

option entitles U to voting rights equivalent to that of a shareholder. Accordingly, all of the facts and circumstances surrounding the sale of the call option must be taken into consideration in determining whether it is reasonably certain that the call option will be exercised.

Example 6. (i) In 1992, two unrelated corporations, X and Y, decide to engage jointly in a new business venture. To accomplish this purpose, X organizes a new corporation, S, on September 30, 1992. X acquires 100 shares of the voting common stock of S, which are the only shares of S stock outstanding. Y acquires a debenture of S which is convertible, on September 30, 1995, into 100 shares of S common stock. If the conversion right is not exercised, X will have the right, on September 30, 1995, to put 50 shares of its S stock to Y in exchange for 50 percent of the debenture held by Y. The likelihood of the success of the venture is uncertain. It is anticipated that S will generate substantial losses in its early years of operation. X expects to have substantial taxable income during the three years following the organization of S.

(ii) Under the terms of this arrangement, it is reasonably certain on September 30, 1992, a measurement date, that on September 30, 1995, either through Y's exercise of its conversion right or X's right to put S stock to Y, that Y will own 50 percent of the S stock. Additionally, it could reasonably be anticipated, on September 30, 1992, a measurement date, that the affiliation of X and S would result in the elimination of a substantial amount of federal income tax liability. Accordingly, for purposes of determining whether X and S are affiliated, X is treated as owning only 50 percent of the value of the S stock as of September 30, 1992, a measurement date, and S is not a member of the X affiliated group.

Example 7. (i) The facts are the same as in *Example 6* except that rather than acquiring 100 percent of the S stock and the right to put S stock to Y, X acquires only 80 percent of the S stock, while S, rather than acquiring a convertible debenture, acquires 20 percent of the S stock, and an option to acquire an additional 30 percent of the S stock. The terms of the option are such that the option will only be exercised if the new business venture succeeds.

(ii) In contrast to *Example 6*, because of the true business risks involved in the start-up of S and whether the business venture will ultimately succeed, along with the fact that X does not have an option to put S stock to Y, it is not reasonably certain on September 30, 1992, a measurement date, that the option will be exercised and that X will only own 50 percent of the S stock on September 30, 1995. Accordingly, the option is disregarded in determining whether S is a member of the X group.

(i) *Effective date.* This section applies, generally, to options with a measurement date on or after February 28, 1992. This section does not apply to options issued prior to February 28, 1992, which have a measurement date on or after February 28, 1992, if the measurement date for the option occurs solely because of an adjustment in the terms of the option pursuant to the terms of the option as it existed on February 28, 1992. Paragraph (b)(2)(iv) of this section applies to stock outstanding on or after February 28, 1992.

[T.D. 8462, 57 FR 61801, Dec. 29, 1992; 58 FR 7041, Feb. 3, 1993]

REGULATIONS APPLICABLE FOR TAX YEARS FOR WHICH A RETURN IS DUE ON OR BEFORE AUGUST 11, 1999

§ 1.1502-9A Application of overall foreign loss recapture rules to corporations filing consolidated returns due on or before August 11, 1999.

(a) *Scope—(1) Effective date.* This section applies only to consolidated return years for which the due date of the income tax return (without extensions) is on or before August 11, 1999.

(2) *In general.* Affiliated group of corporations filing a consolidated return sustains an overall foreign loss (a consolidated overall foreign loss) in any taxable year in which its gross income from sources without the United States subject to a separate limitation (as defined in § 1.904(f)-1(c)(2)) is exceeded by the sum of the deductions properly allocated and apportioned thereto. However, for taxable years prior to 1983, affiliated groups may have determined their overall foreign losses for income subject to the passive interest limitation, DISC dividend limitation, and general limitation on a combined basis in accordance with the rules in § 1.904(f)-1(c)(1). The rules contained in §§ 1.904(f)-1 through 1.904(f)-6 are applicable to affiliated groups filing consolidated returns. This section provides special rules for applying those sections to such groups. Paragraph (b) provides rules for additions and subtractions of a portion of overall foreign losses to and from consolidated overall foreign loss accounts. Paragraph (c) requires that separate notional overall

