2 does not

result in the deconsolidation of S2, under paragraph (c)(1) of this section, that loss is suspended to the extent of the duplicated loss with respect to the shares sold. The duplicated loss with respect to the shares sold is \$6. Therefore, the entire \$6 loss is suspended. Pursuant to paragraph (c)(3) of this section and §1.1502-32T(b)(3)(iii)(C), the suspended loss is treated as a noncapital, non-deductible expense incurred by S1 during the tax year that includes the date of the disposition of stock to which paragraph (c)(1) of this section applies. Accordingly, P's basis in its S1 stock is reduced from \$200 to \$194.

(iii) *Effect of subsequent asset sale on stock basis.* Of the \$5 loss recognized on the sale of Asset B, \$4 is taken into account in determining the basis adjustments made under §1.1502-32 to the stock of S2 owned by S1. Accordingly, S1's basis in its S2 stock is reduced by \$4 from \$104 to \$100 and P's basis in its S1 stock is reduced by \$4 from \$194 to \$190.

(iv) *Effect of subsequent asset sale on suspended loss.* Because P cannot establish that all or a portion of the loss recognized on the sale of Asset B was not reflected in the calculation of the duplicated loss of S2 on the date of the Year 3 stock sale and such loss is allocable to the period beginning on the date of the Year 3 disposition of the S2 stock and ending on the day before the first date on which S2 is not a member of the P group and is taken into account in determining consolidated taxable income (or loss) of the P group for a taxable year that includes a date on or after the date of the Year 3 disposition and before the first date on which S2 is not a member of the P group, such asset loss reduces the suspended loss pursuant to paragraph (c)(4) of this section. The amount of such reduction, however, cannot exceed \$1, the excess of the amount of such loss, \$5, over the amount of such loss that is taken into account in determining the basis adjustment made to the stock of S2 owned by members of the P group, \$4. Therefore, the suspended loss is reduced to \$5.

(v) *Effect of subsequent stock sale.* In Year 5, when S1 sells its remaining S2 stock for \$100, it recognizes \$0 gain/loss. Pursuant to paragraph (c)(5) of this section, the remaining \$5 of the suspended loss is allowed on the P group's return for Year 5 when S1 sells its remaining S2 stock.

Example 5. Deconsolidating sale of subsidiary member owning stock of another subsidiary member that remains in group. (i) *Facts.* In Year 1, P forms S1 with a contribution of Asset A with a basis of \$50 and a value of \$20 in exchange for 100 shares of common stock of S1 in a transfer to which section 351 applies. Also in Year 1, P and S1 form S2. P contributes \$80 to S2 in exchange for 80 shares of common stock of S2. S1 contributes Asset A to S2 in exchange for 20 shares of common stock of S2 in a transfer to which

section 351 applies. In Year 3, in a transaction that is not part of a plan that includes the Year 1 contributions, P sells its 100 shares of S1 common stock for \$20. Immediately after the Year 3 stock sale, S2 is a member of the P group. At the time of the Year 3 stock sale, S1 owns 20 shares of common stock of S2, and S2 has \$80 and Asset A. In Year 4, S2 sells Asset A, the basis and value of which have not changed since its contribution to S2. On the sale of Asset A for \$20, S2 recognizes a \$30 loss. That \$30 loss is used on the P group return to offset income of P. In Year 5, P sells its S2 common stock for \$80.

(ii) *Application of basis redetermination and loss suspension rules.* Pursuant to paragraph (b)(4) of this section, because immediately before P's transfer of S1 stock S1 owns stock of S2 (another subsidiary member of the same group) that has a basis that exceeds its value, paragraph (b) of this section applies as if S1 had transferred its stock of S2. Because S2 is a member of the group immediately after the transfer of the S1 stock, the group member's basis in the S2 stock is redetermined pursuant to paragraph (b)(1) of this section immediately prior to the sale of the S1 stock. Of the group members' total basis of \$130 in the S2 stock, \$26 is allocated to S1's 20 shares of S2 common stock and \$104 is allocated to P's 80 shares of S2 common stock. Pursuant to paragraph (b)(5) of this section, the redetermination of S1's basis in the stock of S2 results in an adjustment to P's basis in the stock of S1. In particular, P's basis in the stock of S1 is decreased by \$24 to \$26. On P's sale of its 100 shares of S1 common stock for \$20, P recognizes a loss of \$6. Because S1 is not a member of the P group immediately after P's sale of the S1 stock, paragraph (c)(1) of this section does not apply to suspend such loss. However, because P recognizes a loss with respect to the disposition of the S1 stock and S1 owns stock of S2 (which is a member of the P group immediately after the disposition), paragraph (c)(2) of this section does apply to suspend up to \$6 of that loss, an amount equal to the amount by which the duplicated loss with respect to the stock of S1 sold is attributable to S2's adjusted basis in its assets, loss carryforwards, and deferred deductions.

