Internal Revenue
bulletin

Bulletin No. 2008-44
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

T.D. 9424, page 1012.

Final regulations under section 1502 of the Code provide rules for determining the tax consequences of a member's transfer (including by deconsolidation and worthlessness) of loss shares of subsidiary stock. The regulations also provide that section 362(e)(2) generally does not apply to transactions between members of a consolidated group.

REG–157711–02, page 1087.

This document contains a partial withdrawal of proposed regulations under section 1502 of the Code. Proposed section 1.1502-13(e)(4), which would have suspended the application of section 362(e)(2) in the case of intercompany transactions, and section 1502-32(c)(1)(ii), relating to the treatment of items attributable to property transferred in an intercompany section 362(e)(2) transaction, are withdrawn.

Notice 2008–94, page 1070.

This notice provides guidance on certain executive compensation provisions of the Emergency Economic Stabilization Act of 2008 (EESA). Section 302 of EESA added new sections 162(m)(5) and 280G(e) to the Code. Section 162(m) limits the deductibility of compensation paid to certain corporate executives and section 280G provides that a corporate executive's excess parachute payments are not deductible and imposes (under Code section 4999) an excise tax on the executive for those amounts.

Notice 2008–95, page 1076.

This notice provides instructions on how and where to file amended returns to take advantage of section 3082(a) of Public Law 110–289. This notice also provides a benefit to certain taxpayers who took casualty loss deductions resulting from Hurricanes Katrina, Wilma, or Rita and who later received certain grants in compensation.

Notice 2008–96, page 1077.

This notice updates and amplifies the procedures for the allocation of credits under the qualifying advanced coal project program of section 48A of the Code. Notice 2007–52 updated and amplified.

Notice 2008–97, page 1080.

This notice provides that no allocation of credits will be conducted in 2008–09 under the qualifying gasification project program of section 48B of the Code. Notice 2007–53 updated.

Notice 2008–100, page 1081.

Section 382. This document provides guidance regarding section 382 treatment of interests in a loss corporation acquired by the federal government pursuant to the Emergency Economic Stabilization Act of 2008.

Notice 2008–101, page 1082.

This notice provides clarification that, unless and until guidance is issued to the contrary, no amount furnished by the Treasury Department to a financial institution pursuant to the Troubled Asset Relief Program (TARP) established by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 will be treated as the provision of federal financial assistance within the meaning of section 597 of the Code.

(Continued on the next page)

Announcements of Disbarments and Suspensions begin on page 1090.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Rev. Proc. 2008–65, page 1082.
Section 168(k)(4) guidance. This procedure clarifies the effects of making the Code section 168(k)(4) election to forgo additional first year depreciation and accelerate pre-2006 research and alternative minimum tax credits, the property eligible for the election, and the computation of the amount by which the business credit limitation under section 38(c) and alternative minimum tax credit limitation under section 53(c) may be increased if the election is made.

Announcement 2008–98, page 1087.
This announcement proposes amendments to the Qualified Intermediary (QI) Agreement and to the QI Guidance for External Auditors of Qualified Intermediaries. The amendments are intended to ensure that qualified intermediaries are taking the necessary steps to fully comply with their obligations under the QI agreement. The announcement also solicits public comments regarding the amendments.

EMPLOYEE PLANS

Notice 2008–94, page 1070.
This notice provides guidance on certain executive compensation provisions of the Emergency Economic Stabilization Act of 2008 (EESA). Section 302 of EESA added new sections 162(m)(5) and 280G(e) to the Code. Section 162(m) limits the deductibility of compensation paid to certain corporate executives and section 280G provides that a corporate executive's excess parachute payments are not deductible and imposes (under Code section 4999) an excise tax on the executive for those amounts.

Notice 2008–98, page 1080.
This notice provides that the IRS and Treasury intend to amend the normal retirement age regulations to change the effective date for governmental plans to plan years beginning on or after January 1, 2011. This will give governmental plans two additional years to comply with the requirements in the normal retirement age regulations.

EXEMPT ORGANIZATIONS

Announcement 2008–100, page 1090.
The IRS has revoked its determination that the Gordon Space Foundation of Detroit, MI, qualifies as an organization described in sections 501(c)(3) and 170(c)(2) of the Code.

ADMINISTRATIVE

Announcement 2008–98, page 1087.
This announcement proposes amendments to the Qualified Intermediary (QI) Agreement and to the QI Guidance for External Auditors of Qualified Intermediaries. The amendments are intended to ensure that qualified intermediaries are taking the necessary steps to fully comply with their obligations under the QI agreement. The announcement also solicits public comments regarding the amendments.

Announcement 2008–99, page 1089.
This document contains a correction to temporary regulations (T.D. 8073, 1986–1 C.B. 45) relating to effective dates and certain other issues arising under sections 91, 223, and 511–561 of the Tax Reform Act of 1984. This action is necessary because of changes to the applicable tax law made by the Tax Reform Act of 1984. The regulations will affect qualified employee benefit plans, welfare benefit funds, and employees receiving benefits through such plans.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 38.—General Business Credit

Section 168(k)(4) allows corporations to make an election to forgo additional first year depreciation and instead to increase their business credit limitation under § 38(c) (including the research credit determined under § 41) or alternative minimum tax credit limitation under § 53(c). See Rev. Proc. 2008-65, page 1082.

Section 41.—Credit for Increasing Research Activities

Section 168(k)(4) allows corporations to make an election to forgo additional first year depreciation and instead to increase their business credit limitation under § 38(c) (including the research credit determined under § 41) or alternative minimum tax credit limitation under § 53(c). See Rev. Proc. 2008-65, page 1082.

Section 52.—Special Rules — Controlled Group of Corporations

All corporations which are treated as a single employer under § 52(a) (generally any controlled group of corporations within the meaning of § 1563(a), determined by substituting "more than 50 percent" for "more than 80 percent" each place it appears in that section) shall be treated as one taxpayer for purposes of § 168(k)(4) and as having elected to apply § 168(k)(4) if any such corporation so elects. See Rev. Proc. 2008-65, page 1082.

Section 53.—Credit for Prior Year Minimum Tax Liability

Section 168(k)(4) allows corporations to make an election to forgo additional first year depreciation and instead to increase their business credit limitation under § 38(c) (including the research credit determined under § 41) or alternative minimum tax credit limitation under § 53(c). See Rev. Proc. 2008-65, page 1082.

Section 168.—Accelerated Cost Recovery System

Section 168(k)(4) allows corporations to make an election to forgo additional first year depreciation and instead to increase their business credit limitation under § 38(c) (including the research credit determined under § 41) or alternative minimum tax credit limitation under § 53(c). See Rev. Proc. 2008-65, page 1082.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

The final regulations under section 401(a) relating to distributions from a pension plan upon attainment of normal retirement age will be amended to change the effective date for governmental plans to plan years beginning on or after January 1, 2011. See Notice 2008-98, page 1080.

Section 414(d).—Governmental Plan

The final regulations under section 401(a) relating to distributions from a pension plan upon attainment of normal retirement age will be amended to change the effective date for governmental plans to plan years beginning on or after January 1, 2011. See Notice 2008-98, page 1080.

Section 597.—Treatment of Transactions in Which Federal Financial Assistance Provided

A notice provides clarification that, unless and until guidance is issued to the contrary, no amount furnished by the Treasury Department to a financial institution pursuant to the Troubled Asset Relief Program established by the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008 will be treated as the provision of Federal financial assistance within the meaning of section 597 of the Internal Revenue Code. See Notice 2008-101, page 1082.

Section 1502.—Regulations

26 CFR 1.358–6: Stock basis in certain triangular reorganizations.

T.D. 9424

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Unified Rule for Loss on Subsidiary Stock

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under sections 358, 362(e)(2), and 1502 of the Internal Revenue Code (Code). The regulations apply to corporations filing consolidated returns, and corporations that enter into certain tax-free reorganizations. The regulations provide rules for determining the tax consequences of a member's transfer (including by deconsolidation and worthlessness) of loss shares of subsidiary stock. In addition, the regulations provide that section 362(e)(2) generally does not apply to transactions between members of a consolidated group. Finally, the regulations conform or clarify various provisions of the consolidated return regulations, including those relating to adjustments to subsidiary stock basis.

DATES: *Effective Date:* These regulations are effective on September 17, 2008.

Applicability Date: For dates of applicability, see §§1.358–6(f)(3), 1.1502–13(l)(1), 1.1502–19(h), 1.1502–21(h)(1)(iii), 1.1502–31(h)(1), 1.1502–32(h)(9), 1.1502–33(j)(1), 1.1502–35(j), 1.1502–36(h), 1.1502–75(l), 1.1502–30(c), 1.1502–80(h), 1.1502–80(a)(4), 1.1502–80(j), 1.1502–91(h)(2), and 1.1502–99(b)(4).

FOR FURTHER INFORMATION CONTACT: Marcie P. Barese at

(202) 622–7790, Sean P. Duffley at (202) 622–7770, or Theresa Abell at (202) 622–7700 (none of the numbers are toll-free).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–2096. The collection of information in these final regulations is in §1.1502–36(e)(5). The collection of information is necessary to allow a corporation to redetermine basis under the basis redetermination rule when it sells all the stock of a subsidiary, to modify the application of the attribute reduction rule, to apply the Unified Loss Rule retroactively to certain intercompany transfers, and to reattribute a section 382 limitation.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Books or records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On January 23, 2007, the IRS and Treasury Department issued a notice of proposed rulemaking (REG–157711–02, 2007–8 I.R.B. 537 [72 FR 2964]) (January 2007 proposal) that included proposed regulations under §1.1502–36 (Unified Loss Rule). The proposed Unified Loss Rule would implement aspects of the repeal of the General Utilities doctrine and address the duplication of loss by consolidated groups. The proposed Unified Loss Rule consisted of three principal rules that would apply when a member (M) transferred a loss share of stock of a subsidiary (S): a basis redetermination rule (that would reallocate investment adjustments to address both noneconomic and duplicated stock loss), a basis reduction rule (that would address noneconomic stock loss), and an attribute reduction rule (that would address duplicated loss).

In addition, the January 2007 proposal included proposed regulations under §1.1502–13(e)(4) that would address the application of section 362(e)(2) to certain intercompany transactions. The January 2007 proposal also included proposed regulations that would make various technical and administrative revisions to other provisions of the consolidated return regulations and to regulations regarding stock basis following certain corporate restructuring transactions.

No public hearing regarding the proposed regulations was requested or held. Written, electronic, and oral comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, these final regulations generally adopt the rules of the proposed regulations other than proposed §1.1502–13(e)(4) and its related provisions. The significant comments and modifications are discussed in this preamble.

1. *The Unified Loss Rule*

A. *General comments*

In general, commentators and practitioners have consistently described the provisions of the proposed Unified Loss Rule as reaching a fair and reasonable systemic balance. They have generally concurred with the major policy decisions reflected in the proposed regulations, including the retention of the loss limitation model, the rejection of a tracing approach, the application of the rule to built-in income, and the systemic prevention of loss duplication. However, commentators and practitioners have also consistently raised concerns regarding both the complexity of the proposed rules and the anticipated difficulty in compiling the data required to implement the proposed rules, especially those relating to transfers of stock of subsidiaries that hold stock in other subsidiaries.

The IRS and Treasury Department recognize that the proposed rules are complex. However, as recognized by commentators and practitioners, the complexity of the rules is a result of the balancing of benefits and burdens arising from the presumptions on which the rules are based. The IRS and Treasury Department are concerned, therefore, that simplifying the proposed rules would adversely impact the fundamental fairness the rules are intended to achieve. Nevertheless, careful consideration has been given to all simplifying suggestions, and they have been incorporated wherever possible.

The suggestions regarding the general application and operation of the rule, and the conclusions reached as to each, are set forth in this section A of this preamble. Suggestions relating to individual paragraphs of the Unified Loss Rule and to other regulations in the January 2007 proposal, including proposed §1.1502–13(e)(4), and the conclusions reached as to each, are set forth in the following sections.

i. *Order of application of the Unified Loss Rule and other adjustments*

The January 2007 proposal provided that the Unified Loss Rule would apply to a transfer of a share of subsidiary stock if, after giving effect to all applicable rules of law (other than the Unified Loss Rule), the share is a loss share. The provisions of the proposed Unified Loss Rule would then apply sequentially to adjust subsidiary stock basis and attributes. Any adjustments required under the Unified Loss Rule would be given effect immediately before the transfer.

Commentators found the timing rules unclear, particularly as they related to the application of other provisions of the consolidated return regulations that also purport to apply immediately before a transaction. The IRS and Treasury Department have considered this comment and agree that there could be some uncertainty in this respect.

To address this concern, §1.1502–36(a)(3)(i) of these final regulations provides that the Unified Loss Rule applies when a member transfers a share of subsidiary stock and, after taking into account the effects of all rules of law applicable as of the transfer, even those that would not be given effect until after the transfer, the share is a loss share. Such effects may be attributable to lower-tier dispositions and worthlessness, as well as to the application of the Unified Loss Rule. Although the determination of whether a transferred share is a loss share

is made as of the transfer, the Unified Loss Rule as a whole applies, and any adjustments required under the Unified Loss Rule are given effect, immediately before the transfer.

When the Unified Loss Rule applies to a transfer, its individual provisions are each applied in order. Thus, as described in §1.1502–36(a)(3)(i) of these final regulations, the general rule is that paragraph (b) applies first with respect to a transferred loss share (or shares). Then, if there is still a transfer of a loss share after the application of paragraph (b), paragraph (c) applies to the loss share (or shares). Finally, if there is still a transfer of a loss share after the application of paragraph (c), paragraph (d) applies with respect to that loss share (or shares). Section 1.1502–36(a)(3)(ii) provides detailed instruction regarding the order in which the individual provisions of the Unified Loss Rule apply if there are transfers at multiple tiers in the same transaction.

ii. *Application of Unified Loss Rule to nondeconsolidating transfers*

Several commentators have suggested that the final regulations include an election to defer basis recovery in the case of a nondeconsolidating transfer. Under such an election, a group could avoid applying the Unified Loss Rule to such transfers by shifting the basis of a transferred share (to the extent such basis exceeds the share's value) to other shares held by members. As a result, the group would forego any current loss, but the Unified Loss Rule would continue to be applicable to any subsequent transfer of loss shares of stock of that subsidiary.

The IRS and Treasury Department are concerned that such an election could cause significant administrative complexity. The IRS and Treasury Department are also concerned that such an election could cause substantial distortions that could adversely affect the treatment of subsequent deconsolidating transfers. For example, a basis shift resulting from such an election could significantly increase the disconformity amount of the retained shares, potentially causing a substantial and inappropriate reduction in the basis of the retained shares when they are ultimately transferred. Further, because this relief would only address transfers of minority interests, and the IRS and Treasury Department believe that such transfers reflect a small portion of subsidiary stock dispositions, the IRS and Treasury Department do not believe such a rule would give rise to any significant relief. Accordingly, this suggestion was not adopted.

Other suggestions were made that would apply special rules to nondeconsolidating transfers. The final regulations generally do not adopt special rules for nondeconsolidating transfers. The principal reasons are the complexity a dual system would create and the small number of transactions expected to be affected by such rules. In addition, the IRS and Treasury Department believe that taxpayers will typically be able to restructure nondeconsolidating transfers to avoid the application of the Unified Loss Rule, for example, by issuing subsidiary stock.

iii. *Application of Unified Loss Rule to deferred recognition transfers*

The proposed regulations provided that all transfers of loss shares of subsidiary stock are immediately subject to the Unified Loss Rule when the stock is transferred, even if any loss recognized on the transfer would be deferred. The IRS and Treasury Department had concluded that the immediate application of the Unified Loss Rule was necessary to prevent the significant administrative burden of retroactively applying the Unified Loss Rule to members' bases in shares of subsidiary stock, and to the subsidiary's attributes, long after a stock sale.

Commentators questioned the need to apply the Unified Loss Rule to a transfer in which any loss that would be recognized would be deferred, citing as a model §1.1502–20(a)(3) (deferring the application of §1.1502–20, the Loss Disallowance Rule). Commentators also observed that single-entity principles seemed to suggest that an intercompany transfer is not an appropriate time to apply the Unified Loss Rule, urging that it would be more appropriate to apply the Unified Loss Rule to such a transfer when the intercompany item is taken into account.

The IRS and Treasury Department have considered these comments and are persuaded that single-entity principles would be furthered, and group income would be more clearly reflected, if the application of the Unified Loss Rule were coordinated with the intercompany transaction provisions in §1.1502–13. Accordingly, under these final regulations, if a member transfers a share of subsidiary stock to another member and any gain or loss on the transfer is deferred under §1.1502–13, the Unified Loss Rule applies to the transfer, or to any subsequent transfer of that share by a member, when the intercompany item is taken into account. At that time, the determination of whether the Unified Loss Rule applies and, if so, the consequences of its application are made by treating the buying and selling members as divisions of a single corporation. The final regulations also provide that appropriate adjustments will be made to intercompany item(s), any member's basis in the subsidiary's share, and/or the subsidiary's attributes in order to further the purposes of both the Unified Loss Rule and the intercompany transaction provisions in §1.1502–13.

Notwithstanding this modification of the treatment of intercompany transfers, the IRS and Treasury Department continue to believe that the deferral of loss recognized on a sale of subsidiary stock should not, in general, defer the application of the Unified Loss Rule. One reason is that postponing the application of the Unified Loss Rule in transfers that are not intercompany transactions would likely make it much more difficult, and in some cases impossible, to obtain the information and make the determinations necessary to apply the rule. Another reason is that such an approach could require subsequent adjustments to attributes outside the consolidated group. Accordingly, these final regulations continue to apply the Unified Loss Rule to non-intercompany transfers of loss shares at the time the stock is transferred, even if any loss recognized on the transfer is subject to deferral.

These final regulations modify the definition of the term transfer to reflect both the general rule that the deferral of loss does not affect the determination of whether stock is transferred and the limited exception for intercompany transactions.

iv. *Application of Unified Loss Rule to liquidations under section 332*

The proposed Unified Loss Rule provided that the term transfer generally includes transactions in which a member

ceases to own subsidiary stock. However, the proposed regulations included an exception for section 381(a) transactions in which any member acquires assets of the subsidiary, provided that no gain or loss is recognized by member shareholders with respect to the subsidiary's stock. Commentators observed that this exclusion would apply to liquidations in which more than one member owns stock of the subsidiary and that, in such cases, upper-tier distortions could result because the basis redetermination rule would not apply.

The IRS and Treasury Department agree with this observation and are concerned with the potential for distortion and abuse. Accordingly, under the final regulations, a disposition of subsidiary stock in a liquidation to which section 332 applies is not excepted from the definition of a transfer if more than one member owns stock in the liquidating subsidiary. However, the final regulations provide that, in the case of a multiple-member section 332 liquidation, neither paragraph (c) (the basis reduction rule) nor paragraph (d) (the attribute reduction rule) will apply to the transfer. Thus, if more than one member owns stock in a subsidiary and those members dispose of the subsidiary stock in a section 332 liquidation of the subsidiary, the transaction is subject to the other provisions of the Unified Loss Rule, in particular the basis redetermination rule in §1.1502–36(b).

v. *Basis in lower-tier stock*

In formulating the proposed Unified Loss Rule, the IRS and Treasury Department believed that, by using information that taxpayers were otherwise required to create and maintain, the administrative burden on taxpayers would be minimal. However, commentators have uniformly expressed concern that taxpayers will find it costly and time-consuming, if not impossible, to obtain the subsidiary stock basis information needed to apply many of the provisions of the Unified Loss Rule. Particular concern has been expressed regarding the lower-tier subsidiary rules in the proposed basis reduction rule (proposed §1.1502–36(c)) and the proposed attribute reduction rule (proposed §1.1502–36(d)). The reasons cited include the widespread practice of determining stock basis only when necessary to determine a person's tax liability, complicated intercompany accounting rules that make stock basis determinations prone to error, and the frequent inability to obtain accurate historical basis information when acquiring companies with lower-tier subsidiaries.

To address this problem, several commentators have suggested modifying the proposed rules to apply solely based on the net inside attributes of lower-tier subsidiaries (the "look-through" approach). Those commentators have argued that information regarding inside attributes is much more regularly and reliably maintained and available than stock basis information.

The IRS and Treasury Department recognize that adopting a look-through approach would not only address the problem of inadequate stock basis data, it would also significantly simplify the application of the rules. However, the IRS and Treasury Department are concerned that a look-through approach could produce inappropriate results for groups transferring S stock if S holds stock of another subsidiary (S1) and S's basis in its S1 stock reflects unrecognized appreciation in S1's assets (built-in gain).

Example. P, the common parent of a consolidated group, transfers $100 to S in exchange for S's sole outstanding share of stock. S purchases the sole outstanding share of S1 stock for $100 when S1 holds one asset with a basis of $0 and a value of $100. S earns $100, increasing P's basis in S to $200. S1's asset declines in value to $0. P sells its S share to X, an unrelated person, for $100, recognizing a loss of $100. Under the basis reduction rule as proposed, P's basis in S stock is reduced by the lesser of S's disconformity amount and S's net positive adjustment. S's disconformity amount is $0, the excess of P's $200 basis in the S share over S's net inside attribute amount ($200, the sum of S's $100 cash and its $100 basis in the S1 share, which is not treated as reduced under the tentative reduction rule because there were no investment adjustments applied to the basis of the S1 share). Accordingly, although S had a $100 net positive adjustment, there is no reduction to P's basis in S stock and so P's $100 loss on the S stock is allowed. However, because the stock loss is duplicated in S's attributes, the attribute reduction rule will apply to eliminate S's inside loss.

If a look-through approach were adopted, however, S's basis in its S1 share would be disregarded and S's disconformity amount would be $100 (the excess of P's $200 basis in its S share over S's $100 net inside attribute amount, computed as the sum of S's $100 cash and S1's $0 basis in its asset). As a result, P's basis in its S share would be reduced by $100, the lesser of S's $100 disconformity amount and S's $100 net positive adjustment. Although S would retain its $100 basis in its S1 share, P would recognize no loss on its sale of the S stock. Thus, the selling group would have suffered an economic loss but the loss would be neither recognized nor allowed. Such a result would be contrary to the general rule adopted in the proposed regulations, that stock basis is not presumed noneconomic to the extent there is no disconformity amount or no net positive adjustment amount.

The IRS and Treasury Department recognize that, under the proposed regulations, a very different result follows where it is S1, not S, that earns the $100. In that case, the proposed regulation would treat S's basis in the S1 stock as tentatively reduced by $100 (the lesser of S1's $100 disconformity amount and S1's net positive adjustment). As a result, S would have a disconformity amount of $100 and P's basis in its S share would be reduced by $100 (the lesser of S's $100 disconformity amount and S's $100 net positive adjustment). But the IRS and Treasury Department believe this result is appropriate because S1's disconformity amount evidences that S1 has at least $100 of built-in gain. Further, S1 has a net positive adjustment that evidences the recognition of that built-in gain. Thus, in this case, the facts indicate that S1's income is attributable to the recognition of built-in gain and that, as a result, M's loss on the share of S stock should be treated as noneconomic.

The IRS and Treasury Department recognize that this approach could lead to situations in which the location of an item is manipulated to produce inappropriate results, but believe there are adequate protections against such manipulation. See, for example, section 482 and the various anti-abuse provisions of the consolidated return regulations, including these final regulations.

For all these reasons, the IRS and Treasury Department continue to believe that including lower-tier stock basis in determinations made under the Unified Loss Rule more fully safeguards taxpayers' interests and generally produces more appropriate results.

Several commentators argued that an elective look-through rule would address the concerns inherent in a mandatory look-

through rule, as well as the concerns regarding the availability of stock basis information and the complexity of the proposed rules.

The IRS and Treasury Department agree that an elective approach would mitigate the concerns presented by a mandatory look-through rule, but believe that an elective approach would not provide the desired simplification. The reason is that the decision will affect computations under both the basis reduction rule and the attribute reduction rule, and what may be taxpayer favorable for one rule may be taxpayer unfavorable for the other rule. Thus, the benefit (or burden) of ignoring lower-tier stock basis for the basis reduction rule will need to be weighed against any benefit (or burden) of ignoring lower-tier stock basis for the attribute reduction rule.

The IRS and Treasury Department acknowledge that, in order to simplify compliance, some taxpayers might elect a look-through approach without making detailed alternative computations. However, the IRS and Treasury Department believe that, given the consequences of such an election, the vast majority of taxpayers will compute their tax treatment both with and without a look-through approach before deciding whether to make such an election. Thus, in the vast majority of cases, there would be little or no simplification from an elective look-through approach, and one of the major goals of such a rule would not be achieved.

Moreover, the IRS and Treasury Department believe that taxpayers making both computations will then universally choose the method that produces better results. While taxpayers are free to arrange their affairs so as to legitimately minimize their taxes, a system that will always operate to the disadvantage of one party or the other (in this case, the government) is not properly balanced.

Accordingly, the IRS and Treasury Department believe that a mandatory look-through approach would produce inappropriate results in certain cases, and that an elective look-through approach would fail to achieve a significant amount of simplification and would significantly diminish the balance and fairness of the regulations. The final Unified Loss Rule therefore does not adopt any form of the look-through approach.

Still, the IRS and Treasury Department recognize that determining lower-tier subsidiary stock basis may be difficult for the reasons previously noted. Further, although the need to determine lower-tier subsidiary stock basis is not particular to these regulations, the Unified Loss Rule arguably increases both the frequency and significance of these determinations. Accordingly, the IRS and Treasury Department are considering various proposals that would mitigate these difficulties on a system-wide basis.

One alternative under consideration is a conforming basis election. Under this election, consolidated groups could determine members' bases in shares of subsidiary stock by treating the basis in each share owned by a member as being equal to the share's proportionate interest in the subsidiary's net inside attributes. If such an election were made, the determination would presumably be effective for all Federal income tax purposes. Further, because the determination of subsidiary stock basis is not a concern that is unique to the Unified Loss Rule, consideration is being given to allowing the election with respect to all subsidiaries, with no restrictions on consistency or the time for making elections. However, the IRS and Treasury Department are not certain that such a rule would materially simplify the determination of basis because taxpayers are likely to conclude that they must determine stock basis in judging whether to make the election. Further, the IRS and Treasury Department are concerned about the collateral consequences of such a rule.

Accordingly, the IRS and Treasury Department are requesting comments regarding whether such an election would assist taxpayers and whether it would in fact provide any simplification. Additionally, comments are requested regarding what collateral consequences, if any, such an election should or would have, and whether such consequences are appropriate. The issues include, for example, whether such an election would be an appropriate means of eliminating excess loss accounts, whether it could potentially produce inappropriate cross-chain basis shifts, or whether it could inappropriately facilitate the acceleration of losses.

The IRS and Treasury Department also request comments regarding any other method for addressing this issue.

vi. *Items taken into account in determining the net inside attribute amount*

As a result of various questions and comments received, the IRS and Treasury Department have reconsidered the inclusion of credits in the determination of the net inside attribute amount. Commentators have correctly observed that, at least with respect to credits held at the time of a taxable acquisition of subsidiary stock, credits are economically similar to other valuable attributes and it would be appropriate to take such credits into account in determining the disconformity amount. However, the proper treatment of other credits (that is, credits accruing after the subsidiary stock was acquired) in determining the disconformity amount, and of any credits (whenever accruing) in determining loss duplication, is less clear. Presumably, however, any such methodology would need to be tracing-based, and would therefore be expected to present the significant administrative concerns described in the preamble to the January 2007 proposal. Ultimately, no viable presumptive methodology was identified for determining the proper inclusion of credits, and so no change is made in the final Unified Loss Rule regarding the treatment of credits.

vii. *Adjustments for section 362(e)(2) transactions*

As discussed in Section 3 of this preamble, the IRS and Treasury Department have concluded that section 362(e)(2) should generally not apply to intercompany transactions. However, section 362(e)(2) will apply to transactions occurring prior to September 17, 2008, if the taxpayer does not apply the rule in the final regulations. In such cases, distortions will result and, thus, adjustments will need to be made. The IRS and Treasury Department are also concerned that there are other provisions that could create distortions. Accordingly, the final regulations retain the rule in proposed §1.1502–36(e)(2) that provided for adjustments to offset the effects of basis reductions required by section 362(e)(2) with respect to intercompany transactions, and the rule that provided for appropriate adjustments in cases raising similar issues. However, under the final regulations, taxpayers may make appropriate adjustments

without a determination from the Commissioner.

viii. *Effective/applicability date issues*

As proposed, the Unified Loss Rule would have been applicable for all transfers on or after the date the regulations were published as final. Several practitioners observed that the proposed effective date caused problems for taxpayers attempting to negotiate transactions because they could not be certain what set of regulations would be in effect when their transactions were completed. Accordingly, commentators and practitioners requested that the regulations include a transition rule that would exclude transfers effected on or after the date the final regulations are published, if such transfers were made pursuant to a binding agreement in place before the publication date.

The IRS and Treasury Department recognized the difficulty created by the proposed effective date and, in Notice 2008–9, 2008–3 I.R.B. 277 (regarding the Internal Revenue Bulletin generally, see §601.601(d)(2)(ii)(*b*)), announced that the final regulations would include a transition rule for transfers between unrelated parties if made pursuant to an agreement that is binding before the date that final regulations are published and at all times thereafter. Further, Notice 2008–9 stated that the IRS and Treasury Department expect that the rule would incorporate the provisions of section 267(b) in determining whether persons are related for this purpose. Accordingly, as stated in Notice 2008–9, the final Unified Loss Rule applies to transfers on or after September 17, 2008, unless the transfer is made pursuant to a binding agreement between unrelated parties that was in effect before September 17, 2008, and at all times thereafter. The final regulations provide that the term related party has the same meaning as in section 267(b).

One comment was also received suggesting that the final regulations include an election to apply their provisions retroactively. The IRS and Treasury Department considered this suggestion but are concerned that adopting such an approach would disrupt taxpayers' otherwise closed transactions and thereby exacerbate the problems caused by the uncertainty and instability in this area over these past years. Accordingly, the final Unified Loss Rule does not include an election to apply its provisions retroactively.

B. *Section 1.1502–36(b): basis redetermination rule*

Commentators generally recognize and concur with the need for a rule that reallocates investment adjustments to address the problems created when shares of stock are held with disparate bases. As illustrated in Sections B.3, B.4, and E of the preamble to the January 2007 proposal, the allocation of investment adjustments under §1.1502–32 can create a noneconomic stock loss on an individual share that would be eliminated under §1.1502–36(c). Similarly, the allocation of investment adjustments under §1.1502–32 can fail to eliminate a duplicated loss on an individual share. In both cases, however, the allocation creates no net loss if all the shares are taken into account. The basis redetermination rule in §1.1502–36(b) is designed to address these issues.

Commentators have expressed concern, however, with both the availability of the investment adjustment data required to implement the rule and the complexity of the application of the rule.

The IRS and Treasury Department recognize that the information may be difficult and costly to produce. However, unlike lower-tier subsidiary stock basis information, the information required to implement the basis redetermination rule (specifically, the investment adjustment history of the stock of the subsidiary that is being transferred) is generally information obtained from the group's own tax returns and other records. Groups are therefore, as a general matter, not dependent on other taxpayers for this information.

Furthermore, the IRS and Treasury Department expect that this rule will apply to only a small number of transactions due to the exception for transactions in which members transfer all of their S stock to one or more nonmembers in a fully taxable transaction. Accordingly, it is anticipated that, in most transactions, taxpayers will not be required to redetermine basis. Moreover, in those situations in which it does apply, it accomplishes important objectives for both taxpayers and the government.

Some commentators suggested allowing a member to be treated as having an averaged basis in its shares of S stock if S has only one class of stock outstanding and the member holds all of the S stock. The commentators argue that such an election could significantly reduce the number of taxpayers required to apply the basis redetermination rule. While that might be true, such basis averaging could result in additional complexities and distortions. For example, if a portion of the shares were previously transferred in an intercompany transaction and the bases in all of the subsidiary's shares were averaged, it might be difficult to determine the extent to which particular shares reflect the prior intercompany transaction. Further, averaging the basis in the subsidiary's shares could alter the application of section 267 and section 311.

For all these reasons, the final Unified Loss Rule retains the basis redetermination rule without the suggested modifications.

The final regulations do, however, modify the basis redetermination rule to omit the reallocation of positive investment adjustments applied to preferred shares under §1.1502–32. The reason is that §1.1502–32 allocates positive adjustments to preferred shares solely to account for the right to receive distributions. Thus, the positive §1.1502–32 adjustments allocated to preferred shares, like the adjustments for distributions (which were not reallocated under the proposed Unified Loss Rule), are based on economic changes in the shareholder's investment. As a result, they should have no correlation to unrecognized gain or loss reflected in the bases of the shares and so should not be subject to this rule. The final regulations do, however, continue to permit the reallocation of both positive and negative adjustments from common to preferred shares in order to reduce or eliminate any loss on transferred preferred shares and any gain on either transferred or nontransferred preferred shares. The IRS and Treasury Department believe such reallocations are necessary and appropriate to address any reflection of unrecognized gain or loss in preferred shares attributable, for example, to contributions of assets in exchange for preferred stock.

i. *Exceptions to basis redetermination rule*

The proposed basis redetermination rule contained two exceptions to its application, the "no potential for redetermination" exception and the "disposition of entire interest" exception.

The proposed "no potential for redetermination" exception provided that basis redetermination is not required if redetermination would not change any member's basis in S stock. Some commentators found this exception confusing; others suggested that it offered no simplification because it would be necessary to apply the basis redetermination rule to determine whether the exception was available. Other commentators thought that it provided a useful safe-harbor. The IRS and Treasury Department have concluded that the rule should be retained, but that it should be revised to state its scope and effect more clearly. Accordingly, under the final regulations, the basis redetermination rule does not apply if members' bases in shares of S common stock are equal (that is, there is no disparity) and members' bases in shares of S preferred stock reflect no gain or loss. The reason is that, under these circumstances, the only effect that a reallocation of investment adjustments could have would be an increase, not a decrease, in basis disparity.

The proposed "disposition of entire interest" exception provided that basis redetermination is not required if, within the group's taxable year in which the transfer occurs, all of the shares of S stock held by members are transferred to a nonmember in one or more fully taxable transactions. This rule differed from the basis reduction netting rule in proposed §1.1502–36(c)(7) and the net stock loss definition in proposed §1.1502–36(d)(3)(ii), which only netted among shares transferred in the same transaction. Commentators observed that this difference presents a potential for distortion and abuse if items are taken into account by S between transfers. While this problem exists to a certain extent if a transaction is comprised of steps that are not executed simultaneously, the problem may be significantly exacerbated by a rule that allowed netting among all transactions within a year. Moreover, because the netting rule in the basis reduction rule is intended, in part, to protect taxpayers when the basis redetermination rule is not applied, the IRS and Treasury Department believe that the application of these rules should be coextensive. Accordingly, the final regulations provide that this exception only applies if members dispose of their entire interest in S stock to one or more nonmembers, if all members' shares of S stock become worthless, or if all members' shares of S stock are either worthless or disposed of to one or more nonmembers, in one fully taxable transaction.

Commentators also inquired whether the "disposition of entire interest" exception was mandatory, that is, whether the basis redetermination rule could be applied even if a group disposed of its entire interest in a transaction that qualifies for the exception. The IRS and Treasury Department recognize that taxpayers might choose to apply the basis redetermination rule in such cases in order to reduce gain or avoid the Unified Loss Rule with respect to upper-tier shares. The IRS and Treasury Department do not believe that doing so would be inappropriate, as the premise of the basis redetermination rule is that reallocations made under the rule are appropriate allocations. However, because the IRS and Treasury Department believe that taxpayers will most often not want to apply the basis redetermination rule, the final regulations generally provide that basis is not redetermined when the exception applies, but include an election to apply the basis redetermination rule in such cases.

ii. *Manner in which investment adjustments are reallocated*

Some commentators observed that the proposed rules were vague regarding the manner in which reallocations were to be made. The IRS and Treasury Department generally agree with this observation, but had concluded that the rule would work best if taxpayers were given considerable flexibility in determining how to make specific reallocations. In recognition of the fact that such an approach would allow differing interpretations, section F.2 of the preamble to the January 2007 proposal stated that the IRS would respect any reasonable method or formula employed in applying the basis redetermination rule.

