(4) The amended return(s) permitted by the applicable statute of limitations is/are filed before March 26, 1997.

(e) *Section 383.* This section also applies for the purposes of section 383, with appropriate adjustments to reflect that section 383 applies to credits and net capital losses.

[T.D. 8678, 61 FR 33364, June 27, 1996, as amended by T.D. 8823, July 2, 1999. Redesignated and amended by T.D. 8824, 64 FR 36126–36128, July 2, 1999]

DUAL CONSOLIDATED LOSSES INCURRED IN TAXABLE YEARS BEGINNING BEFORE OCTOBER 1, 1992

§ 1.1503–2A Dual consolidated loss.

(a) *In general.* This section applies for purposes of determining whether and to what extent the net operating loss of a dual resident corporation incurred in tax years beginning after December 31, 1986, shall be allowed to reduce the taxable income of any other member of the affiliated group. Except as provided in paragraph (c) of this section, any dual consolidated loss of a domestic corporation incurred in taxable years beginning after December 31, 1986, cannot reduce the taxable income of any affiliate of such domestic corporation for that or any other taxable year, regardless of whether those losses offset income of another corporation under the income tax laws of the foreign country and regardless of whether any of the income of any corporation that the loss may reduce in the foreign country is, has been, or will be subject to tax in the United States. This rule shall also apply to preclude the use of a dual consolidated loss to offset any income of an affiliate (whether or not an election to file a consolidated return has been made) by means of a transaction subject to section 381 of the Code. For purposes of the preceding sentence, an "affiliate" means any member of the affiliated group as determined under section 1504(a) without regard to the exceptions contained in section 1504(b) (other than section 1504(b)(3)) relating to includible corporations. Further, this rule shall also apply to preclude the use of a dual consolidated loss of a separate unit by a domestic corporation upon or as a result of the termination, liquidation, or sale of the separate unit. The following example illustrates the application of this paragraph (a).

Example. P, a domestic corporation, owns all of the outstanding stock of DRC, a domestic corporation. DRC is managed and controlled in Country W, a country which determines the tax residence of corporations according to place of management and control. Therefore, the income of DRC is subject to tax in both the United States and in Country W. There are currently no other corporations in Country W which could use the losses of DRC to offset income under the income tax laws of Country W. P no longer wishes to operate DRC as a separate corporation. Therefore DRC will be liquidated into P under section 332 of the Code. Normally, P, under section 381, would succeed to and take into account DRC's net operating loss carryovers. However, this paragraph (a) prohibits the net operating loss of DRC from reducing P's income (including income of P generated by assets previously held by DRC) for U.S. tax purposes. Therefore, DRC's net operating loss carryovers will not be available to offset P's income unless one of the exceptions described in paragraph (c) of this section applies.

(b) *Definitions.* The following definitions apply for purposes of this section.

(1) *Domestic corporation.* For purposes of this section, the term "domestic corporation" has the meaning assigned to it by sections 7701 (a)(3) and (a)(4) and shall also include any corporation treated as a domestic corporation by the Internal Revenue Code, including, but not limited to, section 269B and section 1504(d). Subject to the rules of paragraph (d) of this section, any separate unit (as defined in paragraph (b)(4) of this section) of a domestic corporation will be treated as a separate domestic corporation (and as a dual resident corporation) for purposes of this section. The following example illustrates the application of this paragraph (b)(1).

Example. A is a domestic corporation with a branch operation in Country X. A is owned by FP, a Country X corporation. Country X allows the Country X branch income and losses of A to be used to offset FP's losses or income. Under paragraph (d) of this section, the branch operations of A in Country X will be treated as a separate domestic corporation and as a dual resident corporation for purposes of this section. See paragraph (d) of this section for the treatment of any dual consolidated loss of the branch operations of A.

(2) *Dual consolidated loss.* The term "dual consolidated loss" means the net operating loss (as defined in section 172(c) and the regulations thereunder) of a domestic corporation incurred in a year in which the corporation is a dual resident corporation. The fact that a particular item taken into account in computing such net operating loss deduction is not taken into account in computing income subject to income tax in a foreign country shall not cause such item to be excluded from the calculation of the dual consolidated loss. A dual consolidated loss shall arise even though no other person, corporation, or entity is permitted, under the income tax laws of the foreign country, to use by any means the losses, expenses or deductions of the dual resident corporation to offset income. A dual consolidated loss shall not include—

(i) The net operating loss incurred during that portion of the taxable year prior to the date on which the domestic corporation becomes a dual resident corporation or subsequent to the date on which the domestic corporation ceases to be a dual resident corporation. For purposes of determining the amount of the net operating loss incurred in that portion of the taxable year prior to the date on which the domestic corporation becomes a dual resident corporation or subsequent to the date on which the domestic corporation ceases to be a dual resident corporation, in no event shall more than a pro rata portion of the net operating loss commensurate with the portion of the taxable year during which the domestic corporation was not a dual resident corporation be allocated to that portion of the taxable year in which the domestic corporation was not a dual resident corporation; or

(ii) Losses incurred in taxable years beginning on or before December 31, 1986.

(3) *Dual resident corporation.* For purposes of this section, a domestic corporation shall be a dual resident corporation if the worldwide income of such corporation is subject to the income tax of a foreign country, or such corporation is subject to the income tax of a foreign country on a residence basis (and not on a source basis).

(4) *Separate unit.* Solely for purposes of this section, the term "separate unit" shall mean any of the following:

(i) A foreign branch as defined in § 1.367 (a)–6T(g);

(ii) A partnership interest; or

(iii) A trust interest.