foreign loss accounts be kept for each member of the group that contributes to a consolidated overall foreign loss account and provides for allocation of a portion of the group's overall foreign loss account to a member when the member leaves the group prior to recapture of the entire amount of the loss account. These rules are similar to the rules provided in §1.1502-21(b)(2) (or §1.1502-79A, as appropriate) concerning the apportionment of consolidated net operating losses to a member who leaves the group. However, the rules differ somewhat because the absorption rule of §1.1502-21(b)(1) (or §1.1502-79A, as appropriate) is applied year-by-year, consistently with the sequence rules of section 172(b), and recapture of overall foreign losses is based on overall foreign loss accounts that may consist of losses in more than one year. Paragraph (d) provides rules for recapture of amounts in consolidated overall foreign loss accounts. Paragraph (e) provides special rules pertaining to section 904(f)(3) dispositions between members of a group. Paragraphs (b), (c), and (e) also contain special rules that apply to overall foreign losses that arise in separate return limitation years; the principles therein also apply to overall foreign losses when there has been a consolidated return change of ownership (as defined in §1.1502-1(g)). See §1.1502-9T(b)(1)(v) for the rule that ends the separate return limitation year limitation for consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, and §1.1502-9T(b)(1)(vi) for an election to continue the separate return limitation year limitation for consolidated return years beginning before January 1, 1998. See also §1.1502-3(d)(4) for an optional effective date rule (generally making the rules of paragraphs (b)(1)(iii) and (iv) of this section inapplicable for a consolidated return year beginning after December 31, 1996, if the due date of the income tax return (without extensions) for such year is on or before March 13, 1998).

(b) *Consolidated overall foreign loss accounts.* Any group that sustains an overall foreign loss (or acquires a member with a balance in an overall foreign loss account) must establish a consoli-

dated overall foreign loss account for such loss, and amounts shall be added to and subtracted from such account as provided in §§1.904(f)-1 through 1.904(f)-6 and this section.

(1) *Additions to the consolidated overall foreign loss accounts—(i) Consolidated overall foreign losses.* Any consolidated overall foreign loss shall be added to the applicable consolidated overall foreign loss account for such separate limitation, to the extent that the overall foreign loss has reduced United States source income, in accordance with the rules of §§1.904(f)-1 and 1.904(f)-3.

(ii) *Overall foreign losses from separate return years.* If a corporation joins in the filing of a consolidated return in a taxable year in which such corporation has a balance in an overall foreign loss account from a prior separate return year that is not a separate return limitation year, such balance shall be added to the applicable consolidated overall foreign loss account in such year and treated as a consolidated overall foreign loss incurred in the previous year (and shall therefore be subject to recapture, in accordance with paragraph (d) of this section, beginning in the same year in which it is added to the consolidated overall foreign loss account).

(iii) *Overall foreign losses from separate return limitation years.* If a corporation joins in the filing of a consolidated return in a taxable year in which such corporation has a balance in an overall foreign loss account from a prior separate return limitation year, such balance shall be added to the applicable consolidated overall foreign loss account in such consolidated return year to the extent of the lesser of the balance in the overall foreign loss account from the separate return limitation year or 50 percent (or such larger percentage as the taxpayer may elect) of the difference between the consolidated foreign source taxable income subject to the same separate limitation (computed in accordance with §§1.904(f)-2(b) and 1.1502-4(d)(1)) minus such consolidated foreign source taxable income recomputed by excluding the items of income and deduction of such corporation (but not less than zero). The amount added to a consolidated overall foreign loss account in any taxable

year under this paragraph (b)(1)(iii) shall be treated as a consolidated overall foreign loss in the previous year (and shall therefore be subject to recapture, in accordance with paragraph (d) of this section, beginning in the same year in which it is added to the consolidated overall foreign loss account).