The IRS and Treasury Department continue to believe that the rule should be as flexible as possible. However, in response to these comments, the specific provisions of the final basis redetermination rule provide some additional guidance (discussed more fully in the next section). But the rule is still intended to be flexible in its application and, therefore, the final regulations explicitly provide that the reallocation of an investment adjustment may be made using any reasonable method or formula that is consistent with the basis redetermination rule and furthers the purposes of the Unified Loss Rule. Thus, like the proposed regulations, the final regulations contemplate that more than one result may be reasonable in any specific case.

iii. *Decreasing disparity in basis of members' shares*

The general operating rules of the proposed basis redetermination rule provided that reallocations are made in a manner that reduces the extent to which there is disparity in members' bases in S stock. The IRS and Treasury Department have received various questions regarding the scope of this rule. Some practitioners read the rule to completely eliminate the loss on transferred shares even if overall disparity were increased. One practitioner suggested that the general rule, in referring only to the manner of redetermination, did not clearly restrict the amount of redetermination that would otherwise be required under the rules.

To address these concerns, each of the specific allocation provisions in the final regulations includes a statement regarding the manner and extent to which allocations are to be made under the provision. In addition, the operating rules generally provide that the overall application of the rule must reduce disparity among members' bases in preferred shares of subsidiary stock (as provided in the applicable reallocation provisions) and among members' bases in common shares of subsidiary stock, to the greatest extent possible.

C. *Section 1.1502–36(c): basis reduction rule*

In general, commentators found the general structure of the basis reduction

rule and its components (limiting basis reduction to the lesser of the share's disconformity amount and net positive adjustment) to be a reasonable approach to addressing the issue of noneconomic loss. The principal concern expressed was the anticipated difficulty with respect to gathering the information necessary to implement the lower-tier subsidiary rules. Nevertheless, commentators uniformly agreed that basis adjustments from lower-tier subsidiaries must be taken into account in order to identify and address noneconomic stock loss.

The principal suggestion for addressing the lack of readily accessible and reliable information on lower-tier stock basis was to adopt a look-through approach, as discussed in section 1.A.v. of this preamble. For the reasons set forth in that section of this preamble, the final regulations do not adopt this approach. However, as noted, the IRS and Treasury Department continue to request and consider comments on mechanisms for alleviating the difficulty in determining lower-tier subsidiary stock basis.

Commentators and practitioners did suggest a number of other modifications to the basis reduction rule. Those suggestions and the decisions reached are discussed in the following sections.

i. *Treatment of intercompany debt*

Several commentators suggested revising the net positive adjustment amount to exclude items related to intercompany debt. The rationale for this suggestion was that, in general, the nature of such amounts makes them more like capital transactions than the recognition of built-in gain or loss. Thus it is argued that these amounts should be treated like contributions and distributions, which are not included in the net positive adjustment amount.

The IRS and Treasury Department recognize that, in certain circumstances, intercompany debt has some inherent similarity to capital contributions and distributions, at least with respect to the principal amounts of such obligations. However, the IRS and Treasury Department also recognize that there are circumstances in which unrecognized appreciation in intercompany debt can be reflected in stock basis. For example, if a subsidiary receives cash in exchange for newly issued stock when it holds an intercompany obligation, the basis of the newly issued shares will reflect a portion of any unrecognized appreciation in the obligation. Because the consequences of having that unrecognized appreciation reflected in stock basis are no different from the consequences of any other built-in gain, the regulations would have to provide a system to identify and monitor those amounts. Such a system would need to rely on a tracing-based methodology, which the IRS and Treasury Department have rejected for the reasons articulated in the preamble to the January 2007 proposal. Accordingly, the IRS and Treasury Department have concluded that no special rules would be adopted for items related to intercompany debt.

ii. *Disconformity amount: net inside attributes*

In the proposed regulations, the term net inside attributes was defined as the excess of the sum of S's loss carryovers, deferred deductions, and asset basis over S's liabilities. Although different rules applied to determine basis in lower-tier subsidiary stock, the terms otherwise had the same meaning for purposes of both the basis reduction and attribute reduction rules.

The proposed regulations defined the term loss carryover to mean any net operating or capital loss carryover attributable to S that is or, under the principles of §1.1502–21 would be, carried to S's first taxable year, if any, following the year of the transfer. Thus, if a buyer were to waive a loss carryover under §1.1502–32(b)(4), the loss would not be carried to S's first taxable year after the transfer, and so it would be excluded from the computation of net inside attributes.

Practitioners agree that this definition is appropriate for purposes of measuring loss duplication, as it prevents attributes that cannot be duplicated from being taken into account in computing S's attribute reduction amount. However, one commentator observed that this definition seemed inappropriate for purposes of measuring S's disconformity amount.

The IRS and Treasury Department have considered this comment and agree that the definition is inappropriate for computing S's disconformity amount. As discussed in the January 2007 preamble, the disconformity amount was incorporated in the basis reduction rule in order to limit basis reduction to the net amount of a subsidiary's built-in gain. The IRS and Treasury Department believed that, by limiting basis reduction to the amount of net built-in gain, the basis reduction rule would not reduce stock basis by an amount that could not be attributed to the recognition of built-in gain.

However, by adopting a definition of loss carryovers that required such losses to be carried to a separate return year, the rule allowed a waiver of a loss carryover under §1.1502–32(b)(4) to reduce the amount of a subsidiary's loss carryovers and, as a result, the subsidiary's net inside attributes. That, in turn, caused an increase in the subsidiary's disconformity amount. But, as the commentator observed, any disconformity created by the waiver of a loss carryover would be unrelated to the existence of built-in gain. Thus, this definition of loss carryovers undermined the protection otherwise afforded by the use of the disconformity amount as a limit on basis reduction.

In addition, other commentators found the proposed rule unclear in its reference to losses that would be carried to a separate return year.

To address these concerns, the final regulations provide that the term loss carryovers means those losses that are attributable to the subsidiary, including any losses that would be apportioned to the subsidiary under the principles of §1.1502–21(b)(2) if the subsidiary had a separate return year. However, because a waiver under §1.1502–32(b)(4) does affect the extent to which a loss can be duplicated, the final regulations provide that, solely for purposes of applying the attribute reduction rule, a subsidiary's loss carryovers (and therefore its net inside attributes) do not include the amount of any losses waived under §1.1502–32(b)(4).

D. *Section 1.1502–36(d): the attribute reduction rule*

As discussed in the preamble to the January 2007 proposal, the loss duplication component of the Unified Loss Rule addresses loss duplication systemically in order to clearly reflect the income of both the group and its members, including former members. The IRS and Treasury Department view this rule as a necessary and appropriate complement to §1.1502–32 be-

cause, together they work to eliminate the duplication of a group item once the group enjoys the benefit of the item, without regard to which of the duplicative items is recognized and allowed first. The IRS and Treasury Department also view this rule as a necessary and appropriate complement to the basis reduction rule because it eliminates S's unrecognized built-in loss to the extent it prevented the identification of S's recognized built-in gain (and thus prevented the reduction of noneconomic stock basis, and noneconomic stock loss). See sections C.3 and C.4.v of the preamble to the January 2007 proposal for a discussion of the interaction between unrecognized built-in loss and recognized built-in gain.

Commentators generally agreed with the IRS and Treasury Department on the need for, and appropriateness of, the systemic approach to loss duplication. However, like the basis redetermination and basis reduction rules, the attribute reduction rule received considerable commentary regarding the issues of data availability and computational complexity. Commentators and practitioners made several suggestions for technical revisions to the proposed regulations. The IRS and Treasury Department have considered the suggestions received as well as other revisions to the proposed attribute reduction rule. The suggestions and conclusions are discussed in the following sections.

i. *Lower-tier subsidiary rules*

In general, commentators and practitioners recognize that the rules for measuring and eliminating loss duplication must take into account both the basis in lower-tier subsidiary stock and the attributes of lower-tier subsidiaries in order to be most effective. Nevertheless, as already noted, commentators expressed much concern regarding the administrability of the proposed lower-tier subsidiary rules. Their principal suggestion for addressing this concern was the adoption of a look-through approach that would address loss duplication only by taking lower-tier attributes into account.

The IRS and Treasury Department considered a look-through approach when drafting the January 2007 proposal, but were concerned that such an approach would not adequately address loss duplication. The principal reasons for this concern were that loss duplication can reside in the basis of lower-tier subsidiary stock and in the attributes of that lower-tier subsidiary and, moreover, that it can reside in those locations in differing amounts. Therefore, a rule that measures loss duplication solely by reference to lower-tier attributes, or solely by reference to lower-tier stock basis, would permit potentially significant amounts of loss duplication to avoid reduction. To avoid this problem, the IRS and Treasury Department concluded that the loss duplication regulations must measure loss duplication by reference to both.

The IRS and Treasury Department recognized, however, that when duplication is not uniformly reflected in stock basis and attributes, this approach could cause an over-reduction in lower-tier attributes (when loss duplication resides primarily in lower-tier stock basis) or in lower-tier stock basis (when loss duplication resides primarily in lower-tier attributes). To prevent the former result, the conforming limitation on lower-tier attribute reduction limits the application of tiered-down attribute reduction (generally permitting a lower-tier subsidiary's attributes to be reduced only to the extent necessary to conform them to members' bases in that subsidiary's stock, as reduced under this rule). To prevent the latter result, the basis restoration rule reverses reductions to lower-tier stock basis made by the Unified Loss Rule (generally to the extent necessary to conform members' bases in the subsidiary's stock to the subsidiary's net inside attributes, as reduced under this rule).

Thus, these rules work together to protect the government's interests (by addressing the entire potential for loss duplication) and taxpayers' interests (by preventing the over-reduction of either lower-tier stock basis or lower-tier attributes). Accordingly, the IRS and Treasury Department continue to believe these rules are essential to the balance and fundamental fairness of the Unified Loss Rule.

Nevertheless, the IRS and Treasury Department recognize that the conforming limitation and basis restoration rules can add considerable complexity to the application of the Unified Loss Rule. To address this concern, commentators have suggested that one or the other of these rules could be omitted to simplify the proposed rule. The IRS and Treasury Department are concerned, however, that eliminating either of these rules would considerably undermine the overall fairness of the regulation. But the IRS and Treasury Department are persuaded that, if a taxpayer determines that the expected benefit of applying these rules is outweighed by the additional complexity, then that taxpayer should be permitted to choose not to apply these rules.

Accordingly, these final regulations continue to measure the potential for loss duplication by taking both stock basis and attributes into account and continue to safeguard against over-reduction of either inside attributes or stock basis by applying both the conforming limitation and the basis restoration rules. However, under the final regulations, taxpayers are permitted to elect not to apply the conforming limitation or the basis restoration rule if they decide the protection afforded by either or both of those rules does not outweigh the burden of applying them.

ii. *Attribute reduction amount below five percent of value*

Although the fundamental structure of the attribute reduction rule has been retained, the IRS and Treasury Department have determined that it is appropriate to provide an exception to the application of the attribute reduction rule if the attribute reduction amount (that is, the duplicated loss) is small relative to the size of the transaction. This decision reflects a balancing of the need to eliminate duplicated loss and the administrative burden of applying the attribute reduction rule. Accordingly, under these final regulations, taxpayers must still compute their attribute reduction amount, but if the total attribute reduction amount is less than five percent of the aggregate value of the subsidiary shares that are transferred by members in the transaction, the attribute reduction rule does not apply to the transfer.

However, the IRS and Treasury Department also recognize that, in certain circumstances, a taxpayer may prefer to have the attribute reduction rule apply. For example, a group may want to apply the rule in order to reattribute a subsidiary's attributes. Accordingly, the final regulations allow taxpayers to elect to apply the

attribute reduction rule notwithstanding that their total attribute reduction amount is less than five percent of the aggregate value of the transferred shares. If this election is made, the attribute reduction rule will apply with respect to the entire attribute reduction amount determined in the transaction, and thus applies with respect to all members transferring shares, and all shares transferred, in the transaction.

iii. *Ordering of reduction of recognized losses*

Commentators generally agreed with the decision to reduce recognized losses (net operating loss (NOL) carryovers, capital loss carryovers, and deferred deductions, identified as Category A, Category B, and Category C attributes, respectively) before reducing asset basis, since the former items represent actual, identified losses. The proposed regulations provided that the attribute reduction amount would be first applied to reduce NOL carryovers (from oldest to newest), then capital loss carryovers (from oldest to newest), and then deferred deductions (proportionately). However, several commentators questioned the need for a mandatory order in which these attributes would be reduced. These commentators observed that, because loss duplication is a mathematical determination under the Unified Loss Rule, and because it is difficult (if not impossible) to know which attributes are economically duplicative of a stock loss, the reduction of any item in those categories should be equally appropriate and effective.

The IRS and Treasury Department have reconsidered this issue and agree with the commentators. Accordingly, the final regulations provide that if the attribute reduction amount is less than the total attributes in Category A, Category B, and Category C, the taxpayer may specify the allocation of S's attribute reduction amount among the attributes in those categories.

The final regulations do, however, prescribe a default allocation for the reduction of such attributes that is used to the extent the taxpayer does not specify an allocation. This default allocation differs from the order provided in the proposed rule in that capital loss carryovers (not NOLs) are reduced first. This modification was made in response to a commentator's suggestion, based on the observation that capital loss carryovers have a significantly shorter expiration period and are therefore more likely than NOLs to expire unused. Accordingly, except to the extent a taxpayer elects to specify an allocation, the final regulations first reduce capital loss carryovers (oldest to newest), then NOL carryovers (oldest to newest), and then deferred deductions (proportionately). This change in the order of reduction is intended to minimize the possibility that the attribute reduction rule will reduce attributes in an amount greater than the amount that would ultimately be available for duplicative use.

The final regulations continue to provide that, regardless of the order in which attributes in these categories are reduced, they are reduced in full before any reduction is made to asset basis.

iv. *Methodology for reduction of asset basis*

Several commentators have suggested simplifying modifications to the manner in which asset basis is reduced under the attribute reduction rule. One is the elimination of the proposed Category D attributes (unrecognized losses on publicly traded property). This category was included in the proposed rule because the IRS and Treasury Department recognized that these amounts represent a readily identifiable loss that could be eliminated before the presumptive reduction of the bases of other assets. This approach prevented the attribute reduction rule from creating or increasing gain in publicly traded assets. However, commentators viewed this rule as increasing the complexity of an already complex analysis while providing only a marginal benefit.

The IRS and Treasury Department are persuaded that this extra complexity might not be warranted in this context and that the elimination of this rule would not materially affect the balance otherwise reached by the Unified Loss Rule. Accordingly, the final regulations include publicly traded property in the general asset basis category (now designated Category D).

Another suggestion made by commentators was to apply the attribute reduction amount remaining after reducing Category A, Category B, and Category C attributes to reduce asset basis in the reverse order of the residual method of allocating consideration paid or received in a transaction under section 1060.

The IRS and Treasury Department have concluded that this approach is readily administrable and reflects an appropriate balancing of presumptions regarding the location of duplicated loss. An important consideration is that such a rule reduces basis in purchased goodwill and going concern value before basis in other assets, and the IRS and Treasury Department are persuaded that duplicated loss is generally more likely to be reflected in the bases of such assets. Therefore, the elimination of the basis in those assets first seems particularly appropriate. Further, the IRS and Treasury Department believe that this approach would generally be more administrable than the proposed *pro rata* reduction of asset basis.

Accordingly, these final regulations adopt this suggestion and generally provide that the attribute reduction amount is applied to reduce the basis of assets in the asset classes specified in §1.338–6(b) other than Class I (cash and general deposit accounts, other than certificates of deposit held in depository institutions), but in the reverse order from the order specified in that section. Thus, under this reverse residual method, any attribute reduction amount applied to reduce asset basis is generally applied first to reduce any basis of assets in Class VII (proportionately, based on basis instead of value, until all such basis is eliminated). Any remaining attribute reduction amount is then applied in the same manner to reduce the basis of assets in each succeeding lower asset class, other than Class I.

Notwithstanding the general adoption of this allocation methodology for Category D attributes, these final regulations provide that the portion of the attribute reduction amount that is not applied to attributes in Category A, Category B, and Category C, is first allocated between S's basis in any stock of lower-tier subsidiaries (treating all S's shares of any one lower-tier subsidiary as a deemed single share) and the subsidiary's other assets (treating the non-stock Category D assets as one asset). The allocation is made in proportion to S's deemed basis in each single share of lower-tier subsidiary stock and S's basis in the non-stock Category D asset (S's aggregate basis in all of its Category D assets other than subsidiary stock). Only the por-

tion of the attribute reduction amount not allocated to lower-tier subsidiary stock is applied under the reverse residual method. This initial allocation between lower-tier subsidiary stock and other assets is necessary to ensure that, to the extent the attribute reduction amount reflects items attributable to a lower-tier subsidiary's stock basis or attributes, the attribute reduction amount is properly directed and applied to those items.

v. *Suspension of excess attribute reduction amount*

Several commentators and practitioners questioned the need to suspend attribute reduction amounts in excess of reducible attributes and apply those suspended amounts to reduce or eliminate attributes otherwise arising when all or part of the liability is paid or otherwise satisfied, whether by S or another person. The IRS and Treasury Department proposed this rule because the mathematical operation of the formula for computing the attribute reduction amount results in such an excess only if there is a liability or similar item that has reduced economic value but that has not been taken into account for tax purposes (generally a contingent liability).

The IRS and Treasury Department continue to believe that it is inappropriate to permit the duplication of economic losses that have not accrued for tax purposes and, therefore, that this rule is both necessary and appropriate. Accordingly, the rule is retained in the final regulations.

The IRS and Treasury Department recognize that this rule could create an administrative burden that could last for many years and transfer to taxpayers beyond the initial buyer and seller. However, the IRS and Treasury Department believe that the elimination of the special rule for publicly traded property substantially lessens the administrative burden of this rule. The reason is that, under this revised approach in the final regulations, a subsidiary's attribute reduction amount can only exceed reducible assets to the extent of the subsidiary's Class I assets. In such cases, the IRS and Treasury Department do not believe the burden imposed to be unreasonable or, in most cases, substantial. Moreover, a taxpayer believing the rule to be overly burdensome in its situation can readily avoid any suspension of its attribute reduction amount by converting its Class I assets into assets of another class; in that case, the remaining attribute reduction amount will be applied to the bases of those assets and will not give rise to a suspended attribute reduction amount.

The IRS and Treasury Department received a comment that, if the suspended attribute reduction rule is retained, it should be clarified to provide that present value principles are to be taken into account in valuing liabilities. The final regulations do not include an explicit statement on this point because the rule implicitly incorporates present value principles (by limiting the attribute reduction amount to the lesser of the net stock loss and the aggregate inside loss, which are both a function of value).

vi. *Election to reduce stock basis and/or reattribute attributes*

Several commentators suggested that the final regulations should expressly permit taxpayers to make a protective election to reattribute attributes (other than asset basis) and/or to reduce stock basis (and thereby reduce stock loss) in order to avoid attribute reduction. The IRS and Treasury Department intend these elections to be as flexible as possible. Accordingly, the final regulations explicitly provide that, if the election is made and it is ultimately determined that S has no attribute reduction amount, the election will have no effect, or if the election is made for an amount that exceeds S's finally determined attribute reduction amount, the election will have no effect to the extent of that excess.

In addition, the final regulations permit taxpayers to reduce (or not reduce) stock basis, or to reattribute (or not reattribute) attributes, or some combination thereof, in any amount that does not exceed S's attribute reduction amount.

Thus, under the final regulations, taxpayers have considerable flexibility in making this election, and may make a protective election.

Further, in order to protect against inadvertent attribute reduction, these final regulations provide for a deemed stock basis reduction election equal to the net stock loss (taking into account any actual elections under §1.1502–36(d)(6)) in the case of a transfer in which the stock loss in the transferred shares would otherwise be permanently disallowed (for example under section 311(a)).

Several commentators also questioned the need for a mandatory order for the reattribution of losses for the same reasons they questioned the need for a mandatory order for the reduction of such attributes. For the reasons discussed in section 1.D.iii. of this preamble, the IRS and Treasury Department agree that a mandatory order of reattribution is not necessary. Thus, under the final regulations, attributes are reattributed in the same amount, order, and category that they would otherwise be reduced under the attribute reduction rule. Accordingly, because the final regulations provide that taxpayers can specify the attributes in Category A, Category B, and Category C to be reduced, taxpayers may similarly specify the attributes in Category A, Category B, and Category C to be reattributed. As in the rule regarding the allocation of the attribute reduction amount, to the extent the taxpayer elects to reattribute attributes but does not specify the attributes to be reattributed, any attributes not specifically reattributed will be reattributed in the default amount, order, and category applicable for attribute reduction.

Additionally, the final regulations revise the provisions regarding the election to reattribute attributes to provide for the reattribution of a section 382 limitation. The final regulations also include conforming amendments to the consolidated section 382 rules in §§1.1502–90, 1.1502–91(h)(2), 1.1502–95(d), 1.1502–96(d), and 1.1502–99(b)(4).

vii. *The conforming limitation*

As previously discussed, the proposed regulations limited the application of the attribute reduction amount that tiered down to a lower-tier subsidiary in order to prevent an excessive reduction to that subsidiary's attributes. Under this limitation (the conforming limitation), the tier-down attribute reduction amount (when combined with any attribute reduction amount computed with respect to a transfer of the shares of the lower-tier subsidiary) could be applied to reduce a lower-tier subsidiary's attributes only to the extent necessary to conform those attributes to an amount equal to the sum of all members' bases in nontransferred shares, and the

value of all members' transferred shares, of that subsidiary's stock.

Commentators observed that the conforming limitation could allow duplication to survive the application of the attribute reduction rule when lower-tier stock basis reflects noneconomic basis. The commentators illustrated their observation with the following example:

Example. M forms S with $100 of cash. S has no other assets or operations. S acquired S1 stock for $100 and no section 338 election is made with respect to such acquisition. S1 has one asset (A1) with a basis of $20 and a value of $100. S1 sells A1 for $100. M's basis in its S stock, and S's basis in its S1 stock, both increase by $80 to $180. S1 invests the $100 of proceeds in another asset (A2). A2 subsequently, declines in value to $40. M sells the S stock for $40.

Under the proposed basis reduction rule, M's basis in the S stock is reduced by the lesser of S's $80 net positive adjustment and S's $80 disconformity amount (determined by treating S's $180 basis in the S1 stock as tentatively reduced by $80, the lesser of S1's $80 net positive adjustment and S1's $80 disconformity amount). After the application of the proposed basis reduction rule, M would recognize a $60 loss on the sale of the S stock.

Under the proposed attribute reduction rule, S's attribute reduction amount is $60 (the lesser of the $60 net stock loss, and S's $140 aggregate inside loss), and S would reduce its basis in the S1 stock by $60 to $120. Under the proposed attribute reduction rule, S's $60 attribute reduction amount allocated to the S1 stock becomes an attribute reduction amount of S1. However, under the proposed conforming limitation on tier-down attribute reduction, S1 is not required to reduce its $100 basis in A2 because S1's $100 of attributes do not exceed S's post-reduction $120 basis in the S1 stock. As a result, M's $60 loss continues to be duplicated in both S's basis in the S1 stock and S1's basis in A2.

The IRS and Treasury Department agree that, under these facts, the attribute reduction rule does not eliminate all lower-tier duplication. However, this effect follows directly from policy decisions underlying the Unified Loss Rule, specifically, that it would be a loss limitation rule and that the basis reduction rule would apply only upon a disposition, deconsolidation, or worthlessness of a loss share. Under this approach, as long as a share is held by the same person and is subject to the consolidated return provisions, noneconomic lower-tier subsidiary stock basis is preserved. As a result, subsequent appreciation can permit the stock to be transferred without being subject to the Unified Loss Rule, and the noneconomic stock basis can reduce any gain that would otherwise be recognized. It is the preservation of that noneconomic stock basis that prevents the full elimination of duplicated loss in S1's attributes.

The issue could be addressed in several ways. First, the decision to preserve basis until there is a loss transfer could be reversed. However, the rule could then either reduce lower-tier stock basis below value or rely on valuation to limit such basis reduction. The IRS and Treasury Department are concerned that adding a valuation component to this rule would present substantial administrative concerns. More importantly, however, the IRS and Treasury Department do not believe that such an approach adequately protects the balance struck in the regulation as proposed and so are not reconsidering that decision.

Alternatively, the conforming limitation could be revised such that any conforming limit would be reduced by the amount of any tentative reduction to stock basis under the basis reduction rule. In the example set forth by the commentators, this would reduce S1's conforming limitation by $80 (S1's tentative reduction amount), from $120 to $40. As a result, S1's basis in A2 would be reduced to $40. While this would produce an appropriate result with respect to A2, it leaves S's basis in the S1 stock reflecting $80 of disconformity. Accordingly, absent additional adjustments, S's basis in the S1 stock could appear to reflect a noneconomic loss, and so the rule would remain imperfect.

Moreover, the effect of such an approach would be to create a disconformity amount that is not related to built-in gain. Consequently, when the S1 stock is ultimately sold, economic loss could appear noneconomic and, therefore, could be eliminated under the basis reduction rule. Although the Unified Loss Rule affords some protection for this situation in the operating rules (see the discussion in section A.1.vii. of this preamble), the IRS and Treasury Department are concerned that the tracing necessary to make the adjustments to prevent the elimination of economic loss will present substantial administrative difficulty and, in many cases, may not be possible.

Furthermore, in certain circumstances, the proposed conforming limitation on tier-down attribute reduction could prevent an unnecessary reduction in lower-tier inside attributes, for example, when the loss on S stock is attributable to the loss of built-in gain on an asset held by S (other than subsidiary stock).

Based on all of these considerations, the IRS and Treasury Department have decided not to revise this rule in the final regulations, but will continue to consider the issue.

viii. *Attribute Reduction in the Case of Certain Dispositions Due to Worthlessness and Where the Subsidiary Ceases to be a Member and Does Not Become a Nonmember*

Section 1.1502–35(f) generally provides that, if a member treats stock of S as worthless under section 165 (taking into account §1.1502–80(c)) and S continues as a member, or if M recognizes a loss on S stock and on the following day S is not a member and does not have a separate return year following the recognition of the loss, all losses treated as attributable to S under the principles of §1.1502–21(b)(2)(iv) are treated as expired as of the beginning of the day following the last day of the group's taxable year. This rule was intended to prevent any implication that S's share of the consolidated losses could be treated as remaining part of the consolidated net operating or capital loss carryover after S becomes worthless or is dissolved in a taxable transaction. The IRS and Treasury Department continue to believe that the regulations should explicitly clarify that such losses are removed from the consolidated losses.

Commentators have observed that, in the specified circumstances, any credits and built-in losses attributable to S should also be eliminated to prevent their use after S either becomes worthless or is dissolved in a taxable transaction. The IRS and Treasury Department agree that, in such cases, S's credits and other attributes should no longer be available to the group.

Accordingly, these final regulations provide a special attribute elimination rule that applies to transfers that result from one of two events. The first is M's transfer of a share of S stock caused solely by M treating the share as worthless under section 165 (taking into account the provisions of §1.1502–80(c)), if S remains a member of the group and M has a deduction or recognizes a loss with respect to the transfer of the share. The second is M's transfer of a share of S stock caused by S ceasing to

be a member, if S has no separate return year and M recognizes a net deduction or loss on its S shares transferred in the transaction. When there is a transfer of S stock in either of these situations, S's net operating loss carryovers, capital loss carryovers, and deferred deductions (including S's share of such consolidated tax attributes) that are not otherwise reduced or reattributed under §1.1502–36(d), and S's credits (including S's share of consolidated credits), are eliminated. The IRS and Treasury Department do not believe that any special rule is required regarding any built-in loss in assets because excess asset basis should not survive the transactions to which this rule applies.

In considering this rule, the IRS and Treasury Department recognized that the reason for eliminating S's attributes, including credits and deferred deductions, arises from the nature of the specified transactions, not from the amount of the member's basis in the stock transferred in the transaction. Further, as provided in §1.1502–19(a)(2)(ii), an excess loss account is treated as basis that is a negative amount and a reference to P's basis in S's stock includes a reference to P's excess loss account. Accordingly, the IRS and Treasury Department have concluded that the elimination of S's attributes should occur whenever one of the specified transactions occurs, without regard to the amount of the basis of the transferred share. Under such an approach, the treatment of S's attributes following one of the specified transfers would be consistent irrespective of whether the aggregate basis in the members' shares is a positive number (which produces a net loss or deduction), a negative number (an excess loss account, which produces income or gain under §1.1502–19), or zero (which produces no income, gain, deduction or loss).

Accordingly, these final regulations include a provision in §1.1502–19 that applies to the same two transactions that will result in the complete elimination of S's attributes when members have net loss on S stock. Thus, it will apply when a share of S stock is worthless under section 165, the requirements of §1.1502–19(c)(1)(iii) are satisfied, members do not have a net deduction or loss on the S stock, and S continues as a member. It will also apply when S ceases to be a member, S has no separate return year, and members recognize an amount that is not a net loss on the subsidiary's stock in the transaction. When it applies, it will eliminate S's net operating loss carryovers, capital loss carryovers, and deferred deductions (including S's share of such consolidated tax attributes), and S's credits (including S's share of consolidated credits).

Under both the §1.1502–36 and the §1.1502–19 elimination rules, attributes other than consolidated tax attributes (determined as of the event) are eliminated immediately before the event resulting in the application of the rule. Because consolidated tax attributes are first carried to the consolidated return year before being apportioned to a member's first separate return year, the IRS and Treasury Department do not believe that any special timing rule is required regarding the elimination of the portion of any consolidated tax attributes attributable to the member under either of these rules. Mechanically, the elimination of the member's portion of any consolidated tax attributes under either rule can only occur immediately after the close of the group's tax year that includes the event.

To clarify that there is no duplicative adjustment, these final regulations provide that the elimination of these attributes under either rule is not a noncapital, nondeductible expense.

2. *Other Sections Addressing Subsidiary Stock Loss: §§1.337(d)–1, 1.337(d)–2, 1.1502–20, and 1.1502–35*

In general, transfers of loss shares of subsidiary stock on or after September 17, 2008, will be subject to the Unified Loss Rule and not §1.337(d)–1, §1.337(d)–2, §1.1502–20, or §1.1502–35. The IRS and Treasury Department do not expect that §1.1502–20 will affect any transactions occurring on or after September 17, 2008. However, because of the binding-commitment transition rule, the IRS and Treasury Department expect there will be some transactions occurring on or after September 17, 2008, that will be subject to §§1.337(d)–1, 1.337(d)–2, and 1.1502–35. In addition, dispositions subject to §1.1502–35 will continue to be subject to the loss suspension and anti-loss reimportation rules in §1.1502–35. Accordingly, the IRS and Treasury Department are removing §1.1502–20 and retaining §§1.337(d)–1, 1.337(d)–2, and 1.1502–35, subject to certain modifications described below.

Under these final regulations, §§1.337(d)–1 and 1.337(d)–2 are modified to state explicitly that they do not apply to transactions subject to the Unified Loss Rule. However, those sections remain otherwise applicable.

Section 1.1502–35 is also modified to state explicitly that it does not apply to transfers subject to the Unified Loss Rule. Although the provisions of §1.1502–35 are largely unchanged in these final regulations, there are some significant modifications, and those modifications are described in the following paragraphs.

A. *Ten-year termination of application of §1.1502–35*

Under the final regulations, the loss suspension rule is revised to provide that it ceases to apply ten years after the stock disposition that gave rise to the suspended loss. The purpose of this modification is to conform the loss suspension rule and the anti-loss reimportation rule.

In addition, the general provisions of §1.1502–35 are revised to apply only to losses allowed within ten years of the date that they are recognized. Thus, if a loss is deferred and taken into account more than ten years after the disposition, or if an exchanged basis asset is sold at a loss more than ten years after the exchanged basis asset is acquired, the section will have no application to the loss. The purpose of this modification is to conform all application of §1.1502–35 to the ten-year rule applicable to loss suspension and anti-loss reimportation.

B. *Location of suspended loss*

These final regulations modify §1.1502–35 to state explicitly that if M recognized a loss on S stock and the loss was suspended under §1.1502–35(c), and if M ceases to be a member when S remains a member, then, immediately before M ceases to be a member, P is treated as succeeding to the loss in a transaction to which section 381(a) applies. Thus, the suspended loss is explicitly preserved for use by the group that disposed of the loss stock, and the location of the loss is specified. However, §1.1502–35(c)(5)(i)

provides that, "[t]o the extent not reduced ... , any loss suspended ... shall be allowed ... on a return filed by the group of which the subsidiary was a member on the date of the disposition of subsidiary stock that gave rise to the suspended loss ... for the taxable year that includes the day before the first date on which the subsidiary ... is not a member of such group or the date the group is allowed a worthless stock loss ...." Further, §1.1502–35(c)(3) provides that "any loss suspended ... is treated as a noncapital, nondeductible expense of the member that disposes of subsidiary stock, incurred during the taxable year that includes the date of the disposition of stock [that gave rise to the suspended loss]." Accordingly, the IRS and Treasury Department believe these final regulations merely clarify the rule in §1.1502–35.

C. *Effect of elimination of reimported item*

Under the anti-loss reimportation rule, a reimported item is generally eliminated immediately before it would be taken into account by the group. The regulations provided that the elimination of the item was a noncapital, nondeductible expense under §§1.1502–32(b)(2)(iii) and 1.1502–32(b)(3)(iii). A practitioner suggested that this result would inappropriately reduce upper-tier stock basis and, as a result, would either create noneconomic gain or eliminate economic loss. The IRS and Treasury Department considered modifying this provision but have concluded that the elimination of a reimported item is similar to the expiration of a separate return limitation year loss and should be similarly treated. Accordingly, this rule is not modified in the final regulations.

3. *The Application of Section 362(e)(2) to Intercompany Transfers*

The proposed regulations included rules for suspending the application of section 362(e)(2) in the case of transactions between members of a consolidated group. The IRS and Treasury Department had proposed the rule because the interaction of section 362(e)(2) and the consolidated return provisions (which already address duplication issues) causes significant distortions, administrative burden, and the potential for inappropriate loss disallowance and gain creation. In general, the proposed rules were intended to postpone the application of section 362(e)(2) to an intercompany transaction until the consolidated return provisions could no longer address the loss duplication created in the intercompany transaction.

To implement such a regime, however, complex tracing rules would be necessary to identify the extent to which duplication is eliminated and to continuously monitor the extent to which duplication could continue to be eliminated by the consolidated return provisions. Although the intent was to simplify the application of section 362(e)(2) in the consolidated return setting and to prevent the adjustments otherwise made under section 362(e)(2) from causing inappropriate results under the consolidated return provisions, commentators found these rules to be extremely complex and expect them to be extremely burdensome to administer. The IRS and Treasury Department concur with these views.

Commentators offered two suggestions for addressing the concerns raised by the application of section 362(e)(2) to intercompany transactions.

The first suggestion was to treat intercompany section 362(e)(2) transactions as taxable transactions to the extent of the net loss in the transferred assets. Thus, the losses would not be duplicated and, because the transfers would be intercompany transactions, §1.1502–13 would police the recognition of the losses. The rationale supporting this approach was that using a familiar regime (specifically, the intercompany transaction provisions of §1.1502–13) would lessen the overall complexity of the provisions as well as the administrative burden placed on taxpayers and the government. Although this approach would be less burdensome than the approach in the proposed regulations, the IRS and Treasury Department are concerned that this approach would still impose an unnecessary administrative burden. Further, unlike either the general application of §1.1502–13 to a nonrecognition transaction or the general application of section 362(e)(2), this approach would effectively preserve the original location of the net loss in the transferred assets.

The second suggestion was to modify the consolidated return provisions to make section 362(e)(2) generally inapplicable to intercompany transactions. Commentators stated that applying section 362(e)(2) to intercompany transactions gives rise to administrative burden and complexity even if the taxable intercompany transaction model were adopted. Further, they argued that applying section 362(e)(2) to intercompany transactions is unnecessary because the consolidated return regulations (including the Unified Loss Rule) are already structured to address duplication of loss (and gain) within the group (including its members and former members) in a manner and scope that has been determined appropriate in the consolidated return setting, given the competing single and separate entity policy issues. The application of section 362(e)(2) to intercompany transactions is thus not only generally unnecessary and burdensome, it is disruptive of the balance struck in the various consolidated return provisions, most notably the investment adjustment rules in §1.1502–32 and the Unified Loss Rule in §1.1502–36.

