

§ 1.56A-2

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full taxation by reason of certain deductions (such as percentage depletion) or by reason of a special rate of tax (such as the rate of tax on corporate capital gains). The tax imposed by section 56 is in addition to the other taxes imposed by chapter 1.

(b) *Computation of tax.* The amount of such tax is 10 percent of the excess (referred to herein as “the minimum tax base”) of—

(1) The sum of the taxpayer’s items of tax preference for such year in excess of the taxpayer’s minimum tax exemption (determined under § 1.58-1) for such year, over

(2) The sum of:

(i) The taxes imposed for such year under chapter 1 other than the taxes imposed by section 56 (relating to minimum tax for tax preferences), by section 531 (relating to accumulated earnings tax), or by section 541 (relating to personal holding company tax), reduced by the sum of the credits allowable under—

(a) Section 33 (relating to taxes of foreign countries and possessions of the United States),

(b) Section 37 (relating to retirement income),

(c) Section 38 (relating to investment credit),

(d) Section 40 (relating to expenses of work incentive programs), and

(e) Section 41 (relating to contributions to candidates for public office, and

(ii) The tax carryovers to such taxable year (as described in § 1.56A-5).

(c) *Special rule.* For purposes of paragraph (b) of this section where for any taxable year in which a tax is imposed under section 667 (relating to treatment of amounts deemed distributed by a trust in preceding years), that portion of the section 667 tax representing an increase in an earlier year’s chapter 1 taxes (as recomputed), which taxes are allowed as a reduction in any such earlier year’s minimum tax base, is not allowable as a reduction in the minimum tax base for the current taxable year. The remaining portion of the section 667 tax, representing the taxes imposed by section 56, section 531, and section 541, is not allowable as a reduction in the minimum tax base for any taxable year. Similarly, taxes

imposed under section 614(c)(4) (relating to increase in tax with respect to aggregation of certain mineral interests) or under section 1351(d) (relating to recoveries of foreign expropriation losses) for any taxable year are not allowed as a reduction in the minimum tax base for such taxable year to the extent they represent chapter 1 taxes which are allowed as a reduction in a minimum tax base for an earlier taxable year for purposes of the computations under section 614(c)(4) or section 1351(d) or to the extent they represent an increase in the tax imposed by section 56, section 531, or section 541 in an earlier taxable year.

[T.D. 7564, 43 FR 40466, Sept. 12, 1978. Redesignated and amended by T.D. 8138, 52 FR 15309, Apr. 28, 1987]

§ 1.56A-2 Deferral of tax liability in case of certain net operating losses.

(a) *In general.* Section 56(b) provides for the deferral of liability for the minimum tax where, for the taxable year, the taxpayer has—

(1) A net operating loss for such taxable year any portion of which (under sec. 172) remains as a net operating loss carryover to a succeeding taxable year, and

(2) Items of tax preference in excess of the minimum tax exemptions (hereinafter referred to as “excess tax preferences”).

In such a case, an amount of tax equal to the lesser of the tax imposed under section 56(a) (after allowance of the retirement income credit to the extent that such credit cannot be used against the other taxes imposed by chapter 1) or 10 percent of the amount of the net operating loss carryover described in subparagraph (1) of this paragraph is deferred. Such amount is not treated as tax imposed in such taxable year, but is treated as tax imposed in the succeeding taxable year or years in which the net operating loss is used as provided in paragraphs (b) and (c) of this section. Deferral will result in the above case regardless of the character of the tax preference items. Thus, for example, if the taxpayer has \$1,030,000 of items of tax preference, including the stock option item of tax preference, and a \$750,000 net operating loss available for carryover to subsequent

taxable years, the amount of tax imposed for the taxable year under section 56(a) is \$100,000 and \$75,000 is deferred by application of section 56(b). Therefore, only \$25,000 is treated as tax imposed for the taxable year. The provisions of this section are applicable in the case of a net operating loss or comparable item such as an operations loss under section 812 and an unused loss as defined in section 825(b).