(iv) *Overall foreign losses that are part of a net operating loss or net capital loss carried over from a separate return limitation year.* Overall foreign losses that are part of a net operating loss or net capital loss carryover from a separate return limitation year of a member that is absorbed in a consolidated return year shall be treated as though they were added to an overall foreign loss account in a separate return limitation year of such member and will be subject to the limitation on recapture of SRLY losses contained in paragraph (b)(1)(iii) of this section. See paragraph (c)(2) of this section for rules regarding the addition of such losses to the applicable overall foreign loss account of such member.

(v) *Special effective date for SRLY limitation.* Except as provided in paragraph (b)(1)(vi) of this section, paragraphs (b)(1)(iii) and (iv) of this section apply only to consolidated return years for which the due date of the income tax return (without extensions) is on or before March 13, 1998. For consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, the rules of paragraph (b)(1)(ii) of this section shall apply to overall foreign losses from separate return years that are separate return limitation years. For purposes of applying paragraph (b)(1)(ii) of this section in such years, the group treats a member with a balance in an overall foreign loss account from a separate return limitation year on the first day of the first consolidated return year for which the due date of the income tax return (without extensions) is after March 13, 1998, as a corporation joining the group on such first day. An overall foreign loss that is part of a net operating loss or net capital loss carryover from a separate return limitation year of a member that is absorbed in a consolidated return year for which the due date of the in-

come tax return (without extensions) is after March 13, 1998, shall be added to the appropriate consolidated overall foreign loss account in the year that it is absorbed. For consolidated return years for which the due date of the income tax return (without extensions) is after March 13, 1998, similar principles apply to overall foreign losses when there has been a consolidated return change of ownership (regardless of when the change of ownership occurred). See also § 1.1502-3(d)(4) for an optional effective date rule (generally making this paragraph (b)(1)(v) applicable to a consolidated return year beginning after December 31, 1996, if the due date of the income tax return (without extensions) for such year is on or before March 13, 1998).

(vi) *Election to defer application of special effective date.* A consolidated group may elect not to apply paragraph (b)(1)(v) of this section to consolidated return years beginning before January 1, 1998. To make this election, a consolidated group must write "Election Pursuant to Notice 98-40" across the top of page 1 of an original or amended tax return for each consolidated return year subject to the election. For the first consolidated return year to which the overall foreign loss provisions of paragraph (b)(1)(v) of this section apply (i.e., the first year beginning on or after January 1, 1998), such consolidated group must write "Notice 98-40 Election in Effect in Prior Years" across the top of page 1 of the consolidated tax return for that year. For purposes of applying paragraph (b)(1)(ii) of this section with respect to such year, any member with a balance in an overall foreign loss account from a separate return limitation year on the first day of such year shall be treated as joining the group on such first day.

(2) *Reductions of the consolidated overall foreign loss accounts—(i) Amounts allocated to members leaving the group.* When a member leaves the group, each applicable consolidated overall foreign loss account shall be reduced by the amount allocated from such account to such member in accordance with paragraph (c)(3)(i) of this section.

(ii) *Amounts recaptured.* A consolidated overall foreign loss account shall

be reduced by the amount of any overall foreign loss under the same separate limitation that is recaptured from consolidated income in accordance with § 1.904(f)-2.

(c) *Allocation of overall foreign losses among members of an affiliated group—(1) Notional overall foreign loss accounts.* Separate notional overall foreign loss accounts shall be established for each member of a group that contributes to a consolidated overall foreign loss account. Additions to and reductions of such notional accounts shall be made when additions or reductions are made to consolidated overall foreign loss accounts in accordance with paragraph (b) of this section and § 1.904(f)-1.