For these reasons, the IRS and Treasury Department have concluded that section 362(e)(2) should generally not apply to intercompany transactions. Accordingly, these final regulations add a new paragraph (h) in §1.1502–80, which makes section 362(e)(2) generally inapplicable to intercompany transactions. The purpose of the provision is to allow the consolidated return provisions to address loss duplication. The IRS and Treasury Department are therefore withdrawing proposed §1.1502–13(e)(4), which proposed the suspension of the application of section 362(e)(2) to intercompany transactions.

Notwithstanding the decision to make section 362(e)(2) generally inapplicable to intercompany transactions, the IRS and Treasury Department are concerned that the inapplicability of section 362(e)(2) could be used to reach inappropriate results. For example, assume M transfers a loss asset to S in exchange for new shares in a transaction to which section 351(a) applies, S has an asset with offsetting appreciation, and later M sells only the new shares received in exchange for the loss asset. If S has no aggregate inside loss, the Unified Loss Rule will not require any attribute reduction. Accordingly, if S remains a member, the group could obtain more than a single benefit for its economic loss. The final regulations therefore include an anti-abuse rule that provides for

appropriate adjustments to be made to clearly reflect the income of the group if a taxpayer acts with a view to prevent the consolidated return provisions from properly addressing loss duplication. The final regulations also include an example that illustrates both an abusive fact pattern (similar to the one described) and a nonabusive fact pattern (similar to the one described, except that all the stock is sold).

4. *Proposed Revisions to the Investment Adjustment Provisions, §1.1502–32*

In the January 2007 proposal, the IRS and Treasury Department proposed several modifications to the investment adjustment rules in §1.1502–32. The principal modifications that were proposed related to the treatment of items attributable to property transferred in an intercompany section 362(e)(2) transaction and to the treatment of items attributable to the application of §1.1502–36(d).

As discussed in section 3 of this preamble, these final regulations make section 362(e)(2) generally inapplicable to intercompany transactions. Accordingly, the IRS and Treasury Department are withdrawing proposed §1.1502–32(c)(1)(ii)(A) (regarding the allocation of items otherwise attributable to intercompany section 362(e)(2) transactions).

Proposed regulations addressing the treatment of items attributable to the application of §1.1502–36(d) are finalized as §1.1502–32(c)(1)(ii). The IRS and Treasury Department have clarified the language of the proposed rule, but have made no substantive change to that rule.

In addition, the proposed regulations made various nonsubstantive modifications to the language of §1.1502–32 that were intended to simplify, clarify, and then conform various sections of the regulations. Those proposed changes are adopted without substantive change.

5. *Miscellaneous Amendments to Other Regulations*

In addition to the various provisions directly related to the treatment of losses on subsidiary stock and to the treatment of intercompany section 362(e)(2) transactions, the January 2007 proposal included a number of proposed modifications to regulations unrelated to subsidiary stock loss issues. The proposed revisions are described in Section I of the preamble to the January 2007 proposal. These final regulations adopt those proposed regulations without substantive change.

These final regulations also include several additional provisions that are either additional technical corrections to existing regulations or expansions of regulatory modifications proposed in the January 2007 proposal and adopted as final in this Treasury decision.

A. *Technical amendment to §1.1502–13(g)(3)(i)(B)(2)*

One commentator suggested an expansion of §1.1502–13(g)(3)(i)(B)(*2*), which prevents the application of §1.1502–13(c)(6)(i) to items of income or gain attributable to the reduction in basis of an intercompany obligation by reason of sections 108 and 1017 and §1.1502–28 (and thereby prevents such items from being excluded from income). The commentator noted that the same rule should be applied to items of income or gain attributable to the reduction in basis of an intercompany obligation by reason of §1.1502–36(d), in order to prevent the circumvention of the effects of attribute reduction. The IRS and Treasury Department agree that such a revision would be a helpful clarification and that change is incorporated in these final regulations.

B. *Amendments to §1.1502–33(e) "whole-group" exception*

In the January 2007 proposal, modifications were proposed to the "whole-group" exceptions in §1.1502–13(j)(5) (excepting whole-group acquisitions from the general rule that deconsolidations require intercompany items to be taken into account) and §1.1502–19(c)(3) (excepting whole-group acquisitions from the general rule that deconsolidations require excess loss accounts to be taken into account).

In response to the proposed changes to the whole-group exceptions in §§1.1502–13 and 1.1502–19, commentators suggested that a similar revision would be appropriate for the whole-group exception in §1.1502–33(e)(2). That rule excepts whole-group acquisitions from the general rule in §1.1502–33(e)(1) that eliminates a member's earnings and profits upon deconsolidation. The IRS and Treasury Department agree that the same reasoning supports the modification of all three whole-group exceptions.

Accordingly, these final regulations modify the whole-group exception in all three provisions, §§1.1502–13(j)(5), 1.1502–19(c)(3), and 1.1502–33(e)(2), to allow for their application without regard to whether the acquirer is a member of a consolidated group prior to the acquisition. Further, these final regulations provide that taxpayers may apply each of these modified whole-group exceptions retroactively.

C. *Anti-duplicative adjustments provisions*

The January 2007 proposal included a set of modifications that was intended to simplify several existing provisions by removing all references to the continued applicability of the Code and all of the anti-duplicative adjustment rules, and including such rule in a single paragraph in §1.1502–80. The IRS and Treasury Department believed this change would simplify the regulations, as well as remove any potential for inadvertent omission or negative implication in other provisions where such concepts are or should be applicable.

Commentators questioned whether the removal of the discussion of the anti-duplicative adjustment rule in various sections of the consolidated return regulations would eliminate guidance that is helpful to taxpayers and that establishes certain policy determinations. The IRS and Treasury Department have considered these comments and concluded that it is appropriate to retain the anti-duplicative adjustment rule in the various sections of the consolidated return regulations, but to add a cross reference to the rule in §1.1502–80(a). To provide additional guidance in §1.1502–80(a), the final regulations provide that, in determining the application of the anti-duplicative adjustment rule, the purposes of the provisions and single-entity principles are taken into account.

In addition, the final regulations modify the general anti-duplicative adjustment rule in §1.1502–80 to clarify that its principles apply to adjustments, inclusions, and all similar items.

D. *Technical correction to text example in §1.1502–75(d)(1)*

A practitioner informed the IRS and Treasury Department that the rationale in the text example in §1.1502–75(d)(1) needed modification. Section 1.1502–75(d)(1) provides that a group remains in existence for a tax year if the common parent remains as the common parent and at least one subsidiary that was affiliated with it at the end of the prior year remains affiliated with it at the beginning of the year. It then sets forth an example in which, at the end of 1965, P is the common parent of a group that includes S and, at the beginning of 1966, P is still the common parent of a group that includes S. The example concludes that the group continues through 1966 even though P acquires another subsidiary and S leaves the group.

The practitioner noted that the result is correct, but that the rationale is misleading and appears to be based on a prior formulation of the continuation of the group rule. Accordingly, these final regulations revise the analysis of this text example so that the rationale reflects the current continuation of the group rule.

E. *Amendment to the section 358 stock basis rules for certain triangular reorganizations*

In addition to adopting the proposed technical correction to the cross-reference paragraph in §1.358–6(e), these final regulations add triangular G reorganizations (other than by statutory merger) to the definition of triangular reorganizations in §1.358–6(b)(2).

F. *Request for comments on gain duplication*

Finally, in the preamble to the January 2007 proposal, the IRS and Treasury Department requested comments on the need for a provision that would address the gain duplication that occurs when S stock is sold at a gain and that gain is attributable to unrecognized net appreciation in S's assets. The IRS and Treasury Department have not previously addressed this form of gain duplication directly because taxpayers can structure their transactions to avoid duplicative recognition of the gain, for example, by selling assets directly or by electing to have their stock sales treated as assets sales under section 338. While it is believed that taxpayers generally have adequate means to mitigate this problem, comments were requested.

In response, commentators expressed the view that the IRS and Treasury Department underestimate the frequency and extent of gain duplication and overestimate the efficacy of self-help mechanisms.

Some commentators suggested that gain duplication could be addressed through a section 338-like election, pursuant to which gain recognized on subsidiary stock could be allocated to the basis of the subsidiary's assets, at least to the extent necessary to bring the basis of the assets into conformity with the basis of the stock in the buyer's hands. However, those commentators have explicitly stated that they are not urging this or any other particular model. Moreover, the IRS and Treasury Department have been advised that there is disagreement among commentators and practitioners as to whether the additional burden and complexity inherent in such additional rules would be warranted by the potential relief they could provide.

Accordingly, the IRS and Treasury Department will continue to accept comments and consider this issue.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

These regulations are necessary to provide taxpayers with immediate guidance regarding the tax consequences of a member's transfer of loss shares of subsidiary stock to prevent the creation and recognition of noneconomic stock loss and prevent the group from obtaining more than one tax loss from a single economic loss. Further, these regulations are necessary to provide taxpayers with immediate guidance regarding various other provisions of the consolidated return regulations. Therefore, good cause is found for dispensing with a delayed effective date pursuant to 5 U.S.C. 553(d)(3).

Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Moreover, the number of taxpayers affected is minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Drafting Information

The principal authors of these regulations are Marcie Barese, Sean Duffley, and Theresa Abell of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–36 also issued under 26 U.S.C. 1502 * * *

Section 1.1502–36 also issued under 26 U.S.C. 337(d). * * *

Par. 2. Section 1.337(d)–1 is amended by adding two sentences at the end of paragraph (a)(1) to read as follows:

§1.337(d)–1 Transitional loss limitation rule.

(a) * * * (1) * * * However, for transactions involving loss shares of subsidiary stock occurring on or after September 17, 2008, see §1.1502–36. Further, this section does not apply to a transaction that is subject to §1.1502–36.

* * * * *

Par. 3. Section 1.337(d)–2 is amended by adding two sentences at the end of paragraph (a)(1) to read as follows:

§1.337(d)–2 Loss limitation rules.

(a) * * * (1) * * * However, for transactions involving loss shares of subsidiary stock occurring on or after September 17, 2008, see §1.1502–36. Further, this section does not apply to a transaction that is subject to §1.1502–36.

* * * * *

Par. 4. Section 1.358–6 is amended by:

1. Adding paragraph (b)(2)(v).

2. Revising paragraph (e).

3. Revising the heading for paragraph (f) and adding paragraph (f)(3).

The additions and revisions read as follows:

§1.358–6 Stock basis in certain triangular reorganizations.

* * * * *

(b) * * *

(2) * * *

(v) *Triangular G reorganization.* A triangular G reorganization is an acquisition by S (other than by statutory merger) of substantially all of T's assets in a title 11 or similar case in exchange for P stock in a transaction that qualifies as a reorganization under section 368(a)(1)(G) by reason of the application of section 368(a)(2)(D).

* * * * *

(e) *Cross-reference regarding triangular reorganizations involving members of a consolidated group.* For rules relating to stock basis adjustments made as a result of a triangular reorganization in which P and S, or P and T, as applicable, are, or become, members of a consolidated group, see §1.1502–30. However, if a transaction is a group structure change, stock basis adjustments are determined under §1.1502–31 and not under §1.1502–30, even if the transaction also qualifies as a triangular reorganization otherwise subject to §1.1502–30.

(f) *Effective/applicability dates.* * * *

(3) *Triangular G reorganization and special rule for triangular reorganizations involving members of a consolidated group.* Paragraphs (b)(2)(v) and (e) of this section shall apply to triangular reorganizations occurring on or after September 17, 2008. However, taxpayers may apply paragraph (b)(2)(v) of this section to triangular reorganizations occurring before September 17, 2008 and on or after December 23, 1994.

Par. 5. Section 1.362–4 is added to read as follows:

§1.362–4 Limitations on built-in loss duplication.

(a) *Purpose and scope*—(1) *In general.* [Reserved].

(2) *Intercompany transactions.* For rules relating to the application of section 362(e)(2) to transfers between members of a consolidated group on or after October 22, 2004, see §1.1502–80(h).

(b) [Reserved].

Par. 6. Section 1.1502–13 is amended by:

1. Revising the heading and adding a new first sentence in paragraph (a)(4).

2. Revising paragraphs (f)(6)(ii), (g)(3)(ii)(B)(*2*), (j)(5)(i)(A).

3. Revising the last sentence of paragraph (f)(6)(iv)(A).

4. Removing the second sentence in paragraph (f)(6)(v).

5. Revising the heading for paragraph (l) and adding two sentences at the end of paragraph (l)(1).

The revisions and additions read as follows:

§1.1502–13 Intercompany transactions.

(a) * * *

(4) *Application of other rules of law.* See §1.1502–80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments. * * *

* * * * *

(f) * * *

(6) * * *

(ii) *Gain stock.* For dispositions of P stock occurring before May 16, 2000, see §1.1502–13(f)(6)(ii) as contained in 26 CFR part 1 in effect on April 1, 2000. For dispositions of P stock occurring on or after May 16, 2000, see §1.1032–3.

* * * * *

(iv) * * *

(A) * * * If P grants M an option to acquire P stock in a transaction meeting the requirements of §1.1032–3, M is treated as having purchased the option from P for fair market value with cash contributed to M by P.

* * * * *

(g) * * *

(3) * * *

(ii) * * *

(B) * * *

(*2*) Paragraph (c)(6)(i) of this section (treatment of intercompany items if corresponding items are excluded or nondeductible) will not apply to exclude any amount of income or gain attributable to a reduction of the basis of an intercompany obligation pursuant to sections 108 and 1017 and §1.1502–28 or to §1.1502–36(d); and

* * * * *

(j) * * *

(5) * * *

(i) * * *

(A) The acquisition of either the assets of the common parent of the terminating group in a reorganization described in section 381(a)(2), or the stock of the common parent of the terminating group; or

* * * * *

(l) *Effective/applicability dates.* * * *

(1) * * * Paragraphs (a)(4), (f)(6)(ii), (f)(6)(iv)(A), (g)(3)(ii)(B)(*2*), and (j)(5)(i)(A) of this section apply with respect to transactions occurring on or after September 17, 2008. However, taxpayers may apply paragraph (j)(5)(i)(A) of this section to transactions that occurred prior to September 17, 2008.

* * * * *

Par. 7. Section 1.1502–19 is amended by:

1. Removing the language "P" throughout the entire section and adding "M" in its place.

2. Adding a new sentence at the end of paragraph (a)(1).

3. Revising paragraphs (a)(3), (c)(1)(iii)(A), and (c)(3)(i)(A).

4. Adding new paragraph (b)(1)(iv).

5. Revising the heading for paragraph (h) and adding three sentences at the end of paragraph (h)(1).

The revisions and additions read as follows:

§1.1502–19 Excess loss accounts.

(a) *In general*—(1) *Purpose.* * * * This section also provides rules for eliminating losses and other attributes attributable to S

in certain cases in which S stock becomes worthless or S ceases to be a member and does not have a separate return year.

* * * * *

(3) *Application of other rules of law, duplicative recapture*. See §1.1502–80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments and recapture.

(b) * * *

(1) * * *

(iv) *Reduction of attributes in the case of certain dispositions by worthlessness or where S ceases to be a member and does not become a nonmember*. If this paragraph (b)(1)(iv) applies, any net operating or capital loss carryover that is attributable to S, including any losses that would be apportioned to S under the principles of §1.1502–21(b)(2) if S had a separate return year, any deferred deductions attributable to S, including S's portion of such consolidated tax attributes (for example, consolidated excess charitable contributions that would be apportioned to S under the principles of §1.1502–79(e) if S had a separate return year), and any credit carryover attributable to S, including any consolidated credits that would be apportioned to S under the principles of §1.1502–79 if S had a separate return year, are eliminated. Attributes other than consolidated tax attributes (determined as of the disposition) are eliminated under this paragraph (b)(1)(iv) immediately before the disposition resulting in the application of this paragraph (b)(1)(iv). The elimination of attributes under this paragraph (b)(1)(iv) is not a noncapital, nondeductible expense described in §1.1502–32(b)(2)(iii). This paragraph (b)(1)(iv) applies if—

(A) A share of S stock becomes worthless under section 165, the requirements of paragraph (c)(1)(iii) of this section are satisfied, M does not recognize a net deduction or loss on the S stock, and S is a member of the group on the day following the last day of the group's taxable year during which the share becomes worthless; or

(B) M recognizes any amount that is not a net deduction or loss on the stock of S in a transaction in which S ceases to be a member and does not become a nonmember.

* * * * *

(c) * * *

(1) * * *

(iii) * * *

(A) All of S's assets (other than its corporate charter and those assets, if any, necessary to satisfy state law minimum capital requirements to maintain corporate existence) are treated as disposed of, abandoned, or destroyed for Federal income tax purposes (for example, under section 165(a) or §1.1502–80(c), or, if S's asset is stock of a lower-tier member, the stock is treated as disposed of under this paragraph (c)). An asset of S is not considered to be disposed of or abandoned to the extent the disposition is in complete liquidation of S under section 332 or is in exchange for consideration (other than relief from indebtedness);

* * * * *

(3) * * *

(i) * * *

(A) The acquisition of either the assets of the common parent of the terminating group in a reorganization described in section 381(a)(2), or the stock of the common parent of the terminating group; or

* * * * *

(h) *Effective/applicability dates*—(1) * * * Paragraphs (a)(3), (c)(1)(iii)(A), and (c)(3)(i)(A) of this section apply with respect to determinations and transactions occurring on or after September 17, 2008. However, taxpayers may apply paragraph (c)(3)(i)(A) of this section to transactions that occurred prior to September 17, 2008. The last sentence of paragraph (a)(1) and paragraph (b)(1)(iv) of this section applies with respect to dispositions on or after December 16, 2008.

* * * * *

§1.1502–20 [Removed]

Par. 8. Section 1.1502–20 is removed.

§1.1502–20T [Removed]

Par. 9. Section 1.1502–20T is removed.

Par. 10. Section 1.1502–21 is amended by:

1. Removing the last sentence of paragraph (b)(1).

2. Removing paragraph (b)(3)(v).

3. Revising paragraphs (b)(2)(ii)(A), (b)(2)(iv)(B)(*2*)(*iv*), and (h)(6).

4. Adding a new paragraph (b)(2)(iv)(B)(*2*)(*v*).

5. Revising the heading for paragraph (h) and adding new paragraph (h)(1)(iii).

6. Revising the first sentence of paragraph (h)(8).

The revisions and addition reads as follows:

§1.1502–21 Net operating losses.

* * * * *

(b) * * *

(2) * * *

(ii) *Special rules*—(A) *Year of departure from group*. If a corporation ceases to be a member during a consolidated return year, net operating loss carryovers attributable to the corporation are first carried to the consolidated return year, then are subject to reduction under section 108 and §1.1502–28 (regarding discharge of indebtedness income that is excluded from gross income under section 108(a)), and then are subject to reduction under §1.1502–36 (regarding transfers of loss shares of subsidiary stock). Only the amount that is neither absorbed by the group in that year nor reduced under section 108 and §1.1502–28 or under §1.1502–36 may be carried to the corporation's first separate return year. For rules concerning a member departing a subgroup, see paragraph (c)(2)(vii) of this section.

* * * * *

(iv) * * *

(B) * * *

(*2*) * * *

(*iv*) *Reduction of attributes for stock loss*. If during a taxable year a member does not cease to be a member of the group and any portion of the CNOL attributable to any member is reduced under §1.1502–36, the percentage of the CNOL attributable to each member as of immediately after the reduction of attributes under §1.1502–36 shall be recomputed pursuant to paragraph (b)(2)(iv)(B)(*2*)(*v*) of this section.

(*v*) *Recomputed percentage*. The recomputed percentage of the CNOL attributable to each member shall equal the unabsorbed CNOL attributable to the member at the time of the recomputation divided by the sum of the unabsorbed CNOL attributable to all of the members at the time of the recomputation. For purposes of the preceding sentence, a CNOL that is reduced under section 108 and

§1.1502–28, or under §1.1502–36, or that is otherwise permanently disallowed or eliminated, shall be treated as absorbed.

* * * * *

(h) *Effective/applicability dates*—(1) * * *

(iii) Paragraphs (b)(2)(ii)(A) and (b)(2)(iv)(B)(*2*) of this section apply to taxable years for which the due date of the original return (without regard to extensions) is on or after September 17, 2008.

* * * * *

(6) *Certain prior periods*. Paragraphs (b)(1), (b)(2)(iv)(A), (b)(2)(iv)(B)(*1*), and (c)(2)(vii) of this section apply to taxable years for which the due date of the original return (without regard to extensions) is after March 21, 2005. Paragraphs (b)(2)(ii)(A) and (b)(2)(iv)(B)(*2*) (as contained in 26 CFR part 1 revised as of April 1, 2008) apply to taxable years for which the due date of the original return (without regard to extensions) is on or after March 21, 2005, and before September 17, 2008. Paragraph (b)(2)(ii)(A) of this section and §1.1502–21T(b)(1), (b)(2)(iv), and (c)(2)(vii), as contained in 26 CFR part 1 revised as of April 1, 2004, apply to taxable years for which the due date of the original return (without regard to extensions) is after August 29, 2003, and on or before March 21, 2005. For taxable years for which the due date of the original return (without regard to extensions) is on or before August 29, 2003, see paragraphs (b)(1), (b)(2)(ii)(A), (b)(2)(iv), and (c)(2)(vii) of this section and §1.1502–21T(b)(1) as contained in 26 CFR part 1 revised as of April 1, 2003.

* * * * *

(8) *Losses treated as expired under §1.1502–35(f)(1)*. For rules regarding losses treated as expired under §1.1502–35(f) on or after March 10, 2006, see §1.1502–21(b)(3)(v) as contained in 26 CFR part 1 in effect on April 1, 2006.

* * *

Par. 11. Section 1.1502–30 is amended by:

1. Revising paragraph (b)(4).

2. Revising the heading for paragraph (c) and adding a second sentence.

The revision and addition reads as follows:

§1.1502–30 Stock basis after certain triangular reorganizations.

* * * * *

(b) * * *

(4) *Application of other rules of law*. If a transaction otherwise subject to this section is also a group structure change subject to §1.1502–31, the provisions of §1.1502–31 and not this section apply to determine stock basis. See §1.1502–80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments. See §1.1502–80(d) for the non-application of section 357(c) to P.

* * * * *

(c) *Effective/applicability date*. * * * However, paragraph (b)(4) of this section applies to reorganizations occurring on or after September 17, 2008.

Par. 12. Section 1.1502–31 is amended by:

1. Revising paragraph (a)(2).

2. Revising the heading for paragraph (h) and revising paragraph (h)(1).

3. Removing paragraphs (i) and (j).

The revisions read as follows:

§1.1502–31 Stock basis after a group structure change.

(a) * * *

(2) *Application of other rules of law*. If a transaction subject to this section is also a triangular reorganization otherwise subject to §1.1502–30, the provisions of this section and not those of §1.1502–30 apply to determine stock basis. See §1.1502–80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments.

* * * * *

(h) *Effective/applicability dates*—(1) *General rule*. This section applies to group structure changes that occur after April 26, 2004. However, a group may apply this section to group structure changes that occurred on or before April 26, 2004, and in consolidated return years beginning on or after January 1, 1995. In addition, paragraph (a)(2) of this section applies to group structure changes that occurred on or after September 17, 2008. Paragraph (e)(2) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see §1.1502–31T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see §1.1502–31 as contained in 26 CFR part 1 in effect on April 1, 2006.

* * * * *

Par. 13. Section 1.1502–32 is amended by:

1. Removing the language "P" throughout the entire section and adding "M" in its place.

2. Revising the heading, adding a new first sentence, and removing the last two sentences in paragraph (a)(2).

3. Revising paragraphs (b)(3)(ii)(C)(*2*), (c)(1), and (c)(2)(i)

4. Revising the first sentence of paragraphs (c)(2)(ii)(A), (c)(3), and the first three sentences of paragraph (c)(4)(i), introductory text.

5. Removing paragraphs (b)(3)(iii)(C) and (b)(3)(iii)(D).

6. Revising the heading for paragraph (h) and adding paragraph (h)(9).

The revisions and addition read as follows:

§1.1502–32 Investment adjustments.

(a) * * *

(2) *Application of other rules of law, duplicative adjustments*. See §1.1502–80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments. * * *

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(C) * * *

(*2*) *Expired loss carryovers*. If the amount of the discharge exceeds the amount of the attribute reduction under sections 108 and 1017, and §1.1502–28, the excess nevertheless is treated as applied to reduce tax attributes to the extent a loss carryover attributable to S expired without tax benefit, the expiration was taken into account as a noncapital, nondeductible expense under paragraph (b)(3)(iii) of this section, and the loss carryover would have been reduced had it not expired.

* * * * *

(c) *Allocation of adjustments among shares of stock*—(1) *In general*—(i) *Distributions*. The adjustment that is described in paragraph (b)(2)(iv) of this section (negative adjustments for distributions) is allocated to the shares of S stock to which the distribution relates.

(ii) *Special rules applicable in the case of certain loss transfers of subsidiary stock*—(A) *Losses reattributed pursuant to an election under §1.1502–36(d)(6)*—(*1*) *General rule*. If a member transfers loss shares of S stock and the common parent elects under §1.1502–36(d)(6) to reattribute all or a portion of S's attributes, S's resulting noncapital, nondeductible expense is allocated to all loss shares of S stock transferred by members in the transaction. The expense is allocated among those S shares in proportion to the loss in the shares. The tier-up of that expense is included in the remaining adjustment (see paragraph (c)(1)(iii) of this section).

(*2*) *Reattribution of attributes of a subsidiary that is lower-tier to S*. If a member transfers loss shares of S stock and the common parent elects under §1.1502–36(d)(6) to reattribute attributes of a subsidiary (S2) that is lower-tier to S, S2's resulting noncapital, nondeductible expense is allocated among S2 shares held by members as of the transaction, other than those transferred in the transaction and with respect to which gain or loss was recognized (recognition transfer), in a manner that permits the full amount of the expense to tier up and be applied to the bases of the loss shares of S stock transferred by members in the transaction. The expense is allocated among those S2 shares with positive basis in a manner that, first, reduces the bases of S2's preferred shares to equalize and then eliminate loss and, second, reduces the bases of S2's common shares in a manner that reduces disparity among the bases of those common shares to the greatest extent possible. The noncapital, nondeductible expense applied to the S2 shares tiers up and is applied to the stock of any subsidiaries that are lower-tier to S (middle-tier subsidiaries) in a manner that will permit the full amount of this expense to be applied to reduce the bases of the loss shares of S stock transferred by members in the transaction. Similar to the allocation among the S2 shares, the tier-up of this expense is allocated among the middle-tier subsidiary shares held by members as of the transaction, other than those transferred in a recognition transfer, in a manner that permits the full amount of the expense to tier up and be applied to the bases of the loss shares of S stock transferred by members in the transaction. The tier-up of this expense is allocated among those middle-tier subsidiary shares with positive basis in a manner that, first, reduces the bases of the middle-tier subsidiary's preferred shares to equalize and then eliminate loss and, second, reduces the bases of the middle-tier subsidiary's common shares in a manner that reduces disparity among the bases of those common shares to the greatest extent possible. The tier-up of this expense is allocated to the loss shares of S stock transferred by members in the transaction in the same manner as provided in paragraph (c)(1)(ii)(A)(*1*) of this section, and thereafter the tier-up of that expense is included in the remaining adjustment (see paragraph (c)(1)(iii) of this section).

(*3*) *Example*. The following example illustrates the rules of this paragraph (c)(1)(ii)(A).

Example. Assume P owns M1, P and M1 own M2, M2 owns S, M1 and S own S1, and M1 and S1 own S2. If S sells a portion of the S1 shares at a gain and M2 sells all of the S stock at a net loss (after adjusting the basis for the gain recognized by S on the sale of the S1 shares), and P elects under §1.1502–36(d)(6) to reattribute attributes of S2, the resulting noncapital, nondeductible expense is allocated entirely to the S2 shares held by S1 with positive basis in a manner that reduces the disparity in those bases to the greatest extent possible. The tier-up of this amount is allocated entirely to the S1 shares held by S (excluding the S1 shares sold) with positive basis in a manner that reduces the disparity in those bases to the greatest extent possible. The tier-up of this amount is allocated to the loss shares of S stock sold by M2 in proportion to the loss in those shares. The tier-up of this amount is then included in the remaining adjustment and tiers up from M2 to M1 and P, and from M1 to P under the general rules of this section.

(B) *Tier-up of reallocated investment adjustments subject to prior use limitation*. If the reallocation of an investment adjustment under §1.1502–36(b)(2) is subject to the prior use limitation in §1.1502–36(b)(2)(iii)(B)(*2*), no amount of the tier-up of such reallocated investment adjustment shall be allocated to any share whose prior use resulted in the application of the limitation. Thereafter, the tier-up of this amount is included in the remaining adjustment (see paragraph (c)(1)(iii) of this section).

(iii) *Remaining adjustment*. The *remaining adjustment* is the adjustment that consists of the items described in paragraphs (b)(2)(i) through (b)(2)(iii) of this section (adjustments for taxable income or loss, tax-exempt income, and noncapital, nondeductible expenses), including adjustments to lower-tier stock basis that tier up under paragraph (a)(3)(iii) of this section, but only to the extent not specially allocated under paragraph (c)(1)(ii) of this section. The remaining adjustment is allocated among the shares of S stock as provided in paragraphs (c)(2) through (c)(4) of this section. If the remaining adjustment is positive, it is allocated first to any preferred stock as provided in paragraph (c)(3) of this section, and then to the common stock as provided in paragraph (c)(2) of this section. If the remaining adjustment is negative, it is allocated only to common stock as provided in paragraph (c)(2) of this section.

(iv) *Nonmember shares*. No adjustment under this section that is allocated to a share for the period it is owned by a nonmember affects the basis of the share.

(v) *Cross-references*. See paragraph (c)(4) of this section for the reallocation of adjustments, and paragraph (d) of this section for definitions. See §1.1502–19(d) for special allocations of basis determined or adjusted under the Internal Revenue Code (Code) with respect to excess loss accounts.

(2) *Common stock*—(i) *Allocation within a class*. The remaining adjustment described in paragraph (c)(1)(iii) of this section that is allocable to a class of common stock is generally allocated equally to each share within the class. However, if a member has an excess loss account in a share of a class of common stock at the time a positive remaining adjustment is to be allocated, the portion of the positive remaining adjustment allocable to the member with respect to the class is allocated first to equalize and then eliminate that member's excess loss accounts. It is then allocated equally among the members' shares in that class. Similarly, the portion of any negative remaining adjustment allocable to the member with respect to the class is allocated equally to the member's shares with positive bases, eliminating all positive basis in shares of

the class before creating or increasing any excess loss accounts. After positive basis is eliminated, any remaining portion of the negative remaining adjustment is allocated to equalize the member's excess loss accounts in the shares of that class to the greatest extent possible. Distributions and any adjustments or determinations under the Internal Revenue Code (for example, under section 358, including any modifications under §1.1502–19(d)) are taken into account before the allocation is made under this paragraph (c)(2)(i).

(ii) * * *

(A) * * * If S has more than one class of common stock, the extent to which the remaining adjustment described in paragraph (c)(1)(iii) of this section is allocated to each class is determined, based on consistently applied assumptions, by taking into account the terms of each class and all other facts and circumstances relating to the overall economic arrangement. * * *

* * * * *

(3) * * * If the remaining adjustment described in paragraph (c)(1)(iii) of this section is positive, it is allocated to preferred stock to the extent required (when aggregated with prior allocations to the preferred stock during the period that S is a member of the consolidated group) to reflect distributions described in section 301 (and all other distributions treated as dividends) to which the preferred stock becomes entitled, and arrearages arising, during the period that S is a member of the consolidated group. * * *

* * * * *

(4) * * *—(i) * * * A member's basis in each share of S preferred and common stock must be redetermined whenever necessary to determine the tax liability of any person. See paragraph (b)(1) of this section. The redetermination is made by reallocating S's adjustments described in paragraphs (c)(1)(ii)(B) (specially allocated adjustments for tier-up of reallocated investment adjustments subject to prior use limitation) and (c)(1)(iii) (remaining adjustments) of this section for each consolidated return year (or other applicable period) of the group by taking into account all of the facts and circumstances affecting allocations under this paragraph (c) as of the redetermination date with respect to all of the S shares. * * *

* * * * *

(h) *Effective/applicability date*. * * *

(9) *Allocations of investment adjustments, including adjustments attributable to certain loss transfers; certain conforming amendments*. Paragraphs (a)(2), (b)(3)(ii)(C)(*2*), (c)(1), (c)(2)(i), (c)(2)(ii)(A), (c)(3), and (c)(4)(i) of this section are applicable for determinations of the basis of stock of a subsidiary on or after September 17, 2008.

* * * * *

§1.1502–32T [Removed]

Par. 14. Section 1.1502–32T is removed.

Par. 15. Section 1.1502–33 is amended by:

1. Revising the heading and adding a new first sentence to paragraph (a)(2).

2. Revising paragraph (e)(2)(i)(A).

3. Revising the heading for paragraph (j) and adding two sentences to the end of paragraph (j)(1).

The additions and revision read as follows:

§1.1502–33 Earnings and profits.

(a) * * *

(2) *Application of other rules of law, duplicative adjustments*. See §1.1502–80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments. * * *

* * * * *

(e) * * *

(2) * * *

(i) * * *

(A) The acquisition of either the assets of the common parent of the terminating group in a reorganization described in section 381(a)(2), or the stock of the common parent of the terminating group; or

* * * * *

(j) *Effective/applicability date*—(1) * * * Paragraphs (a)(2) and (e)(2)(i)(A) of this section apply with respect to determinations of the earnings and profits of a member in consolidated return years beginning on or after September 17, 2008. However, taxpayers may apply paragraph (e)(2)(i)(A) of this section with respect to determinations of the earnings and profits of a member in consolidated return years beginning prior to September 17, 2008.

* * * * *

Par. 16. Section 1.1502–35 is amended by:

1. Revising paragraphs (a), (c)(3), (c)(4)(i), (c)(5)(i), (g)(3), (g)(6), (h), and (j).

2. Revising the heading of paragraph (c)(8).

3. Removing paragraph (k).

§1.1502–35 Transfers of subsidiary stock and deconsolidations of subsidiaries.

(a) *In general*—(1) *Purpose*. The purpose of this section is to prevent a group from obtaining more than one tax benefit from a single economic loss. The provisions of this section shall be construed in a manner that is consistent with that purpose and in a manner that reasonably carries out that purpose.

(2) *Dates of applicability*. This section applies if—

(i) On or after March 7, 2002, a member recognizes a loss on the disposition of a share of stock of a subsidiary (or, on or after April 10, 2007, a share of stock of a former subsidiary) or a carryover basis asset (subject to paragraph (c)(6) of this section),

(ii) The member's loss on the share of subsidiary stock or the carryover basis asset is allowed on or before the date that is ten years after the disposition of the share or carryover basis asset, and

(iii) If the disposition is of a share of subsidiary stock, it is not a transfer to which §1.1502–36 applies.

* * * * *

(c) * * *

(3) *Treatment of suspended loss*—(i) *General rule*. For purposes of the rules of §1.1502–32, any loss suspended pursuant to paragraph (c)(1) or (c)(2) of this section is treated as a noncapital, nondeductible expense of the member that disposes of subsidiary stock, incurred during the taxable year that includes the date of the disposition of stock to which paragraph (c)(1) or (c)(2) of this section applies. See §1.1502–32(b)(3)(iii)(C). Consequently, the basis of a higher-tier member's stock of the member that disposes of subsidiary stock is reduced by the suspended loss in the year it is suspended.

(ii) *Location of suspended loss following deconsolidation of selling member*. If a member recognizes a loss that is suspended under this paragraph (c) but that

member ceases to be a member of the group before the loss is allowable, the common parent is treated as succeeding to the loss in a transaction to which section 381(a) applies.