(iii) *Effect of subsequent asset sale on stock basis.* Of the \$30 loss recognized on the sale of Asset A, \$24 is taken into account in determining the basis adjustments made under §1.1502-32 to the stock of S2 owned by P. Accordingly, P's basis in its S2 stock is reduced by \$24 from \$104 to \$80.

(iv) *Effect of subsequent asset sale on suspended loss.* Because P cannot establish that all or a portion of the loss recognized on the sale of Asset A was not reflected in the calculation of the duplicated loss of S2 on the date of the Year 3 stock sale and such loss is allocable to the period beginning on the date

of the Year 3 deemed disposition of the S2 stock and ending on the day before the first date on which S2 is not a member of the P group and is taken into account in determining consolidated taxable income (or loss) of the P group for a taxable year that includes a date on or after the date of the Year 3 deemed disposition and before the first date on which S2 is not a member of the P group, such asset loss reduces the suspended loss pursuant to paragraph (c)(4) of this section. The amount of such reduction, however, cannot exceed \$6, the excess of the amount of such loss, \$30, over the amount of such loss that is taken into account in determining the basis adjustment made to the stock of S2 owned by P, \$24. Therefore, the suspended loss is reduced to zero.

(v) *Effect of subsequent stock sale.* P recognizes \$0 gain/loss on the Year 5 sale of its remaining S2 common stock. No amount of suspended loss remains to be allowed under paragraph (c)(5) of this section.

Example 6. Loss recognized on asset with basis determined by reference to stock basis of subsidiary member. (i) *Facts.* In Year 1, P forms S with a contribution of \$80 in exchange for 80 shares of common stock of S which at that time represents all of the outstanding stock of S. S becomes a member of the P group. In Year 2, P contributes Asset A with a basis of \$50 and a value of \$20 in exchange for 20 shares of common stock of S in a transfer to which section 351 applies. In Year 3, in a transaction that is not part of a plan that includes the Year 1 and Year 2 contributions, P contributes the 20 shares of S common stock it acquired in Year 2 to PS, a partnership, in exchange for a 20 percent capital and profits interest in a transaction described in section 721. Immediately after the contribution to PS, S is a member of the P group. In Year 4, P sells its interest in PS for \$20, recognizing a \$30 loss.

(ii) *Application of basis redetermination rule upon nonrecognition transfer.* Because P's basis in the S common stock contributed to PS exceeds its value immediately prior to the transfer and S is a member of the P group immediately after the transfer, P's basis in all of the S stock is redetermined pursuant to paragraph (b)(1) of this section. Of P's total basis of \$130 in the common stock of S, a proportionate amount is allocated to each share of S common stock. Accordingly, \$26 is allocated to the S common stock that is contributed to PS and, under section 722, P's basis in its interest in PS is \$26.

(iii) *Application of loss suspension rule on disposition of asset with basis determined by reference to stock basis of subsidiary member.* P recognizes a \$6 loss on its disposition of its interest in PS. Because P's basis in its interest in PS was determined by reference to the basis of S stock and at the time of the determination of P's basis in its interest in PS

such S stock had a duplicated loss of \$6, and, immediately after the disposition, S is a member of the P group, such loss is suspended to the extent of such duplicated loss. Principles similar to those of paragraphs (c)(3), (c)(4), and (c)(5) of this section shall apply to such suspended loss.