(i) *Additions to notional accounts—(A) Consolidated overall foreign losses.* When a consolidated overall foreign loss is added to a consolidated overall foreign loss account, each member shall add its pro rata share of the amount of such loss to the member's notional overall foreign loss account. A member's pro rata share of a consolidated overall foreign loss for any taxable year is determined by multiplying the consolidated loss by a fraction. The numerator of this fraction is the amount by which the member's separate gross income for the taxable year from sources without the United States subject to the applicable separate limitation is exceeded by the sum of the deductions properly allocated and apportioned thereto (including such member's share of any consolidated net operating loss deduction and consolidated net capital loss carryovers and carrybacks to the taxable year), for each member with such deductions in excess of such income. The denominator of this fraction is the sum of the numerators of this fraction for all such members of the group.

(B) *Overall foreign losses from separate return years and separate return limitation years.* When an amount from a member's overall foreign loss account from a separate return year or separate return limitation year is added to a consolidated overall foreign loss account in accordance with paragraph (b)(1) (ii) or (iii) of this section, such amount shall also be added to that member's notional overall foreign loss account for such separate limitation.

(ii) *Reductions of notional accounts.* When a consolidated overall foreign loss account is reduced by recapture, in accordance with paragraph (b)(2)(ii) of this section, each member of the group shall reduce its notional overall foreign loss account for that separate limitation by its pro rata share of the amount by which the consolidated overall foreign loss account is reduced. A member's pro rata share of the amount by which a consolidated overall foreign loss account is reduced and determined by multiplying the amount recaptured by a fraction, the numerator of which is the amount in such member's notional account under such separate limitation, and the denominator of which is the amount in the consolidated overall foreign loss account under such separate limitation before reduction for the amount recaptured for that taxable year.

(2) *Overall foreign losses that are part of a net operating loss or net capital loss from a separate return limitation year.* An overall foreign loss that is part of a net operating loss or net capital loss carryover from a separate return limitation year of a member that is absorbed in a consolidated return year shall be treated as an overall foreign loss of such member (rather than the group) and shall be added to such member's separate overall foreign loss account to the extent it reduces United States source income, in accordance with § 1.904(f)-1(d)(5). Such overall foreign losses shall be added to the appropriate consolidated overall foreign loss account in later years in accordance with paragraph (b)(1)(iii) of this section.

(3) *Allocation of a portion of overall foreign loss accounts to a member leaving the group—(i) Consolidated overall foreign losses.* When a corporation ceases to be a member of an affiliated group filing consolidated returns, a portion of the balance in each applicable consolidated overall foreign loss account shall be allocated to such corporation. The amount allocated to such corporation shall be equal to the amount, if any, in such member's notional overall foreign loss account under the same separate limitation.

(ii) *Overall foreign losses from separate return limitation years.* When a corporation ceases to be a member of an affiliated group filing consolidated returns, it shall take with it the remaining portion of each separate overall foreign loss account for overall foreign losses from separate return limitation years (including amounts added to such accounts under paragraph (c)(2) of this section).

(d) *Recapture of consolidated overall foreign losses.* The amount in any consolidated overall foreign loss account shall be recaptured under §§ 1.904(f)-1 through 1.904(f)-6 by recharacterizing consolidated foreign source taxable income subject to the separate limitation under which the loss arose as United States source taxable income. For purposes of recapture, consolidated foreign source taxable income subject to the separate limitation under which the loss arose shall be determined in accordance with §§ 1.904(f)-2 and 1.1502-4. Amounts in a member's excess loss account that are included in income under § 1.1502-19 shall be subject to recapture to the extent that they are included in consolidated foreign source taxable income subject to the separate limitation under which the loss arose.

(e) *Dispositions of property between members of the same affiliated group during a consolidated return year—(1) In general.* Except as provided in paragraph (2) with respect to overall foreign losses of a selling member from a separate return limitation year, the rules of § 1.1502-13 with respect to intercompany transactions will apply to dispositions of property to which section 904(f)(3)(A) applies.