(4) *Reduction of suspended loss*—(i) *General rule*. The amount of any loss suspended pursuant to paragraph (c)(1) or (c)(2) of §1.1502–35 shall be reduced, but not below zero, by the subsidiary's (and any successor's) items of deduction and loss, and the subsidiary's (and any successor's) allocable share of items of deduction and loss of all lower-tier subsidiaries, that are allocable to the period beginning on the date of the disposition that gave rise to the suspended loss and ending on the day before the first date on which the subsidiary (and any successor) is not a member of the group of which it was a member immediately prior to the disposition (or any successor group), and that are taken into account in determining consolidated taxable income (or loss) of such group for any taxable year that includes any date on or after the date of the disposition and before the first date on which the subsidiary (and any successor) is not a member of such group; provided, however, that such reduction shall not exceed the excess of the amount of such items over the amount of such items that are taken into account in determining the basis adjustments made under §1.1502–32 to stock of the subsidiary (or any successor) owned by members of the group. The preceding sentence shall not apply to items of deduction and loss to the extent that the group can establish that all or a portion of such items was not reflected in the computation of the duplicated loss with respect to the subsidiary on the date of the disposition of stock that gave rise to the suspended loss.

* * * * *

(5) *Allowable loss*—(i) *General rule.* To the extent not reduced under paragraph (c)(4) of this section, any loss suspended pursuant to paragraph (c)(1) or (c)(2) of this section shall be allowed, to the extent otherwise allowable under applicable provisions of the Internal Revenue Code and regulations, on a return filed by the group of which the subsidiary was a member on the date of the disposition of subsidiary stock that gave rise to the suspended loss (or any successor group) for the taxable year that includes the earlier of—

(A) The day before the first date on which the subsidiary (and any successor) is not a member of such group or the date the group is allowed a worthless stock loss under section 165 (taking into account the provisions of §1.1502–80(c)) with respect to all of the subsidiary stock owned by members and;

(B) The date that is ten years after the date of the disposition of subsidiary stock that gave rise to the suspended loss.

* * * * *

(8) *No elimination of economic loss.* * * *

* * * * *

(g) * * *

(3) *Anti-loss reimportation rule*—(i) *Conditions for application.* This paragraph (g)(3) applies when—

(A) A member of a group (selling group) recognized and was allowed a loss with respect to a share of stock of S, a subsidiary or former subsidiary of the selling group;

(B) That stock loss was duplicated (in whole or in part) in S's attributes (duplicating items) at the earlier of the time that the loss was recognized or that S ceased to be a member; and

(C) Within ten years of the date that S ceased to be a member, there is a reimportation event. For this purpose, a reimportation event is any event after which a duplicating item is a reimported item. A reimported item is any duplicating item that is reflected in the attributes of any member of the selling group, including S, or, if not reflected in the attributes, would be properly taken into account by any member of the selling group (for example as the result of a carryback).

(ii) *Effect of application.* Immediately before the time that a reimported item (or any portion of a reimported item) would be properly taken into account (but for the application of this paragraph (g)(3)), such item (or such portion of the item) is reduced to zero and no deduction or loss is allowed, directly or indirectly, with respect to that item.

(iii) *Operating rules.* For purposes of this paragraph (g)(3)—

(A) The terms *member*, *subsidiary*, and *group* include their predecessors and successors to the extent necessary to effectuate the purposes of this section; and

(B) The reduction of a reimported item (other than duplicating items that are carried back to a consolidated return year of the selling group) is a noncapital, nondeductible expense within the meaning of §1.1502–32(b)(3)(iii).

* * * * *

(6) *General anti-avoidance rule*. If a taxpayer acts with a view to avoid the purposes of this section, appropriate adjustments will be made to carry out the purposes of this section.

(h) *Application of other rules of law*. See §1.1502–80(a) regarding the general applicability of other rules of law.

* * * * *

(j) *Effective/applicability dates*. This section applies with respect to stock transfers, deconsolidations of subsidiaries, determinations of worthlessness, and stock dispositions on or after September 17, 2008. For prior law, see §§1.1502–35 and 1.1502–35T as contained in 26 CFR part 1 in effect on April 1, 2008.

§1.1502–35T [Removed]

Par. 17. Section 1.1502–35T is removed.

Par. 18. Section 1.1502–36 is added to read as follows:

§1.1502–36 Unified loss rule.

(a) *In general*—(1) *Scope*. This section provides rules for adjusting members' bases in stock of a subsidiary (S) and for reducing S's attributes when a member (M) transfers a loss share of S stock. See paragraph (f) of this section for definitions of the terms used in this section, including *transfer* and *value*.

(2) *Purpose*. The rules in this section have two principal purposes. The first is to prevent the consolidated return provisions from reducing a group's consolidated taxable income through the creation and recognition of noneconomic loss on S stock. The second is to prevent members (including former members) of the group from collectively obtaining more than one tax benefit from a single economic loss. Additional purposes are set forth in other paragraphs of this section. The rules of this section must be interpreted and applied in a manner that is consistent with and reasonably carries out the purposes of this section.

(3) *Overview*—(i) *General application of section.* This section applies when M transfers a share of S stock and, after taking into account the effects of all applicable rules of law (even if the adjustments required by such provisions are not deemed effective until after the transfer, such as certain adjustments required under sections 108 and 1017 and §1.1502–28), the share is a loss share. When this section applies, paragraph (b) of this section applies first and may redetermine members' bases in their shares of S stock. If the transferred share is a loss share after any basis redetermination under paragraph (b) of this section, paragraph (c) of this section applies and may reduce M's basis in the transferred loss share. If the transferred share is a loss share after any basis reduction required by paragraph (c) of this section, paragraph (d) of this section applies and may reduce attributes of S and subsidiaries that are lower-tier to S. Although the determination of whether there is a transfer of a loss share is made as of the transfer, this section applies, and any adjustments it requires are given effect, immediately before the transfer. Paragraphs (e), (f), and (g) of this section provide general operating rules (including rules for transfers of S stock between members), definitions, and an anti-abuse rule, respectively.

(ii) *Stock of multiple subsidiaries transferred in the transaction*—(A) *Initial application of section to transferred shares in lowest tier.* If shares of stock of more than one subsidiary are transferred in a transaction, the application of this section begins at the lowest tier. If no transferred shares of stock of the lowest-tier subsidiary (S2) are loss shares, any gain recognized with respect to the S2 shares immediately tiers up and adjusts members' bases in subsidiary stock under §1.1502–32. However, if any of the transferred S2 shares are loss shares, paragraph (b) of this section applies with respect to those shares. If, after the application of paragraph (b) of this section, any transferred S2 shares are still loss shares, paragraph (c) of this section applies with respect to those shares. If, after the application of paragraph (c) of this section, any transferred S2 shares are still loss shares and P makes an election under paragraph (d)(6) of this section with respect to those S2 shares, then paragraph (d) of this section applies with respect to those shares, but only to the extent necessary to give effect to the election. After taking into account the effects of any adjustments required by this initial application of this section, recognized gain or loss is computed on all transferred S2 shares. Any adjustments under paragraph (b) or (c) of this section, the effect of any election under paragraph (d)(6) of this section, any gain or loss recognized on the transferred S2 shares (whether allowed or disallowed), and any other related or resulting adjustments then tier-up and apply to adjust members' bases in subsidiary stock under §1.1502–32.

(B) *Initial application of section to transferred shares in higher tiers.* After taking into account the effects of any adjustments described in paragraph (a)(3)(ii)(A) of this section, transferred shares in the next higher tier, and then in each next higher tier successively, other than the transferred loss shares at the highest tier, are treated in the manner described in paragraph (a)(3)(ii)(A) of this section.

(C) *Application of section to transferred shares in highest tier.* After paragraphs (b) and (c) of this section, and, to the extent necessary to give effect to any election under paragraph (d)(6) of this section, paragraph (d) of this section, have been applied to or with respect to all lower-tier transferred loss shares, and after all lower-tier adjustments have been taken into account (whether resulting from the application of paragraph (b) or (c) of this section, an election under paragraph (d)(6) of this section, the recognition of gain or loss on a transfer, or otherwise), paragraphs (b), then (c), and then (d) of this section apply with respect to the highest-tier shares that are transferred loss shares.

(D) *Final application of section to transferred shares in lower tiers.* After paragraph (d) of this section has been applied with respect to transferred loss shares in the highest tier, it is applied with respect to transferred shares in each next lower tier, successively, to the extent such shares are loss shares after the application of paragraph (d) of this section.

(4) *Other rules of law and coordination with deferral and disallowance provisions.* In general, this section applies and has effect immediately upon the transfer of a loss share even if the loss is deferred, disallowed, or otherwise not taken into account under any other applicable rules of law. However, see paragraph (e)(3) of this section for special rules applicable to shares of S stock transferred in an intercompany transaction. See section §1.1502–80(a) for the general applicability of other rules of law and a limitation on duplicative adjustments.

(5) *Nomenclature, factual assumptions adopted in this section.* Unless otherwise stated, for purposes of this section, the following nomenclature and assumptions are adopted. P is the common parent of a consolidated group of which S, M, and M1 are members. X is not a member of the P group. If a corporation has preferred stock outstanding, it is stock described in section 1504(a)(4). The examples set forth the only facts, elections, and activities relevant to the example. All transactions are between unrelated persons and are independent of each other. Tax liabilities and their effect, and the application of any other loss disallowance or deferral provisions of the Internal Revenue Code (Code) or regulations, including but not limited to section 267, are disregarded. All persons report on a calendar year basis and use the accrual method of accounting. All parties comply with filing and other requirements of this section and all other provisions of the Code and regulations.

(b) *Basis redetermination to reduce disparity*—(1) *In general*—(i) *Purpose and scope.* The rules of this paragraph (b) reduce the extent to which there is disparity in members' bases in shares of S stock. These rules supplement the operation of the investment adjustment system; their purpose is to prevent the realization of noneconomic loss and facilitate the elimination of duplicated loss when members hold S shares with disparate bases. The rules of this paragraph (b) only reallocate investment adjustments previously applied to members' bases in shares of S stock, thus they do not alter the aggregate amount of basis in shares of S stock held by members or the aggregate amount of investment adjustments applied to shares of S stock.

(ii) *Special rules for applicability of redetermination rule.* Notwithstanding the general rule in paragraph (b)(2) of this section, members' bases in shares of S stock are not redetermined under this paragraph (b) if—

(A) There is no disparity among members' bases in shares of S common stock and no member owns a share of S preferred

stock with respect to which there is unrecognized gain or loss; or

(B) All the shares of S stock held by members are transferred to one or more nonmembers, become worthless under section 165 (taking into account the provisions of §1.1502–80(c)), or a combination thereof, in one fully taxable transaction. However, in such a case, P may elect to redetermine such bases under this paragraph (b). Such an election is made in the manner provided in paragraph (e)(5) of this section. If stock of more than one subsidiary is transferred in the transaction, the election may be made with respect to one or more of such subsidiaries.

(iii) *Investment adjustment*. For purposes of this paragraph (b), the term *investment adjustment* includes adjustments specially allocated under §1.1502–32(c)(1)(ii)(B) and remaining adjustments described in §1.1502–32(c)(1)(iii). In applying any provision of this section, the term includes all such adjustments reflected in the basis of the share as of the application of the provision, whether originally allocated under §1.1502–32 or otherwise. The term therefore includes adjustments previously reallocated to the share, and it does not include adjustments previously reallocated from the share, whether pursuant to this section or any other provision of law. It also includes the proportionate amount of adjustments reflected in the exchanged basis of a share, such as the basis determined under section 358 in connection with a reorganization or a transaction qualifying under section 355.

(2) *Basis redetermination rule*. If M transfers a loss share of S stock, all members' bases in all their shares of S stock are subject to redetermination under this paragraph (b). The determination of whether a share is a loss share is made as of the transfer, taking into account the effects of all applicable rules of law. The redeterminations are made immediately before applying paragraph (c) of this section and in accordance with the following:

(i) *Decreasing the bases of transferred loss shares*—(A) *Removing positive investment adjustments from transferred loss shares of common stock*. M's basis in each of its transferred loss shares of S common stock is first reduced, but not below value, by removing positive investment adjustments previously applied to the basis of the share. The positive investment adjustments removed from transferred loss shares of S common stock are reallocated under paragraph (b)(2)(ii) of this section after negative investment adjustments are reallocated under paragraph (b)(2)(i)(B) of this section.

(B) *Reallocating negative investment adjustments from shares of S common stock*. If a transferred share is still a loss share after applying paragraph (b)(2)(i)(A) of this section, M's basis in the share is reduced, but not below value, by reallocating negative investment adjustments to the transferred loss share (whether common or preferred stock) from members' shares of S common stock that are not transferred loss shares. The adjustments reallocated under this paragraph (b)(2)(i)(B) are reallocated and applied first to M's bases in transferred loss shares of S preferred stock and then to M's bases in transferred loss shares of S common stock. Reallocations under this paragraph (b)(2)(i)(B) are made in a manner that, to the greatest extent possible, reduces the disparity among members' bases in all transferred loss shares of S preferred stock, and reduces the disparity among members' bases in all shares of S common stock.

(ii) *Increasing the bases of gain preferred and all common shares*—(A) *Preferred stock*. After the application of paragraph (b)(2)(i) of this section, the positive investment adjustments removed from transferred loss shares of S common stock under paragraph (b)(2)(i)(A) of this section are reallocated and applied to increase, but not above value, members' bases in shares of S preferred stock (without regard to whether such shares are transferred in the transaction). Reallocations under this paragraph (b)(2)(ii)(A) are made in a manner that, to the greatest extent possible, reduces the disparity among members' bases in all shares of S preferred stock.

(B) *Common stock*. Any positive investment adjustments removed from transferred loss shares of S common stock under paragraph (b)(2)(i)(A) of this section and not reallocated and applied to S preferred shares are reallocated and applied to increase members' bases in shares of S common stock. Reallocations are made to shares of S common stock without regard to whether a particular share is a loss share or a transferred share, and without regard to the share's value. Reallocations under this paragraph (b)(2)(ii)(B) are made in a manner that, to the greatest extent possible, reduces the disparity among members' bases in all shares of S common stock.

(iii) *Operating rules*—(A) *Method*. In general, reallocations should be made first with respect to the earliest available adjustments. However, the overall application of this paragraph (b) to a transaction must be made in a manner that, to the greatest extent possible, reduces basis disparity (as provided in paragraphs (b)(2)(i)(B) and (b)(2)(ii) of this section). The specific reallocation of an investment adjustment under this paragraph (b) may be made using any reasonable method or formula that is consistent with the provisions of this paragraph (b)(2) and furthers the purposes of this section.

(B) *Limits on reallocation*—(*1*) *Restriction to members' outstanding shares*. Investment adjustments can only be reallocated to shares that were held by members at the time the adjustment was originally applied.

(*2*) *Limitation by prior use*—(*i*) *In general*. In order to prevent the reallocation of investment adjustments from either increasing or decreasing members' aggregate bases in subsidiary stock, no investment adjustment (positive or negative) may be reallocated under this paragraph (b)(2) to the extent that it was (or would have been) used prior to the time that it would otherwise be reallocated under this paragraph (b)(2). For this purpose, an investment adjustment was used (or would have been used) to the extent that it was reflected in (or would have been reflected in) the basis of a share of subsidiary stock and the basis of that share has already been taken into account, directly or indirectly, in determining income, gain, deduction, or loss (including by affecting the application of this section to a prior transfer of subsidiary stock) or in determining the basis of any property that is not subject to §1.1502–32. However, if the prior use was in an intercompany transaction, an investment adjustment may be reallocated to the extent that §1.1502–13 has prevented the gain or loss on the transaction from being taken into account. (In that case, appropriate adjustments must be made to the intercompany item from the prior intercompany transaction that has not yet been taken into account.) Further, if an investment adjustment was reflected in (or

would have been reflected in) the basis of a share that has been taken into account, the limitation on reallocation under this paragraph (b)(2)(iii)(B)(*2*) does not apply to the extent the basis of that share would not change as a result of the reallocation (for example, because the reallocation is between shares that are both lower-tier to the share with the previously used basis). See §1.1502–32(c)(1)(ii)(B) regarding special allocations applicable to the tier-up of the reallocated investment adjustment if the reallocation is limited under this paragraph (b)(2)(iii)(B)(*2*) due to prior use at a higher tier.

(*ii*) *Example*. The application of this paragraph (b)(2)(iii)(B)(*2*) is illustrated by the following example:

Example. (i) *Facts*. P owns all 20 shares of M stock, and 10 shares of S stock. M owns the remaining 10 shares of S stock. In year 1, S recognizes $200 of income that results in a $10 positive investment adjustment being allocated to each share of S stock. The group does not recognize any other items. The $100 positive adjustment to M's basis in the S stock tiers up, and results in a $5 positive adjustment to each share of M stock. In year 2, P sells one share of M stock and recognizes a gain. In year 3, M sells one loss share of S stock, and this paragraph (b) applies and requires a reallocation of the year 1 positive investment adjustment applied to the basis of the transferred S share.

(ii) *Application of limitation by prior use*. M's basis in the transferred loss share of S stock reflects a $10 positive investment adjustment attributable to S's year 1 income. Under the general rule of this paragraph (b), that $10 would be subject to reallocation to reduce basis disparity. However, that $10 adjustment had originally tiered up to adjust P's basis in its M shares and, as a result, $.50 of that adjustment was reflected in P's basis in each share of M stock. When P sold the share of M stock, the basis of that share (which included the tiered-up $.50) was used in determining the gain on the sale. Thus, $.50 of the $10 investment adjustment originally allocated to the transferred S share that tiered-up to the sold M share was previously used and, as such, cannot be reallocated in a manner that would (if it were the original allocation) affect the basis of the sold M share. Accordingly, no more than $9.50 of the adjustment to M's transferred S share could be reallocated to P's shares of S stock. If so, under the special allocation rule in §1.1502–32(c)(1)(ii)(B), the tier-up of this $9.50 would only be allocated among P's remaining 19 shares of M stock. Alternatively, all $10 of the investment adjustment could be reallocated to M's other S shares (because the tier-up to P's M shares would have been the same regardless which of M's shares of S stock were adjusted).

(iii) *Application of limitation where adjustment would have been used*. The facts are the same as in paragraph (i) of this *Example* except that M does not sell any shares of S stock and, in year 3, P sells a loss share of S stock. As in paragraph (i) of this *Example*, when P sold the share of M stock, the basis of that share was used in determining the gain on the share. When P sells the loss share of S stock, the $10 positive investment adjustment from S's year 1 income cannot be reallocated in a manner that would (if it were the original adjustment) affect the basis of the sold M share. If this $10 positive investment adjustment had originally been allocated to the S shares held by M, $.50 of the $10 investment adjustment would have tiered up to the M share that P sold, would have been reflected in P's basis in that M share, and would have been used in determining P's gain or loss on the sale. Accordingly, up to $9.50 of the $10 investment adjustment applied to the basis of P's transferred S share could be reallocated to M's shares of S stock. If so, under the special allocation rule in §1.1502–32(c)(1)(ii)(B), the tier-up of this $9.50 would only be allocated among P's remaining 19 shares of M stock. Alternatively, all $10 of the investment adjustment could be reallocated to P's other S shares.

(3) *Examples*. The general application of this paragraph (b) is illustrated by the following examples:

Example 1. Transfer of stock received in section 351 exchange. (i) *Redetermination to prevent noneconomic loss*. (A) *Facts*. For many years, M has owned two assets, Asset 1 and Asset 2. On January 1, year 1, M receives the only four outstanding shares of S common stock (Block 1 shares) in exchange for Asset 1, which has a basis and value of $80. Section 351 applies to the exchange and, therefore, under section 358, M's aggregate basis in the Block 1 shares is $80 ($20 per share). On July 1, year 2, M receives another share of S common stock (Block 2 share) in exchange for Asset 2, which has a basis of $0 and value of $20. Section 351 applies to this exchange and, under section 358, M's basis in the Block 2 share is $0. On October 1, year 3, S sells Asset 2 for $20, recognizing a $20 gain. On December 31, year 3, M sells one of its Block 1 shares to X for $20. After taking into account the effects of all applicable rules of law, M's basis in each Block 1 share is $24 (M's original $20 basis increased under §1.1502–32 by $4, the share's allocable portion of the $20 gain recognized on the sale of Asset 2). In addition, M's basis in its Block 2 share is $4 (M's original $0 basis increased under §1.1502–32 by $4 (the share's allocable portion of the $20 gain recognized on the sale of Asset 2)). M's sale of the Block 1 share is a transfer of a loss share and therefore subject to this section.

(B) *Basis redetermination under this paragraph (b)*. Under this paragraph (b), M's bases in all its shares of S stock are subject to redetermination. First, paragraph (b)(2)(i)(A) of this section applies to reduce M's basis in the transferred loss share, but not below value, by removing positive investment adjustments applied to the basis of the share. Accordingly, M's basis in the transferred Block 1 share is reduced by $4 (the amount of the positive investment adjustment applied to the share), from $24 to $20. Even if there were negative investment adjustments applied to adjust the bases of nontransferred common shares, no further reduction to the basis of the share would be required under this paragraph (b) because the basis of the transferred share is then equal to the share's value. Under paragraph (b)(2)(ii)(B) of this section, the positive investment adjustment removed from the transferred loss share is reallocated and applied to increase M's bases in its S common shares in a manner that reduces disparity in M's bases in all the S common shares, to the greatest extent possible. Accordingly, the $4 positive investment adjustment removed from the Block 1 share is reallocated and applied to the basis of the Block 2 share, increasing it from $4 to $8.

(C) *Application of paragraphs (c) and (d) of this section*. Because M's sale of the Block 1 share is not a transfer of a loss share after the application of this paragraph (b), neither paragraph (c) of this section nor paragraph (d) of this section applies to the transfer.

(ii) *Redetermination to eliminate duplicated loss*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 1*, except that, at the time of the second contribution, the value of Asset 1 had declined to $20 and so, instead of contributing Asset 2, M contributed Asset 3 to S in exchange for the Block 2 share. At the time of that exchange, Asset 3 had a basis and value of $5. On October 1, year 3, S sells Asset 1 for $20, recognizing a $60 loss that is absorbed by the group. On December 31, year 3, M sells one of its Block 1 shares to X for $5. After taking into account the effects of all applicable rules of law, M's basis in each Block 1 share is $8 (M's original $20 basis decreased under §1.1502–32 by $12 (the share's allocable portion of the $60 loss recognized on the sale of Asset 1)). M's basis in its Block 2 share is an excess loss account of $7 (M's original basis of $5 reduced under §1.1502–32 by $12, the share's allocable portion of the loss recognized on the sale of Asset 1). M's sale of the Block 1 share is a transfer of a loss share and therefore subject to this section.

(B) *Basis redetermination under this paragraph (b)*. Under this paragraph (b), M's bases in all its shares of S stock are subject to redetermination. There are no positive investment adjustments and so there is no adjustment under paragraph (b)(2)(i)(A) of this section. However, under paragraph (b)(2)(i)(B) of this section, M's basis in the transferred Block 1 share is reduced, but not below value, by reallocating negative investment adjustments from common shares that are not transferred loss shares. In total, there were $48 of negative investment adjustments applied to common shares that are not transferred loss shares. Accordingly, M's basis in the Block 1 share is reduced by $3, from $8 to its value of $5. Under paragraph (b)(2)(i)(B) of this section, the negative investment adjustments applied to the transferred share are reallocated from (and therefore cause an increase in the basis of) S common shares that are not transferred loss shares in a manner that reduces disparity among members' bases in all S common shares to the greatest extent possible. Accordingly, the $3 negative investment adjustment reallocated and applied to the transferred Block 1 share is reallocated entirely from the Block 2 share, increasing the basis in the Block 2 share from an excess loss account of $7 to an excess loss account of $4.

(C) *Application of paragraphs (c) and (d) of this section*. Because M's sale of the Block 1 share is not a transfer of a loss share after the application of this paragraph (b), neither paragraph (c) of this section nor paragraph (d) of this section applies to the transfer.

(iii) *Nonapplicability of redetermination rule to sale of entire interest*. The facts are the same as in paragraph (ii)(A) of this *Example 1*, except that, on December 31, year 3, M sells all its shares of S stock to X for $25. M's sale of the S stock to X is a transfer of all of the shares of S stock held by members to one or more nonmembers in one fully taxable trans-

action and, therefore, basis is not redetermined under this paragraph (b). Accordingly, the sale of the Block 1 shares remains a transfer of loss shares and, as such, subject to paragraphs (c) and (d) of this section. However, paragraphs (c)(7) and (d)(3)(i)(A) of this section apply netting principles to prevent adjustments under either paragraph (c) or paragraph (d) of this section, respectively. Alternatively, the group could elect to apply this paragraph (b). In that case, the $12 negative adjustment applied to the Block 2 shares would be reallocated to the Block 1 shares with the result that there would be no loss (or gain) on any of the transferred shares following the application of this paragraph (b). In that case, there would be no further application of this section to the transfer.

(iv) *Transfer of entire interest, partially taxable*. The facts are the same as in paragraph (iii) of this *Example 1*, except that, instead of selling the Block 2 share to X, M contributes the share to a nonmember in a section 351 exchange that is part of the same transaction. Although all the S shares held by members are transferred in the transaction, not all the shares are transferred to one or more nonmembers in one fully taxable transaction. Therefore, paragraph (b)(1)(ii)(B) of this section does not apply and M must redetermine its bases in its shares of S stock under this paragraph (b). In total, there were $12 of negative investment adjustments applied to common shares that are not transferred loss shares (the Block 2 share, a gain share). Accordingly, M's basis in each of the Block 1 shares is reduced by $3, from $8 to its value of $5. Under paragraph (b)(2)(i)(B) of this section, the negative investment adjustments applied to the transferred shares are reallocated from (and therefore cause an increase in the basis of) S shares that are not transferred loss shares in a manner that reduces disparity among members' bases in all S common shares to the greatest extent possible. Accordingly, the $12 negative investment adjustment reallocated and applied to the transferred Block 1 shares is reallocated entirely from the Block 2 share, increasing the basis in the Block 2 share from an excess loss account of $7 to a basis of $5. Because M's transfer is not a transfer of loss shares after the application of this paragraph (b), neither paragraph (c) of this section nor paragraph (d) of this section applies to the transfer.

Example 2. *Redetermination increases basis of transferred loss share*. (i) *Facts*. On January 1, year 1, M owns all 10 outstanding shares of S common stock. Five of the shares have a basis of $20 per share (Block 1 shares) and five of the shares have a basis of $10 per share (Block 2 shares). S's only asset, Asset 1, has a basis of $50. S has no other attributes. On October 1, year 1, S sells Asset 1 for $100, recognizing a $50 gain. On December 31, year 2, M sells one Block 1 share and one Block 2 share to X for $10 per share. After taking into account the effects of all applicable rules of law, M's basis in each Block 1 share is $25 (M's original $20 basis increased under §1.1502–32 by $5, the share's allocable portion of the $50 gain recognized on the sale of Asset 1), and M's basis in each Block 2 share is $15 (M's original $10 basis increased under §1.1502–32 by $5, the share's allocable portion of the $50 gain recognized on the sale of Asset 1). M's sale of the Block 1 and Block 2 shares is a transfer of loss shares and therefore subject to this section.

(ii) *Basis redetermination under this paragraph (b)*. Under this paragraph (b), M's bases in all its shares of S stock are subject to redetermination. First, paragraph (b)(2)(i)(A) of this section applies to reduce M's basis in the transferred Block 1 and Block 2 shares, but not below value, by removing the positive investment adjustments applied to the bases of the transferred loss shares. Accordingly, the basis of the transferred Block 1 share is reduced by $5, from $25 to $20. The basis of the transferred Block 2 share is also reduced by $5, from $15 to $10. (Although the transferred Block 1 share is still a loss share, there is no reduction to its basis under paragraph (b)(2)(i)(B) of this section because there were no negative investment adjustments applied to the bases of the S common shares that are not transferred loss shares.) Next, paragraph (b)(2)(ii)(B) of this section applies to reallocate and apply the $10 of positive investment adjustments removed from the transferred loss shares to increase M's bases in its S common shares in a manner that reduces the disparity in its bases in all S common shares to the greatest extent possible. Accordingly, of the $10 of positive investment adjustments to be reallocated, $6 is reallocated and applied to the basis of the transferred Block 2 share (increasing it from $10 to $16) and $4 is reallocated and applied equally to the basis of each of the four retained Block 2 shares (increasing the basis of each from $15 to $16). After giving effect to the reallocations under this paragraph (b), M's basis in each retained Block 1 share is $25, M's basis in the transferred Block 1 share is $20, and M's basis in each Block 2 share is $16.

(iii) *Application of paragraph (c) of this section*. After the application of this paragraph (b), M's sale of the Block 1 and Block 2 shares is still a transfer of loss shares and, accordingly, subject to paragraph (c) of this section. No adjustment is required to the basis of the transferred Block 1 share under paragraph (c) of this section because, after its basis is redetermined under this paragraph (b), the net positive adjustment to the basis of the share is $0. See paragraph (c)(3) of this section. However, under paragraph (c) of this section M's basis in the transferred Block 2 share is reduced by $6 (the lesser of its net positive adjustment, $6, and its disconformity amount, $6), from $16 to $10, its value. See paragraph (c)(2) of this section.

(iv) *Application of paragraph (d) of this section*. After the application of paragraph (c) of this section, M's sale of the Block 1 share is still a transfer of a loss share and, accordingly, subject to paragraph (d) of this section. No adjustment is required under paragraph (d) of this section because there is no aggregate inside loss. See paragraph (d)(3)(iii) of this section. Because M's sale of the Block 2 share is no longer a transfer of a loss share after the application of paragraph (c) of this section, paragraph (d) of this section does not apply to the transfer of the Block 2 share.

Example 3. *Tiered subsidiaries*. (i) *Transfer of all shares of common stock*. (A) *Facts*. P owns the sole outstanding share of S stock with a basis of $100, and the sole outstanding share of M stock with a basis of $300. M has $200 and owns an asset with a basis of $0. S owns one asset, Asset 1, with a basis of $100. At a time when Asset 1 has a value of $200, S issues a second share of common stock to M in exchange for $200. Later S sells Asset 1 for $200, recognizing a $100 gain. After taking into account the effects of all applicable rules of law, P's basis in its S stock is $150 (P's original $100 basis increased under §1.1502–32 by $50, the share's allocable portion of the $100 gain recognized on the sale of Asset 1), M's basis in its S stock is $250 (M's original $200 basis increased under §1.1502–32 by $50, the share's allocable portion of the $100 gain recognized on the sale of Asset 1), and P's basis in its M stock is $350 (P's original $300 basis increased under §1.1502–32 by $50, the tier-up of M's increase in its basis in its S stock). P then sells its M share and its S share to X for $300 and $200, respectively. M and S are not members of the same consolidated group immediately after the sale. Therefore, the M share and both of the S shares are transferred in the transaction. Regarding P's sale of its share of S stock and its share of M stock, see paragraph (f)(10)(i)(A) of this section (ceasing to own a share in a taxable transaction) and paragraph (f)(10)(i)(C) of this section (nonmember acquires share); regarding M's share of S stock, see paragraph (f)(10)(i)(B) of this section (ceasing to be members of the same group). The application of this section begins with respect to the stock of S, the subsidiary at the lowest tier in which there is a transfer of subsidiary stock. See paragraph (a)(3)(ii) of this section. Although both P and M transfer their S shares, only M's S share is a loss share. Thus, only M's transfer is a transfer of a loss share of S stock and only M's transfer is subject to this section.

(B) *Application of section to transferred S shares*. Although only M's transfer is subject to this section, all members' bases in their shares of S stock are subject to redetermination under this paragraph (b). First, paragraph (b)(2)(i)(A) of this section applies to reduce M's basis in its transferred S share, but not below value, by removing the positive investment adjustment applied to that share. Accordingly, the basis of M's S share is reduced by $50, from $250 to $200 (under §1.1502–32, that redetermination adjustment tiers up to reduce P's basis in its M stock by $50, from $350 to $300). Because there are no negative adjustments to reallocate under paragraph (b)(2)(i)(B) of this section, paragraph (b)(2)(ii)(B) of this section then applies to reallocate and apply the $50 positive investment adjustment removed from the transferred loss S share to increase P's basis in its S share in a manner that reduces disparity among members' bases in all S common shares to the greatest extent possible. Accordingly, all $50 of the positive investment adjustment is reallocated and applied to P's basis in its S share (increasing the basis from $150 to $200). Because M's transfer of its S share is not a transfer of a loss share after the application of this paragraph (b), neither paragraph (c) of this section nor paragraph (d) of this section applies to that transfer.

(C) *Application of section to transfers at next higher tier*. After the adjustments to M's share of S stock are given effect, P's transfer of its share of M stock is not a transfer of a loss share and so this section does not apply to that transfer.

(D) *Result of application of section*. After the application of this section, P recognizes no gain or loss on its sale of either the S share or the M share. In addition, the unrecognized (noneconomic) loss in M's basis in its S share is eliminated. The results would be the same if, in addition to the facts in paragraph (i)(A) of this *Example 3*, M transferred its S share to X in a fully taxable transaction and, as permitted un-

der paragraph (b)(1)(ii)(B) of this section, P elected to redetermine basis under this paragraph (b).

(ii) *Transfer of less than all lower-tier shares of stock*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 1*, except that M and S are members of the same consolidated group immediately after the sale. Therefore, in this case, M's S share is not transferred and so this section has no application with respect to M's S share. P's transfer of its S share is not a transfer of a loss share and so is also not subject to this section. However, P's sale of its share of M stock is a transfer of a loss share and is subject to this section.

(B) *Basis redetermination under this paragraph (b)*. Although P's transfer of its share of M stock is subject to this section, this paragraph (b) does not apply to the transfer because there is only one share of M stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). Accordingly, after the application of this paragraph (b), P's sale of its M share is still a transfer of a loss share and therefore subject to paragraph (c) of this section.

(C) *Application of paragraphs (c) and (d) of this section*. Under paragraph (c) of this section, P must reduce its basis in its M share by $50, the lesser of its net positive adjustment ($50, see paragraph (c)(3) of this section) and its disconformity amount ($150, see paragraphs (c)(4), (c)(5), and (c)(6) of this section). As a result, the share is no longer a loss share and the transfer is not subject to paragraph (d) of this section.

(D) *Result of application of section*. After the application of this section, P recognizes a $50 gain on its sale of the S share and no loss on its sale of the M share. Although there is unrecognized loss preserved in M's basis in its S share, if M later transfers the share when it is a loss share, that transfer will be subject to this section.

Example 4. Application to outstanding common and preferred shares. (i) *Facts*. P owns all the stock of M and all eight outstanding shares of S common stock. S also has two shares of nonvoting preferred stock outstanding; the preferred shares each have a $100 annual, cumulative preference as to dividends. M owns one of the preferred shares (PS1) and P owns the other (PS2). On January 1, year 1, the bases and values of the outstanding S shares are:

	Preferred		Common							
	PS1 (M)	PS2 (P)	CS1 (P)	CS2 (P)	CS3 (P)	CS4 (P)	CS5 (P)	CS6 (P)	CS7 (P)	CS8 (P)
Basis	1250	990	1025	710	550	400	375	250	215	100
Value	1000	1000	375	375	375	375	375	375	375	375

(A) As of January 1, year 1, there are no arrearages on the preferred stock. In year 1, S has a $1100 capital loss and $100 of ordinary income. The group absorbs the loss and the negative remaining adjustment of $1000 is allocable entirely to the common stock, equally to each common share ($125 per share). See §1.1502–32(c)(1)(iii) and (c)(2).