(5) *Subject to tax.* For purposes of determining whether a domestic corporation is subject to the income tax of a foreign country on its income, the fact that the corporation has no actual tax liability to the foreign country for a particular taxable year shall not be taken into consideration.

(c) *Exceptions*—(1) *No ability to use dual consolidated loss under foreign law*—(i) *In general.* Paragraph (a) of this section shall not apply to a dual consolidated loss if—

(A) At no time after December 31, 1986, has there been any other person, corporation, or entity which, under the income tax laws of the foreign country, is permitted to use by any means the losses, expenses, or deductions of the dual resident corporation to offset income; and

(B) Under the income tax laws of the foreign country, the losses, expenses, or deductions of the dual resident corporation incurred in taxable years beginning after December 31, 1986, cannot be carried over or back to be used, by any means, to offset the income of any other person, corporation, or entity in other years.

(ii) *Limitations.* For purposes of paragraph (c)(1)(i) of this section, none of the following circumstances shall constitute a satisfaction of paragraph (c)(1)(i)(A) of this section—

(A) The failure to make use of an election (including, but not limited to, the ability to surrender losses, expenses or deductions) that would enable another person, corporation, or entity to use the losses, expenses, or deductions of the dual resident corporation to offset income under the income tax laws of the foreign country;

(B) The fact that the income tax laws of the foreign country deny the use of losses, expenses, or deductions of its corporate residents that are also residents for tax purposes of another country to offset income of another person, corporation, or entity;

(C) The fact that the other person, corporation, or entity does not have sufficient income to benefit from an offset permitted under the income tax laws of the foreign country for a particular taxable year; or

(D) The fact that the dual resident corporation has no losses, expenses, or deductions during a particular taxable year.

(iii) *Examples.* The following examples illustrate this paragraph (c)(1).

Example (1). DRC, a domestic corporation, is also subject to tax in Country Y on its worldwide income. DRC has been filing a consolidated return for U.S. income tax purposes with DP, its domestic parent. DRC has also been able to use its losses to offset income of its affiliates in Country Y by using Country Y's form of consolidation. In order to prevent companies like DRC from taking losses against income of affiliates under Country Y law and then again using the losses of DRC to offset income of affiliates for U.S. tax purposes. Country Y law prevents a company which is also subject to tax on its worldwide income in another country, or is subject to tax on a residence basis in another country, from using the Country Y form of consolidation. DRC is a dual resident corporation as defined in paragraph (b)(3) of this section. DRC's losses are dual consolidated losses as defined in paragraph (b)(2) of this section which under paragraph (a) of this section may not be used to offset income of any other U.S. affiliate of DRC. The Country Y statute does not cause the exception provided by this paragraph (c)(1) to apply.

Example (2). P, a domestic corporation, owns DRC, a domestic corporation which is also subject to the income tax laws of Country Z on a residence basis, and FS, a Country Z corporation. Under Country Z laws, income or losses of DRC may not be consolidated with income or losses of P or FS. There is, however, a provision under Country Z's law by which DRC's unused losses could be carried forward, acquired, and used by FS if DRC is merged into FS. DRC's dual consolidated loss does not qualify for the exception from application of paragraph (a) provided by this paragraph (c)(1) because of the loss carryforward provisions under Country Z's income tax laws. However, DRC may qualify for an exemption from paragraph (a) of this section under the provisions of paragraph (c)(3) of this section.

Example (3). DRC is a dual resident corporation subject to tax on a residence basis in foreign country Y. Under the income tax laws of Y, DRC could elect to use its losses to offset the income of foreign entity FE on a Country Y consolidated income tax return for the taxable year ending December 31, 1987. Regardless of whether such election is made, DRC fails to satisfy the requirement of paragraph (c)(1)(i)(A) of this section.

Example (4). The same facts apply as in *Example* (3), except that Country Y changes its income tax law, effective as of January 1, 1987, to prevent the consolidation of losses by dual resident corporations. Under paragraph (c)(1)(ii)(B) of this section, the fact that this Country Y legislation prevents DRC from using its losses to offset the income of FE is disregarded and DRC fails to satisfy the requirement of paragraph (c)(1)(i)(A) of this section.

Example (5). The same facts apply as in *Example* (4), except that FE has no taxable income in taxable years 1987 through 1989. Moreover, DRC is profitable throughout this period and consequently has no losses which it could share with FE. Under paragraphs (c)(1)(ii) (C) and (D) of this section, the fact that FE would not receive a tax benefit from consolidation with DRC on a Country Y return is disregarded and DRC fails to satisfy the requirement of paragraph (c)(1)(i)(A) of this section. Because DRC does not have a net operating loss during 1987 through 1989, section 1503(d) does not affect the consolidation of DRC on a U.S. return for these years. However, DRC's failure to satisfy paragraph (c)(1)(i)(A) of this section at all times after December 31, 1986 will make it ineligible for the exception described in paragraph (c)(1) of this section with respect to any future taxable year in which it incurs a net operating loss.

Example (6). The same facts apply as in *Example* (5). In 1990, FE is transferred and is no longer eligible for consolidation on a Country Y return. There are no other entities with which DRC could consolidate under the income tax laws of Y. Nevertheless, since FE and DRC could have consolidated on a Country Y return during the period after December 31, 1986 and before the transfer of FE, DRC fails to satisfy the requirement of paragraph (c)(1)(i)(A) of this section in 1990 and in all future taxable years.

(2) *Elective agreement in place between United States and the foreign country.* Paragraph (a) of this section shall not apply to a dual consolidated loss to the extent such loss is subject to an election by the dual resident corporation to deduct the loss in the United States pursuant to an agreement entered into between the United States and the foreign country which puts into place an elective procedure through which losses would offset income in only one country.