(b) *Year of liability.* In any taxable year in which any portion of a net operating loss carryover attributable to the amount of excess tax preferences reduces taxable income (in the form of a net operating loss deduction), section 56(b)(2) treats as tax liability imposed in such taxable year an amount equal to 10 percent of such reduction. For this purpose, the portion of such net operating loss which is considered attributable to the amount of excess tax preferences is an amount equal to the lesser of such excess or the amount of the net operating loss carryover described in paragraph (a)(1) of this section. In no case, however, shall the total amount of tax imposed by reason of section 56(b) in subsequent years exceed the amount of the tax that was deferred in the loss year.

(c) *Priority of reduction.* (1) If a portion of a net operating loss is attributable to an amount of excess tax preferences, such portion is considered to reduce taxable income in succeeding taxable years only after the other portion (if any) of such net operating loss is used to reduce taxable income. Accordingly, if the amount of a net operating loss which may be carried to succeeding taxable years is reduced because of a modification required to be made pursuant to section 172(b)(2), such reduction is to be considered to be first from that portion of the net operating loss that is attributable to excess tax preferences. If a portion of a net operating loss carryover which is attributable to an amount of excess tax preferences is not used to reduce taxable income in any succeeding taxable year, no minimum tax will be imposed with respect to such portion.

(2) In the case of taxpayers with deductions attributable to foreign sources which are suspense preferences (as defined in paragraphs (c) (1)(ii) and

(2)(ii) of §1.58-7), the amount of such deductions is not included in the portion of the net operating loss not attributable to excess tax preferences. The portion of the net operating loss attributable to excess tax preferences is increased by the amount of suspense preferences which are, in accordance with the provisions of §1.58-7(c), converted to actual items of tax preference (and not used against the minimum tax exemption of the loss year) in subsequent taxable years. The other portion of the net operating loss is increased by the amount of suspense preferences which reduce taxable income in subsequent taxable years but are not converted to actual items of tax preference (or are so converted but used against the minimum tax exemption of the loss year). See §1.58-7(c)(1)(iii) example 4.

(d) *Multiple net operating loss carryovers.* In determining whether a net operating loss is used to reduce taxable income in a taxable year to which two or more net operating losses are carried, the ordering rules of section 172(b) and the regulations thereunder are to be applied. Thus, for example, the portion of a net operating loss carried over from an earlier taxable year which is attributable to an amount of excess tax preference is used to reduce taxable income in the carryover year before any portion of any other net operating loss carried over or back from a taxable year subsequent to the earlier taxable year.

(e) *Examples.* The application of this section may be illustrated by the following examples:

Example 1. In 1970, A, a calendar year taxpayer, who is a single individual, has \$180,000 of items of tax preference, a \$150,000 net operating loss of which \$100,000 may be carried forward, and no tax liability under chapter 1 without regard to the minimum tax. His minimum tax computed under section 56(a) is \$15,000 (10 percent times (\$180,000 minus \$30,000)). Under section 56(b)(1) an amount equal to the lesser of the amount determined under section 56(a) (\$15,000) or 10 percent of the net operating loss which may be carried forward (\$10,000) is treated as a deferred liability. Thus, his minimum tax liability for 1970 is \$5,000 (\$15,000 minimum tax under section 56(a) minus \$10,000 deferred tax liability under section 56(b)). If, in 1971, he has \$80,000 of taxable income before the deduction for the 1970 net operating loss, his minimum tax

liability is \$8,000 (10 percent of the amount by which the net operating loss carryforward from 1970 reduces taxable income) plus any minimum tax liability resulting from items of tax preference arising in 1971. If, by reason of the modifications provided by section 172(b)(2), no portion of the 1970 net operating loss remains as a carryover from 1971, no further minimum tax liability will result from the items of tax preference arising in 1970.

Example 2. In 1970, A, a calendar year taxpayer who is a single individual, has \$90,000 of items of tax preference, a \$100,000 net operating loss available for carryover to future taxable years, no net operating loss carryovers from prior taxable years, and no tax liability under chapter 1 without regard to the minimum tax. His minimum tax computed under section 56(a) is \$6,000 (10 percent times (\$90,000 minus \$30,000)). Under section 56(b)(1) an amount equal to the lesser of the amount determined under section 56(a) (\$6,000) or 10 percent of the net operating loss subject to carryforward (\$10,000) is treated as a deferred liability. Thus, A owes no minimum tax in 1970 and the entire \$6,000 of minimum tax liability is deferred. Under section 56(b)(2), the portion of the net operating loss attributable to the excess tax preferences described in section 56(b)(1)(B) is \$60,000.