(B) In year 2, S has $700 of ordinary income and a $100 ordinary loss. Also, on October 1, year 2, S declares and makes a $200 dividend distribution with respect to the preferred stock ($100 per share). Under §1.1502–32(c)(1)(i), a negative adjustment of $100 is first allocated to each of the preferred shares to reflect the declaration of the dividend. The $600 positive remaining adjustment determined under §1.1502–32(c)(1)(iii) (reflecting S's net income reduced by the distribution) is then allocated to each of the preferred shares to the extent of its entitlement to dividends accruing in year 1 and year 2 ($200 per share). See §1.1502–32(c)(1)(iii) and (c)(3). The $200 of the positive remaining adjustment not allocated to the preferred shares is then allocated to the common stock, equally to each common share ($25 per share). See §1.1502–32(c)(1)(iii) and (c)(2). After taking into account the effects of all applicable rules of law, the adjusted bases and the values of the shares as of January 1, year 3, are:

	Preferred		Common							
	PS1 (M)	PS2 (P)	CS1 (P)	CS2 (P)	CS3 (P)	CS4 (P)	CS5 (P)	CS6 (P)	CS7 (P)	CS8 (P)
Basis	1250	990	1025	710	550	400	375	250	215	100
Year 1 §1.1502–32 adjustments	N/A	N/A	-125	-125	-125	-125	-125	-125	-125	-125
Year 2 §1.1502–32 adjustments	-100 +200 +100	-100 +200 +100	+25	+25	+25	+25	+25	+25	+25	+25
Adjusted basis	1350	1090	925	610	450	300	275	150	115	0
Value	1100	1100	275	275	275	275	275	275	275	275
Unrecognized gain/(loss)	(250)	10	(650)	(335)	(175)	(25)	0	125	160	275

(C) On January 1, year 3, M sells PS1 for $1100 and P sells CS2 for $275. The sales of PS1 and CS2 are transfers of loss shares and therefore subject to this section.

(ii) *Basis redetermination under this paragraph (b)*. Under this paragraph (b), all members' bases in shares of S stock are subject to redetermination in accordance with the following:

(A) *Removing positive investment adjustments from transferred loss common shares*. First, paragraph (b)(2)(i)(A) of this section applies to reduce P's basis in CS2, but not below value, by removing the positive investment adjustment applied to the basis of the share. Accordingly, P's basis in CS2 is reduced by $25, from $610 to $585.

(B) *Reallocating negative investment adjustments from common shares that are not transferred loss shares*. Because the transferred shares remain loss shares after the removal of positive investment adjustments, their bases are further reduced under paragraph (b)(2)(i)(B) of this section, but not below value, by reallocating negative investment adjustments applied to common shares that are not transferred loss shares. Reallocations are made first to preferred shares and then to the common shares, in a manner that reduces disparity among members' bases in transferred loss preferred shares, and reduces disparity among members' bases in all common shares, to the greatest extent possible. The loss on PS1 is $250, the remaining loss on CS2 is $310, and the total amount of negative investment adjustments applied to shares that are not transferred loss shares is $875 (the sum of the negative adjustments applied to all common shares other than CS2). Thus, $250 of negative investment adjustments are reallocated and applied to the basis of PS1, reducing it to the share's value, $1100. The negative investment adjustments are reallocated from the common shares that are not transferred loss shares in a manner that reduces disparity among members' bases in all common shares to the greatest extent possible. The negative investment adjustments may be reallocated to PS1 from the common shares that are not transferred loss shares as follows: $125 from each of CS7 and CS8. Such reallocations increase the basis of CS7 by

$125, from $115 to $240, and increase the basis of CS8 by $125, from $0 to $125. Negative investment adjustments are then reallocated to CS2 from the common shares that are not transferred loss shares in a manner that reduces disparity among members' bases in all common shares to the greatest extent possible. The negative investment adjustments may be reallocated to CS2 from the other common shares as follows: $80 from CS4, $105 from CS5, and $125 from CS6. Such reallocations reduce the basis of CS2 by $310, from $585 to $275, increase the basis of CS4 by $80, from $300 to $380, increase the basis of CS5 by $105, from $275 to $380, and increase the basis of CS6 by $125, from $150 to $275. However, there may be other reasonable reallocations.

(C) *Increasing basis by reallocated positive investment adjustments*. Under paragraph (b)(2)(ii)(A) of this section, the $25 positive investment adjustment removed from CS2 (the transferred loss common share) is then reallocated and applied to increase the basis of preferred shares, but not above value. Accordingly, $10 of that amount is reallocated to PS2, increasing its basis from $1090 to $1100, its value. Under paragraph (b)(2)(ii)(B) of this section, the remaining $15 is reallocated and applied to the common shares in a manner that reduces disparity among members' bases in all common shares to the greatest extent possible. The $15 positive investment adjustment that is reallocated to common shares may be reallocated entirely to CS8, increasing its basis from $125 to $140. However, there may be other reasonable reallocations.

(D) *Summary of the reallocation of adjustments*. The adjustments made under this paragraph (b) are:

	Preferred		Common							
	PS1 (M)	PS2 (P)	CS1 (P)	CS2 (P)	CS3 (P)	CS4 (P)	CS5 (P)	CS6 (P)	CS7 (P)	CS8 (P)
Adjusted basis before redetermination	1350	1090	925	610	450	300	275	150	115	0
Removing positive adjustments from transferred loss shares				-25						
Reallocating negative adjustments	-250			-310		+80	+105	+125	+125	+125
Applying positive adjustments removed from transferred loss shares		+10								+15
Basis after redetermination	1100	1100	925	275	450	380	380	275	240	140
Value	1100	1100	275	275	275	275	275	275	275	275
Gain/(loss)	0	0	(650)	0	(175)	(105)	(105)	0	35	135

(iii) *Application of paragraphs (c) and (d) of this section*. Because M's sale of PS1 and P's sale of CS2 are not transfers of loss shares after the application of this paragraph (b), paragraphs (c) and (d) of this section do not apply.

(iv) *Higher-tier effects*. The $250 reduction in the basis of PS1 under this paragraph (b) is a noncapital, nondeductible expense under §1.1502–32(b)(3)(iii)(B) that will be included in the year 3 investment adjustment to be applied to P's basis in its M stock.

(c) *Stock basis reduction to prevent noneconomic loss*—(1) *In general*. The rules of this paragraph (c) reduce M's basis in a transferred share of S stock to prevent noneconomic stock loss and thus promote the clear reflection of the group's income. These rules limit the reduction to M's basis in the S share to the amount of net unrealized appreciation reflected in the share's basis as of the transfer (the disconformity amount). These rules also limit the reduction to M's basis in the S share to the portion of the share's basis that is attributable to investment adjustments made pursuant to the consolidated return regulations.

(2) *Basis reduction rule*. This paragraph (c) applies if M transfers a share of S stock and, after taking into account the effects of all applicable rules of law, including any adjustments under paragraph (b) of this section, the share is a loss share. Under this paragraph (c), M's basis in the share is reduced, but not below value, by the lesser of—

(i) The share's net positive adjustment (as defined in paragraph (c)(3) of this section); and

(ii) The share's disconformity amount (as defined in paragraph (c)(4) of this section).

(3) *Net positive adjustment*. A share's *net positive adjustment* is the greater of—

(i) Zero; and

(ii) The sum of all investment adjustments reflected in the basis of the share. The term *investment adjustment* has the same meaning as in paragraph (b)(1)(iii) of this section, except that it includes all adjustments specially allocated under §1.1502–32(c)(1)(ii).

(4) *Disconformity amount*. A share's *disconformity amount* is the excess, if any, of—

(i) M's basis in the share; over

(ii) The share's allocable portion of S's net inside attribute amount (as defined in paragraph (c)(5) of this section).

(5) *Net inside attribute amount*. S's *net inside attribute amount* is determined as of the transfer, taking into account all applicable rules of law (even if the adjustments required by such rules are not deemed effective until after the transfer, such as certain adjustments required under sections 108 and 1017 and §1.1502–28). S's net inside attribute amount is the sum of S's net operating and capital loss carryovers, deferred deductions, money, and basis in assets other than money, reduced by the amount of S's liabilities. For this purpose, S's basis in any share of lower-tier subsidiary stock is generally S's basis in that share, adjusted to reflect any gain or loss recognized in the transaction with respect to the share and any other related or resulting adjustments to the basis of the share. However, see paragraph (c)(6) of this section for special rules regarding the computation of S's net inside attribute amount for purposes of this paragraph (c) if S holds stock of a subsidiary that is not transferred in the transaction. See paragraph (f) of

this section for definitions of "allocable portion," "deferred deduction," "liability," "loss carryover," and other relevant terms.

(6) *Determination of S's net inside attribute amount if S owns stock of a lower-tier subsidiary*—(i) *Overview*. If a loss share of S stock is transferred when S holds a share of stock of another subsidiary (S1) and the S1 share is not transferred in the same transaction, S's net inside attribute amount is determined by treating S's basis in its S1 share as tentatively reduced under this paragraph (c)(6). The purpose of this rule is to reduce the extent to which S1's investment adjustments increase noneconomic loss on S stock (as a result of S1's recognition of items that are indirectly reflected in a member's basis in a share of S stock).

(ii) *General rule for nontransferred shares of lower-tier subsidiary stock*. For purposes of determining the disconformity amount of a share of S stock, S's basis in a nontransferred share of S1 stock is treated as reduced by the share's tentative reduction amount. The tentative reduction amount is the lesser of the S1 share's net positive adjustment and the S1 share's disconformity amount.

(iii) *Multiple tiers of nontransferred shares*. If S directly or indirectly owns nontransferred shares of stock of subsidiaries in multiple tiers, then, subject to the limitations in paragraph (c)(6)(iv) of this section (regarding nontransferred shares that are lower-tier to transferred shares), the rules of this paragraph (c)(6) first apply to determine the tentatively reduced basis of stock of the subsidiary at the lowest tier. These rules then apply to determine the tentatively reduced basis of nontransferred shares of stock of subsidiaries successively at each next higher tier that is lower-tier to S. The tentative reductions at each tier are treated as noncapital, nondeductible expenses that tier up under the principles of §1.1502–32, and, as such, result in a tentative reduction of basis and any net positive adjustment of subsidiary shares that are lower-tier to S.

(iv) *Nonapplicability of tentative basis reduction rule to transferred shares*. The tentative basis reduction rule in this paragraph (c)(6) does not apply to any share of stock of a lower-tier subsidiary (S1) that is transferred in the same transaction in which the S share is transferred. Further, for purposes of determining the S share's disconformity amount, the tentative basis reduction rule in this paragraph (c)(6) only applies with respect to stock of a lower-tier subsidiary if such stock is lower-tier to a nontransferred S1 share. The purpose of this rule is to prevent tentative adjustments to the bases of lower-tier shares if this paragraph (c) has already applied with respect to the shares, without regard to whether such application resulted in the reduction of the basis of any share.

(v) *Example*. The rules of this paragraph (c)(6) are illustrated by the following example:

Example. (i) *Facts*. M owns the sole outstanding share of S stock, S owns the sole outstanding share of S1 stock, S1 owns all five outstanding shares of S2 stock (the bases of which are equal), and S2 owns the sole outstanding share of S3 stock. The basis of each of the shares reflects its allocable portion of a $5 positive investment adjustment attributable to income recognized by S3. The basis of the S share exceeds its value by $10 and the basis of the S1 share exceeds its value by $5. The basis of each S2 share is $1 less than its value. In one transaction, M sells its S share to X, S1 issues new shares in an amount that prevents S and S1 from being members of the same group, and S1 sells one of its S2 shares to an unrelated individual. S1, S2, and S3 elect to file a consolidated return following the transaction.

(ii) *General applicability of section*. As a result of the transaction, there is a transfer of the S share and the S2 share that was sold (because both shares were sold to nonmembers) and of the S1 share (because S and S1 cease to be members of the same group as a result of the stock issuance). The transfer of the S2 share is not a transfer of a loss share, and so this section does not apply to that transfer. The transfers of the S and S1 shares are transfers of loss shares, and so this section applies to those transfers. The S3 share and the four retained S2 shares are not transferred in the transaction. Under paragraph (a)(3)(ii)(A) of this section, this section applies first to the transfer of the S1 share because it is the lowest-tier transferred loss share.

(iii) *Application of paragraph (b) of this section and this paragraph (c) to transfer of S1 stock*. First, the $1 gain recognized on the transfer of the S2 share tiers up to adjust the basis of each upper-tier share. The transferred S1 share is still a loss share (by $4) and is therefore subject to this section. Although the transfer is subject to paragraph (b) of this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S1 stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the S1 share is still a loss share and, as such, subject to this paragraph (c). In determining the amount of any basis reduction under this paragraph (c), the disconformity amount of the S1 share is computed by comparing S's basis in its S1 share to S1's net inside attribute amount (because there is only one S1 share outstanding, the entire amount is allocable to that share). In determining S1's net inside attribute amount, the tentative reduction rule in this paragraph (c)(6) applies to nontransferred lower-tier shares (provided they are lower-tier to nontransferred shares). Thus, the rule applies to S1's four retained shares of S2 stock and to S2's share of S3 stock. The tentative reduction begins at the lowest level (S2's share of S3 stock) and any tentative reduction amount tiers up as a noncapital, nondeductible expense under the principles of §1.1502–32, tentatively reducing the bases of any upper tier nontransferred shares that are lower-tier to the transferred loss share (the S1 share). Accordingly, each of S1s nontransferred share of S2 stock is tentatively reduced by its portion of the tentative reduction to S2's share of S3 stock. S1 then applies the tentative reduction rule to its four nontransferred S2 shares. S1's net inside attribute amount is the sum of its basis in each of its nontransferred S2 shares, as tentatively reduced under this paragraph (c)(6) and S1's actual basis in the transferred S2 share, increased to reflect the gain recognized on the sale of that share. After the application of this paragraph (c) to the transfer of the S1 share, paragraph (b) of this section applies to M's transfer of the S share.

(iv) *Application of section to transfer of S stock*. Because the S share is still a loss share after applying paragraph (b) of this section and this paragraph (c) to the transfer of the S1 stock, this section applies to M's transfer of the S share. Although paragraph (b) of this section applies to the transfer, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c). In determining the disconformity amount of the S share, S's net inside attribute amount is determined using S's actual basis in the transferred S1 stock (after any reduction under this paragraph (c)), because the tentative reduction rule in this paragraph (c)(6) does not apply to shares that are transferred in the transaction. All other shares are lower-tier to the transferred S1 share and are therefore also not subject to tentative reduction for purposes of determining the disconformity amount of the S share. After the application of this paragraph (c) to the transfer of the S share, paragraph (d) of this section applies with respect to M's transfer of the S share. After the application of paragraph (d) of this section with respect to the transfer of the S share, if the S1 share is still a loss share, paragraph (d) of this section applies with respect to S's transfer of the S1 share.

(7) *Netting of gains and losses taken into account*—(i) *General rule*. Solely for purposes of computing the basis reduction required under this paragraph (c), the basis of each transferred loss share of S stock is treated as reduced proportionately (as to loss) by the amount of income or gain taken into account by members with respect to transferred shares of S stock, provided that—

(A) The shares are transferred in one transaction; and

(B) The gain is taken into account as of the transaction.

(ii) *Example*. The netting rule of this paragraph (c)(7) is illustrated by the following example:

Example. Disposition of gain and loss shares. (i) *Facts.* M owns the only three outstanding shares of S stock. Share A has a basis of $54, Share B has a basis of $100, and Share C has a basis of $80. In the same transaction, M sells all three S shares to X for $60 each. M realizes a gain of $6 on Share A, a loss of $40 on Share B, and a loss of $20 on Share C. M's sales of Share B and Share C are transfers of loss shares and therefore subject to this section. M's sale is a transfer of all of the shares of S stock held by members to one or more nonmembers in one fully taxable transaction and, therefore, basis is not redetermined under paragraph (b) of this section. See paragraph (b)(1)(ii)(B) of this section. The transfer is then subject to this paragraph (c). However, for this purpose, M treats its bases in Share B and Share C as reduced by the $6 gain taken into account on Share A. The gain is allocated to Share B and Share C proportionately based on the amount of loss in each share. Thus, $4 of gain ($40/$60 x $6) is treated as allocated to Share B and $2 of gain ($20/$60 x $6) is treated as allocated to Share C. Accordingly, M computes the basis reduction required under this paragraph (c) by treating its basis in Share B as $96 ($100 less $4) and its basis in Share C as $78 ($80 less $2). If, after the application of this paragraph (c), the sales of Share B and Share C are still transfers of loss shares, then the transfers are subject to paragraph (d) of this section. (Although the bases of Share B and Share C are not actually reduced by any portion of the gain, paragraph (d)(3)(i)(A) of this section applies netting principles to limit adjustments under paragraph (d) of this section.)

(ii) *Disposition of stock with deferred gain.* The facts are the same as in paragraph (i) of this *Example*, except that M sells the gain share to another member. Under §1.1502–13, M's gain recognized on Share A is not taken into account in the taxable year of the transfer and therefore cannot be treated as reducing M's loss recognized on Share B and Share C for purposes of this paragraph (c). The applicability of this section to the transfer of Share A is determined as of the time that the intercompany item (the gain on M's sale to the other member) is taken into account. See paragraph (e)(3) of this section. However, if Share B (instead of Share A) were sold to a member, the entire gain on Share A would be treated as reducing the loss on Share C for purposes of applying this paragraph (c). See paragraph (e)(3) of this section.

(8) *Examples.* The application of this paragraph (c) is illustrated by the following examples.

Example 1. Appreciation reflected in stock basis at acquisition. (i) *Appreciation recognized as gain.* (A) *Facts.* On January 1, year 1, M purchases the sole outstanding share of S stock for $100. At that time, S owns two assets, Asset 1 with a basis of $0 and a value of $40, and Asset 2 with a basis and value of $60. In year 1, S sells Asset 1 for $40, recognizing a $40 gain. On December 31, year 1, M sells its S share for $100. After taking into account the effects of all applicable rules of law, M's basis in the S share is $140 (M's original $100 basis increased under §1.1502–32 by $40, the share's allocable portion of the gain recognized on the sale of Asset 1). M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(B) *Application of paragraph (b) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c).* Under this paragraph (c), M's basis in the S share, $140, is reduced, but not below value, $100, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is the greater of zero and the sum of all investment adjustments (as defined in paragraph (b)(1)(iii) of this section) applied to the basis of the share. The only investment adjustment applied to the basis of the share is the $40 adjustment attributable to the gain recognized on the sale of Asset 1. Thus, the share's net positive adjustment is $40. The share's disconformity amount is the excess, if any, of its basis, $140, over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is the sum of S's money ($40 from the sale of Asset 1) and S's basis in Asset 2, $60, or $100. The share is the only outstanding S share and so its allocable portion of the $100 net inside attribute amount is the entire $100. Thus, the share's disconformity amount is $40, the excess of $140 over $100. The lesser of the net positive adjustment, $40, and the share's disconformity amount, $40, is $40. Accordingly, immediately before the application of paragraph (d) of this section, M's basis in the share is reduced by $40, from $140 to $100.

(D) *Application of paragraph (d) of this section.* Because M's sale of the S share is not a transfer of a loss share after the application of this paragraph (c), paragraph (d) of this section does not apply to the transfer.

(ii) *Appreciation recognized as income earned in the consumption of built-in gain.* The facts are the same as in paragraph (i)(A) of this *Example 1*, except that, instead of selling Asset 1, the value of Asset 1 is consumed in the production of $40 of income in year 1 (reducing the value of Asset 1 to $0). Because the net positive adjustment includes items of income as well as items of gain, the results are the same as those described in paragraph (i) of this *Example 1*.

(iii) *Post-acquisition appreciation eliminates stock loss.* The facts are the same as in paragraph (i)(A) of this *Example 1* except that, in addition, the value of Asset 2 increases to $100 before the stock is sold. As a result, M sells the S share for $140. Because M's sale of the S share is not a transfer of a loss share, this section does not apply to the transfer, notwithstanding that P's basis in the S share was increased by the gain recognized on Asset 1.

(iv) *Distributions.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 1* except that, in addition, S declares and makes a $10 dividend distribution before the end of year 1. As a result, the value of the share decreases and M sells the share for $90. After taking into account the effects of all applicable rules of law, M's basis in the S share is $130 (M's original $100 basis increased under §1.1502–32 by $30, the $10 distribution on the share reduced by the share's allocable portion of the $40 gain recognized on the sale of Asset 1). M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(B) *Application of paragraph (b) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section for the reasons set forth in paragraph (i)(B) of this *Example 1*. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c).* Under this paragraph (c), M's basis in the S share, $130, is reduced, but not below value, $90, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $40 (the sum of all investment adjustments (as defined in paragraph (b)(1)(iii) of this section) applied to the basis of the share). The share's disconformity amount is the excess of its basis, $130, over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is $90, the sum of S's money ($30, the $40 sale proceeds less the $10 distribution) and S's basis in Asset 2, $60. The share is the only outstanding S share and so its allocable portion of the $90 net inside attribute amount is the entire $90. The lesser of the share's net positive adjustment, $40, and its disconformity amount, $40, is $40. Accordingly, immediately before the application of paragraph (d) of this section, the basis in the share is reduced by $40, from $130 to $90.

(D) *Application of paragraph (d) of this section.* Because M's sale of the S share is not a transfer of a loss share after the application of this paragraph (c), paragraph (d) of this section does not apply to the transfer.

Example 2. Loss of appreciation reflected in basis. (i) *Facts.* On January 1, year 1, M purchases the sole outstanding share of S stock for $100. At that time, S owns two assets, Asset 1 with a basis of $0 and a value of $40, and Asset 2 with a basis and value of $60. The value of Asset 1 declines to $0 and M sells its S share for $60. After taking into account the effects of all applicable rules of law, M's basis in the S share is $100. M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(ii) *Application of paragraph (b) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(iii) *Basis reduction under this paragraph (c).* Under this paragraph (c), M's $100 basis in the S share is reduced, but not below its $60 value by the lesser of the share's net positive adjustment and disconformity amount. There were no investment adjustments applied to M's basis in the share and so the

share's net positive adjustment is $0. Thus, although the share's disconformity amount is $40 (the excess of M's $100 basis in the share over the share's $60 allocable portion of S's net inside attribute amount), no basis reduction is required under this paragraph (c).

(iv) *Application of paragraph (d) of this section*. After the application of this paragraph (c), M's sale of the S share is still a transfer of a loss share, and, accordingly, subject to paragraph (d) of this section. No adjustment is required under paragraph (d) of this section because there is no aggregate inside loss. See paragraph (d)(3)(iii) of this section.

Example 3. Items accruing after S becomes a member. (i) *Recognition of loss accruing after S becomes a member*. (A) *Facts*. On January 1, year 1, M purchases the sole outstanding share of S stock for $100. At that time, S owns two assets, Asset 1, with a basis of $0 and a value of $40, and Asset 2, with a basis and value of $60. In year 1, S sells Asset 1 for $40, recognizing a $40 gain. Also in year 1, the value of Asset 2 declines and S sells Asset 2 for $20, recognizing a $40 loss that is absorbed by the group. On December 31, year 1, M sells its S share for $60. After taking into account the effects of all applicable rules of law, M's basis in the S share is $100 (M's original $100 basis, unadjusted under §1.1502–32 because the $40 gain recognized on the sale of Asset 1 and the $40 loss on the sale of Asset 2 net, resulting in an adjustment of $0). M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(B) *Application of paragraph (b) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c)*. Under this paragraph (c), M's basis in the S share is reduced, but not below the share's $60 value, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $0. Thus, although the share has a disconformity amount of $40 (the excess of M's basis in the share, $100, over the share's allocable portion of S's net inside attribute amount, $60), no basis reduction is required under this paragraph (c).

(D) *Application of paragraph (d) of this section*. After the application of this paragraph (c), M's sale of the S share is still a transfer of a loss share, and, accordingly, subject to paragraph (d) of this section. No adjustment is required under paragraph (d) of this section because there is no aggregate inside loss. See paragraph (d)(3)(iii) of this section.

(ii) *Recognition of gain accruing after S becomes a member*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 3*, except that M does not sell the S share and S does not sell either asset in year 1. In addition, in year 2, the value of Asset 1 declines to $0, the value of Asset 2 returns to $60, and S creates Asset 3 (with a basis of $0). In year 3, S sells Asset 3 for $40, recognizing a $40 gain. On December 31, year 3, M sells its S share for $100. After taking into account the effects of all applicable rules of law, M's basis in the S share is $140 (M's original $100 basis increased under §1.1502–32 by $40 (the share's allocable portion of the gain recognized on the sale of Asset 3 in year 3)). M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(B) *Application of paragraph (b) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section for the reasons set forth in paragraph (i)(B) of this *Example 3*. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c)*. Under this paragraph (c), M's basis in the S share, $140, is reduced, but not below value, $100, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $40 (the year 3 investment adjustment). The share's disconformity amount is the excess of its basis, $140, over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is $100, the sum of S's money ($40 from the sale of Asset 3) and its basis in its assets ($60 (the sum of Asset 1's basis of $0 and Asset 2's basis of $60)). S's $100 net inside attribute amount is allocable entirely to the sole outstanding S share. Thus, the share's disconformity amount is the excess of $140 over $100, or $40. The lesser of the share's net positive adjustment, $40, and its disconformity amount, $40, is $40. Accordingly, the basis in the share is reduced by $40, from $140 to $100.

(D) *Application of paragraph (d) of this section*. Because M's sale of the S share is not a transfer of a loss share after the application of this paragraph (c), paragraph (d) of this section does not apply to the transfer.

(iii) *Recognition of income earned after S becomes a member*. The facts are the same as in paragraph (ii)(A) of this *Example 3*, except that instead of creating Asset 3, S earns $40 of income from services provided in year 3. Because the net positive adjustment includes items of income as well as items of gain, the results are the same as those described in paragraph (ii) of this *Example 3*.

Example 4. Computing the disconformity amount. (i) *Unrecognized loss reflected in stock basis*. (A) *Facts*. M owns the sole outstanding share of S stock with a basis of $100. S owns two assets, Asset 1 with a basis of $20 and a value of $60, and Asset 2 with a basis of $60 and a value of $40. In year 1, S sells Asset 1 for $60, recognizing a $40 gain. On December 31, year 1, M sells the S share for $100. After taking into account the effects of all applicable rules of law, M's basis in the S share is $140 (M's original $100 basis increased under §1.1502–32 by $40, the share's allocable portion of the gain recognized on the sale of Asset 1). M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(B) *Application of paragraph (b) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c)*. Under this paragraph (c), M's basis in the S share, $140, is reduced, but not below the share's $100 value, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $40 (the year 1 investment adjustment). The share's disconformity amount is the excess of its basis, $140, over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is $120, the sum of S's money ($60 from the sale of Asset 1) and S's basis in Asset 2, $60. S's net inside attribute amount is allocable entirely to the sole outstanding S share. Thus, the share's disconformity amount is $20, the excess of $140 over $120. The lesser of the share's net positive adjustment, $40, and its disconformity amount, $20, is $20. Accordingly, the basis in the share is reduced by $20, from $140 to $120.

(D) *Application of paragraph (d) of this section*. After the application of this paragraph (c), M's sale of the S share is still a transfer of a loss share, and, accordingly, S's attributes (to the extent of the $20 duplicated loss) are subject to reduction under paragraph (d) of this section.

(ii) *Loss carryover*. The facts are the same as in paragraph (i)(A) of this *Example 4*, except that Asset 2 has a basis of $0 (rather than $60) and S has a $60 loss carryover (as defined in paragraph (f)(6) of this section). The analysis is the same as paragraph (i) of this *Example 4*. Furthermore, the analysis of the application of this paragraph (c) would be the same if the $60 loss carryover were subject to a section 382 limitation from a prior ownership change, or if, instead, the $60 loss carryover were subject to the limitation in §1.1502–21(c) on losses carried from separate return limitation years.

(iii) *Liabilities*. The facts are the same as in paragraph (i)(A) of this *Example 4*, except that S borrows $100 before M sells the S share. S's net inside attribute amount remains $120, computed as the sum of S's money ($160, $60 from the sale of Asset 1 plus the $100 borrowed) and S's basis in Asset 2, $60, less its liabilities, $100. Thus, the S share's disconformity amount remains the excess of $140 over $120, or $20. The results are the same as in paragraph (i) of this *Example 4*.

Example 5. Computing the allocable portion of the net inside attribute amount. (i) *Facts*. On January 1, year 1, M owns all five outstanding shares of S stock with a basis of $20 per share. S owns Asset with a basis of $0. In year 1, S sells Asset for $100, recognizing a $100 gain. On December 31, year 1, M sells one of the S shares, Share 1, for $20. After taking into account the effects of all applicable rules of law, M's basis in Share 1 is $40 (M's original $20 basis increased under §1.1502–32 by $20 (the share's allocable portion of the gain recognized on the sale of Asset)). M's sale of Share 1 is a transfer of a loss share and therefore subject to this section.

(ii) *Application of paragraph (b) of this section*. Although the transfer is subject to this section, basis is not redetermined under paragraph (b) of this section because there is no disparity among M's bases in shares of S common stock and there are no shares of S

preferred stock outstanding (so there can be no unrecognized gain or loss with respect to preferred shares). See paragraph (b)(1)(ii)(A) of this section. After the application of paragraph (b) of this section, M's sale of Share 1 is still a transfer of a loss share and therefore subject to this paragraph (c).

(iii) *Basis reduction under this paragraph (c).* Under this paragraph (c), M's $40 basis in Share 1 is reduced, but not below its $20 value by the lesser of the share's net positive adjustment and disconformity amount. Share 1's net positive adjustment is $20 (the year 1 investment adjustment). Share 1's disconformity amount is the excess of its $40 basis over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is equal to the amount of S's money ($100 from the sale of the asset). Share 1's allocable portion of S's $100 net inside attribute amount is $20 (1/5 x $100). Thus, Share 1's disconformity amount is the excess of $40 over $20, or $20. The lesser of the share's $20 net positive adjustment and its $20 disconformity amount is $20. Accordingly, the basis in the share is reduced by $20, from $40 to $20.

(iv) *Application of paragraph (d) of this section.* Because M's sale of Share 1 is not a transfer of a loss share after the application of this paragraph (c), paragraph (d) of this section does not apply to the transfer.

Example 6. Liabilities. (i) *In general.* (A) *Facts.* On January 1, year 1, M purchases the sole outstanding share of S stock for $100. At that time, S owns Asset, with a basis of $0 and value of $100, and $100 cash. S also has a $100 liability. In year 1, S declares and makes a $60 dividend distribution to M and recognizes $20 of income. The value of Asset declines to $60 and, on December 31, year 1, M sells the S share for $20. After taking into account the effects of all applicable rules of law, M's basis in the S share is $60 (M's original $100 basis decreased under §1.1502–32 by $40 (the net of the $60 distribution and the $20 income recognized)). M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(B) *Application of paragraph (b) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c).* Under this paragraph (c), M's basis in the S share, $60, is reduced, but not below value, $20, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $20 (the year 1 investment adjustment, as defined in paragraph (b)(1)(iii) of this section). The share's disconformity amount is the excess of its basis, $60, over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is negative $40, computed as the sum of S's money ($60 ($100 less the $60 distribution plus the $20 income recognized)) and S's basis in Asset, $0, less S's liability, $100. S's net inside attribute amount is allocable entirely to the sole outstanding S share. Thus, the share's disconformity amount is the excess of $60 over negative $40, or $100. The lesser of the share's net positive adjustment, $20, and its disconformity amount, $100, is $20. Accordingly, the basis in the share is reduced by $20, from $60 to $40.

(D) *Application of paragraph (d) of this section.* After the application of this paragraph (c), the S share is still a loss share and, accordingly, S's attributes are subject to reduction under paragraph (d) of this section. No adjustment is required under paragraph (d) of this section, however, because there is no aggregate inside loss. See paragraph (d)(3)(iii) of this section.

(ii) *Excluded cancellation of indebtedness income—insufficient attributes available for reduction under sections 108 and 1017, and §1.1502–28.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 6*, except that M does not sell the S share. Instead, in year 4, Asset is destroyed in a fire and S spends its $60 on deductible expenses that are not absorbed by the group. S's loss becomes part of the consolidated net operating loss (CNOL). In year 5, S becomes insolvent and S's debt is discharged. Because of S's insolvency, S's discharge of indebtedness income is excluded under section 108 and, as a result, S's attributes are subject to reduction under sections 108 and 1017, and §1.1502–28. S's only attribute is the portion of the CNOL attributable to S, $60, and it is reduced to $0. There are no other consolidated attributes. In year 5, the S stock (which is treated as a capital asset) becomes worthless under section 165, taking into account §1.1502–80(c). After taking into account the effects of all applicable rules of law, M's basis in the S share is $60 (M's original $100 basis decreased under §1.1502–32 by the year 1 investment adjustment of $40 (the net of the $60 distribution and the $20 income recognized). The investment adjustment for year 5 is $0 (the net of the $60 tax exempt income from the excluded COD applied to reduce attributes and the $60 noncapital, nondeductible expense from the reduction of S's portion of the CNOL). Under paragraph (f)(10)(i)(D) of this section, a share is transferred on the last day of the taxable year during which it becomes worthless under section 165 if the share is treated as a capital asset, or the date the share becomes worthless if the share is not treated as a capital asset, taking into account §1.1502–80(c). Accordingly, M transfers the loss share of S stock on December 31, year 5, and the transfer is therefore subject to this section.

(B) *Application of paragraph (b) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section for the reasons set forth in paragraph (i)(B) of this *Example 6*. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c).* Under this paragraph (c), M's basis in its S share, $60, is reduced, but not below value, $0, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $20 (the year 1 investment adjustment, as defined in paragraph (b)(1)(iii) of this section). The share's disconformity amount is the excess of its basis, $60, over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is $0. (The effects of the attribute reduction required under sections 108 and 1017 and §1.1502–28 are taken into account in applying this section; therefore, for purposes of this section, S's portion of the CNOL is treated as eliminated under section 108 and §1.1502–28.) S's net inside attribute amount is allocable entirely to the sole outstanding S share. Thus, the share's disconformity amount is the excess of $60 over $0, or $60. The lesser of the share's net positive adjustment, $20, and its disconformity amount, $60, is $20. Accordingly, the basis in the share is reduced by $20, from $60 to $40, immediately before the transfer.

(D) *Application of paragraph (d) of this section.* After the application of this paragraph (c), the S share is still a loss share, and, accordingly, S's attributes are subject to reduction under paragraph (d) of this section. No adjustment is required under paragraph (d) of this section, however, because there is no aggregate inside loss. See paragraph (d)(3)(iii) of this section.

(iii) *Excluded cancellation of indebtedness income—full attribute reduction under sections 108 and 1017, and §1.1502–28 (using attributes attributable to another member).* (A) *Facts.* The facts are the same as in paragraph (ii)(A) of this *Example 6* except that M loses the $60 distributed in year 1 and the group does not absorb the loss. Thus, as of December 31, year 5, the CNOL is $120, attributable $60 to S and $60 to P. As a result, under §1.1502–28(a)(4), after the portion of the CNOL attributable to S is reduced to $0, the remaining $40 of excluded COD applies to the portion of the CNOL attributable to P, reducing it from $60 to $20. After taking into account the effects of all applicable rules of law, M's basis in the S share at the end of year 5 is $100 (M's original $100 basis decreased under §1.1502–32 by $40 at the end of the year 1 and then increased under §1.1502–32 by $40 at the end of the year 5 (the net of the $100 tax exempt income from the excluded COD applied to reduce attributes and the $60 noncapital, nondeductible expense from the reduction of S's portion of the CNOL)). Under paragraph (f)(10)(i)(D) of this section, a share is transferred on the last day of the taxable year during which it becomes worthless under section 165 if the share is treated as a capital asset, or the date the share becomes worthless if the share is not treated as a capital asset, taking into account §1.1502–80(c). Accordingly, M transfers the loss share of S stock on December 31, year 5, and the transfer is therefore subject to this section.

(B) *Application of paragraph (b) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section for the reasons set forth in paragraph (i)(B) of this *Example 6*. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(C) *Basis reduction under this paragraph (c).* Under this paragraph (c), M's basis in the S share, $100, is reduced, but not below value, $0, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $60 (the sum of the year 1 investment adjustment, as defined in paragraph (b)(1)(iii) of this section, $20, and the year 5 investment adjustment, $40). The share's disconformity amount is the excess of its basis, $100, over its allocable portion of S's net inside attribute amount. S's net inside attribute amount is $0 (taking into account the effects of the attribute reduction required under sections 108 and 1017 and §1.1502–28). S's net inside attribute amount is allocable entirely

to the sole outstanding S share. The share's disconformity amount is therefore $100. The lesser of the share's net positive adjustment, $60, and its disconformity amount, $100, is $60. Accordingly, M's basis in the share is reduced by $60, from $100 to $40, immediately before the transfer.