(3) *Agreement to amend returns upon later use of losses, expenses, or deductions of a dual resident corporation*—(i) *In general.* Notwithstanding that, under the income tax laws of the foreign country, the losses, expenses, or deductions of the dual resident corporation can be carried over or back to offset, by some means, the income of any other person, corporation, or entity in other taxable years, paragraph (a) of this section shall not apply to a dual consolidated loss of that dual resident corporation if the requirements described in this paragraph (c)(3)(i) are satisfied.

(A) At no time after December 31, 1986, has there been any other person, corporation, or entity which, under the income tax laws of the foreign country, is permitted to use by any means the losses, expenses, or deductions of the dual resident corporation to offset income. For purposes of the preceding sentence, none of the circumstances described in paragraphs (c)(1)(ii) (A) through (D) of this section shall constitute a satisfaction of this paragraph (c)(3)(i)(A).

(B) The affiliated group or, if there is no affiliated group filing a consolidated return, the dual resident corporation which incurs the loss, files with its U.S. tax return for the taxable year in which the dual consolidated loss arises a binding agreement described in paragraphs (c)(3) (ii) and (iii) of this section. The agreement must be filed under this paragraph (c)(3) even if the only effect of the dual consolidated loss is to increase a net operating loss for U.S. tax purposes.

(ii) *Description of agreement.* Except as otherwise provided in paragraph (c)(3)(viii) of this section, the agreement described in this paragraph (c)(3)(ii) must be attached to, and filed by the due date (including extensions) of, the tax return of the affiliated group or dual resident corporation for the taxable year in which the dual consolidated loss arises. The agreement must be signed under penalties of perjury by the person who signs the tax return of the group or dual resident corporation. The agreement must include the following items, in paragraphs labeled to correspond with the subdivisions set forth below:

(A) The name, address, identifying number, and place and date of incorporation of the dual resident corporation and the country or countries which tax the dual resident corporation on a residence basis or which tax the worldwide income of the dual resident corporation;

(B) A statement that the document submitted constitutes the agreement of the affiliated group or dual resident corporation in accordance with the requirements of § 1.1503–2T(c)(3);

(C) A statement of the amount of the dual consolidated loss to be covered by the agreement and the year in which it arose;

(D) The agreement of the group or dual resident corporation to amend returns, as described in paragraph (c)(3)(iii) of this section;

(E) A waiver of the period of limitations, as described in paragraph (c)(3)(iv) of this section; and

(F) An agreement to file with the tax returns of the group or dual resident corporation for each of the fifteen years following the year the dual consolidated loss arose a waiver of the period of limitation, as described in paragrapah (c)(3)(iv) of this section, and a certification as described in paragraph (c)(3)(v) of this section.

(iii) *Terms of agreement.* The affiliated group or dual resident corporation must agree that if there is a "triggering event" described in this paragraph (c)(3)(iii), then, the affiliated group filing a consolidated return, or if there is no affiliated group filing a consolidated return, the dual resident corporation, shall, within 90 days after the date of occurrence of the triggering event, file an amended U.S. income tax return for the taxable year in which the dual consolidated loss arose reporting the dual consolidated loss on the amended return as a loss to which paragraph (a) of this section applies. An amended U.S. income tax return must also be filed for any other taxable year in which the tax liability increases as a result of such applications of paragraph (a) of this section. In addition, upon examination, the group or dual resident corporation must provide to the District Director a schedule of the amended carryforward and carryback losses and credits for each of the group's or dual resident corporation's taxable years for which no amended return is required to be filed pursuant to this paragraph (c)(3)(iii). For purposes of section 6601, the last date prescribed for payment of the additional amount of tax shown on an amended return filed pursuant to this paragraph (c)(3)(iii) shall be the same date as the date prescribed for the payment of tax for the taxable year with respect to which the amended return is filed. Any of the following events shall constitute a "triggering event" for purposes of this section—

(A) There is a failure for any taxable year to file the annual waiver or certification described in paragraphs (c)(3)(iv) and (v) of this section.

(B) Prior to the close of the fifteenth taxable year following the taxable year in which the dual consolidated loss arose, any of the following events—

(*1*) There is a failure to satisfy both the requirement of paragraph (c)(3)(i)(A) of this section and the requirements of paragraph (c)(4) of this section;

(*2*) Where the agreement is made by an affiliated group filing a consolidated return, the dual resident corporation (or its successor-in-interest) ceases to be a member of the affiliated group;

(*3*) Where the agreement is made by a dual resident corporation that is not a member of an affiliated group filing a consolidated return, the dual resident corporation is no longer in existence; or

(*4*) Where the dual resident corporation is a separate unit of a domestic corporation, the domestic corporation sells or transfers the dual resident corporation.

(iv) *Waiver of period of limitation*. The affiliated group or the dual resident corporation (or the successor-in-interest of such group or dual resident corporation) must file, with the agreement to amend returns and with the tax return for each of the fifteen taxable years following the taxable year in which the dual consolidated loss arose, a waiver of the limitation on assessment of any tax resulting from the amendment of any return as described in paragraph (c)(3)(iii) of this section. The waiver shall extend the period for assessment of such tax to a date not earlier than three years after the return is filed for the fifteenth taxable year following the taxable year in which the dual consolidated loss arose. The waiver shall also contain such other terms with respect to assessment as may be considered by the Commissioner to be necessary to insure the assessment and collection of the correct tax liability for each year for which the waiver is required. The waiver must be signed by a person authorized to sign the agreement described in paragraph (c)(3)(ii) of this section. A failure, at any time, to comply with the requirements of this paragraph (c)(3) or with the terms of any agreement filed pursuant to this paragraph (c)(3) shall extend the period of assessment of such tax until three years after the date on which the Internal Revenue Service receives actual notice of the use of or of the ability to use the losses, expenses, or deductions of the dual resident corporation to offset the income of another person, corporation, or entity under the income tax laws of the foreign country.