(2) *Recapture of overall foreign loss from a separate return limitation year.* Paragraph (1) will not apply and gain will be recognized to the extent that the selling member has a balance in its overall foreign loss account from a separate return limitation year unless the selling member adds the entire amount of its overall foreign loss account from separate return limitation years to the applicable consolidated overall foreign loss account and treats such amount as an overall foreign loss incurred in the previous year. Such loss shall be subject to recapture, in accordance with paragraph (d) of § 1.1502-9, beginning in

the same year in which it is added to the consolidated overall foreign loss account.

(f) *Illustrations.* The provisions of this section are illustrated by the following examples. All foreign source income or loss in these examples is subject to the general limitation.

Example (1). A, B, and C are the members of an affiliated group of corporations (as defined in section 1504), and all use the calendar year as their taxable year. For 1983, A, B, and C file a consolidated return. ABC has United States source income of \$1,000 and foreign source losses (overall foreign loss) of \$400. In accordance with paragraph (b)(1)(i) of this section, ABC adds \$400 to its consolidated overall foreign loss account at the end of 1983. For 1983, the separate foreign source taxable income (or loss) of A is \$400, of B is (\$200), and of C is (\$600). Under paragraph (c)(1) of this section, B and C must establish separate notional overall foreign loss accounts. Under paragraph (c)(1)(i)(A) of this section, the amount added to each notional account is the pro rata share of the consolidated overall foreign loss of each member contributing to such loss. The pro rata share is determined by multiplying the consolidated loss by the member's proportionate share of the total foreign source losses of all members having such losses. B's foreign source loss is \$200 and C's foreign source loss is \$600, totaling \$800. B must add $\$400 \times 200/800$, or \$100, to its notional overall foreign loss account. C must add $\$400 \times 600/800$, or \$300, to its notional overall foreign loss account.

Example (2). The facts are the same as in example (1). In 1984, ABC has consolidated foreign source taxable income of \$200. Under paragraph (d) of this section and § 1.904(f)-2, ABC is required to recapture \$100 of the amount in its consolidated overall foreign loss account, which reduces that account by \$100 under paragraph (b)(2)(ii) of this section. In accordance with paragraph (c)(1)(ii) of this section, B reduces its notional account by $\$100 \times 100/400$, or \$25, and C reduces its notional account by $\$100 \times 300/400$, or \$75. At the end of 1984 ABC has \$300 in its consolidated overall foreign loss account, B has \$75 in its notional account, and C has \$225 in its notional account.

Example (3). D and E are members of an affiliated group and file separate returns using the calendar year as their taxable year for 1980. In 1980, D has an overall foreign loss of \$200, which it adds to its overall foreign loss account, and E has no overall foreign losses. For 1981, D and E file a consolidated return, and DE must establish a consolidated overall foreign loss account, to which D's overall foreign loss from 1980 is added under paragraph (b)(1)(ii) of this section. D also adds the same amount \$200 to its notional account

under paragraph (c)(1)(i)(B) of this section. In 1981, DE has consolidated foreign source taxable income of \$300. Since the amount added to the consolidated overall foreign loss account in 1981 is treated as a consolidated overall foreign loss from 1980, DE must recapture \$150 in 1981 under paragraph (d) of this section and §1.904(f)-2. DE's consolidated overall foreign loss account is reduced by \$150 under paragraph (b)(2)(ii) of this section, and D's notional account is reduced by \$150 under paragraph (c)(1)(ii) of this section, leaving balances of \$50 in each of those accounts at the end of 1981.

Example (4). F and G are not members of an affiliated group in 1980, and G has an overall foreign loss of \$200, which it adds to its overall foreign loss account. F has no overall foreign loss. On January 1, 1981, F acquires G, and FG files a consolidated return for the calendar year 1981. In 1981, F has no foreign source taxable income or loss, and G has \$100 of foreign source taxable income. FG's consolidated foreign source taxable income, \$100, minus such income without G's items of income and deduction, \$0, is \$100. Therefore 50% of that amount, \$50, of G's overall foreign loss from its 1980 separate return limitation year is added to FG's consolidated overall foreign loss account under paragraph (b)(1)(iii) of this section, and the same amount is added to G's notional account under paragraph (c)(1)(i)(B) of this section. In accordance with paragraph (d) of this section and §1.904(f)-2, FG must recapture the \$50 balance in its consolidated overall foreign loss account in 1981 because the amount added from G's separate return limitation year is treated as a 1980 consolidated overall foreign loss. At the end of 1981, FG has a balance of \$0 in its consolidated overall foreign loss account, G has \$0 in its notional account, and G also has \$150 remaining from its 1980 overall foreign loss that has not yet been added to the consolidated overall foreign loss account.