(D) *Application of paragraph (d) of this section*. After the application of this paragraph (c), the S share is still a loss share, and, accordingly, S's attributes are subject to reduction under paragraph (d) of this section. No adjustment is required under paragraph (d) of this section, however, because there is no aggregate inside loss. See paragraph (d)(3)(iii) of this section.

Example 7. Lower-tier subsidiary (no transfer of lower-tier stock). (i) *Facts*. M owns the sole outstanding share of S stock with a basis of $160. S owns two assets, Asset 1 with a basis and value of $100, and the sole outstanding share of S1 stock with a basis of $60. S1 owns one asset, Asset 2, with a basis of $20 and value of $60. In year 1, S1 sells Asset 2 to X for $60, recognizing a $40 gain. On December 31, year 1, M sells its S share to Y, a member of another consolidated group, for $160. After taking into account the effects of all applicable rules of law, M's basis in the S share is $200 (M's original $160 basis increased under §1.1502–32 by $40 (to reflect the tier-up of the adjustment to S's basis in the S1 stock for the gain recognized on S1's sale of Asset 2)). M's sale of the S share is a transfer of a loss share and therefore subject to this section. (S does not transfer the S1 share because S and S1 are members of the same group following the transfer. See paragraph (f)(10) of this section.)

(ii) *Application of paragraph (b) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to this paragraph (c).

(iii) *Basis reduction under this paragraph (c)*. (A) *In general*. Under this paragraph (c), M's basis in the S share, $200, is reduced, but not below value, $160, by the lesser of the share's net positive adjustment and disconformity amount. The S share's net positive adjustment is $40. The share's disconformity amount is the excess of its basis, $200, over the share's allocable portion of S's net inside attribute amount. S's net inside attribute amount is the sum of S's basis in Asset 1, $100, and S's basis in the S1 share.

(B) *S's basis in the S1 share*. Although S's actual basis in the S1 share is $100 (S's original $60 basis increased under §1.1502–32 by $40 (the share's allocable portion of the gain recognized on the sale of Asset 2)), for purposes of computing the S share's disconformity amount, S's net inside attribute amount is determined by treating S's basis in the S1 share as tentatively reduced by the lesser of the S1 share's net positive adjustment and the S1 share's disconformity amount. The S1 share's net positive adjustment is $40 (the year 1 investment adjustment). The S1 share's disconformity amount is the excess of its basis, $100, over the share's allocable portion of S1's net inside attribute amount. S1's net inside attribute amount is equal to the amount of S1's money ($60 from the sale of Asset 2), and is allocable entirely to the sole outstanding S1 share. Thus, the S1 share's disconformity amount is the excess of $100 over $60, or $40. The lesser of the S1 share's net positive adjustment, $40, and its disconformity amount, $40, is $40. Accordingly, for purposes of computing the disconformity amount of the S share, S's net inside attribute amount is determined by treating S's basis in its S1 share as tentatively reduced by $40, from $100 to $60.

(C) *The disconformity amount of M's S share*. S's net inside attribute amount is treated as the sum of its basis in Asset 1, $100, and its tentatively reduced basis in the S1 share, $60, or $160. S's net inside attribute amount is allocable entirely to the sole outstanding S share. Thus, the S share's disconformity amount is the excess of $200 over $160, or $40.

(D) *Amount of reduction*. M's basis in its S share is reduced by the lesser of the S share's net positive adjustment, $40, and disconformity amount, $40, or $40. Accordingly, M's basis in the S share is reduced by $40, from $200 to $160.

(E) *Effect on S's basis in its S1 share*. The tentative reduction under this paragraph (c) has no effect on S's actual basis in the S1 share. Thus, after the application of this paragraph (c), S owns the S1 share with a basis of $100 (S's original $60 basis increased under §1.1502–32 by $40 (the share's allocable portion of the gain recognized on the sale of Asset 2)).

(iv) *Application of paragraph (d) of this section*. Because M's sale of the S share is not a transfer of a loss share after the application of this paragraph (c), paragraph (d) of this section does not apply to the transfer.

(d) *Attribute reduction to prevent duplication of loss*—(1) *In general*. The rules of this paragraph (d) reduce attributes of S and its lower-tier subsidiaries to the extent they duplicate a net loss on shares of S stock transferred by members in one transaction. This rule furthers single-entity principles by preventing S (or its lower-tier subsidiaries) from using deductions and losses to the extent that the group or its members (including former members) have either used, or preserved for later use, a corresponding loss in S shares.

(2) *Attribute reduction rule*—(i) *General rule*. If a transferred share is a loss share after taking into account the effects of all applicable rules of law, including any adjustments under paragraph (b), (c), or (d)(5)(iii) of this section, S's attributes are reduced by S's attribute reduction amount immediately before the transfer. S's attribute reduction amount is determined under paragraph (d)(3) of this section and applied in accordance with the provisions of paragraphs (d)(4), (d)(5), and (d)(6) of this section. In addition, paragraph (d)(7) of this section provides for additional attribute reduction in the case of certain transfers due to worthlessness and certain transfers not followed by a separate return year.

(ii) *Attribute reduction amount less than five percent of value*. This paragraph (d) generally does not apply to a transaction if the aggregate attribute reduction amount in the transaction is less than five percent of the aggregate value of the shares transferred by members in the transaction. However, in such a case, P may elect to apply this paragraph (d) to the transaction. If such an election is made, this paragraph (d) will apply with respect to the entire aggregate attribute reduction amount determined in the transaction. Such an election is made in the manner provided in paragraph (e)(5) of this section.

(3) *Attribute reduction amount*—(i) *In general*. S's *attribute reduction amount* is the lesser of—

(A) The net stock loss (as defined in paragraph (d)(3)(ii) of this section); and

(B) S's aggregate inside loss (as defined in paragraph (d)(3)(iii) of this section).

(ii) *Net stock loss*. The *net stock loss* is the excess, if any, of—

(A) The aggregate basis of all shares of S stock transferred by members in the transaction; over

(B) The aggregate value of those shares.

(iii) *Aggregate inside loss*—(A) *In general*. S's *aggregate inside loss* is the excess, if any, of—

(*1*) S's net inside attribute amount; over

(*2*) The value of all outstanding shares of S stock.

(B) *Net inside attribute amount*. S's *net inside attribute amount* generally has the same meaning as in paragraph (c)(5) of this section. However, if S holds stock of a lower-tier subsidiary, the provisions of paragraph (d)(5) of this section (and not the provisions of paragraph (c)(6) of this section) modify the computation of S's net inside attribute amount for purposes of this paragraph (d).

(iv) *Lower-tier subsidiaries*. See paragraph (d)(5) of this section for special rules relating to the application of this paragraph (d) if S owns shares of stock of a subsidiary.

(4) *Application of attribute reduction amount*—(i) *Attributes available for reduction*. S's attributes available for reduction under this paragraph (d) are—

(A) *Category A*. Capital loss carryovers;

(B) *Category B*. Net operating loss carryovers;

(C) *Category C*. Deferred deductions; and

(D) *Category D*. Basis of assets other than assets identified as Class I assets in §1.338–6(b)(1).

(ii) *Rules of application*—(A) *Category A, Category B, and Category C attributes*. S's attribute reduction amount is first allocated and applied to reduce the attributes in Category A, Category B, and Category C.

(*1*) *Attribute reduction amount less than total attributes in Category A, Category B, and Category C*. If S's attribute reduction amount is less than S's total attributes in Category A, Category B, and Category C, all of S's attribute reduction amount will be applied to reduce such attributes. However, P may specify the allocation of S's attribute reduction amount among such attributes. An election to specify the allocation of S's attribute reduction amount is made in the manner provided in paragraph (e)(5) of this section. To the extent that P does not specify an allocation of S's attribute reduction amount, S's attribute reduction amount will be applied to reduce any Category A attributes not reduced as a result of the specific allocation of S's attribute reduction amount, from oldest to newest, until they are eliminated. Then, any remaining attribute reduction amount will be applied to reduce any Category B attributes not reduced as a result of the specific allocation of S's attribute reduction amount, from oldest to newest, until they are eliminated. Finally, any remaining attribute reduction amount will be applied to reduce any Category C attributes not reduced as a result of the specific allocation of S's attribute reduction amount, proportionately.

(*2*) *Attribute reduction amount not less than the total attributes in Category A, Category B, and Category C*. If S's attribute reduction amount equals or exceeds S's total attributes in Category A, Category B, and Category C, all such attributes are eliminated and any remaining attribute reduction amount is allocated and applied as provided in paragraphs (d)(4)(ii)(B) and (d)(4)(ii)(C) of this section.

(B) *Category D attributes*. Any attribute reduction amount not applied to reduce S's Category A, Category B, and Category C attributes is allocated and applied as provided in this paragraph (d)(4)(ii)(B) and, to the extent applicable, paragraph (d)(5) of this section.

(*1*) *Allocation if S holds stock of another subsidiary*. If S holds shares of stock of another subsidiary, the attribute reduction amount not applied to reduce S's Category A, Category B, and Category C attributes is first allocated between S's shares of lower-tier subsidiary stock and S's other Category D assets in the manner provided in paragraph (d)(5)(ii) of this section. S's attribute reduction amount allocated to shares of lower-tier subsidiary stock is applied to reduce S's bases in those shares, becomes an attribute reduction amount of the lower-tier subsidiary, and, subject to certain limitations, reduces the lower-tier subsidiary's attributes. See paragraphs (d)(5)(iii) through (d)(5)(vi) of this section.

(*2*) *Allocation and application of attribute reduction amount not applied to lower-tier subsidiary stock*. Any portion of S's attribute reduction amount not applied to reduce S's Category A, Category B, and Category C attributes and not allocated to lower-tier subsidiary stock is allocated to S's Category D assets other than lower-tier subsidiary stock in the manner provided in this paragraph (d)(4)(ii)(B)(*2*). Such amount is first allocated to S's bases (if any) in its assets identified as Class VII assets in §1.338–6(b)(2)(vii). If the attribute reduction amount allocated to Class VII assets is less than S's aggregate basis in those assets, it is applied proportionately (by basis) to reduce the bases of such assets. If the attribute reduction amount allocated to Class VII assets equals or exceeds S's aggregate basis in those assets, it is applied to reduce the bases of such assets to zero. Any remaining attribute reduction amount is then allocated and applied in the same manner to reduce S's bases (if any) in assets identified as Class VI assets in §1.338–6(b)(2)(vi), and then to reduce S's bases (if any) in its assets identified in §1.338–6(b)(2) as Class V, Class IV, Class III, and Class II, successively.

(C) *Attribute reduction amount exceeding attributes available for reduction*. If the amount to be allocated and applied to attributes in Category D other than lower-tier subsidiary stock exceeds the amount of attributes in that category, then—

(*1*) To the extent of any liabilities of S that are not taken into account for tax purposes before the transfer, such excess amount is suspended. The suspended amount is applied proportionately to reduce any amounts attributable to S that would be deductible or capitalizable as a result of such liabilities being taken into account by S or any other person. Solely for purposes of this paragraph (d)(4)(ii)(C)(*1*) and paragraph (d)(5)(ii)(B) of this section, the term *liability* means any liability or obligation the satisfaction of which would be required to be capitalized as an assumed liability by a person that purchased all of S's assets and assumed all of S's liabilities in a single transaction.

(*2*) To the extent such excess amount is greater than any amount suspended under paragraph (d)(4)(ii)(C)(*1*) of this section, it is disregarded and has no further effect.

(iii) *Time and effect of attribute reduction*. In general, the reduction of attributes is effective immediately before the transfer of a loss share of S stock. If the reduction to a member's basis in a share of lower-tier subsidiary stock exceeds the basis of that share, to the extent the excess is not restored under paragraph (d)(5)(vi) of this section it is an excess loss account in that share (and such excess loss account is not taken into account under §1.1502–19 or otherwise as a result of the transaction). The reductions to attributes required under this paragraph (d)(4), including by reason of paragraph (d)(5)(v) of this section (tier down of attribute reduction amounts to lower-tier subsidiaries), are not noncapital, nondeductible expenses described in §1.1502–32(b)(2)(iii).

(5) *Special rules applicable if S holds stock of another subsidiary*. If S holds shares of stock of any other subsidiary (S1) as of a transfer of loss shares of S stock, the rules of this paragraph (d)(5) apply with respect to each such subsidiary.

(i) *Treatment of lower-tier subsidiary stock for computation of S's attribute reduction amount*. For purposes of determining S's net inside attribute amount and attribute reduction amount under paragraph (d)(3) of this section—

(A) *Single share*. All of S's shares of S1 stock held as of the transfer of S stock (whether or not transferred in, or held by S immediately after, the transaction) are

treated as a single share of stock (generally referred to as the S1 stock); and

(B) *Deemed basis*. S's basis in its S1 stock is treated as its *deemed basis* in the stock, which is equal to the greater of—

(*1*) The sum of S's basis in each share of S1 stock (adjusted to reflect any gain or loss recognized on the transfer of any S1 shares in the transaction, whether allowed or disallowed); and

(*2*) The portion of S1's net inside attribute amount allocable to S's shares of S1 stock.

(C) *Multiple tiers*. For purposes of computing deemed basis under paragraph (d)(5)(i)(B) of this section, a subsidiary's basis in stock of a lower-tier subsidiary is the deemed basis in that lower-tier subsidiary stock. Thus, if stock is held in multiple tiers, the computation of deemed basis begins at the lowest tier, so that the computation of deemed basis at each tier takes into account the deemed basis of all lower-tier shares.

(ii) *Allocation of S's attribute reduction amount between lower-tier subsidiary stock and other Category D assets*. The portion of S's attribute reduction amount that is not applied to reduce S's Category A, Category B, and Category C attributes must be allocated between each of S's deemed single shares of S1 stock and all of S's other Category D assets. For this purpose, S's Category D assets other than lower-tier subsidiary stock are treated as one asset with a basis equal to the aggregate bases of all Category D assets other than lower-tier subsidiary stock (non-stock Category D asset). S's attribute reduction amount is allocated proportionately (by basis) between (among) the non-stock Category D asset and S's deemed single share(s) of subsidary stock. (See paragraphs (d)(4)(ii)(B)(*2*) and (d)(4)(ii)(C) of this section regarding the portion of S's attribute reduction amount allocated to the Category D assets other than lower-tier subsidiary stock.) For allocation purposes, S's basis in each deemed single share of S1 stock is its deemed basis (determined under paragraphs (d)(5)(i)(B) and (d)(5)(i)(C) of this section), reduced by—

(A) The value of S's transferred shares of S1 stock; and

(B) The nontransferred S1 shares' allocable portion of the excess of S1's non-loss assets over S1's liabilities (including liabilities described in paragraph (d)(4)(ii)(C)(*1*) of this section). For this purpose, S1's non-loss assets are—

(*1*) S1's assets identified as Class I assets in §1.338–6(b)(1),

(*2*) The value of S1's transferred shares of lower-tier subsidiary stock, and

(*3*) The nontransferred lower-tier subsidiary shares' allocable portions of lower-tier non-loss assets (net of liabilities, including liabilities described in paragraph (d)(4)(ii)(C)(*1*) of this section) of all lower-tier subsidiaries.

(iii) *Application of attribute reduction amount to S's S1 stock*. The portion of S's attribute reduction amount allocated under paragraph (d)(5)(ii) of this section to each deemed single share of S1 stock (allocated attribute reduction amount) is apportioned among, and applied to reduce S's bases in, individual S1 shares in accordance with the following—

(A) No portion of the allocated attribute reduction amount is apportioned to an individual share of transferred S1 stock if gain or loss is recognized on its transfer (recognition transfer);

(B) The allocated attribute reduction amount is apportioned among all of S's other shares of S1 stock in a manner that, first reduces the loss in and disparity among S's bases in loss shares of S1 preferred stock to the greatest extent possible, and then reduces the disparity among S's bases in the shares of S1 common stock (other than those transferred in a recognition transfer) to the greatest extent possible;

(C) The allocated attribute reduction amount apportioned to an individual S1 share is applied to reduce the basis of that share to, but not below, value if the share is either a preferred share or a common share that is transferred other than in a recognition transfer; and

(D) The allocated attribute reduction amount apportioned to an individual S1 share is applied to reduce the basis of that share without regard to value if the share is a common share that is not transferred in the transaction.

(iv) *Unapplied allocated attribute reduction amount*. Any portion of the allocated attribute reduction amount that is not applied to reduce S's basis in a share of S1 stock has no effect on any other attributes of S, it is not a noncapital, nondeductible expense of S, and it does not cause S to recognize income or gain. However, such amounts continue to be part of the allocated attribute reduction amount for purposes of the tier down rule in paragraph (d)(5)(v) of this section.

(v) *Tier down of attribute reduction amount*—(A) *General rule*. The allocated attribute reduction amount of each deemed single share of S1 stock is an attribute reduction amount of S1 (tier-down attribute reduction amount). Accordingly, the tier-down attribute reduction amount, in combination with any attribute reduction amount computed with respect to the transferred S1 shares (if any) (direct S1 attribute reduction amount), applies to reduce S1's attributes under the provisions of this paragraph (d). The tier-down attribute reduction amount is an attribute reduction amount of S1 that must be allocated to S1's assets, and may become an allocated attribute reduction amount of lower-tier subsidiary stock (and thus a tier-down attribute reduction amount of a lower-tier subsidiary), even if its application to S1's attributes is limited under paragraph (d)(5)(v)(B) of this section.

(B) *Conforming limitation on reduction of lower-tier subsidiary's attributes.* Notwithstanding the general rule in paragraph (d)(5)(v)(A) of this section, and unless P elects otherwise in the manner provided in paragraph (e)(5) of this section, the application of S1's tier-down attribute reduction amount to S1's attributes is limited to an amount equal to the excess of the portion of S1's net inside attribute amount that is allocable to all S1 shares held by members as of the transaction (whether or not transferred in the transaction) over the sum of—

(*1*) Any direct S1 attribute reduction amount;

(*2*) The aggregate value of all S1 shares transferred by members in the transaction with respect to which gain or loss was recognized (recognition transfer);

(*3*) The sum of all members' bases (after any reduction under this section, including this paragraph (d)) in any shares of S1 stock transferred by members in the transaction (other than in a recognition transfer), reduced by any direct S1 attribute reduction amount computed with respect to the transfer of such S1 shares; and

(*4*) The sum of all members' bases (after any reduction under this section, including this paragraph (d)) in any non-

transferred shares of S1 stock held as of the transaction.

(vi) *Stock basis restoration*—(A) *In general*. After paragraph (d)(5)(v) of this section has applied with respect to all shares of subsidiary stock transferred in the transaction, lower-tier subsidiary stock basis is restored under this paragraph (d)(5)(vi). Under this paragraph (d)(5)(vi), the reductions to members' bases in shares of lower-tier subsidiary stock under paragraph (d)(5)(iii) of this section are reversed to the extent necessary to restore such bases to an amount that conforms the basis of each such share to its allocable portion of the subsidiary's net inside attribute amount, taking into account any reductions under this paragraph (d). Restoration adjustments are first made at the lowest tier and then at each next higher tier successively. Restoration adjustments do not tier up to affect the bases of higher-tier shares. Rather, restoration is computed and applied separately at each tier. For purposes of this rule, when computing a subsidiary's net inside attribute amount—

(*1*) The subsidiary's basis in stock of a lower-tier subsidiary is the actual basis of the stock after application of this paragraph (d); and

(*2*) Any attribute reduction amount allocated to the subsidiary's Category D assets other than lower-tier subsidiary stock that is suspended under paragraph (d)(4)(ii)(C)(*1*) of this section is treated as reducing the subsidiary's net inside attribute amount.

(B) *Election not to restore basis*. Notwithstanding paragraph (d)(5)(vi)(A) of this section, P may elect not to restore basis in stock of a lower-tier subsidiary that was reduced under paragraph (d)(5)(iii) of this section. An election not to restore lower-tier subsidiary stock basis is made in the manner provided in paragraph (e)(5) of this section.

(6) *Elections to reduce the potential for loss duplication*—(i) *In general*. Notwithstanding the general operation of this paragraph (d), P may elect to reduce the potential for loss duplication, and thereby reduce or avoid attribute reduction. To the extent of S's attribute reduction amount tentatively computed without regard to any election under this paragraph (d)(6), P may elect—

(A) To reduce all or any portion (including any portion in excess of a specified amount) of members' bases in transferred loss shares of S stock;

(B) To reattribute all or any portion (including any portion in excess of a specified amount) of S's Category A, Category B, and Category C attributes (including such attributes of lower-tier subsidiaries), to the extent they would otherwise be subject to reduction under this paragraph (d); or

(C) Any combination thereof.

(ii) *Manner and effect of election*. An election to reduce loss duplication under this paragraph (d)(6) is made in the manner provided in paragraph (e)(5) of this section. Although such elections are irrevocable, they have no effect—

(A) If there is no attribute reduction amount; or

(B) To the extent S's attribute reduction amount is less than the amount specified in the election.

(iii) *Order of application*—(A) *Stock of one subsidiary transferred in the transaction*. If shares of stock of only one subsidiary are transferred in the transaction, any stock basis reduction and reattribution of attributes (including from lower-tier subsidiaries) is deemed to occur immediately before the application of this paragraph (d). If a transferred share is still a loss share after giving effect to this election, the other provisions of this paragraph (d) then apply with respect to that share.

(B) *Stock of multiple subsidiaries transferred in the transaction*. If shares of stock of more than one subsidiary are transferred in the transaction and elections under this paragraph (d)(6) are made with respect to transfers of stock of subsidiaries in multiple tiers, effect is given to the elections from the lowest tier to the highest tier in the manner provided in this paragraph (d)(6)(iii)(B). The amount of the election for the transfer at the lowest tier is determined by applying this paragraph (d) with respect to the transferred loss shares of this lowest-tier subsidiary immediately after applying paragraphs (b) and (c) of this section to the stock of such subsidiary. The effect of any stock basis reduction or reattribution of losses immediately tiers up under §1.1502–32 to adjust members' bases in higher-tier shares. Elections and adjustments are then made with respect to transfers at each next higher tier successively.

(iv) *Special rules for reattribution elections*—(A) *In general*. Because the reattribution election is intended to provide the group a means to retain certain S attributes, and not to change the location of attributes where S continues to be a member of the same group as P, the election to reattribute attributes may only be made if S becomes a nonmember (within the meaning of §1.1502–19(c)(2)) as a result of the transaction and S does not become a member of any group that includes P. The election to reattribute S's attributes can only be made for attributes in Category A, Category B, and Category C. The attributes that would otherwise be reduced under paragraph (d)(4) of this section may be reattributed to P. Accordingly, P may specify the attributes in Category A, Category B, and Category C to be reattributed. Such an election is made in the manner provided in paragraph (e)(5) of this section. To the extent that P elects to reattribute attributes but does not specify the attributes to be reattributed, any attributes not specifically reattributed will be reattributed in the default amount, order, and category described in paragraph (d)(4)(ii)(A)(*1*) of this section. P succeeds to reattributed attributes as if such attributes were succeeded to in a transaction to which section 381(a) applies. Any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or section 382(l)(3)) in connection with the transaction is not taken into account under section 382 with respect to the reattributed attributes. (See §1.1502–96(d) for rules relating to section 382 and the reattribution of losses under this paragraph (d)(6)). The reattribution of S's attributes is a noncapital, nondeductible expense described in §1.1502–32(b)(2)(iii). See §1.1502–32(c)(1)(ii)(A) regarding special allocations applicable to such noncapital, nondeductible expense. If P elects to reattribute S attributes (including attributes of a lower-tier subsidiary) and reduce S stock basis, the reattribution is given effect before the stock basis reduction.

(B) *Insolvency limitation*. If S, or any higher-tier subsidiary, is insolvent within the meaning of section 108(d)(3) at the time of the transfer, S's losses may be reattributed only to the extent they exceed the sum of the separate insolvencies of any subsidiaries (taking into account only S and its higher-tier subsidiaries) that are

insolvent. For purposes of determining insolvency, liabilities owed to higher-tier members are not taken into account, and stock of a subsidiary that is limited and preferred as to dividends and that is not owned by higher-tier members is treated as a liability to the extent of the amount of preferred distributions to which the stock would be entitled if the subsidiary were liquidated on the date of the transfer.

(C) *Limitation on reattribution from lower-tier subsidiaries*. P's ability to reattribute attributes of lower-tier subsidiaries is limited under this paragraph (d)(6)(iv)(C) in order to prevent circular computations of the attribute reduction amount. Accordingly, attributes that would otherwise be reduced as a result of tier-down attribute reduction under paragraph (d)(5)(v) of this section may only be reattributed to the extent that the reduction in the basis of any lower-tier subsidiary stock resulting from the noncapital, nondeductible expense (as allocated under §1.1502–32(c)(1)(ii)(A)(*2*)) will not create an excess loss account in any such stock.

(v) *Special rules for stock basis reduction elections*—(A) *In general*. An election to reduce basis in S stock is made with respect to all members' bases in loss shares of S stock that are transferred in the transaction. The reduction is allocated among all such shares in proportion to the amount of loss on each share. This reduction in S stock basis is a noncapital, nondeductible expense described in §1.1502–32(b)(2)(iii) of the transferring member.

(B) *Adjustment to the attribute reduction amount*. The attribute reduction amount (determined under paragraph (d)(3)(i) of this section) is treated as reduced by the amount of any elective reduction in the basis of the S stock under this paragraph (d)(6). Accordingly, the election to reduce stock basis under this paragraph (d)(6) is treated as reducing or eliminating the duplication even if the shares of S stock are loss shares after giving effect to the election.

(C) *Deemed stock basis reduction election in the case of certain disallowed stock losses*. If there is a net stock loss in transferred shares after taking into account any actual elections under this paragraph (d)(6), and the stock loss would otherwise be permanently disallowed (for example, under section 311(a)), P will be deemed to have made a stock basis reduction election equal to such net stock loss.

(7) *Additional attribute reduction in the case of certain transfers due to worthlessness and certain transfers not followed by a separate return year*—(i) *In general*. Notwithstanding any other provision of this paragraph (d), if a transfer is subject to this paragraph (d)(7) any of S's Category A, Category B, and Category C attributes not otherwise reduced or reattributed under this paragraph (d), and any credit carryover attributable to S, including any consolidated credits that would be apportioned to S under the principles of §1.1502–79 if S had a separate return year, are eliminated. Attributes other than consolidated tax attributes are eliminated under this paragraph (d)(7)(i) immediately before the transfer subject to this paragraph (d)(7)(i). The elimination of attributes under this paragraph (d)(7)(i) is not a noncapital, nondeductible expense described in §1.1502–32(b)(2)(iii).

(ii) *Transfers subject to this paragraph (d)(7)*. A transfer is subject to this paragraph (d)(7) if—

(A) M transfers a share of S stock solely by reason of a transfer defined in paragraph (f)(10)(i)(D) of this section (worthlessness where the provisions of §1.1502–80(c) are satisfied), M recognizes a net deduction or loss on the share, and S is a member of the group on the day following the last day of the group's taxable year during which the share becomes worthless under section 165 (taking into account the provisions of §1.1502–80(c)), or

(B) M recognizes a net deduction or loss on the stock of S in a transaction in which S ceases to be a member and does not become a nonmember within the meaning of §1.1502–19(c)(2).

(iii) *Example*. The application of this paragraph (d) to transfers due to worthlessness and to loss transfers not followed by separate return years is illustrated by the following example.

Example. (i) *Worthlessness where S continues as a member*. M owns the sole share of S stock. The share is worthless under section 165. In addition, S has disposed of all its assets within the meaning of §1.1502–19(c)(1)(iii)(A) and therefore satisfies the provisions of §1.1502–80(c). M claims a worthless securities deduction with respect to the share. The worthlessness is a transfer of the S share, a loss share, and therefore subject to this section. After the application of paragraphs (b) and (c) of this section, M's basis in the share (and therefore M's net stock loss) is $75. The portion of the consolidated net operating loss attributable to S is $100. Under the general rules of this paragraph (d), S's attribute reduction amount is $75 (the lesser of M's $75 net stock loss and S's $100 aggregate inside loss ($100 net inside attribute amount over $0 value of S share). S's attributes are reduced by $75, from $100 to $25. In addition, if S remains a member of the P group, this paragraph (d)(7) applies to eliminate the remaining $25 of the consolidated net operating loss attributable to S because the S share is worthless, and M recognizes a deduction (taking into account §1.1502–80(c)) with respect to the share. Accordingly, after the application of this section, M recognizes a $75 worthless securities deduction, S has $0 net inside attributes, and the consolidated net operating loss is reduced by a total of $100.

(ii) *Dissolution of insolvent subsidiary*. The facts are the same as in paragraph (i) of this *Example*, except that S is insolvent, does not dispose of all its assets within the meaning of §1.1502–19(c)(1)(iii)(A), M causes S to be legally dissolved, and the S share held by M is cancelled without consideration. Under paragraph (d)(7)(ii)(B) of this section, the dissolution of S is subject to this paragraph (d)(7) and the result is the same as in paragraph (i) of this *Example*. The result would also be the same if instead of being legally dissolved, S was converted into an entity that is disregarded as separate from M.

(iii) *Stock cancelled in connection with a section 381(a) transaction with another member*. M owns the sole share of S common stock with a basis of $75. M1 owns the sole share of S preferred stock. The value of S's assets (net of liabilities) is less than the liquidation preference on the S preferred stock. In a reorganization described in section 368(a)(1)(D), S transfers all of its assets to M2 in exchange for M2 common stock and M2's assumption of S's liabilities, S distributes all of the M2 common stock received in the exchange to M1 in exchange for M1's S preferred stock, the S common stock held by M is cancelled without consideration, and S ceases to exist. Notwithstanding that M is not entitled to treat its common share of S stock as worthless until §1.1502–80(c) is satisfied, M's share is transferred within the meaning of paragraph (f)(10)(i)(A) of this section because M ceases to own the share in a transaction in which, but for this section (and notwithstanding the deferral of any amount recognized on the transfer, other than by reason of §1.1502–13), M would recognize a loss or deduction with respect to the share. Accordingly, there is a transfer of the S common share and this section applies to the transfer. There are no adjustments under paragraphs (b) or (c) of this section because no investment adjustments have been applied to the bases of the shares. The transfer of the S common stock is subject to the general rules of this paragraph (d), but is not subject to the additional attribute reduction under this paragraph (d)(7) because the transfer was not solely by reason of worthlessness where §1.1502–80(c) is satisfied, and S did not cease to be a member because M2 is a successor to S.

(iv) *Stock cancelled in connection with a section 381(a) transaction with a nonmember*. The facts are the same as in paragraph (iii) of this *Example*, except that the S preferred share is held by X, instead of M2 acquiring S's assets, S merges into Y in a reorganization described in section 368(a)(1)(A), M1 receives all of the Y stock issued in the merger in ex-

change for M1's S preferred stock, and Y does not become a member as a result of the transaction. M treats the cancelled S common stock as worthless, and §1.1502–80(c) is satisfied because S ceases to be a member. In this case, there is a transfer of M's S common share because it becomes worthless (taking into account §1.1502–80(c)); because M ceases to own the share in a transaction in which, but for this section (and notwithstanding the deferral of any amount recognized on the transfer, other than by reason of §1.1502–13), M would recognize a loss or deduction with respect to the share; and because M and S cease to be members of the same group. The transfer of the S common stock is subject to the general rules of this paragraph (d), but is not subject to the additional attribute reduction under this paragraph (d)(7) because the transfer was not solely by reason of worthlessness where §1.1502–80(c) is satisfied and, although S did cease to be a member, S became a nonmember within the meaning of §1.1502–19(c)(2) because Y is a successor to S.

(8) *Examples*. The application of this paragraph (d) is illustrated by the following examples:

Example 1. Computation of attribute reduction amount. (i) *Transfer of all S shares.* (A) *Facts.* M owns all 100 of the outstanding shares of S stock with a basis of $2 per share. S owns land with a basis of $100, has a $120 loss carryover, and has no liabilities. Each share has a value of $1. M sells 30 of the S shares to X for $30. As a result of the sale, M and S cease to be members of the same group. Accordingly, all 100 of the S shares are transferred. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) (with respect to the 30 S shares sold to X) of this section. M's transfer of the S shares is a transfer of loss shares and therefore subject to this section.

(B) *Application of paragraphs (b) and (c) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is no disparity among M's bases in shares of S common stock and there are no shares of S preferred stock outstanding (so there can be no unrecognized gain or loss on preferred stock). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. No adjustment is required under paragraph (c) of this section because the net positive adjustment is $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's transfer of the S shares is still a transfer of loss shares and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d).* Under this paragraph (d), S's attributes are reduced by S's attribute reduction amount. Paragraph (d)(3) of this section provides that S's attribute reduction amount is the lesser of the net stock loss and S's aggregate inside loss. The net stock loss is the excess of the $200 aggregate bases of the transferred shares over the $100 aggregate value of the transferred shares, or $100. S's aggregate inside loss is the excess of its $220 net inside attribute amount (the sum of the $100 basis in the land and the $120 loss carryover) over the $100 value of all outstanding S shares, or $120. The attribute reduction amount is therefore the lesser of the $100 net stock loss and the $120 aggregate inside loss, or $100. Under paragraph (d)(4) of this section, S's $100 attribute reduction amount is allocated and applied to reduce S's $120 loss carryover to $20. Under paragraph (d)(4)(iii) of this section, the reduction of the loss carryover is not a noncapital, nondeductible expense and has no effect on M's basis in the S stock.

(ii) *Transfer of less than all S shares.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 1*, except that M only sells 20 S shares to X. M's sale of the 20 S shares is a transfer of loss shares and therefore subject to this section. See paragraph (f)(10)(i)(A) and (f)(10)(i)(C) of this section. (There is no transfer of the remaining shares because S and M remain members of the same group.)

(B) *Application of paragraphs (b) and (c) of this section.* No adjustment is required under paragraph (b) or paragraph (c) of this section for the reasons set forth in paragraph (i)(B) of this *Example 1*. Thus, after the application of paragraph (c) of this section, M's transfer of the S shares is still a transfer of loss shares and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d).* Under this paragraph (d), S's attributes are reduced by S's attribute reduction amount. Paragraph (d)(3) of this section provides that S's attribute reduction amount is the lesser of the net stock loss and S's aggregate inside loss. The net stock loss is $20, the excess of the $40 aggregate bases of the transferred shares over the $20 aggregate value of the transferred shares. S's aggregate inside loss is $120, the excess of its $220 net inside attribute amount (the sum of the $100 basis in the land and the $120 loss carryover) over the $100 value of all outstanding S shares. The attribute reduction amount is therefore $20, the lesser of the $20 net stock loss and the $120 aggregate inside loss. Under paragraph (d)(4) of this section, S's $20 attribute reduction amount is allocated and applied to reduce S's $120 loss carryover to $100.

Example 2. Proportionate allocation of attribute reduction amount. (i) *Facts.* M owns the sole outstanding share of S stock with a basis of $150. S owns land with a basis of $60, a factory with a basis of $30, publicly traded property with a basis of $30 and goodwill with a basis of $30. M sells its S share for $90. M's sale of the S share is a transfer of a loss share and therefore subject to this section. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section.