(f) *Worthlessness not followed by separate return years—(1) General rule.* Notwithstanding any other provision in the regulations under section 1502, if a member of a group (the claiming group) treats stock of a subsidiary as worthless under section 165 (taking into account the provisions of §1.1502-80(c) and, on the day following the last day of the claiming group's taxable year in which the worthless stock deduction is claimed, the subsidiary (or its successor, determined without regard to paragraphs (d)(5)(iii) and (iv) of this section) is a member of a group that includes any corporation that, during that taxable year, was a member of the claiming group (other than a lower-tier subsidiary of the subsidiary) or is a successor (determined without regard to paragraphs (d)(5)(iii) and (iv) of this section) of such a member, then all losses treated as attributable to the subsidiary under the principles of §1.1502-21T(b)(2)(iv) shall be treated as expired as of the day following the last day of the claiming group's taxable year in which the worthless stock deduction is claimed. In addition, notwithstanding any other provision in the regulations under section 1502, if a member recognizes a loss with respect to subsidiary stock and on the following day the subsidiary is not a member of the group and does not have a separate return year, then all losses treated as attributable to the subsidiary under the principles of §1.1502-21T(b)(2)(iv) shall be treated as expired as of the day following the last day of the group's taxable year in which the stock loss is claimed. For purposes of this paragraph (f), the determination of the losses attributable to the subsidiary shall be made after computing the taxable income of the group for the taxable year in which the group treats the stock of the subsidiary as worthless or the subsidiary liquidates and after computing the taxable income for any taxable year to which such losses may be carried back. The loss treated as expired under this paragraph (f)

shall not be treated as a noncapital, nondeductible expense under §1.1502-32(b)(2)(iii). This paragraph (f) applies to worthlessness determinations and liquidations that occur after March 18, 2004 and before March 12, 2006. However, the group may apply this paragraph (f) to worthlessness determinations and liquidations that occur on or after March 7, 2002 and before March 18, 2004; otherwise, paragraph (f) of §1.1502-35T as contained in 26 CFR part 1 edition revised as of April 1, 2003, shall apply to such determinations of worthlessness and liquidations.

(2) *Election in the case of determinations of worthlessness and dispositions not followed by a separate return that occurred prior to March 14, 2003.* If stock of a subsidiary member is treated as worthless under section 165 (taking into account the provisions of §1.1502-80(c)) on or after March 7, 2002, and prior to March 14, 2003, or if a member of a group disposes of subsidiary member stock on or after March 7, 2002, and prior to March 14, 2003 and on the following day the subsidiary is not a member of the group and does not have a separate return year, then, notwithstanding paragraph (f)(1) of this section, the common parent may make an irrevocable election to reattribute to itself all or any portion of the losses treated as attributable to such subsidiary member under the principles of §1.1502-21(b)(2)(iv). The election shall be in the form of a statement filed with or as part of the group's return for the taxable year in which the worthlessness is established or the disposition occurs. The statement shall be entitled "Election under Section 1.1502-35T(f)(2)" and must state that the common parent is making an irrevocable election under this paragraph (f)(2) to reattribute to itself the losses of the subsidiary member the stock of which is worthless or disposed of. In addition, it must identify the subsidiary to which the election relates and the portion of losses subject to the election. If the election provided in this paragraph is made, the common parent shall be treated as succeeding to the reattributed losses as if the losses were succeeded to in a transaction described in section 381(a). For purposes of applying the provisions of §1.1502-32, the re-

attributed losses shall be treated as absorbed by the group immediately prior to the allowance of any loss or inclusion of any income or gain with respect to the determination of worthlessness or the disposition. In the case of an election to reattribute less than all of the losses otherwise treated as attributable to such subsidiary member under the principles of §1.1502-21(b)(2)(iv), paragraph (f)(1) of this section shall apply to that portion of the losses for which an election under this paragraph (f)(2) is not made.

(g) *Anti-avoidance rules—(1) Transfer of share without a loss in avoidance.* If a share of subsidiary member stock has a basis that does not exceed its value and the share is transferred with a view to avoiding application of the rules of paragraph (b) of this section prior to the transfer of a share of subsidiary member stock that has a basis that does exceed its value or a deconsolidation of a subsidiary member, the rules of paragraph (b) of this section shall apply immediately prior to the transfer of stock that has a basis that does not exceed its value.