(v) *Annual certification*. The affiliated group or the dual resident corporation (or the successor-in-interest of such group or dual resident corporation) must file with its income tax return for each of the fifteen taxable years following the taxable year in which the dual consolidated loss arose a certification that the losses, expenses, or deductions of the dual resident corporation were not used or permitted to be used to offset the income of another person, corporation, or entity under the income tax laws of a foreign country. The annual certification pursuant to this paragraph (c)(3)(v) must be signed under penalties of perjury by a person authorized to sign the agreement described in paragraph (c)(3)(ii) of this section. The certification must identify the dual consolidated loss with respect to which it is given by setting forth the taxpayer's year in which the loss arose and the amount of such loss and must warrant that arrangements have been made to insure that the group or dual resident corporation will be informed of any subsequent use of or ability to use the losses, expenses, or deductions of the dual resident corporation to offset the income of another person, corporation, or entity under the income tax laws of the foreign country. If dual consolidated losses of more than one taxable year are subject to the rules of this paragraph (c)(3), the certifications for those years may be combined in a single document, but each dual consolidated loss must be separately identified.

(vi) *Special rules for a succeeding group or a successor-in-interest*—(A) *Ceasing to be a member of the affiliated group.* For purposes of this paragraph (c)(3), and except as otherwise provided in this paragraph (c)(3)(vi), a dual resident corporation shall be deemed to have ceased to be a member of the affiliated group that filed the agreement described in paragraph (c)(3)(ii) of this section if it is no longer a member of that group, as defined in § 1.1502–1(b), or if the group ceases to exist because the common parent is no longer in existence or is no longer a common parent or the group no longer files on the basis of a consolidated return. However, the obligation to file an amended return pursuant to the agreement described in paragraph (c)(3)(ii) of this section shall not apply and the dual resident corporation shall not be deemed to have ceased to be a member of the group for purposes of this paragraph (c)(3) where the dual resident corporation ceases to be a member of the group solely by reason of an acquisition of its assets by a member of the group in a transaction to which section 381(a) applies provided the successor-in-interest of the dual resident corporation continues to be a member of the group.

(B) *Special rules for a succeeding group.* The obligation to file an amended return pursuant to the agreement described in paragraph (c)(3)(ii) of this section shall not apply where the dual resident corporation becomes a member of a succeeding group as a result of an acquisition described in § 1.1502–13(f)(2)(i) (*a*) or (*b*) (relating generally to the acquisition of assets of, by, or from a member of the affiliated group in a tax-free reorganization) and the succeeding group attaches to, and files with, its timely filed (including extensions) tax return for the taxable year in which the acquisition takes place a binding agreement—

(*1*) Which sets forth the same terms as are described in paragraph (c)(3)(ii) of this section,

(*2*) In which the group agrees to be bound by the terms of the agreement previously filed by the terminating group, and

(*3*) In which the group agrees to all the terms set forth in paragraph (c)(3)(iii) of this section.

The agreement must be signed under penalties of perjury by the person who signs the tax return of the succeeding group.

(C) *Special rules for a successor-in-interest.* In the case of a dual resident corporation that was not a member of an affiliated group filing a consolidated return in the taxable year in which the dual consolidated loss arose and that filed an agreement described in paragraph (c)(3)(ii) of this section, the assets of which are acquired in a transaction described in section 381(a), such corporation shall not be required to file an amended return pursuant to paragraph (c)(3)(iii)(B)(*3*) of this section provided its successor-in-interest attaches a binding agreement to its timely filed (including extensions) tax return for the taxable year in which the acquisition takes place. The agreement must be signed under penalties of perjury by the person who signs the tax return of the successor-in-interest. The agreement must:

(*1*) Set forth the same terms as are described in paragraph (c)(3)(ii) of this section,

(*2*) State the agreement of the successor-in-interest to be bound by the terms of the agreement previously filed by the dual resident corporation, and

(*3*) State the agreement of the successor-in-interest to all the terms set forth in paragraph (c)(3)(iii) of this section.

(vii) *Definitions.* For purposes of this section—

(A) The terms *succeeding group* and *terminating group* shall have the same meaning as in § 1.1502.13(f)(2)(i); and

(B) The term *successor-in-interest* shall mean an acquiring corporation that succeeds to the tax attributes of an acquired corporation under the provisions of section 381 by reason of a transaction described in section 381(a).

(viii) *Transition rules.* An affiliated group or a dual resident corporation (or a succeeding group or a successor-in-interest of a dual resident corporation) that meets the eligibility requirements described in paragraph (c)(3)(ix) of this section will be permitted to apply the transition rules in this paragraph (c)(3)(viii) for taxable years ending before December 31, 1989.

(A) The agreement in satisfaction of paragraph (c)(3) (ii) or (vi) of this section may be attached to the timely filed (including extensions) tax return of the affiliated group or of the dual resident corporation (or the succeeding group or the successor-in-interest of such dual resident corporation) for the first taxable year which ends on or after December 31, 1989. The agreement required for each of the taxable years ending before December 31, 1989 and for the first taxable year ending on or after December 31, 1989 may be combined on a single document.

(B) The requirement of paragraphs (c)(3)(iv) and (c)(3)(v) of this section regarding the filing of an annual waiver of the period of limitation and certification shall be satisfied for the taxable years ending before December 31, 1989, and no failure to file shall be deemed to have occurred with respect to such taxable years for purposes of paragraph (c)(3)(iii)(A) of this section if the waivers and certifications required under paragraphs (c)(3)(iv) and (c)(3)(v) of this section are filed with the tax return for the first taxable year ending on or after December 31, 1989.