(ii) *Application of paragraphs (b) and (c) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. No adjustment is required under paragraph (c) of this section because both the disconformity amount and the net positive adjustment are $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's sale of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(iii) *Attribute reduction under this paragraph (d).* Under paragraph (d)(3) of this section, S's attribute reduction amount is determined to be $60, the lesser of the $60 net stock loss ($150 basis over $90 value) and S's $60 aggregate inside loss (the excess of S's $150 net inside attribute amount (the $60 basis of the land, plus the $30 basis of the factory, plus the $30 basis of the publicly traded property, plus the $30 basis of the goodwill) over the $90 value of the S share). Under paragraph (d)(4)(ii)(B)(*2*) of this section, the $60 attribute reduction amount is allocated and applied to reduce S's bases in its Category D assets, S's only attributes available for reduction, as follows:

Available attributes, Basis in Category D assets	Attribute amount	Allocable portion of attribute reduction amount	Adjusted attribute amount
Class VII, Goodwill	$ 30	$30	$ 0
Class V			
Land	$ 60	(60/90 x $60) $40	$20
Factory	$ 30	(30/90 x $60) $20	$10
Total Class V	$ 90	$60	$30
Class II, publicly traded property	$ 30	$ 0	$30
Totals	$150	$60	$90

Example 3. Attribute reduction amount less than total attributes in Category, A, Category B, and Category C. (i) *No election to prescribe the allocation of S's attribute reduction amount.* (A) *Facts.* P owns the sole outstanding share of M stock with a basis of $1,000 and M owns the sole outstanding share of S stock with a basis of $210. M sells its S share to X for $100. M's sale of the S share is a transfer of a loss share and therefore subject to this section. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section. At the time of the sale, S has no liabilities and the following attributes:

Category	Attribute	Attribute amount
Category A	Capital loss carryover	$ 10
Category B	NOL carryover	$200
Category C	Deferred deductions	$ 40
Category D, Class V	Basis in Land	$ 50
	Total Attributes	$300

(B) *Application of paragraphs (b) and (c) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. No adjustment is required under paragraph (c) of this section because both the disconformity amount and the net positive adjustment are $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's transfer of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d).* (*1*) *Computation of attribute reduction amount.* Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of the $110 net stock loss ($210 basis over $100 value) and S's aggregate inside loss. S's aggregate inside loss is $200 (S's $300 net inside attribute amount (the $10 capital loss carryover, plus the $200 NOL carryover, plus the $40 deferred deductions, plus the $50 basis in land) less the $100 value of all outstanding S shares). Thus, the attribute reduction amount is $110, the lesser of the $110 net stock loss and S's $200 aggregate inside loss. Under paragraph (d)(4)(ii)(A)(*1*) of this section, the $110 attribute reduction amount is allocated and applied to reduce S's attributes as follows:

Category	Attribute	Attribute amount	Allocation of attribute reduction amount	Adjusted attribute amount
Category A	Capital loss carryover	$ 10	$ 10	$ 0
Category B	NOL carryover	$200	$100	$100
Category C	Deferred deductions	$ 40	$ 0	$ 40
Category D, Class V	Basis in land	$ 50	$ 0	$ 50
Totals		$300	$110	$190

(ii) *Election to prescribe the allocation of attribute reduction amount.* (A) *Facts.* The facts are the same as in paragraph (i)(A) of this *Example 3*, except that, P elects to allocate the attribute reduction amount to eliminate the Category C attributes, preserve the capital loss carryover, and reduce Category B attributes.

(B) *Application of paragraphs (b) and (c) of this section.* No adjustment is required under paragraph (b) or paragraph (c) of this section for the reasons set forth in paragraph (i)(B) of this *Example 3*. Thus, after the application of paragraph (c) of this section, M's sale of the S share is still a transfer of a loss share, and accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d).* For the reasons set forth in paragraph (i)(C) of this *Example 3*, under this paragraph (d)(3), S's attribute reduction amount is determined to be $110. M elects to apply S's $110 attribute reduction amount as follows:

Category	Attribute	Attribute amount	Allocation of attribute reduction amount	Adjusted attribute amount
Category A	Capital loss carryover	$ 10	$ 0	$ 10
Category B	NOL carryover	$200	$ 70	$130
Category C	Deferred deductions	$ 40	$ 40	$ 0
Category D, Class V	Basis of land	$ 50	$ 0	$ 50
Totals		$300	$110	$190

Example 4. Attributes attributable to liability not taken into account. (i) *S operates one business.* (A) *Facts.* On January 1, year 1, M forms S by exchanging $150 for the sole outstanding share of S stock. In year 1, S earns $500, purchases land for $50, spends $100 to build a factory on that land, and then purchases publicly traded property for $250. In year 2, S earns a section 38 general business credit of $50. However, pollution generated by S's business gives rise to an environmental remediation liability under Federal law that would be required to be capitalized if a person purchased S's assets and assumed the liability. Before any amounts have been taken into account with respect to the environmental remediation liability, when the liability has a present value of $500, M sells its S share to X for $150. After giving effect to all other provisions of law, M's basis in the S share is $650 (the original basis of $150 increased under §1.1502–32 by $500 for the income earned). The sale is therefore a transfer of a loss share of subsidiary stock and subject to this section. See para-

graphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section.

(B) *Application of paragraphs (b) and (c) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. No adjustment to basis is made under paragraph (c) of this section because, although the net positive adjustment is $500, the disconformity amount is $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's sale of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d)*. (*1*) Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of the $500 net stock loss ($650 basis over $150 value) and the aggregate inside loss. The aggregate inside loss is $500, computed as the excess of S's $650 net inside attribute amount (the sum of S's $100 basis in the factory, $50 basis in the land, $250 basis in the publicly traded property, and $250 cash remaining after the purchases) over the $150 value of the S share. Thus, S's attribute reduction amount is $500, the lesser of the $500 net stock loss and the $500 aggregate inside loss. Under paragraph (d)(4)(ii)(B)(*2*) of this section, S's $500 attribute reduction amount is allocated and applied to reduce S's attributes as follows:

Available attributes	Attribute amount	Allocable portion of attribute reduction amount	Adjusted attribute amount
Category D			
Class V Assets			
Basis of factory	$100	$100	$0
Basis of land	$ 50	$ 50	$0
Class II Assets			
Publicly traded property	$250	$250	$0

(*2*) The remaining $100 attribute reduction amount is not applied to S's $250 cash (Class I asset) or to S's $50 general business tax credit. Under the general rule of this paragraph (d), that remaining $100 attribute reduction amount would have no further effect on S's attributes. However, S has a $500 liability that has not been taken into account. Therefore, under paragraph (d)(4)(ii)(C)(*1*) of this section, the remaining $100 attribute reduction amount is suspended and will be allocated and applied to reduce any amounts that become deductible or capitalizable as a result of the environmental remediation liability later being taken into account. If the liability is satisfied for an amount that is less than $100, under paragraph (d)(4)(ii)(C)(*2*) of this section the remaining portion of that $100 suspended attribute reduction amount is disregarded and has no further effect.

(ii) *Lower-tier subsidiary with additional liability*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of *Example 4*, except that, in addition, S exchanged $50 for the sole outstanding share of stock of S1. S1 has $50 and equipment with an aggregate basis of $0. S1 also has employee medical expense liabilities that have not been taken into account and that would be required to be capitalized if a person purchased S1's assets and assumed the liabilities. At the time of the sale, S's environmental remediation liability had a present value of $475 and S1's employee medical expenses had a present value of $25. For the reasons set forth in paragraph (i)(A) of this *Example 4*, M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(B) *Application of paragraphs (b) and (c) of this section*. No adjustment is made under paragraph (b) or paragraph (c) of this section for the reasons set forth in paragraph (i)(B) of this *Example 4*. Thus, after the application of paragraph (c) of this section, M's sale of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d)*. (*1*) *Computation of attribute reduction amount*. Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of the $500 net stock loss ($650 basis over $150 value) and the aggregate inside loss. The aggregate inside loss is the excess of S's net inside attribute amount over the value of the S share. Under paragraphs (d)(3)(iii)(B) and (d)(5)(i)(B) of this section, S's net inside attribute amount is determined by using S's $50 deemed basis in the S1 share (the greater of S's $50 actual basis in the share and S1's $50 net inside attribute amount). Accordingly, S's net inside attribute amount is $650 (the sum of its $100 basis in the factory, $50 basis in the land, $250 basis in the publicly traded property, $200 cash, and $50 deemed basis in its S1 share). The aggregate inside loss is $500, the excess of S's $650 net inside attribute amount over the $150 value of the S share. Thus, S's attribute reduction amount is $500, the lesser of the $500 net stock loss and S's $500 aggregate inside loss.

(*2*) *Allocation, apportionment, and application of attribute reduction amount*. Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $500 attribute reduction amount is allocated proportionately (by basis) between its S1 share and its non-stock Category D asset (consisting of all S's Category D assets other than its share of S1 stock, with a basis equal to $600, the aggregate basis of S's non-stock assets). However, under paragraph (d)(5)(ii) of this section, for purposes of allocating S's attribute reduction amount between its non-stock Category D asset and the S1 share, S's $50 deemed basis in its S1 share is treated as reduced by S1's $25 net non-loss assets (its Class I asset, $50 cash over S1's liabilities (which, for this purpose include the $25 of employee medical expense liabilities not taken into account as of the transfer)). As a result, S's attribute reduction amount is allocated $480 (600/625 x 500) to S's non-stock Category D asset and $20 (25/625 x 500) to the S1 share. The $480 attribute reduction amount allocated to S's non-stock Category D asset produces the same reduction in the bases of S's assets (other than the S1 stock) as in paragraph (i)(C) of this *Example 4*; in addition, the $80 attribute reduction amount not applied to reduce S's attributes is suspended and applied to reduce any amounts that become deductible or capitalizable as a result of the environmental remediation liability later being taken into account. If the liability is satisfied for an amount that is less than $80, under paragraph (d)(4)(ii)(C)(*2*) of this section the remaining portion of that $80 suspended attribute reduction amount is disregarded and has no further effect. Because the S1 share is not transferred within the meaning of paragraph (f)(10) of this section, the allocated attribute reduction amount apportioned to the S1 share is applied fully to reduce the basis of the S1 share to $30. See paragraph (d)(5)(iii) of this section.

(D) *Tier down of S's attribute reduction amount*. The $20 portion of S's attribute reduction amount allocated to the S1 share is an attribute reduction amount of S1. Because S1 holds only cash, it has no attributes available for reduction under this paragraph (d). However, because S1 has a $25 liability not taken into account for tax purposes, paragraph (d)(4)(ii)(C)(*1*) of this section requires that $20 of the unapplied attribute reduction amount be suspended and then allocated and applied to reduce any amounts that become deductible or capitalizable as a result of the employee medical expense liabilities later being taken into account. If these liabilities are satisfied for an amount that is less than $20, under paragraph (d)(4)(ii)(C)(*2*) of this section the remaining portion of that $20 suspended attribute reduction amount is disregarded and has no further effect.

Example 5. Wholly owned lower-tier subsidiary (no lower-tier transfer). (i) *Application of conforming limitation*. (A) *Facts*. M owns the sole outstanding share of S stock with a basis of $250. S owns Asset with a basis of $100 and the only two outstanding shares of S1 stock (Share A has a basis of $40 and Share B has a basis of $60). S1 owns Asset 1 with

a basis of $50. M sells its S share to P1, the common parent of another consolidated group, for $50. The sale is a transfer of a loss share and therefore subject to this section. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section.

(B) *Application of paragraphs (b) and (c) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. No adjustment is required under paragraph (c) of this section because, although there is a $50 disconformity amount, the net positive adjustment is $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's sale of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d)*. (*1*) *Computation of attribute reduction amount*. Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of M's net stock loss and S's aggregate inside loss. M's net stock loss is $200 ($250 basis over $50 value). S's aggregate inside loss is the excess of S's net inside attribute amount over the value of the S share. Under paragraphs (d)(3)(iii)(B) and (d)(5)(i)(B) of this section, S's net inside attribute amount is $200, computed as the sum of S's $100 basis in Asset and its $100 deemed basis in the deemed single share of S1 stock (computed as the greater of S's $100 aggregate basis in the S1 shares and S1's $50 basis in Asset 1). S's aggregate inside loss is therefore $150, $200 net inside attribute amount over the $50 value of the S share. Accordingly, S's attribute reduction amount is $150, the lesser of the $200 net stock loss and the $150 aggregate inside loss.

(*2*) *Allocation, apportionment, and application of S's attribute reduction amount*. Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $150 attribute reduction amount is allocated proportionately (by basis) between Asset (non-stock Category D asset) with a basis of $100, and the S1 stock (treated as a single share with a deemed basis of $100). Accordingly, $75 of the attribute reduction amount ($100/$200 x $150) is allocated to Asset and $75 of the attribute reduction amount ($100/$200 x $150) is allocated to the S1 stock. The $75 of the attribute reduction amount allocated to Asset is applied to reduce S's basis in Asset from $100 to $25. The $75 of the attribute reduction amount allocated to the S1 stock is first apportioned between the shares in a manner that reduces disparity to the greatest extent possible. Thus, of the total $75 allocated to the S1 stock, $27.50 is apportioned to Share A and $47.50 is apportioned to Share B. Because neither of the S1 shares is transferred within the meaning of paragraph (f)(10) of this section, the allocated attribute reduction amount apportioned to each of the individual S1 shares is applied fully to reduce the basis of each share to $12.50. See paragraph (d)(5)(iii) of this section. As a result, immediately after the allocation, apportionment, and application of S's attribute reduction amount, S's basis in Asset is $25 and S's basis in each of the S1 shares is $12.50.

(*3*) *Tier down of S's attribute reduction amount, application of conforming limitation*. Under paragraph (d)(5)(v)(A) of this section, the $75 portion of S's attribute reduction amount allocated to the S1 stock is an attribute reduction amount of S1 (regardless of the extent, if any, to which it is apportioned and applied to reduce the basis of any shares of S1 stock). Under the general rules of this paragraph (d), the $75 tier-down attribute reduction amount would be allocated and applied to reduce S1's basis in Asset 1 from $50 to $0. However, under paragraph (d)(5)(v)(B) of this section, S1's attributes can be reduced by only $25, the excess of the $50 portion of S1's net inside attribute amount that is allocable to all S1 shares held by members as of the transaction over $25, the aggregate amount of members' bases in nontransferred S1 shares after reduction under this paragraph (d). Thus, of S1's $75 tier-down attribute reduction amount, only $25 is applied to reduce S1's basis in Asset 1, from $50 to $25. The $50 unapplied portion of the tier-down attribute reduction amount subject to the conforming limitation has no further effect.

(ii) *Application of basis restoration rule*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 5*, except that S's basis in Share A is $15 and S's basis in Share B is $35, and S1's basis in Asset 1 is $100.

(B) *Basis redetermination and basis reduction under paragraphs (b) and (c) of this section*. No adjustment is required under paragraph (b) or paragraph (c) of this section for the reasons set forth in paragraph (i)(B) of this *Example 5*. Thus, after the application of paragraph (c) of this section, M's transfer of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d)*. (*1*) *Computation of attribute reduction amount*. Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of M's net stock loss and S's aggregate inside loss. M's net stock loss is $200 ($250 basis over $50 value). S's aggregate inside loss is the excess of S's net inside attribute amount over the value of the S share. Under paragraphs (d)(3)(iii)(B) and (d)(5)(i)(B) of this section, S's net inside attribute amount is $200, the sum of S's $100 basis in Asset and its $100 deemed basis in the deemed single share of S1 stock (computed as the greater of S's $50 aggregate basis in the S1 shares and S1's $100 basis in Asset 1). S's aggregate inside loss is therefore $150, $200 net inside attribute amount over the $50 value of the S share. Accordingly, S's attribute reduction amount is $150, the lesser of the $200 net stock loss and the $150 aggregate inside loss.

(*2*) *Allocation, apportionment, and application of S's attribute reduction amount*. Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $150 attribute reduction amount is allocated proportionately (by basis) between Asset (non-stock Category D asset) with a basis of $100, and the S1 stock (treated as a single share with a deemed basis of $100). Accordingly, $75 of the attribute reduction amount ($100/$200 x $150) is allocated to Asset and $75 of the attribute reduction amount ($100/$200 x $150) is allocated to the S1 stock. The $75 of the attribute reduction amount allocated to Asset is applied to reduce S's basis in Asset from $100 to $25. The $75 of the attribute reduction amount allocated to the S1 stock is first apportioned between the shares in a manner that reduces disparity to the greatest extent possible. Thus, of the total $75 allocated to the S1 stock, $27.50 is apportioned to Share A and $47.50 is apportioned to Share B. Because neither of the S1 shares is transferred within the meaning of paragraph (f)(10) of this section, the allocated attribute reduction amount apportioned to each of the individual S1 shares is applied fully to reduce the basis of each share to an excess loss account of $12.50. See paragraph (d)(5)(iii) of this section. As a result, immediately after the allocation, apportionment, and application of S's attribute reduction amount, S's basis in Asset is $25 and S's basis in each of the S1 shares is an excess loss account of $12.50.

(*3*) *Tier down of S's attribute reduction amount*. Under paragraph (d)(5)(v)(A) of this section, the $75 portion of S's attribute reduction amount allocated to S1 stock is an attribute reduction amount of S1 (regardless of the extent, if any, to which it is apportioned and applied to reduce the basis of any shares of S1 stock). Accordingly, under the general rules of this paragraph (d), the $75 tier-down attribute reduction amount is applied to reduce S1's basis in Asset 1 from $100 to $25.

(*4*) *Basis restoration*. Under paragraph (d)(5)(vi)(A) of this section, after this paragraph (d) has been applied with respect to all transfers of subsidiary stock, any reduction made to the basis of a share of lower-tier subsidiary stock under paragraph (d)(5)(iii) of this section is reversed to the extent necessary to conform the basis of that share to the share's allocable portion of the subsidiary's net inside attribute amount (after reduction). S1's net inside attribute amount after the application of this paragraph (d) is $25 and thus each of the two S1 share's allocable portion of S1's net inside attribute amount is $12.50. Accordingly, the reductions to Share A and to Share B under paragraph (d)(5)(iii) of this section are reversed to the extent necessary to restore the basis of each share to $12.50. Thus, $25 of the $27.50 of reduction to the basis of Share A, and $25 of the $47.50 of reduction to the basis of share B, is reversed, restoring the basis of each share to $12.50.

Example 6. Multiple blocks of lower-tier subsidiary stock outstanding. (i) *Excess loss account taken into account (transfer of upper-tier share causes disposition within the meaning of §1.1502–19(c)(1)(ii)(B))*. (A) *Facts*. M owns the sole outstanding share of S stock with a basis of $200. S holds all five outstanding shares of S1 common stock (Shares A, B, C, D, and E). S has an excess loss account of $20 in Share A and a positive basis of $20 in each of the other shares. The only investment adjustment applied to any S1 share was a negative $20 investment adjustment applied to Share A when it was the only outstanding share, and this amount tiered up and adjusted M's basis in the S share. S1 owns one asset with a basis of $250. M sells its S share to P1, the common parent of a consolidated group, for $20. The sale of the S share is a disposition of Share A under §1.1502–19(c)(1)(ii)(B) (S1 becomes a nonmember because it will have a separate return year as a member of the P1 group). Accordingly, under §1.1502–19(b)(1)(i) and paragraph (a)(3)(i) of this section, before the application of this section, S's excess loss account in Share A is

taken into account, increasing S's basis in Share A to $0 and M's basis in its S share to $220. After giving effect to the recognition of the excess loss account, M's sale of the S share is a transfer of a loss share and therefore subject to this section. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section.

(B) *Basis redetermination and basis reduction under paragraphs (b) and (c) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. No adjustment is made under paragraph (c) of this section because, even though there is a disconformity amount of $140, the net positive adjustment is $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's sale of the S share remains a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d)*. (*1*) *Computation of attribute reduction amount*. Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of M's net stock loss and S's aggregate inside loss. M's net stock loss is $200 ($220 basis over $20 value). S's aggregate inside loss is the excess of S's net inside attribute amount over the value of the S share. Under paragraphs (d)(3)(iii)(B) and (d)(5)(i)(B) of this section, S's net inside attribute amount is $250, S's $250 deemed basis in the deemed single share of S1 stock (computed as the greater of S's $80 aggregate basis in the S1 shares ($0 basis in Share A plus $20 basis in each of the four other shares) and S1's $250 basis in its asset). S's aggregate inside loss is therefore $230, $250 net inside attribute amount over the $20 value of the S share. Accordingly, S's attribute reduction amount is $200, the lesser of the $200 net stock loss and the $230 aggregate inside loss.

(*2*) *Allocation, apportionment, and application of S's attribute reduction amount*. Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $200 attribute reduction amount is allocated entirely to the S1 stock (treated as a single share) and then apportioned among the shares in a manner that reduces disparity to the greatest extent possible. Thus, $24 is apportioned to Share A and $44 is apportioned to each of the other shares. Because none of the S1 shares are transferred within the meaning of paragraph (f)(10) of this section (notwithstanding that there is a disposition under §1.1502–19(c)(1)(ii)(B)), the allocated attribute reduction amount apportioned to each of the individual S1 shares is applied fully to reduce the basis of each share to an excess loss account of $24. See paragraph (d)(5)(iii) of this section.

(*3*) *Tier down of S's attribute reduction amount*. Under paragraph (d)(5)(v)(A) of this section, the $200 of S's attribute reduction amount allocated to the S1 shares is an attribute reduction amount of S1 (regardless of the extent, if any, to which it is apportioned and applied to reduce the basis of any shares of S1 stock). Under the general rules of this paragraph (d), S1's $200 tier-down attribute reduction amount is allocated and applied to reduce S1's basis in its asset from $250 to $50.

(*4*) *Basis restoration*. Under paragraph (d)(5)(vi)(A) of this section, after this paragraph (d) has been applied with respect to all transfers of subsidiary stock, any reduction made to the basis of a share of lower-tier subsidiary stock under paragraph (d)(5)(iii) of this section is reversed to the extent necessary to conform the basis of that share to the share's allocable portion of the subsidiary's net inside attribute amount (after reduction). S1's net inside attribute amount after the application of this paragraph (d) is $50 and thus each of the five S1 share's allocable portion of S1's net inside attribute amount is $10. Accordingly, the reductions to the bases of S1 shares under paragraph (d)(5)(iii) of this section are reversed to the extent necessary to restore (to the extent possible) the basis of each share to $10. Thus, $24 of the $24 of reduction to the basis of Share A is reversed, restoring the basis of Share A to $0, and $34 of the $44 of reduction to the basis of each other share is reversed, restoring the basis of each of those shares to $10.

(ii) *Sale of gain share to member*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 6*, except that M owns Shares A, B, C, and D, S owns Share E, S has a liability of $20, and S1's basis in its asset is $500. Also, as part of the transaction, S sells Share E to M for $40. Unlike under the facts of paragraph (i)(A) of this *Example 6*, there is no disposition of Share A within the meaning of §1.1502–19(c)(1)(ii)(B) (S1 continues to be a member of the group, and thus does not have a separate return year). As a result, the Share A excess loss account is not taken into account. Although S's sale of Share E is a transfer of that share, the share is not a loss share and thus the transfer is not subject to this section. M's sale of the S share, however, is a transfer of a loss share and therefore subject to this section. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section.

(B) *Transfer in lowest tier (gain share)*. S's sale of Share E is the lowest-tier transfer in the transaction. Under paragraph (a)(3)(ii)(A) of this section, because there are no transfers of loss shares at that tier, no adjustments are required under paragraph (b) or (c) of this section. However, S's gain recognized on the transfer of Share E is computed and immediately adjusts members' bases in subsidiary stock under §1.1502–32 (because M and S are not members of the same group immediately after the transaction, the sale is not an intercompany transaction subject to §1.1502–13). Accordingly, M's basis in its S share is increased by $20, from $200 to $220.

(C) *Transfers in next higher tier, application of paragraphs (b) and (c) of this section*. The next higher tier transfer is M's sale of the S stock. The sale is a transfer of a loss share and therefore subject to this section. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. Under paragraph (c) of this section, M's basis in its S share is decreased by $20, the lesser of S's $200 disconformity amount (computed as the excess of M's $220 basis in the S stock over S's $20 net inside attribute amount (computed as the $20 basis in Share E, increased by $20 to reflect the gain recognized with respect to the share, less the $20 liability)), and the $20 net positive adjustment. Thus, after the application of paragraph (c) of this section, M's basis in the S share is $200, and the sale remains a transfer of a loss share. There are no higher tier transfers and, therefore, M's transfer of the S share is then subject to this paragraph (d).

(D) *Attribute reduction under this paragraph (d)*. (*1*) *Computation of attribute reduction amount*. Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of M's net stock loss and S's aggregate inside loss. M's net stock loss is $180 ($200 basis over $20 value). S's aggregate inside loss is the excess of S's net inside attribute amount over the value of the S share. Under paragraphs (d)(3)(iii)(B) and (d)(5)(i)(B) of this section, S's net inside attribute amount is $80, computed as $100 (S's deemed basis in Share E (the greater of $40 (S's $20 basis in Share E, adjusted for the $20 gain recognized with respect to the share), and Share E's allocable portion of S1's net inside attribute amount of $100 (1/5 of S1's $500 basis in its asset)), less S's $20 liability. Accordingly, S's aggregate inside loss is $60 ($80 net inside attribute amount over the $20 value of the S stock). S's attribute reduction amount is therefore $60, the lesser of $180 net stock loss and $60 aggregate inside loss.

(*2*) *Allocation, apportionment, and application of S's attribute reduction amount*. Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $60 attribute reduction amount is allocated entirely to its S1 stock, Share E. However, because Share E was transferred within the meaning of paragraph (f)(10) of this section and gain was recognized on its transfer, none of the allocated amount is apportioned to, or applied to reduce the basis of Share E. See paragraph (d)(5)(iii)(A) of this section. Under paragraph (d)(5)(iv) of this section, the $60 allocated attribute reduction amount not apportioned or applied to Share E has no effect on S or S's attributes.

(*3*) *Tier down of S's attribute reduction amount*. Notwithstanding the fact that no portion of the allocated attribute reduction amount was apportioned to or applied to reduce the basis of Share E, the entire $60 allocated attribute reduction amount is an attribute reduction amount of S1. See paragraphs (d)(5)(v)(A) of this section. Under the general rules of this paragraph (d), S1's $60 tier-down attribute reduction amount is allocated and applied to reduce S1's basis in its asset from $500 to $440. See paragraph (d)(5)(v)(A) of this section.

(*4*) *Basis restoration*. Under paragraph (d)(5)(vi)(A) of this section, after this paragraph (d) has been applied with respect to all transfers of subsidiary stock, any reduction made to the basis of a share of subsidiary stock under paragraph (d)(5)(iii) of this section is reversed to the extent necessary to conform the basis of that share to the share's allocable portion of the subsidiary's net inside attribute amount. No reduction was made to the basis of the S1 stock under paragraph (d)(5)(iii) of this section. Therefore, no stock basis is increased under the basis

restoration rule in paragraph (d)(5)(vi)(A) of this section.

Example 7. Allocation of attribute reduction if lower-tier subsidiary has non-loss assets or liabilities. (i) *S1 holds cash.* (A) *Facts.* M owns the sole outstanding share of S stock with a basis of $800. S owns Asset with a basis of $400 and the sole outstanding share of S1 stock with a basis of $300. S1 holds Asset 1 with a basis of $50, and $100 cash. M sells its S share to P1, the common parent of a consolidated group, for $100. The sale is not a transfer of the S1 share because S and S1 are members of the same group following the transaction. However, the sale is a transfer of the S share, a loss share, and therefore subject to this section. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section.

(B) *Application of paragraphs (b) and (c) of this section.* Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to the provisions of this paragraph (c). No adjustment is required under paragraph (c) of this section because, even though there is a disconformity amount of $100, the net positive adjustment is $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's sale of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d).* (*1*) *Computation of attribute reduction amount.* Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of M's net stock loss and S's aggregate inside loss. M's net stock loss is $700 ($800 basis over $100 value). S's aggregate inside loss is the excess of S's net inside attribute amount over the value of the S share. Under paragraphs (d)(3)(iii)(B) and (d)(5)(i)(B) of this section, S's net inside attribute amount is $700, the sum of its $400 basis in Asset and its $300 deemed basis in the S1 share (computed as the greater of S's $300 basis in the S1 share and S1's $150 net inside attribute amount (reflecting the sum of S1's $50 basis in Asset 1 and S1's $100 cash)). Therefore, S's aggregate inside loss is $600 ($700 net inside attribute amount over the $100 value of the S stock). S's attribute reduction amount is $600, the lesser of the $700 net stock loss and the $600 aggregate inside loss.

(*2*) *Allocation, apportionment, and application of S's attribute reduction amount.* Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $600 attribute reduction amount is allocated proportionately (by basis) between S's $400 basis in Asset (non-stock Category D asset) and its deemed basis in the S1 share. However, under paragraph (d)(5)(ii) of this section, for purposes of allocating the attribute reduction amount, S's $300 deemed basis in the S1 share is treated as reduced by S1's net non-loss assets (its Class I asset, $100 cash) to $200. Thus, the $600 is allocated $400 to Asset ($400/$600 x $600) and $200 to the S1 share ($200/$600 x $600). The $400 allocated to Asset is applied to reduce S's basis in Asset from $400 to $0. Because the S1 share is not transferred within the meaning of paragraph (f)(10) of this section, the allocated attribute reduction amount apportioned to the S1 share is applied fully to reduce the basis of the S1 share to $100. See paragraph (d)(5)(iii) of this section.

(*3*) *Tier down of S's attribute reduction amount.* Under paragraph (d)(5)(v)(A) of this section, the $200 portion of S's attribute reduction amount allocated to the S1 stock is an attribute reduction amount of S1 (regardless of the extent, if any, to which it is apportioned and applied to reduce the basis of any shares of S1 stock). Under the general rules of this paragraph (d), S1's $200 tier-down attribute reduction amount is allocated and applied to reduce S1's basis in Asset 1 (S1's only attribute available for reduction) from $50 to $0. The $150 unapplied attribute reduction amount is disregarded and has no further effect.

(*4*) *Basis restoration.* Under paragraph (d)(5)(vi)(A) of this section, after this paragraph (d) has been applied with respect to all transfers of subsidiary stock, any reduction made to the basis of a share of subsidiary stock under paragraph (d)(5)(iii) of this section is reversed to the extent necessary to conform the basis of that share to the share's allocable portion of the subsidiary's net inside attribute amount. There is only one share of S1 stock outstanding and so S1's entire $100 net inside attribute amount is allocable to that share. Because S's $100 basis in the S1 share (as reduced under this paragraph (d)) is already conformed with its $100 allocable portion of S1's net inside attribute amount, there is no restoration under paragraph (d)(5)(vi)(A) of this section.

(ii) *S1 borrows cash.* The facts are the same as in paragraph (i)(A) of this *Example 7* except that, in addition, S1 borrows $50 from X immediately before M sells the S share. The computation of the attribute reduction amount is the same as in paragraph (i)(C) of this *Example 7* (the $50 cash from the loan proceeds and the $50 liability offset in the computation of S1's net inside attribute amount and so the net amount is unaffected, and the computation of S's deemed basis in the S1 stock is unaffected). Similarly, for purposes of allocating the attribute reduction amount between the non-stock Category D asset and the S1 stock, paragraph (d)(5)(ii) of this section requires S's deemed basis in the S1 share to be treated as reduced by S1's net non-loss assets (S1's non-loss assets over S1's liabilities). Accordingly, the additional $50 cash proceeds is offset by the $50 liability and there is no effect on the allocation of the attribute reduction amount. The results are the same as in paragraph (i) of this *Example 7*.

(iii) *S1 has a liability not taken into account for tax purposes.* (A) *Facts.* The facts are the same as in paragraph (ii) of this *Example 7* except that, in addition, S1 has a $40 liability that is not taken into account for tax purposes as of the transfer and that would be required to be capitalized if a person purchased S1's assets and assumed the liability.

(B) *Application of paragraphs (b) and (c) of this section.* No adjustment is required under paragraph (b) or paragraph (c) of this section for the reasons set forth in paragraph (i)(B) of this *Example 7*. Thus, after the application of paragraph (c) of this section, P's sale of the S share is still a transfer of a loss share and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d).* (*1*) *Computation of attribute reduction amount.* The attribute reduction amount is the same as computed in paragraph (i)(C)(*1*) of this *Example 7* (under paragraph (f)(5) of this section, the term liability does not include liabilities not taken into account for tax purposes and so the additional $40 liability not yet taken into account for tax purposes does not affect the computation of S's attribute reduction amount).

(*2*) *Allocation, apportionment, and application of S's attribute reduction amount.* Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $600 attribute reduction amount is allocated proportionately (by basis) between S's $400 basis in Asset 1 (non-stock Category D asset) and its deemed basis in the S1 share. However, under paragraph (d)(5)(ii) of this section, for purposes of allocating the attribute reduction amount, S's $300 deemed basis in the S1 share is treated as reduced by S1's net non-loss assets (S1's non-loss assets over S1's liabilities). For this purpose, the term liabilities includes liabilities not taken into account for tax purposes, as described in paragraph (d)(4)(ii)(C)(*1*) of this section (generally, liabilities that, if assumed in a purchase, would give rise to a capitalized amount when satisfied). Thus, for this purpose, S's $300 deemed basis in the S1 share is reduced by S1's $60 net non-loss assets (the excess of S1's $150 non-loss assets (its Class I asset, $150 cash) over S1's $90 liabilities ($50 loan and $40 liability not yet taken into account for tax purposes)), to $240. Accordingly, S's $600 attribute reduction amount is allocated and applied $375 ($400/$640 x $600) to Asset (reducing S's basis in Asset from $400 to $25) and $225 ($240/$640 x $600) to the S1 share. Because the S1 share is not transferred within the meaning of paragraph (f)(10) of this section, the allocated attribute reduction amount apportioned to the S1 share is applied fully to reduce the basis of the S1 share to $75. See paragraph (d)(5)(iii) of this section.

(*3*) *Tier down of S's attribute reduction amount, application of conforming limitation.* Under paragraph (d)(5)(v)(A) of this section, the $225 portion of S's attribute reduction amount allocated to the S1 stock is an attribute reduction amount of S1 (regardless of the extent, if any, to which it is apportioned and applied to reduce the basis of any shares of S1 stock). Under the general rules of this paragraph (d), S1's $225 tier-down attribute reduction amount would be allocated and applied to reduce S1's attributes. However, under paragraph (d)(5)(v)(B) of this section, S1's attributes can be reduced by only $75, the excess of the $150 portion of S1's net inside attribute amount that is allocable to all S1 shares held by members as of the transaction over $75, the aggregate amount of members' bases in nontransferred S1 shares, after reduction under this paragraph (d). Thus, of S1's $225 tier-down attribute reduction amount, $50 is applied to reduce S1's basis in Asset 1, from $50 to $0. Although the $25 unapplied attribute reduction amount not subject to the conforming limitation would generally be disregarded without further effect, because S1 has a $40 liability not taken into account for tax purposes, paragraph (d)(4)(ii)(C)(*1*) of this section requires that the $25 of the unapplied attribute reduction amount not subject to the conforming limitation be suspended and then allocated and applied to reduce any amounts that become deductible or capitalizable as a result of that liability later being taken into account. If the liability is satisfied for an amount that

is less than $25, under paragraph (d)(4)(ii)(C)(*2*) of this section the remaining portion of that $25 suspended attribute reduction amount is disregarded and has no further effect. The $150 unapplied portion of the tier-down attribute reduction amount subject to the conforming limitation has no further effect.

(*4*) *Basis restoration*. Under paragraph (d)(5)(vi)(A) of this section, after this paragraph (d) has been applied with respect to all transfers of subsidiary stock, any reduction made to the basis of a share of lower-tier subsidiary stock under paragraph (d)(5)(iii) of this section is reversed to the extent necessary to conform the basis of that share to the share's allocable portion of the subsidiary's net inside attribute amount. Paragraph (d)(5)(vi)(A) provides that, for this purpose, S1's net inside attribute amount is its net inside attribute amount, taking into account any reductions under this paragraph (d) and treating it as reduced by any attribute reduction amount suspended under paragraph (d)(4)(ii)(C)(*1*) of this section. Because S's $75 basis in its S1 stock (after application of this paragraph (d)) is already conformed with its $75 allocable portion of S1's net inside attribute amount ($100 net inside attributes after reduction, reduced by S1's $25 suspended attribute reduction amount), there is no restoration under paragraph (d)(5)(vi)(A) of this section.