(2) *Transfers of loss property in avoidance.* If a member of a consolidated group contributes an asset with a basis that exceeds its value to a partnership in a transaction described in section 721 or a corporation that is not a member of such group in a transfer described in section 351, such partnership or corporation contributes such asset to a subsidiary member in a transfer described in section 351, and such contributions are undertaken with a view to avoiding the rules of paragraph (b) or (c) of this section, adjustments must be made to carry out the purposes of this section.

(3) *Anti-loss reimportation—(i) Application.* This paragraph (g)(3) applies if—

(A) A member of a group recognizes and is allowed a loss on the disposition of a share of stock of a subsidiary member with respect to which there is a duplicated loss; and

(B) Within the 10-year period beginning on the date the subsidiary member (or any successor) ceases to be a member of such group—

(I) The subsidiary member (or any successor) again becomes a member of such group (or any successor group)

when the subsidiary member (or any successor) owns any asset that has a basis in excess of value at such time and that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date;

(2) The subsidiary member (or any successor) again becomes a member of such group (or any successor group) when the subsidiary member (or any successor) owns any asset that has a basis in excess of value at such time and that has a basis that reflects, directly or indirectly, in whole or in part, the basis of any asset that was owned by the subsidiary member on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date;

(3) In a transaction described in section 381 or section 351, any member of such group (or any successor group) acquires any asset of the subsidiary member (or any successor) that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of its value on such date, or any asset that has a basis that reflects, directly or indirectly, in whole or in part, the basis of any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of its value on such date, and, immediately after the acquisition of such asset, such asset has a basis in excess of its value;

(4) The subsidiary member (or any successor) again becomes a member of such group (or any successor group) when the subsidiary member (or any successor) has a liability (within the meaning of section 358(h)(3)) that it had on the date of a disposition of stock of such subsidiary member (or any successor) and such liability will give rise to a deduction;

(5) In a transaction described in section 381 or section 351, any member of such group (or any successor group) assumes a liability (within the meaning of section 358(h)(3)) that was a liability

of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor);

(6) The subsidiary member (or any successor) again becomes a member of such group (or any successor group) when the subsidiary member (or any successor) has any losses or deferred deductions that were losses or deferred deductions of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor);

(7) The subsidiary member (or any successor) again becomes a member of such group (or any successor group) when the subsidiary member (or any successor) has any losses or deferred deductions that are attributable to any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date;

(8) The subsidiary member (or any successor) again becomes a member of such group (or any successor group) when the subsidiary member (or any successor) has any losses or deferred deductions that are attributable to any asset that had a basis that reflected, directly or indirectly, in whole or in part, the basis of any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date;

(9) The subsidiary member (or any successor) again becomes a member of such group (or any successor group) when the subsidiary member (or any successor) has any losses or deferred deductions that are attributable to a liability (within the meaning of section 358(h)(3)) that it had on the date of a disposition of stock of such subsidiary member (or any successor);

(10) Any member of such group (or any successor group) succeeds to any losses or deferred deductions of the subsidiary member (or any successor) that were losses or deferred deductions of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor), that are attributable to

any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date, that are attributable to any asset that had a basis that reflected, directly or indirectly, in whole or in part, the basis of any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date, or that are attributable to a liability (within the meaning of section 358(h)(3)) of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor); or

(11) Any losses or deferred deductions of the subsidiary member (or any successor) that were losses or deferred deductions of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor), that are attributable to any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date, that are attributable to any asset that had a basis that reflected, directly or indirectly, in whole or in part, the basis of any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date, or that are attributable to a liability (within the meaning of section 358(h)(3)) of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) are carried back to a pre-disposition taxable year of the subsidiary member.

(ii) *Operating rules.* (A) For purposes of paragraph (g)(3)(i)(B) of this section, assets shall include stock and securities and the subsidiary member (or any successor) shall be treated as having its allocable share of losses and deferred deductions of all lower-tier subsidiary members and as owning its al-

locable share of each asset of all lower-tier subsidiary members.