(ix) *Eligibility for transition rules.* The rules in paragraph (c)(3)(viii) of this section shall apply only if, as of the date of the agreement in satisfaction of paragraph (c)(3) (ii) or (vi) of this section and filed pursuant to paragraph (c)(3)(viii) of this section, none of the triggering events described in paragraph (c)(3)(iii)(B) of this section has occurred.

(4) *No ability to use dual consolidated loss under foreign law after restructuring*—(i) *In general.* Notwithstanding that a dual resident corporation fails to satisfy either paragraph (c)(1)(i)(A) or (c)(3)(i)(A) of this section, paragraph (a) of this section shall not apply to any dual consolidated loss (or portion of a dual consolidated loss) described in paragraph (c)(4)(iii) of this section provided the requirements of either paragraph (c)(1)(i)(B) or (c)(3)(i)(B) of this section are satisfied and a restructuring that meets the requirements of paragraph (c)(4)(ii) of this section has been completed.

(ii) *Qualified restructuring.* A restructuring meets the requirements of this paragraph (c)(4)(ii) if it is completed on or before December 31, 1989, in the foreign country so that at all times from the date of such restructuring to the close of the taxable year in which the dual consolidated loss arises, there is no other person, corporation, or entity which, under the income tax laws of the foreign country, is permitted to use by any means the losses, expenses, or deductions of the dual resident corporation to offset income. For purposes of the preceding sentence, none of the circumstances described in paragraphs (c)(1)(ii) (A) through (D) of this section shall constitute a satisfaction of this paragraph (c)(4)(ii).

(iii) *Qualified losses.* Losses to which paragraph (c)(4)(i) of this section applies are the dual consolidated losses of a dual resident corporation that arise in a taxable year beginning after the restructuring described in paragraph (c)(4)(ii) of this section (or the portion of any dual consolidated loss that arises during that portion of the taxable year following the restructuring described in paragraph (c)(4)(ii) of this section). For purposes of determining the amount of the dual consolidated loss which arises in that portion of the taxable year following the restructuring, in no event shall more than a pro rata portion of the dual consolidated loss commensurate with the portion of the taxable year beginning with the date of completion of the restructuring and ending on the last day of that same taxable year be allocated to that portion of the taxable year following the restructuring.

(d) *Special rule for separate units*—(1) *Separate units characterized as corporations under foreign law.* If a separate unit of a domestic corporation consists of an interest in an entity (including a foreign branch) that for U.S. tax purposes is not taxable as an association, but the entity is subject to income tax in a foreign jurisdiction as a corporation either on its worldwide income or on a residence basis (and not on a source basis), then for purposes of this section such separate unit of the domestic corporation will be treated as if it were a dual resident corporation and a wholly-owned domestic subsidiary of the domestic corporation. For purposes of paragraphs (c) (3) and (4) of this section, any agreement, waiver and certification required to be filed with respect to such dual resident corporation shall be filed with the federal income tax return of the domestic corporation owning the separate unit or by the affiliated group with which the domestic corporation files a consolidated return.

(2) *Other separate units.* Except as provided in paragraph (d)(3) of this section, if a separate unit of a domestic corporation (other than a separate unit described in paragraph (d)(1) of this section) is permitted under the income tax laws of a foreign country—

(i) To use its losses, expenses, or deductions to offset the income of any other person, corporation, or entity in the taxable year in which the dual consolidated loss arises; or

(ii) To carry over or back its losses, expenses, or deductions so that they may offset the income of any other person, corporation, or entity in other years, then such separate unit will be treated for purposes of this section as if it were a dual resident corporation and a wholly-owned domestic subsidiary of the domestic corporation. For purposes of the preceding sentence, none of the circumstances described in paragraphs (c)(1)(ii) (A) through (D) of this section shall preclude a separate unit from being treated as a dual resident corporation and a separate domestic corporation under this paragraph (d)(2). This paragraph (d)(2) applies regardless of whether the domestic corporation is a member of an affiliated group, and, if it is, regardless of whether the group files a consolidated return.

(3) *Certification.* Paragraph (d)(2) of this section shall not apply with respect to any taxable year for which the domestic corporation owning the separate unit (or the affiliated group of which the domestic corporation is a member) files a certification as described in this paragraph (d)(3). The certification must be attached to, and filed by the due date (including extensions) of, the federal income tax return of the domestic corporation owning the separate unit (or the affiliated group with which the domestic corporation files a consolidated return) for the taxable year to which it applies. With respect to returns filed without an attached certification for taxable years ending before December 31, 1989, the certification in satisfaction of this paragraph (d)(3) may be attached to the return for the first taxable year ending on or after December 31, 1989. The certification must be signed under penalties of perjury by the person who signs the return. The certification must include the following items, in paragraphs labeled to correspond with the subdivisions set forth below:

(i) A statement that the document submitted constitutes the certification required under the provisions of § 1.1503–2T(d)(3);

(ii) Identification of the separate unit, including the name under which it conducts business and its principal activity;

(iii) Identification of the total losses, expenses, and deductions incurred by the separate unit and included on the tax return for the taxable year;

(iv) Certification that no portion of the separate unit's losses, expenses or deductions identified above has been or will be used to offset the income of any other person, corporation, or entity under the income tax laws of the foreign country; and

(v) An agreement to comply with the recapture and interest charge requirements of paragraph (d)(4) of this section.

If the domestic corporation has more than one separate unit, the certification described above may be made on a single document, but the total losses, expenses, and deductions must be separately identified for each separate unit to which the certification applies.