On January 1, 1982, F sells G and G leaves the affiliated group. Under paragraph (c)(3)(i) of this section, G takes with it the balance in its overall foreign loss account from 1980 (its prior separate return limitation year) that has not been added to the consolidated account. G has \$150 of overall foreign loss in its overall foreign loss account. Because the amount in the consolidated overall foreign loss account is zero, no amount from that account is allocated to G.

Example (5). (i) In 1982 corporation H has United States source income of \$300 and foreign source losses of \$500, resulting in a net operating loss of \$200 and a balance in H's overall foreign loss account at the end of 1982 of \$300.

(ii) On January 1, 1983, H is acquired by J, and for the calendar year 1983 JH files a consolidated return. JH has consolidated taxable income of \$700 in 1983, including a con-

solidated net operating loss deduction of \$100. This net operating loss deduction is \$100 of H's \$200 net operating loss from 1982 (a separate return limitation year), which is limited by §1.1502-21A(c). For 1983, H has separate taxable income of \$100, comprised of \$100 of United States source taxable income and zero foreign source taxable income, and J has separate taxable income of \$700, comprised of \$700 of United States source taxable income and zero foreign source taxable income. Under paragraph (c)(2) of this section, H adds \$100 to its separate overall foreign loss account, since that amount of its net operating loss has reduced United States source income. H has \$400 in its separate overall foreign loss account at the end of 1983, none of which has been added to a consolidated overall foreign loss account.

(iii) In 1984, H has separate taxable income of \$400, comprised of \$100 of United States source taxable income and \$300 of foreign source taxable income. J has separate taxable income of \$900, comprised of \$700 of United States source taxable income and \$200 of foreign source taxable income. JH has consolidated taxable income of \$1200, which includes \$100 of consolidated net operating loss deduction from H's 1982 net operating loss. Since this net operating loss deduction is allocated to foreign source income, it does not reduce United States source income and will not be added to an overall foreign loss account. Under paragraph (b)(1)(iii) of this section, \$100, from H's overall foreign loss is added to the consolidated overall foreign loss account computed as follows:

Consolidated foreign source taxable income	\$400
Consolidated foreign source taxable income recomputed by excluding H's foreign source income and deduction	-200
	<hr/>
\$200.	
× 50%	\$100
Amount from H's separate return limitation year overall foreign loss account added to the consolidated overall foreign loss account	\$100

This amount is subject to recapture beginning in the same taxable year, as it is treated as a consolidated overall foreign loss incurred in a previous year. Therefore, under paragraph (d) of this section and §1.904(f)-2 JH also recaptures this \$100, reducing the consolidated overall foreign loss account to \$0. H has \$300 remaining in its separate overall foreign loss account at the end of 1984.

(iv) In 1985, H has separate taxable income of \$400, comprised of \$100 of United States source taxable income and \$300 of foreign source taxable income. J has separate taxable income of \$300 comprised of \$600 of United States source taxable income and \$300

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of foreign source losses. JH has consolidated taxable income of \$700, all of which is United States source. Under paragraph (b)(1)(iii) of this section an additional \$150 from H's separate overall foreign loss is added to the consolidated overall foreign loss account, computed as follows:

Consolidated foreign source taxable income	\$0
Consolidated foreign source taxable income recomputed by excluding H's foreign source income and deductions	- (300)
300.	
× 50%	\$150
Amount from H's separate return limitation year overall foreign loss account added to the consolidated overall foreign loss account	\$150

Thus, an additional \$150 of H's separate overall foreign loss is added to the consolidated overall foreign loss account, and, under paragraph (c)(1)(i)(B) of this section, the same amount is added to J's notional account. While this amount is subject to recapture beginning in the same taxable year, JH has no consolidated foreign source taxable income in 1985, so no overall foreign loss is recaptured. H has a remaining balance of \$150 in its separate return limitation year overall foreign loss account and HJ has \$150 in its consolidated overall foreign loss account.