(B) For purposes of paragraphs (g)(3)(i)(B)(6), (7), (8), and (9) of this section, unless the group can establish otherwise, if the subsidiary member (or any successor) again becomes a member of such group (or any successor group) at a time when the subsidiary member (or any successor) has any losses or deferred deductions, such losses and deferred deductions shall be treated as losses or deferred deductions that were losses or deferred deductions of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor), losses or deferred deductions that are attributable to assets that were owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had bases in excess of value on such date, losses or deferred deductions that are attributable to assets that had bases that reflected, directly or indirectly, in whole or in part, the bases of assets that were owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had bases in excess of value on such date, or losses or deferred deductions attributable to a liability (within the meaning of section 358(h)(3)) of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor).

(C) For purposes of paragraph (g)(3)(i)(B)(10) of this section, unless the group can establish otherwise, if a member of such group (or any successor group) succeeds to any losses or deferred deductions of the subsidiary member (or any successor), such losses and deferred deductions shall be treated as losses or deferred deductions that were losses or deferred deductions of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor), losses or deferred deductions that are attributable to assets that were owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and

that had bases in excess of value on such date, losses or deferred deductions that are attributable to assets that had bases that reflected, directly or indirectly, in whole or in part, the bases of assets that were owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had bases in excess of value on such date, or losses or deferred deductions attributable to a liability (within the meaning of section 358(h)(3)) of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor).

(D) For purposes of paragraph (g)(3)(i)(B)(11) of this section, unless the group can establish otherwise, if any losses or deferred deductions of the subsidiary member (or any successor) are carried back to a pre-disposition taxable year of the subsidiary member, such losses and deferred deductions shall be treated as losses or deferred deductions that were losses or deferred deductions of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor), losses or deferred deductions that are attributable to assets that were owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date, losses or deferred deductions that are attributable to assets that had bases that reflected, directly or indirectly, in whole or in part, the bases of assets that were owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date, or losses or deferred deductions that are attributable to a liability (within the meaning of section 358(h)(3)) of the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor).

(iii) *Loss disallowance.* If this paragraph (g)(3) applies, then, to the extent that the aggregate amount of loss recognized by members of the group (and any successor group) on dispositions of

the subsidiary member stock was attributable to a duplicated loss of such subsidiary member that was allowed, such group (or any successor group) will be denied the use of—

(A) Any loss recognized that is attributable to, directly or indirectly, an asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of value on such date, to the extent of the lesser of the loss inherent in such asset on the date of a disposition of the stock of the subsidiary member (or any successor) and the loss inherent in such asset on the date of the event described in paragraph (g)(3)(i)(B) of this section that gives rise to the application of this paragraph (g)(3);

(B) Any loss recognized that is attributable to, directly or indirectly, an asset that has a basis that reflects, directly or indirectly, in whole or in part, the basis of any asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) and that had a basis in excess of its value on such date, to the extent of the lesser of the loss inherent in the asset that was owned by the subsidiary member (or any successor) on the date of a disposition of stock of such subsidiary member (or any successor) the basis of which is reflected, directly or indirectly, in whole or in part, in the basis of such asset on the date of the disposition and the loss inherent in such asset on the date of the event described in paragraph (g)(3)(i)(B) of this section that gives rise to the application of this paragraph (g)(3);

(C) Any loss or deduction that is attributable to a liability described in paragraph (g)(3)(i)(B)(4) or (5) of this section; and

(D) Any loss or deduction described in paragraph (g)(3)(i)(B)(6), (7), (8), (9), (10), or (11) of this section, provided that a loss or deferred deduction described in paragraph (g)(3)(i)(B)(11) of this section shall be allowed to be carried forward to a post-disposition taxable year of the subsidiary member.

(iv) *Treatment of disallowed loss.* For purposes of § 1.1502-32(b)(3)(iii), any loss

or deduction the use of which is disallowed pursuant to paragraph (g)(3)(iii) of this section (other than a loss or deduction described in paragraph (g)(3)(i)(B)(1) of this section), and with respect to which no waiver described in § 1.1502-32(b)(4) is filed, is treated as a noncapital, nondeductible expense incurred during the taxable year that such loss would otherwise be absorbed.

(4) *Avoidance of recognition of gain.* (i) If a transaction is structured with a view to, and has the effect of, deferring or avoiding the recognition of gain on a disposition of stock by invoking the application of paragraph (b)(1) of this section to redetermine the basis of stock of a subsidiary member, and the stock loss that gives rise to the application of paragraph (b)(1) of this section is not significant, paragraphs (b) and (c) of this section shall not apply.