(4) *Recapture upon subsequent use.* If in any taxable year any portion of the losses, expenses, or deductions of a separate unit which were the subject of a

certification filed under paragraph (d)(3) of this section are used by any means to offset the income of any other person, corporation, or entity under the income tax laws of a foreign country, then the total amount of the dual consolidated loss shall be recaptured and reported as income on the tax return of the domestic corporation (or the affiliated group with which the domestic corporation files a consolidated return) for the taxable year that includes the last day of the taxable year for foreign tax purposes during which such use occurred. In addition, the domestic corporation owning the separate unit (or the affiliated group with which the domestic files a consolidated return) shall pay an interest charge on the amount of additional tax owed as a result of the recapture described in the preceding sentence. Such interest shall be determined under the rules of section 6601(a) as if the additional amount of tax had accrued and been due and owing for the taxable year in which the losses, expenses, or deductions giving rise to the recapture gave rise to a tax benefit for U.S. income tax purposes. For purposes of this paragraph (d)(4), a tax benefit will be considered to have arisen in a taxable year in which a loss that would have been considered a dual consolidated loss if paragraph (d)(3) of this section had not applied has reduced the U.S. income tax liability of the domestic corporation or of the affiliated group with which it files a consolidated return.

(5) *Treatment of separate units as separate entities*—(i) *In general.* A separate unit of a domestic corporation will be treated as a separate entity for purposes of determining under this section whether losses of one entity are permitted under the income tax laws of the foreign country to offset the income of another entity.

(ii) *Exception for separate units in same country.* If two or more separate units (not described in paragraph (d)(1) of this section) located in the same foreign country are owned by a single domestic corporation and the income and losses of such units are consolidated on an income tax return in that foreign country, then the separate units will be treated as one separate unit for purposes of paragraph (d)(2) of this section.

(6) *Examples.* The following examples illustrate this paragraph (d).

Example (1). X, a member of a U.S. affiliated group, has a foreign branch (as defined in §1.367(a)–6T(g)) in Country Y. Under the Country Y income tax laws, the branch will be taxed as a permanent establishment and its income and losses may be used (on an elective basis) in the Country Y form of consolidation to offset the income of Z, an affiliate of X, under Country Y law. The branch of X incurs a net operating loss during the taxable year ending December 31, 1987. The foreign branch of X will be treated as a separate domestic corporation and a dual resident corporation under paragraph (d)(2) of this section, and its net operating loss will constitute a dual consolidated loss. Consequently, under paragraph (a) of this section, the branch's net operating loss may not be used to offset the income of any other U.S. affiliate or any income of X other than income derived from the branch operations. However, the branch will not be treated as a dual resident corporation if X (or the affiliated group of which X is a member) files a certification for the taxable year as described in paragraph (d)(3) of this section that its net operating loss was not in fact used by Z (or any other entity) to offset income under the Country Y income tax laws, and that such loss will be recaptured if it is so used in the future.

Example (2). X is classified as a partnership for U.S. tax purposes under Code section 7701 and applicable regulations. A, B and C are the sole partners of X. A and B are domestic corporations and C is a resident of foreign country Y. Under Country Y's law, X is classified as a corporation and its income and losses may be used in the Country Y form of consolidation to offset the income of the companies that are affiliates of X. X generates net operating losses. The partnership interests held by A and B are each treated as separate domestic corporations and dual resident corporations under paragraph (d)(1) of this section. A's and B's pro rata share of the losses of X are dual consolidated losses as defined in paragraph (b)(2) of this section. Under paragraph (a) of this section, the losses of X may not be used to offset the income of any other U.S. affiliate. A's pro rata share of losses of X may be used by A only to offset A's pro rata share of income of X. However, paragraph (a) of this section shall not apply to A's pro rata share of losses of X if A meets one of the exceptions described in paragraph (c) of this section. The same principles apply to limit the use of losses allocated to B.

Example (3). Domestic corporation W owns two unincorporated business operations in

Country Y. The two businesses, A and B, constitute separate foreign branches (as defined in §1.367(a)–6T(g)). Under the tax laws of Country Y, A is treated as a separate corporation and taxed on a residence basis. Thus, A is a separate unit described in paragraph (d)(1) of this section. B is not a separate unit described in paragraph (d)(1) of this section. W is a calendar year taxpayer for both United States and Country Y purposes. During the calendar year ending December 31, 1987, A operated at a loss and B was profitable. Country Y allows both of W's branches to report their combined operations on a single income tax return. Thus, the losses incurred by A may be used on the 1987 Country Y return to offset the income of B. A will be treated as a dual resident corporation under paragraph (d)(1) of this section. Because A is a separate unit described in paragraph (d)(1) of this section, paragraph (d)(5)(i) of this section treats A and B as separate entities for purposes of determining whether the losses, expenses, or deductions of A may be used to offset the income of another person, corporation, or entity and the exception in paragraph (d)(5)(ii) of this section does not apply. Since the loss incurred by A may be used to offset B's income under foreign tax laws, W will not qualify for the exceptions described in paragraph (c) of this section. Accordingly, W will report the income from B on its 1987 U.S. tax return, but will not be allowed to use the losses from A to offset that income or the income from any source other than from the operations of A.

(e) *Special rule for use of dual consolidated loss to offset tainted income*—(1) *In general.* The dual consolidated loss of any dual resident corporation that ceases to be a dual resident corporation shall not be used to offset income of such corporation to the extent that such income is tainted income as defined in paragraph (e)(2) of this section.

(2) *Tainted income defined.* Tainted income is any income derived from tainted assets (as defined in paragraph (e)(3) of this section), during the period beginning on the date of the transfer or acquisition of tainted assets and ending at the close of the fifteenth taxable year following the taxable year in which the dual resident corporation ceased to be a dual resident corporation.