Example (6). A, B, and C are members of an affiliated group of corporations (as defined in section 1504), and all use the calendar year as their taxable year. For 1986, A, B, and C file a consolidated return. A has an overall foreign loss account which arose in a separate return limitation year. The amount in the overall foreign loss account is \$2,000. A makes a disposition of all its assets to B on January 1, 1986. The gain on the transfer is \$1,500, all of which would be recognized under section 904(f)(3). However, if A adds the total amount of its overall foreign loss from separate return limitation years to ABC's consolidated overall foreign loss account, no gain will be recognized on the transfer until the intercompany gain is taken into account under § 1.1502-13. In the interim, any foreign source gain of the purchasing member (or any other member of the consolidated group) may be used to recapture on a consolidated basis the amount in ABC's consolidated overall foreign loss account.

[T.D. 8153, 52 FR 32005, Aug. 25, 1987; 52 FR 43434, Nov. 12, 1987, as amended by T.D. 8597, 60 FR 36679, July 18, 1995; T.D. 8677, 61 FR 33323, June 27, 1996; T.D. 8766, 63 FR 12643, Mar. 16, 1998; T.D. 8800, 63 FR 71590, Dec. 29, 1998; T.D. 8823, 64 FR 36099, July 2, 1999; Redesignated and amended by T.D. 8833, 64 FR 43615, Aug. 11, 1999; T.D. 8884, 65 FR 33760, May 25, 2000]

REGULATIONS APPLICABLE TO TAXABLE YEARS BEFORE JANUARY 1, 1997

§ 1.1502-15A Limitations on the allowance of built-in deductions for consolidated return years beginning before January 1, 1997.

(a) *Limitation on built-in deductions—*
 (1) *General rule.* Built-in deductions (as defined in subparagraph (2) of this paragraph) for a taxable year shall be subject to the limitation of § 1.1502-21A(c) (determined without regard to such deductions and without regard to net operating loss carryovers to such year) and the limitation of § 1.1502-22A(c) (determined without regard to such deductions and without regard to capital loss carryovers to such year). If as a result of applying such limitations, built-in deductions are not allowable in such consolidated return year, such deductions shall be treated as a net operating loss or net capital loss (as the case may be) sustained in such year and shall be carried to those taxable years (consolidated or separate) to which a consolidated net operating loss or a consolidated net capital loss could be carried under §§ 1.1502-21A, 1.1502-22A and 1.1502-79A, (or §§ 1.1502-21T and 1.1502-22T, as appropriate) except that such losses shall be treated as losses subject to the limitations contained in §§ 1.1502-21T(c) or 1.1502-22T(c) (or §§ 1.1502-21A(c), 1.1502-22A(c), as appropriate), as the case may be. Thus, for example, if member X sells a capital asset during a consolidated return year at a \$1,000 loss and such loss is treated as a built-in deduction, then such loss shall be subject to the limitation contained in § 1.1502-22(c), which, in general, would allow such loss to be offset only against X's own capital gain net income (net capital gain for taxable years beginning before January 1, 1977). Assuming X had no capital gain net income (net capital gain for taxable years beginning before January 1, 1977) reflected in such year (after taking into account its capital losses, other than capital loss carryovers and the built-in deduction), such \$1,000 loss shall be treated as a net capital loss and shall be carried over for 5 years under § 1.1502-22, subject to the limitation contained in § 1.1502-22(c) for consolidated return years.