(ii) If a transaction is structured with a view to, and has the effect of, deferring or avoiding the recognition of gain on a disposition of stock by invoking the application of paragraph (b)(2) of this section to redetermine the basis of stock of a subsidiary member, and the duplicated loss of the subsidiary member that is reflected in stock of the subsidiary member owned by members of the group immediately before the deconsolidation is not significant, paragraphs (b) and (c) of this section shall not apply.

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

Example 1. Transfers of property in avoidance of basis redetermination rule. (i) *Facts.* In Year 1, P forms S with a contribution of \$100 in exchange for 100 shares of common stock of S which at that time represents all of the outstanding stock of S. S becomes a member of the P group. In Year 2, P contributes 20 shares of common stock of S to PS, a partnership, in exchange for a 20 percent capital and profits interest in a transaction described in section 721. In Year 3, P contributes Asset A with a basis of \$50 and a value of \$20 to PS in exchange for an additional capital and profits interest in PS in a transaction described in section 721. Also in Year 3, PS contributes Asset A to S and P contributes an additional \$80 to S in transfers to which section 351 applies. In Year 4, S sells Asset A for \$20, recognizing a loss of \$30. The P group uses that loss to offset income of P.

Also in Year 4, P sells its entire interest in PS for \$40, recognizing a loss of \$30.

(ii) *Analysis.* Pursuant to paragraph (g)(2) of this section, if P's contributions of S stock and Asset A to PS were undertaken with a view to avoiding the application of the basis redetermination or the loss suspension rule, adjustments must be made such that the group does not obtain more than one tax benefit from the \$30 loss inherent in Asset A.

Example 2. Transfers effecting a reimportation of loss. (i) *Facts.* In Year 1, P forms S with a contribution of Asset A with a value of \$100 and a basis of \$120, Asset B with a value of \$50 and a basis of \$70, Asset C with a value of \$90 and a basis of \$100 in exchange for all of the common stock of S and S becomes a member of the P group. In Year 2, in a transaction that is not part of a plan that includes the contribution, P sells the stock of S for \$240, recognizing a loss of \$50. At such time, the bases and values of Assets A, B, and C have not changed since their contribution to S. In Year 3, S sells Asset A, recognizing a \$20 loss. In Year 3, S merges into M in a reorganization described in section 368(a)(1)(A). In Year 8, P purchases all of the stock of M for \$300. At that time, M has a \$10 net operating loss. In addition, M owns Asset D, which was acquired in an exchange described in section 1031 in connection with the surrender of Asset B. Asset C has a value of \$80 and a basis of \$100. Asset D has a value of \$60 and a basis of \$70. In Year 9, P has operating income of \$100 and M recognizes \$20 of loss on the sale of Asset C. In Year 10, P has operating income of \$50 and M recognizes \$50 of loss on the sale of Asset D.

(ii) *Analysis.* P's \$50 loss on the sale of S stock is entirely attributable to duplicated loss. Therefore, pursuant to paragraph (g)(3) of this section, assuming the P group cannot establish otherwise, M's \$10 net operating loss is treated as attributable to assets that were owned by S on the date of the disposition and that had bases in excess of value on such date. Without regard to any other limitations on the group's use of M's net operating loss, the P group cannot use M's \$10 net operating loss pursuant to paragraph (g)(3)(iii)(D) of this section. Pursuant to paragraph (g)(3)(iv) of this section and § 1.1502-32T(b)(3)(iii)(D), such loss is treated as a noncapital, nondeductible expense of M incurred during the taxable year that includes the day after the reorganization. In addition, the P group is denied the use of \$10 of the loss recognized on the sale of Asset C. Finally, the P group is denied the use of \$10 of the loss recognized on the sale of Asset D. Pursuant to paragraph (g)(3)(iv) of this section and § 1.1502-32T(b)(3)(iii)(D), each such disallowed loss is treated as a noncapital, nondeductible expense of M incurred during the taxable year that includes the date of

the disposition of the asset with respect to which such loss was recognized.