(3) *Tainted assets defined.* Tainted assets are any assets transferred to or acquired by a dual resident corporation in a non-recognition transaction (as defined in section 7701(a)(45)) at any time during the three taxable years immediately preceding the taxable year in which such dual resident corporation ceased to be a dual resident corporation or at any time during the 15 taxable years immediately following the taxable year in which a dual resident corporation ceased to be a dual resident corporation. Tainted assets shall not include assets that were transferred to or acquired by such dual resident corporation on or before December 31, 1986.

(4) *Exception.* For assets transferred to or acquired by a dual resident corporation prior to the time it ceased to be a dual resident corporation, if it can be shown that, for the year in which assets were transferred to or acquired by such corporation, the corporation did not incur a dual consolidated loss (or carry forward a dual consolidated loss to such year) and that there was a valid business reason for the transfer or acquisition of such assets, the income derived from such assets shall not be subject to the limitation described in paragraph (e)(1) of this section.

(f) *Special rules for accounting for dual consolidated losses*—(1) *Determination of amount of dual consolidated loss*—(i) *Dual resident corporation that is a member of an affiliated group.* For purposes of determining whether a dual resident corporation that is a member of an affiliated group filing a consolidated return has a dual consolidated loss for the taxable year, the dual resident corporation shall compute its taxable income (or loss) in accordance with the provisions of §1.1502–12 (relating to computation of separate taxable income of a member of an affiliated group filing a consolidated return), determined by taking into account the adjustments provided in §1.1502–79A(a)(3), that is:

(A) The portion of the consolidated dividends received deduction, the consolidated charitable contributions deductions, and the consolidated section 247 deduction, attributable to such member;

(B) Such member's capital gain net income (determined without regard to any net capital loss carryover attributable to such member);

(C) Such member's net capital loss and section 1231 net loss, reduced by the portion of the consolidated net capital loss attributable to such member (as determined under paragraph (b)(2) of § 1.1502–22; and

(D) The portion of any consolidated net capital loss carryover attributable to such member which is absorbed in the taxable year.

For purposes of this paragraph (f), any income, gain, or loss of a dual resident corporation shall not be deferred or eliminated under § 1.1502–13 (b)(2) or (c), or § 1.1502–14. Further, sections 267 and 163(e)(3) shall not apply.

(ii) *Dual resident corporation that is a separate unit of a domestic corporation.* For purposes of determining whether a dual resident corporation that is a separate unit of a domestic corporation has a dual consolidated loss for the taxable year, the dual resident corporation shall compute its taxable income (or loss) as if it were a separate domestic corporation and a dual resident corporation, using only those items of income, expenses, and deductions which are otherwise attributable to such separate unit.

(2) *Effect of dual consolidated loss.* For any taxable year in which a dual resident corporation has a dual consolidated loss to which paragraph (a) of this section applies, the following rules shall apply.

(i) If the dual resident corporation is a member of an affiliated group filing a consolidated return, then such affiliated group shall compute its taxable income without regard to the items of income, loss, or deduction of the dual resident corporation for the taxable year. The amount of taxable loss of the dual resident corporation for the taxable year shall be the amount of dual consolidated loss determined under paragraph (f)(1)(i) of this section. Such loss may be carried over or back for use in other taxable years as a net operating loss deduction by the dual resident corporation to the extent permitted under section 172. However, such loss shall be treated as a loss incurred by the dual resident corporation in a separate return limitation year, and, including in the case of a dual resident corporation that is a common parent, shall be subject to all of the limitations of §§ 1.1502–21A(c)(2) or 1.1502–21(c) (as appropriate) (relating to limitations on net operating loss carryovers and carrybacks from separate return limitation years).

(ii) If the dual resident corporation is a separate unit of a domestic corporation, then such domestic corporation and the affiliated group with which it may file a consolidated return shall compute taxable income for the taxable year without regard to the items of income, loss, or deductions of the dual resident corporation for the current year. Further, the loss of the dual resident corporation (the separate unit of the domestic corporation) shall be treated as a loss incurred by a separate corporation and its use shall be subject to all of the limitations of §§ 1.1502–21A(c)(2) or 1.1502–21(c) (as appropriate) (relating to limitations on net operating loss carryovers and carrybacks from separate return limitation years), as if such dual resident corporation were filing a consolidated return with the domestic corporation or with the affiliated group with which the domestic corporation files a consolidated return.

(3) *Basis adjustments for dual consolidated losses.* When a dual resident corporation is a member of an affiliated group filing a consolidated return, each member owning stock in the dual resident corporation shall adjust the basis of the stock in the manner described in subparagraphs (i) and (ii) of this paragraph (f)(3).

(i) *Positive adjustment.* Adjustments shall be made in accordance with the principles of § 1.1502–32(b)(1), except that there shall be no positive adjustment under § 1.1502–32(b)(1)(ii) for any amount of the dual consolidated loss which is not absorbed. There shall be no positive adjustment for any amount included in income upon the use of a dual consolidated loss in a foreign country under § 1.1503–2T(c)(3).

(ii) *Negative adjustments.* Adjustments shall be made in accordance with the principles of § 1.1502–32(b)(2), except that there shall be no negative adjustments under § 1.1502–32(b)(2)(ii) for the amount of the dual consolidated loss.

(4) *Examples.* The following examples illustrate this paragraph (f).

Example (1). (i) P, S1, S2, and T are domestic corporations. P owns all of the stock of S1 and S2. S2 owns all of the stock of T. T is a dual resident corporation. None of the exceptions described in paragraph (c) apply with respect to T. P, S1, S2, and T have filed and continue to file a consolidated federal income tax return. X, Y, and Bank are corporations which are not members of the affiliated group of which P is the common parent.