(a) In 1971, A has \$25,000 of taxable income before the deduction for the 1970 net operating loss. Thus, in 1971, A has no minimum tax liability attributable to the items of tax preference arising in 1970 since, by application of section 56(b)(3), the portion of the 1970 net operating loss carryforward not attributable to the excess described in section 56(b)(1)(B), or \$40,000, is considered applied against taxable income before the remaining portion.

(b) In 1972, A has \$50,000 of taxable income before the deduction for the remaining 1970 net operating loss. Thus, the first \$15,000 of reduction in taxable income is considered as from the portion of the 1970 net operating loss carryforward not attributable to the excess tax preferences described in section 56(b)(1)(B) and the remaining \$35,000 of reduction in taxable income is considered attributable to such excess. A's 1972 minimum tax attributable to items of tax preference arising in 1970 is, therefore, \$3,500 (10 percent times \$35,000).

(c) In 1973, A has \$80,000 of taxable income before the deduction for the 1970 net operating loss. The remaining \$25,000 of the 1970 net operating loss carryforward is used to reduce taxable income in 1973. Thus, A's 1973 minimum tax liability attributable to items of tax preference arising in 1970 is \$2,500 (10 percent times \$25,000).

Example 3. In 1971, M Corporation, a Western Hemisphere trade corporation (as defined in sec. 921), reporting on a calendar year basis has \$20,000 of taxable income after all deductions including the Western Hemisphere

trade deduction allowable under section 922 in the amount of \$30,000. In 1970, M Corporation had a net operating loss of \$100,000 all of which was available for carryover to 1971 and \$60,000 of which was attributable to excess tax preferences. In computing the amount of the 1970 net operating loss carried over to 1972 pursuant to section 172(b), the 1971 Western Hemisphere trade corporation deduction is not taken into account. Thus, M Corporation's recomputed income under section 172(b) is \$50,000 (\$20,000 taxable income plus \$30,000 Western Hemisphere trade corporation deduction). Pursuant to paragraph (c)(1) of this section, \$20,000 of the \$40,000 portion of the 1970 net operating loss not attributable to excess tax preferences is considered to reduce taxable income in 1971 and \$30,000 of the \$60,000 portion of the 1970 net operating loss attributable to excess tax preferences is considered reduced pursuant to section 172(b)(2). Thus, M Corporation has no 1971 minimum tax attributable to items of tax preference arising in 1970. Of the \$50,000 remaining of the 1970 net operating loss, \$30,000 is attributable to excess tax preference.

Example 4. In 1972, A, a calendar year taxpayer who is a single individual, has \$25,000 of taxable income resulting from \$50,000 of net long-term capital gains. In 1971, A had a net operating loss of \$100,000 all of which is available to carryover to 1972 and \$60,000 of which is attributable to excess tax preferences. By application of section 172(b) only \$50,000 of the 1971 net operating loss is carried over to 1973. Pursuant to paragraph (c) of this section, \$25,000 of the \$40,000 portion of the 1971 net operating loss not attributable to excess tax preferences is considered to reduce taxable income in 1972. Of the \$50,000 remaining of the 1971 net operating loss, \$15,000 is not attributable to excess tax preferences and \$35,000 is attributable to excess tax preferences. Thus, the \$25,000 section 1202 deduction, in effect, reduces the portion of the 1971 net operating loss attributable to excess tax preferences. Because a net operating loss carryover is reduced to the extent of any section 1202 deduction, section 1202 deductions do not normally produce a tax benefit in such circumstances and, pursuant to § 1.57-4, would not be treated as items of tax preference. However, in this case, to the extent the portion of the 1971 net operating loss carryover attributable to excess tax preferences is reduced by reason of the section 1202 deduction, such deduction does result in a tax benefit to the taxpayer and is, therefore, treated as an item of tax preference in 1971. See § 1.57-4(b)(2).

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