Example 3. Transfers to avoid recognition of gain. (i) *Facts.* P owns all of the stock of S1 and S2. The S2 stock has a basis of \$400 and a value of \$500. S1 owns 50% of the stock of the S3 common stock with a basis of \$150. S2 owns the remaining 50% of the S3 common stock with a basis of \$100 and a value of \$200 and one share of S3 preferred stock with a basis of \$10 and a value of \$9. P intends to sell all of its S2 stock to an unrelated buyer. P, therefore, engages in the following steps to dispose of S2 without recognizing a substantial portion of the built-in gain in S2. First, P causes a recapitalization of S3 in which S2's S3 common stock is exchanged for new S3 preferred shares. P then sells all of its S2 stock. Immediately after the sale of the S2 stock, S3 is a member of the P group.

(ii) *Analysis.* Pursuant to paragraph (b)(4) of this section, because S2 owns stock of S3 (another subsidiary member of the same group) and, immediately after the sale of the S2 stock, S3 is a member of the group, then for purposes of applying paragraph (b) of this section, S2 is deemed to have transferred its S3 stock. Because S3 is a member of the group immediately after the transfer of the S2 stock and the S3 stock deemed transferred has a basis in excess of value, the group member's basis in the S3 stock is re-determined pursuant to paragraph (b)(1) of this section immediately prior to the sale of the S2 stock. Pursuant to paragraph (b)(1) of this section, the total basis of S3 stock held by members of the P group is allocated first to the S3 preferred shares, up to their value of \$209, and then to the remaining shares of S3 common held by S1. S2's aggregate basis in the S3 preferred stock is increased from \$110 to \$209. This increase tiers up and increases P's basis in the S2 stock from \$400 to \$499. Accordingly, P will recognize only \$1 of gain on the sale of its S2 stock. However, because the recapitalization of S3 was structured with a view to, and has the effect of, avoiding the recognition of gain on a disposition of stock by invoking the application of paragraph (b) of this section, paragraph (g)(4)(i) of this section applies. Accordingly, paragraph (b) of this section does not apply upon P's disposition of the S2 stock and P recognizes \$100 of gain on the disposition of the S2 stock.

(h) *Application of other anti-abuse rules.* The rules of this section do not preclude the application of anti-abuse rules under other provisions of the Internal Revenue Code and regulations thereunder.

(i) [Reserved]

(j) *Effective date.* This section, except for paragraph (g)(3) of this section, applies with respect to stock transfers,

deconsolidations of subsidiary members, determinations of worthlessness, and stock dispositions on or after March 7, 2002, and no later than March 11, 2006, but only if such events occur during a taxable year the original return for which is due (without regard to extensions) after March 14, 2003. Paragraph (g)(3) of this section applies to events described in paragraph (g)(3)(iii) of this section occurring on or after October 18, 2002, and no later than March 11, 2006, but only if such events occur during a taxable year the original return for which is due (without regard to extensions) after March 14, 2003.

[T.D. 9048, 68 FR 12292, Mar. 14, 2003; 68 FR 16431, Apr. 4, 2003; 68 FR 33382, June 4, 2003; 69 FR 1918, Jan. 13, 2004, as amended by T.D. 9118, 69 FR 12801, Mar. 18, 2004]

SPECIAL TAXES AND TAXPAYERS

§ 1.1502-42 Mutual savings banks, etc.

(a) *In general.* This section applies to mutual savings banks and other institutions described in section 593(a).

(b) *Total deposits.* In computing for purposes of section 593(b)(1)(B)(ii) total deposits or withdrawable accounts at the close of the taxable year, the total deposits or withdrawable accounts of other members shall be excluded.

(c) *Taxable income; taxable years for which the due date (without extensions) for filing returns is before March 15, 1983.* For taxable years for which the due date (without extensions) for filing returns is before March 15, 1983, a member's taxable income for purposes of section 593(b)(2) is determined under § 1.1502-27(b) (computed without regard to any deduction under section 593(b)(2)). In addition, for taxable years beginning after July 11, 1969, taxable income as computed under the preceding sentence is subject to the adjustments provided in section 593(b)(2)(E). See § 1.593-6A(b)(5).

(d) *Taxable income; taxable years for which the due date (without extensions) for filing returns is after March 14, 1983—*
 (1) *In general.* For a taxable year for which the due date (without extensions) for filing returns is after March 14, 1983, a thrift's taxable income for