(ii) At the beginning of 1989, P had a basis in S2 of $1000. S2 had a basis in T of $500.

(iii) In 1989, T had an interest expense of $100 on a loan from Bank. T sold a noncapital item *u* in which it had a basis of $10 to S1 for $50. T sold noncapital item *v* in which it had a basis of $200 to S1 for $100. The sale of *u* and *v* are deferred intercompany transactions described in § 1.1502–13(a)(2). S1 had separate taxable income calculated in accordance with § 1.1502–12 of $200. In addition, S1 sold item *w* in which it had a basis of $50 to T for $100. The sale of item *w* is a deferred intercompany transaction described in § 1.1502–13(a)(2). P and S2 had no items of income, loss, or deduction for 1989.

(iv) For purposes of determining whether T has a dual consolidated loss in 1989 and the amount of such dual consolidated loss, T's taxable income (loss) is calculated under paragraph (f)(1) as follows:

($100)	interest expense to Bank
($100)	sale of item *v* to S1
$40	sale of item *u* to S1
($160)	

T therefore has a dual consolidated loss of $160 for 1989.

(v) Because T has a dual consolidated loss for the year, the consolidated taxable income of the P affiliated group is calculated without regard to the items of income, loss, or deduction of T. However, T is still a member of the P affiliated group. Therefore, the consolidated taxable income of the P group is $200 (attributable solely to the income of S1). The $50 gain recognized by S1 upon the sale of item *w* to T is deferred pursuant to § 1.1502–13(c)(1).

(vi) S2 may not make the positive adjustment provided for in § 1.1502–32(b)(1)(ii) to its basis in T for the dual consolidated loss incurred by T. However, S2 must make the negative adjustment provided for in § 1.1502–32(b)(2)(i) for the amount of its allocable part of the deficit in earnings and profits of T for the taxable year. Thus, as provided in § 1.1502–32(e)(1), S2 shall make a net negative adjustment to its basis in T of $160 and S2's basis in T is now $340. As provided in § 1.1502–33(b)(4)(ii)(a), S2's earnings and profits for 1989 must reflect S2's decrease in its basis in T stock for the taxable year. Since S2 has no other earnings and profits for the taxable year, S2 has a deficit in earnings and profits of $160 for the taxable year. As provided in § 1.1502–32(b)(2)(i), P must make a negative adjustment for the amount of its allocable part of the deficit in earnings and profits of S2 for the taxable year. Thus, P must make a net negative adjustment to its basis in S2 of $160 and P's basis in S2 is now $840.

Example (2). (i) The facts are the same as in *Example (1)*, except that in 1990, S1 sold items *u* and *v* to X for no gain or loss. T incurred an interest expense of $100 on a loan from Bank. T also sold item *q* in which it had a basis of $50 to S1 for $100. T also sold item *r* in which it had a basis of $100 to Y for $300. P and S2 had no items of income, loss, or deduction for 1990.

(ii) For purposes of determining whether T has a dual consolidated loss in 1990 and the amount of such dual consolidated loss, T's taxable income (loss) is:

($100)	interest expense to Bank
$50	sale of item *q* to S1
$200	sale of item *r* to Y
$150	

T therefore has no dual consolidated loss for 1990.

(iii) Since T does not have a dual consolidated loss for the taxable year, the group's consolidated taxable income is calculated in accordance with the general rule of § 1.1502–11 and not in accordance with the rule of § 1.1503–2T(f)(2). T has separate taxable income calculated in accordance with § 1.1502–12 of $100. On the disposition of items *u* and *v* outside the P affiliated group, no gain or loss is restored to income to T in accordance with § 1.1502–13(f)(1)(i) because the gain or loss on these items was not deferred, pursuant to § 1.1503–2T(f)(3). The $50 gain on the sale of item *q* from T to S1 is an intercompany transaction on which the gain or loss recognized is deferred pursuant to § 1.1502–13(c)(1). The consolidated taxable income of the P affiliated group computed without regard to the consolidated net operating loss deduction is $100.

(iv) As provided by § 1.1502–21A(c)(2) of the regulations, the amount of the dual consolidated loss arising in 1989 which may be absorbed by the P affiliated group in 1990 is $100; that is, the consolidated taxable income computed without regard to the consolidated net operating loss deduction minus such consolidated taxable income recomputed by excluding the items of income and deduction of T. Section 1.1502–21A(c) allows $100 of the dual consolidated loss to be included in the consolidated net operating loss deduction for 1990. The consolidated taxable income of the P group for 1990 is $0.

(v) S2 must make the positive adjustment provided for in § 1.1502–32(b)(1)(i) to its basis in T for the amount of its allocable part of the undistributed earnings and profits of T for the taxable year. S2 can not make the negative adjustment provided for in § 1.1502–32(b)(2)(ii) for the dual consolidated loss of T incurred in 1989 and absorbed in 1990. Thus, as provided in §1.1502–32(e)(2), S2 shall make a net positive adjustment to its basis in T of $100 and S2's basis in T is now $440. As provided in §1.1502–33(b)(4)(ii)(a), S2's earnings and profits for 1989 must reflect S2's increase in its basis in T stock for the taxable year. Since S2 has no other earnings and profits for the taxable year, S2 has earnings and profits of $100 for the taxable year. As provided in §1.1502–32(b)(1)(i), P must make a positive adjustment for the amount of its allocable part of the undistributed earnings and profits of S2 for the taxable year. Thus, P must make a net positive adjustment to its basis in S2 of $100 and P's basis in S2 is now $940.

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