Example 8. Election to reduce stock basis or reattribute attributes under paragraph (d)(6) of this section. (i) *Deconsolidating sale*. (A) *Facts*. P owns the sole outstanding share of M stock with a basis of $1,000. M owns all 100 outstanding shares of S stock with a basis of $2.10 per share ($210 total). M sells all its S shares to X for $1 per share ($100 total). M's sale of the S shares is a transfer of loss shares and therefore subject to this section. See paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section. At the time of the sale, S has no liabilities and the following:

Category	Attribute	Attribute amount
Category A	Capital loss carryover	$ 10
Category B	NOL carryover	$ 90
Category C	Deferred deduction	$ 40
	Total Category A, Category B, and Category C Attributes	$140
Category D, Class V	Basis in land	$ 70
	Total Attributes	$210

(B) *Application of paragraphs (b) and (c) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is no disparity among M's bases in shares of S common stock and there are no shares of S preferred stock outstanding (so there can be no unrecognized gain or loss with respect to preferred shares). See paragraph (b)(1)(ii)(A) of this section. No adjustment is required under paragraph (c) of this section because both the disconformity amount and the net positive adjustment are $0. See paragraph (c)(3) of this section. Thus, after the application of paragraph (c) of this section, M's transfer of the S shares is still a transfer of loss shares and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d)*. (*1*) *Computation of attribute reduction amount*. Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of the $110 net stock loss ($210 aggregate basis over the $100 aggregate value) and S's aggregate inside loss. S's aggregate inside loss is $110 (S's $210 net inside attribute amount (the $10 capital loss carryover, plus the $90 NOL carryover, plus the $40 deferred deduction, plus the $70 basis in the land) over the $100 value of all outstanding S shares). S's attribute reduction amount is $110, the lesser of the $110 net stock loss and the $110 aggregate inside loss.

(*2*) *Application of attribute reduction amount*. (*i*) S's $110 attribute reduction amount is applied as follows:

Category	Attribute	Attribute amount	Allocation of attribute reduction amount	Adjusted attribute amount
Category A	Capital loss carryover	$ 10	$ 10	$ 0
Category B	NOL carryover	$ 90	$ 90	$ 0
Category C	Deferred deduction	$ 40	$ 10	$ 30
Category D, Class V	Basis in land	$ 70	$ 0	$ 70
Totals		$210	$110	$100

(*ii*) Alternatively, under paragraph (d)(4)(ii)(A)(*1*) of this section, P could specify the allocation of S's $110 attribute reduction amount among S's $10 capital loss carryover, S's $90 NOL carryover, and S's $40 deferred deduction.

(D) *Results*. The P group recognizes a $110 loss on M's sale of the S shares that is absorbed by the group, which reduces P's basis in the M share under §1.1502–32 from $1,000 to $890. Immediately after the transaction, the entities own the following:

Entity	Asset	Basis
P	M share	$890
X	100 S shares	$100
S	Category C, deferred deduction	$ 30
	Category D, Class V Asset (land)	$ 70

(E) *Election to reduce stock basis*. The facts are the same as in paragraph (ii)(A) of this *Example 8*, except that P elects under paragraph (d)(6) of this section to reduce M's basis in the S shares by the full attribute reduction amount of $22, in lieu of S reducing its attributes. The election is effective for all transferred loss shares and is allocated to those shares in proportion to the loss in each. See paragraph (d)(6)(v)(A) of this section. Accordingly, the basis of each of the 100 transferred shares is reduced from $2.10 to $1.00. After giving effect to the election, the S shares are not loss shares and this section has no further application to the transfer. The $110 reduction in M's basis in the S shares pursuant to the election under paragraph (d)(6) of this section is a noncapital, nondeductible expense of M that will reduce P's basis in the M share. See paragraph (d)(6)(v)(A) of this section. Immediately after the transaction, the entities own the following:

Entity	Asset	Basis/Attribute
P	M share	$890
X	100 S shares	$100
S	Category A, capital loss carryover	$ 10
	Category B, NOL carryover	$ 90
	Category C, deferred deduction	$ 40
	Category D, Class V Asset (land)	$ 70

(F) *Election to reattribute losses*. The facts are the same as in paragraph (ii)(A) of this *Example 8*, except that P elects under paragraph (d)(6) of this section to reattribute S's attributes. S's attribute reduction amount is $110, and P can reattribute all or any portion of the attributes in Category A, Category B, and Category C to the extent of $110. P elects to reattribute the $90 NOL, and, as a result, S's NOL is $0. Under paragraph (d)(6)(iv)(A) of this section, the reattribution of the $90 NOL is a noncapital, nondeductible expense of S. Under §1.1502–32(c)(1)(ii)(A)(1) this $90 expense is allocated to the transferred loss shares of S stock in proportion to the loss in the shares, or $.90 per share. Further, this expense tiers up under §1.1502–32 and reduces P's basis in the M stock by $90. After giving effect to the election, the P group would recognize a $20 loss on M's sale of the S shares, S would have an aggregate inside loss of $20 (S's $120 net inside attribute amount (the $10 capital loss carryover, plus the $40 deferred deduction, plus the $70 basis in the land) over the $100 value of all outstanding S shares), and S's attribute reduction amount would be $20 (applied $10 to the $10 capital loss carryover and $10 to the $40 deferred deduction). (Alternatively, under paragraph (d)(4)(ii)(A)(*1*) of this section, P could specify the allocation of S's $20 attribute reduction amount between S's $10 capital loss carryover and S's $40 deferred deduction. Further, P could elect to reduce M's remaining basis in the S shares by any amount up to the $20 attribute reduction amount, thereby reducing or eliminating S's attribute reduction amount.)

(ii) *Nondeconsolidating sale*. (A) *Facts*. The facts are the same as in paragraph (i)(A) of this *Example 8*, except that M only sells 20 S shares ($20 total).

(B) *Application of paragraphs (b) and (c) of this section*. No adjustment is required under paragraph (b) or paragraph (c) of this section for the reasons set forth in paragraph (i)(B) of this *Example 8*. Thus, after the application of paragraph (c) of this section, M's sale of the S shares is still a transfer of loss shares and, accordingly, subject to this paragraph (d).

(C) *Attribute reduction under this paragraph (d)*. (*1*) *Computation of attribute reduction amount*. Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of the $22 net stock loss ($42 aggregate basis over $20 aggregate value) and S's $110 aggregate inside loss (as calculated in paragraph (i)(C)(*1*) of this *Example 8*). S's attribute reduction amount is $22, the lesser of the $22 net stock loss and the $110 aggregate inside loss.

(*2*) *Application of attribute reduction amount*. (*i*) S's $22 attribute reduction amount is applied as follows:

Category	Attribute	Attribute amount	Allocation of attribute reduction amount	Adjusted attribute amount
Category A	Capital loss carryover	$10	$10	$ 0
Category B	NOL carryover	$90	$12	$78
Category C	Deferred deduction	$40	$ 0	$40
Category D, Class V	Land	$70	$ 0	$70

(*ii*) Alternatively, under paragraph (d)(4)(ii)(A)(*1*) of this section, P could specify the allocation of S's $22 attribute reduction amount among S's $10 capital loss carryover, S's $90 NOL carryover, and S's $40 deferred deduction.

(D) *Results*. The P group recognizes a $22 loss on M's sale of the S shares that is absorbed by the group, which reduces P's basis in the M share under §1.1502–32 from $1,000 to $978. Immediately after the transaction, the entities have the following:

Entity	Asset	Basis
P	M share	$978
X	20 S shares	$ 20
S	Category B, NOL carryover	$ 78
	Category C, deferred deduction	$ 40
	Category D, Class V Asset (land)	$ 70

(E) *Election to reduce stock basis*. The facts are the same as paragraph (ii)(A) of this *Example 8*, except that P elects under paragraph (d)(6) of this section to reduce M's basis in the S shares by the full attribute reduction amount of $22, in lieu of S reducing its attributes. The election is effective for all transferred loss shares and is allocated to such shares in proportion to the loss in each share. See paragraph (d)(6)(v)(A) of this section. Accordingly, the basis of each of the 20 transferred shares is reduced from $2.10 to $1.00. After giving effect to the election, the transferred S shares are not loss shares and this section has no further application to the transfer. The $22 reduction in M's basis in the S shares pursuant to the election under paragraph (d)(6) of this section is a noncapital, nondeductible expense of M that will reduce P's basis in the M share. See paragraph (d)(6)(v)(A) of this section. Immediately after the transaction, the entities have the following:

Entity		Basis/Attribute
P	M share	$978
M	80 S shares	$168
X	20 S shares	$ 20
S	Category A, capital loss carryover	$ 10
	Category B, NOL	$ 90
	Category C, deferred deduction	$ 40
	Category D, Class V Asset (land)	$ 70

(F) *Election to reattribute attributes*. The facts are the same as paragraph (ii)(A) of this *Example 8*. Because S remains a member of the same group as P following M's sale of S stock, P cannot elect under paragraph (d)(6) of this section to reattribute any portion of S's attributes in lieu of attribute reduction.

Example 9. Transfers at multiple tiers, gain and loss shares. (i) *Facts*. M owns the sole outstanding share of S stock with a basis of $700. S owns Asset 1 (basis of $170) and all ten outstanding shares of S1 common stock ($170 basis in share 1, $10 basis in share 2, and $15 basis in each of share 3 through share 10). S1 owns the sole outstanding share of S2 ($0 basis), the sole outstanding share of S3 ($60 basis), and the sole outstanding share of S4 ($100 basis). S2's sole asset is Asset 2 ($75 basis). S3's sole asset is Asset 3 ($75 basis). S4's sole asset is Asset 4 ($80 basis). In one transaction, M sells its S share to P1 (the common parent of a consolidated group) for $240, S sells S1 share 1 to X for $20, S contributes S1 share 2 to a partnership in a section 721 transaction, and S1 sells its S2 share to Y for $50. M's sale of the S share and S1's sale of the S2 share are transfers under paragraphs (f)(10)(i)(A), (f)(10)(i)(B), and (f)(10)(i)(C) of this section. S's sale of S1 share 1 to X is a transfer under paragraphs (f)(10)(i)(A) and (f)(10)(i)(C) of this section. S's contribution of S1 share 2 to the partnership is a transfer under paragraph (f)(10)(i)(C) of this section.

(ii) *Transfer in lowest tier (gain share)*. S1's sale of the S2 share is the lowest-tier transfer in the transaction. Under paragraph (a)(3)(ii)(A) of this section, because there are no transfers of loss shares at that tier, no adjustments are required under paragraph (b) or (c) of this section. However, S1's gain recognized on the transfer of the S2 share is computed and immediately adjusts members' bases in subsidiary stock under §1.1502–32. Accordingly, $5 is allocated to each of 10 S1 shares, increasing the basis of share 1 to $175, the basis of share 2 to $15, and the basis of each other share to $20. The $50 applied to S's bases in the S1 shares then tiers up to increase P's basis in the S share from $700 to $750.

(iii) *Transfers in next highest tier (loss share)*. S's sale of the S1 share 1 and S's transfer of the S1 share 2 to a partnership are both transfers of stock in the next higher tier. However, only the S1 share 1 is a loss share and so this section only applies with respect to the transfer of that share.

(A) *Basis redetermination under paragraph (b) of this section*. Under paragraph (b)(2)(i)(A) of this section, members' bases in S1 shares are redetermined by first removing the positive investment adjustments applied to the bases of transferred loss common shares. Accordingly, the $5 positive investment adjustment applied to the basis of S1 share 1 is removed, reducing the basis of S1 share 1 from $175 to $170. Because there were no negative adjustments applied to the bases of S1 shares, there are no negative adjustments that can be reallocated to further reduce the basis of S1 share 1 under paragraph (b)(2)(i)(B) of this section. Finally, under paragraph (b)(2)(ii)(B) of this section, the $5 positive investment adjustment removed from S1 share 1 is reallocated and applied to increase the bases of other S1 common shares in a manner that reduces disparity to the greatest extent possible. Accordingly, the entire $5 investment adjustment removed from S1 share 1 is reallocated and applied to increase the basis of S1 share 2, from $15 to $20. After basis is redetermined under paragraph (b) of this section, the S1 share 1 is still a loss share and therefore subject to basis reduction under paragraph (c) of this section. (Because the S1 share 2 is not a loss share, this section does not apply with respect to the transfer of that share.)

(B) *Basis reduction under paragraph (c) of this section*. No adjustment is required to the basis of S1 share 1 under paragraph (c) of this section. The S1 share 1 has a disconformity amount of $149. This $149 disconformity amount is computed as the excess of the $170 basis in the S1 share 1 over the S1 share 1's $21 allocable portion (1/10) of S1's $210 net inside attribute amount. S1's $210 net inside attribute amount is determined under paragraph (c)(5) of this section as the sum of $50 (S1's $0 basis in the S2 share, adjusted for the $50 gain recognized with respect to that share), S1's $60 basis in the S3 stock, and S1's $100 basis in the S4 stock. (In computing the disconformity amount, the basis of the S2 share is not treated as tentatively reduced because that share is transferred in the transaction, and the bases of the S3 and S4 shares are not treated as tentatively reduced because no positive investment adjustments were applied to the bases of those shares.) However, the S1 share 1's net positive adjustment is $0 because the $5 positive investment adjustment originally allocated to S1 share 1 was reallocated to S1 share 2 under paragraph (b) of this section. See paragraph (c)(3) of this section. No adjustment is required to the basis of S1 share 2 under paragraph (c) of this section because S1 share 2 is not a loss share.

(C) *Computation of loss, adjustments to stock basis*. S recognizes a loss of $150 on the sale of the S1 share 1 ($170 basis over $20 amount realized) that is absorbed by the group. Under §1.1502–32, M's basis in its S share is therefore decreased by $100, the net of the $150 loss recognized by S on the sale of the S1 share, and the $50 gain that tiered up from S1 (as a result of S1's sale of the S2 share). Following these adjustments, M's basis in the S share is $600 and the sale of the S share is still a transfer of a loss share.

(iv) *Transfer in highest tier (loss share)*. The sale of the S share is a transfer in the next higher tier, which is the highest tier in this transaction. Because the sale is a transfer of a loss share, it is subject to this section.

(A) *Basis redetermination and basis reduction under paragraphs (b) and (c) of this section*. Although the transfer is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is only one share of S stock outstanding (and so there can be no disparity among members' bases in common shares and there are no outstanding preferred shares with respect to which there can be unrecognized gain or loss). See paragraph (b)(1)(ii)(A) of this section. Therefore, after the application of paragraph (b) of this section, the share is still a loss share and, as such, subject to paragraph (c) of this section. In addition, no adjustment is required under paragraph (c) of this section. The S share has a disconformity amount of $230. This $230 disconformity amount is computed as the excess of the $600 basis in the S share over the S share's $370 allocable portion (1/1) of S's $370 net inside attribute amount. S's $370 net inside attribute amount is determined under paragraph (c)(5) of this section as the sum of $200 (S's $170 basis in the S1 share 1, adjusted for the $150 loss recognized with respect to that share, and S's $20 basis in each of S1 share 2 through share 10), and S's $170 basis in Asset 1. (In

computing the disconformity amount, the bases of S1 share 1 and share 2 are not treated as tentatively reduced because those shares are transferred in the transaction, and the bases of S1 share 3 through share 10 are not treated as tentatively reduced because none of those shares have a disconformity amount – each share has a basis of $20 and a $21 allocable portion (1/10) of S1's $210 net inside attribute amount, as determined in paragraph (iii)(B) of this *Example 9*.) However, the S share's net positive adjustment is $0 (the S share's net adjustment is negative $100). See paragraph (c)(3) of this section. Accordingly, the sale of the S share is still a transfer of a loss share. Because there are no higher-tier loss shares transferred in the transaction, this paragraph (d) then applies with respect to the transfer of the S share.

(B) *Attribute reduction under this paragraph (d).* (*1*) *Computation of S's attribute reduction amount.* Under paragraph (d)(3) of this section, S's attribute reduction amount is the lesser of P's net stock loss and S's aggregate inside loss. P's net stock loss is $360 ($600 basis over $240 amount realized). S's aggregate inside loss is the excess of S's net inside attribute amount over the value of the S share. S's net inside attribute amount is the sum of its bases in its assets, treating its S1 shares as a single share (the S1 stock) and treating S's deemed basis in the S1 stock as its basis in that stock. Under paragraph (d)(5)(i)(C) of this section, when subsidiaries are owned in multiple tiers, deemed basis is first determined for shares at the lowest tier, and then for stock in each next higher tier. Under paragraph (d)(5)(i)(B) of this section, S1's deemed basis in the S2 stock is $75 (computed as the greater of $50 (S1's $0 basis in the S2 share, adjusted for the $50 gain recognized with respect to the share) and $75 (S2's net inside attribute amount, the basis in Asset 2)). S1's deemed basis in the S3 stock is $75 (computed as the greater of $60 (S1's basis in the S3 share) and $75 (S3's net inside attribute amount, the basis in Asset 3)). S1's deemed basis in the S4 stock is $100 (computed as the greater of $100 (S1's basis in the S4 share) and $80 (S4's net inside attribute amount, the basis in Asset 4)). Accordingly, S1's net inside attribute amount is $250 ($75 deemed basis in the S2 stock plus $75 deemed basis in the S3 stock plus $100 deemed basis in the S4 stock). S's deemed basis in the S1 stock is the greater of the sum of S's actual basis in each share of S1 stock (adjusted for any gain or loss recognized) and S1's net inside attribute amount. S's actual basis in the S1 stock, adjusted for the loss recognized, is $200 (the sum of S's $170 basis in the S1 share 1, adjusted by the $150 loss recognized with respect to the share, and S's $20 basis in each of S1 share 2 through share 10). Thus, S's deemed basis in the S1 stock is $250, the greater of $200 (aggregate basis in S1 shares, adjusted for loss recognized) and $250 (S1's net inside attribute amount). As a result, S's net inside attribute amount is $420, the sum of S's $250 deemed basis in the S1 stock and S's $170 basis in Asset 1. Accordingly, the aggregate inside loss is $180, the excess of S's $420 net inside attribute amount over the $240 value of all of the S stock. S's attribute reduction amount is therefore $180, the lesser of the $360 net stock loss and the $180 aggregate inside loss.

(*2*) *Allocation, apportionment, and application of S's attribute reduction amount.* Under paragraphs (d)(4) and (d)(5)(ii) of this section, S's $180 attribute reduction amount is allocated proportionately (by basis) between Asset 1 (non-stock Category D asset) and the S1 stock. However, under paragraph (d)(5)(ii) of this section, for purposes of allocating S's $180 attribute reduction amount between S's non-stock Category D asset and the S1 stock, S's $250 deemed basis in the S1 stock is reduced by the $40 value of the transferred S1 shares (S1 share 1 and share 2) and the nontransferred S1 shares' $40 allocable portion (8/10) of S1's $50 net non-loss assets. S1's net non-loss assets is the $50 value of S1's transferred S2 shares. (S1 has no other non-loss assets, and there are no non-loss assets held by lower-tier subsidiaries.) Accordingly, for this purpose, S's deemed basis in the S1 stock is reduced by $80, from $250 to $170. Thus, $90 of the attribute reduction amount ($170/$340 x $180) is allocated to Asset 1 (reducing S's basis in Asset 1 from $170 to $80) and $90 of the attribute reduction amount ($170/$340 x $180) is allocated to the S1 stock. Under paragraph (d)(5)(iii)(A) of this section, none of the $90 allocated attribute reduction amount is apportioned to S1 share 1 because loss is recognized on the transfer of S1 share 1. Under paragraph (d)(5)(iii)(B) of this section, the $90 allocated attribute reduction amount is apportioned among the other nine shares of S1 common stock in a manner that reduces disparity to the greatest extent possible. Accordingly, of the total $90 allocated amount, $10 is apportioned to each of the remaining nine shares of S1 stock. Under paragraph (d)(5)(iii)(C) of this section, the allocated attribute reduction amount apportioned to an individual share cannot be applied to reduce the basis of the share below its value if the share is transferred other than in a recognition transfer. Because the S1 share 2 is transferred (contributed to the partnership) and the basis of S1 share 2 is already equal to its value, none of the $10 allocated attribute reduction amount apportioned to S1 share 2 is applied to reduce its basis. Because none of S1 share 3 through share 10 are transferred within the meaning of paragraph (f)(10) of this section, the $10 allocated attribute reduction amount apportioned to each of S1 share 3 through share 10 is applied fully to reduce the basis of each of those shares from $20 to $10. As a result, immediately after the allocation and application of S's attribute reduction amount, S's basis in Asset 1 is $80 ($170 minus $90), its bases in S1 share 1 and share 2 are not adjusted under paragraph (d)(5)(iii), and its basis in each of S1 share 3 through share 10 is $10. Under paragraph (d)(5)(v)(A) of this section, the entire $90 of S's attribute reduction amount that was allocated to the S1 stock is an attribute reduction amount of S1, regardless of the fact that none of the allocated amount was apportioned to S1 share 1 and none of the amount apportioned to S1 share 2 was applied to reduce the basis of S1 share 2.

(v) *Attribute reduction under this paragraph (d) in next lower tier.* (A) *Computation of S1's attribute reduction amount.* S's sale of S1 share 1 is a transfer of a loss share and it is in the next lower tier. Thus, this paragraph (d) next applies with respect to S's transfer of S1 share 1. S1's attribute reduction amount will include both the $90 attribute reduction amount that tiered down from S and any attribute reduction amount resulting from the application of this paragraph (d) with respect to S's transfer of S1 share 1 and share 2 (S1's direct attribute reduction amount). Under paragraph (d)(3) of this section, S1's direct attribute reduction amount is the lesser of the net stock loss on transferred S1 shares and S1's aggregate inside loss. The net stock loss on transferred S1 shares is $150, computed as the excess of S's $190 adjusted bases in transferred shares of S1 stock ($170 in S1 share 1 plus $20 in S1 share 2) over the $40 aggregate value of those shares. S1's aggregate inside loss is $50, the excess of S1's $250 net inside attribute amount (as calculated in paragraph (iv)(B)(*1*) of this *Example 9*) over the $200 value of all outstanding S1 shares. Therefore, S1's direct attribute reduction amount is $50, the lesser of the $150 net stock loss and S1's $50 aggregate inside loss. S1's total attribute reduction amount is thus $140, the sum of the $90 tier-down attribute reduction amount and the $50 direct attribute reduction amount.

(B) *Allocation, apportionment, and application of S1's attribute reduction amount.* Under paragraphs (d)(4) and (d)(5)(ii) of this section, S1's $140 attribute reduction amount is allocated proportionately (by basis) among the S2 stock, the S3 stock, and the S4 stock. However, under paragraph (d)(5)(ii) of this section, for purposes of allocating S1's $140 attribute reduction amount among S1's lower-tier subsidiary stock, S1's $75 deemed basis in the S2 stock is reduced by the $50 value of the transferred S2 share. Accordingly, for this purpose, S1's deemed basis in the S2 stock is reduced by $50, from $75 to $25. Thus, $17.50 of S1's attribute reduction amount ($25/$200 x $140) is allocated to the S2 stock, $52.50 of S1's attribute reduction amount ($75/$200 x $140) is allocated to the S3 stock, and $70 of S1's attribute reduction amount ($100/$200 x $140) is allocated to the S4 stock. Under paragraph (d)(5)(iii)(A) of this section, none of the $17.50 of S1's attribute reduction amount allocated to S2 stock is apportioned to the S2 share because gain was recognized on the transfer of the S2 share. Because neither the S3 share nor the S4 share is transferred within the meaning of paragraph (f)(10) of this section, the $52.50 of S1's attribute reduction amount allocated to the S3 stock, and the $70 of S1's attribute reduction amount allocated to the S4 stock, is apportioned to and applied fully to reduce the basis of such shares. Thus, S1's basis in the S3 share is reduced by $52.50, from $60 to $7.50, and S1's basis in the S4 stock is reduced by $70, from $100 to $30. (Note: The conforming limitation in paragraph (d)(5)(v)(B) of this section limits the application of the $90 tier down attribute reduction amount to $80, the amount by which the portion (10/10) S1's $250 net inside attribute amount attributable to S1 shares held by members exceeds $170 (the sum of the $50 direct attribute reduction amount, the $20 value of the S1 share 1 transferred in a recognition transfer, the $20 basis (after reduction) in the S1 share 2 transferred other than in a recognition transfer, and the $80 aggregate basis (after reduction) in the nontransferred S1 shares held by members). However, the conforming limitation does not limit the application of S1's $90 tier-down attribute reduction amount because none of the $17.50 of S1's total attribute reduction amount allocated to the S2 share was applied to reduce the basis of the share. Accordingly, only $78.75 ($90 - ($17.50 x ($90/$140)) of the $90 tier-down attribute reduction was applied to reduce S1's attributes.) Under paragraph (d)(5)(v)(A) of this section, the attribute reduction amount allocated to the S2 stock, the S3 stock, and the S4 stock becomes an attribute reduction amount of S2, S3, and S4, respectively (even though the amount allocated to S2

stock was not apportioned to or applied to reduce the basis of the S2 share).

(vi) *Attribute reduction under this paragraph (d) in lowest tier*. Although the sale of the S2 share is a transfer of subsidiary stock at the next lower tier, the S2 share is not a loss share. Thus, this paragraph (d) does not apply with respect to that transfer. However, S2, S3, and S4 have attribute reduction amounts that tiered down from S1 and that are applied to reduce attributes under this paragraph (d).

(A) *Tier down of S1's attribute reduction amount to S2*. Under the general rules of this paragraph (d), S2's $17.50 tier-down attribute reduction amount is allocated and applied to reduce S2's basis in Asset 2 from $75 to $57.50.

(B) *Tier down of S1's attribute reduction amount to S3*. Under the general rules of this paragraph (d), S3's $52.50 tier-down attribute reduction amount is allocated and applied to reduce S3's basis in Asset 3 from $75 to $22.50.

(C) *Tier down of S1's attribute reduction amount to S4, application of conforming limitation*. Under the general rules of this paragraph (d), S4's $70 tier-down attribute reduction amount is allocated to, and would be applied to reduce, S4's basis in Asset 4. However, under paragraph (d)(5)(v)(B) of this section, the reduction is limited to the excess of S4's $80 net inside attribute amount over the $30 basis of the S4 share (after reduction under this paragraph (d)). As a result, only $50 (the excess of $80 over $30) of S4's $70 attribute reduction amount is applied to S4's basis in Asset 4, reducing it from $80 to $30. The $20 unapplied portion of S4's tier-down attribute reduction amount subject to the conforming limitation is disregarded and has no further effect.

(vii) *Application of basis restoration rule*. Under paragraph (d)(5)(vi)(A) of this section, after this paragraph (d) has been applied with respect to all transfers of subsidiary stock, any reduction made to the basis of a share of lower-tier subsidiary stock under paragraph (d)(5)(iii) of this section is reversed to the extent necessary to conform the basis of that share to the share's allocable portion of the subsidiary's net inside attribute amount. Restoration adjustments are first made at the lowest tier and then at each next higher tier successively.

(A) *Basis restoration at lowest tier*. The basis of the S2 share was not reduced under paragraph (d)(5)(iii) of this section and so there is no restoration of any basis in the S2 share. S3's $22.50 net inside attribute amount (after reduction under this paragraph (d)) exceeds S1's $7.50 basis in the S3 share (after reduction under this paragraph (d)) by $15. To conform S1's basis in the S3 share to S3's net inside attribute amount, the $52.50 reduction to the basis of the S3 share under paragraph (d)(5)(iii) of this section is reversed by $15 (restoring S1's basis in the S3 share to $22.50). The restoration of S1's basis in the S3 share does not tier up to affect the basis in stock of any other subsidiary. S1's $30 basis in the S4 share (after reduction under this paragraph (d)) is already conformed with S4's $30 net inside attribute amount (after reduction under this paragraph (d)) and so there is no restoration of any basis in the S4 share.

(B) *Basis restoration at next higher tier*. Each share of S1 stock has an allocable portion of S1's net inside attribute amount (after reduction) equal to $10.25 (1/10 x $102.50, the sum of S1's $0 basis in the S2 stock, adjusted for the $50 gain recognized with respect to the share, S1's $22.50 basis in the S3 stock (after restoration), and S1's $30 basis in the S4 stock). Neither S's basis in S1 share 1 nor S's basis in S1 share 2 was reduced under paragraph (d)(5)(iii) of this section. Accordingly, there is no restoration of any basis in either S1 share 1 or share 2. However, S's basis in each of S1 share 3 through share 10 was reduced under paragraph (d)(5)(iii) of this section by $10, from $20 to $10. Accordingly, the $10 reduction to the basis of each of those shares is reversed to the extent of $.25, to restore the basis of each such share to $10.25 (its allocable portion of S1's net inside attribute amount).

(viii) *Results*. After the application of this section, P recognizes a loss of $360 on the sale of the S share, S recognizes a loss of $150 on the sale of S1 share 1, and S1 recognizes a $50 gain on the sale of the S2 share. Immediately after the transaction, the entities each directly own the following:

Entity	Asset	Basis	Value
P1	S share	$240	$240
P	Proceeds of the sale of S share	$240	$240
S	Proceeds of sale of S1 share 1	$ 20	$ 20
	Partnership interest received for S1 share 2	$ 20	$ 20
	S1 share 3 through share 10	$82 ($10.25 per share)	
	Asset 1	$ 80	
S1	Proceeds of sale of S2 share	$ 50	$ 50
	The S3 share	$ 22.50	
	The S4 share	$ 30	
S2	Asset 2	$ 57.50	
S3	Asset 3	$ 22.50	
S4	Asset 4	$ 30	
X	S1 share 1	$ 20	$ 20
Partnership	S1 share 2	$ 20	$ 20
Y	The S2 share	$ 50	$ 50

(e) *Operating rules*—(1) *Predecessors, successors*. This section applies to predecessor or successor persons, groups, and assets to the extent necessary to effectuate the purposes of this section.

(2) *Adjustments for prior transactions that altered stock basis or other attributes*. In certain situations, M's basis in S stock or S's attributes may be adjusted in a manner that alters the relationship between stock basis and inside attributes and prevents that relationship from identifying the extent to which stock basis reflects unrecognized gain and duplicated loss. The provisions of this paragraph (e)(2) modify the computations in paragraphs (c) and (d) of this section to adjust for the effects of such adjustments.

(i) *Prior reductions to S's basis in assets or other attributes pursuant to section 362(e)(2)(A)*. If M transferred loss property to S in an intercompany transaction subject to section 362(e)(2) (for example, if the transfer was prior

to September 17, 2008, no election was made to apply §1.1502–80(h), and, as a result, S's attributes were reduced under section 362(e)(2)), then the disconformity amount of the S shares received in the section 362(e)(2) transaction is reduced by the amount that the basis in such shares would have been reduced under section 362(e)(2)(C) had such an election been made. In addition, for purposes of determining the attribute reduction amount under paragraph (d) of this section resulting from the transfer of any S shares received (or deemed received) in such a transfer, and for purposes of applying paragraph (d)(5)(v)(B) of this section (conforming limitation) to S, the bases in such shares is treated as reduced by the amount the bases in such shares would have been reduced under section 362(e)(2)(C) had such an election been made.

(ii) *Prior reductions to the basis of any share of S stock pursuant to an election under section 362(e)(2)(C).* If M transferred loss property to S in an intercompany transaction subject to section 362(e)(2) and the basis of any share of S stock was reduced as the result of an election under section 362(e)(2)(C) (including in the hands of a predecessor, to the extent that the effect of the election remains reflected in the basis of the S stock), then, for purposes of computing either any S share's disconformity amount or S's aggregate inside loss, and for purposes of applying paragraph (d)(5)(vi)(A) of this section (stock basis restoration) to S, S's net inside attribute amount is treated as reduced by the amount that S's attributes would have been reduced under section 362(e)(2)(A) in the absence of an election under section 362(e)(2)(C). Notwithstanding the general rule of this paragraph (e)(2)(ii), no reduction will be required to the extent that the group can establish that the net loss in the S shares transferred by M is no longer reflected in S's net inside attributes.

(iii) *Other adjustments.* Appropriate adjustments will be made in any other case in which an adjustment to S's net inside attributes or to M's basis in a share of S stock alters the relationship between such amounts, and the adjustment does not relate to the extent to which loss reflected in M's basis in S stock is noneconomic or duplicated within the meaning of this section.

(3) *Special rules for subsidiary stock transferred in an intercompany transaction*—(i) *In general.* This section applies with respect to M's transfer of a share of S stock to another member in an intercompany transaction in which M's intercompany item is deferred under §1.1502–13 (and to any subsequent transfer of that share by a member) as of the time M's intercompany item is taken into account under §1.1502–13. In determining the application of this section, all transferor-members are treated as divisions of a single corporation. Appropriate adjustments will be made to the intercompany item(s), any member's basis in an S share, to S's attributes, or any combination thereof, to further the purposes of this section and §1.1502–13.

(ii) *Certain prior intercompany transactions.* If M transferred a share of S stock to another member before September 17, 2008, and M's intercompany item related to the transfer is taken into account on or after September 17, 2008, P may elect to apply this paragraph (e)(3) to the transfer. The election is made in the manner provided in paragraph (e)(5) of this section.

(iii) *Examples.* The application of this paragraph (e)(3) is illustrated by the following examples:

Example 1. Intercompany sale with duplicated loss. (i) *Buying member later sells at gain.* (A) *Facts.* M owns the sole outstanding share of stock of S with a basis of $100. S has one asset with a basis of $100. M sells the S share to M1 for $70, recognizing a loss of $30. While owned by M1, S recognizes $10 of depreciation deductions that are absorbed by the group. S's basis in the asset is reduced by $10 (from $100 to $90), and M1's basis in the S stock is reduced under §1.1502–32 by $10 (from $70 to $60). Later, M1 sells the S share to X, an unrelated person, for $80.

(B) *Analysis.* M's sale of its S share to M1 is a transfer of the share, but this section applies as of the time M's intercompany item is taken into account under §1.1502–13, as if M and M1 were divisions of a single corporation. If M and M1 were divisions of a single corporation, the S share's basis would be $90 ($100 reduced by $10 for the depreciation deductions absorbed by the group) and the group would recognize a $10 loss on the sale of the share that is potentially subject to this section. Thus, the sale would be a transfer of a loss share (to the extent of $10) and would be subject to this section (to the extent of that $10). Although the transfer would be subject to this section, there would be no adjustment under paragraph (b) of this section (S has only one share outstanding and so there is no disparity in bases of common shares and no unrecognized gain or loss with respect to preferred) or under paragraph (c) of this section (S has no net positive adjustment). Thus, after the application of paragraph (c) of this section, the share would still be a loss share and would therefore be subject to paragraph (d) of this section. Under paragraph (d) of this section, S would be subject to $10 of attribute reduction (the lesser of the $10 net stock loss and S's $10 aggregate inside loss), allocable to the basis in S's asset. Accordingly, S's basis in its asset is reduced by $10, from $90 to $80, M takes its $30 intercompany stock loss into account, and M1 recognizes a $20 stock gain.

(ii) *Selling member deconsolidates.* Assume the same facts as in paragraph (i)(A) of this *Example 1*, except that M1 does not sell the S share and M ceases to be a member of the group when the value of the S share is $80. Under §1.1502–13, M's deconsolidation causes M's intercompany loss to be taken into account and this section applies at that time. At the time that M deconsolidates, if M and M1 were divisions of a single corporation, the basis in the S share would be $90 ($100 reduced by $10 for the depreciation deductions absorbed by the group) and the group would recognize a $10 loss on the sale of the share that is potentially subject to this section. Such a sale would be a transfer of a loss share (to the extent of $10) and would be subject to this section (to the extent of that $10). The analysis is then the same as in paragraph (i)(B) of this *Example 1*. As a result, S's basis in its asset is reduced from $90 to $80, M takes its $30 intercompany stock loss into account, and M1 holds the S stock with a basis of $60 (and an unrecognized gain of $20).

(iii) *M1 sells the S share at a loss.* Assume the same facts as in paragraph (i)(A) of this *Example 1*, except that S declines in value and M1 sells the S share to X for $50, realizing a $10 loss. In this case, if M and M1 were divisions of a single corporation, the share's basis would be $90 ($100 reduced by $10 for the depreciation deductions absorbed by the group) and the group would recognize a $40 loss on the sale of the share that is potentially subject to this section. Thus, the sale would be a transfer of a loss share (to the extent of $40) and would be subject to this section (to the extent of that $40). Although the transfer would be subject to this section, for the reasons set forth in paragraph (i)(B) of this *Example 1*, there would be no adjustment under either paragraph (b) or paragraph (c) of this section. Thus, after the application of paragraph (c), the share would still be a loss share and would therefore be subject to paragraph (d) of this section. Under paragraph (d) of this section, S would be subject to $40 of attribute reduction (the lesser of the $40 net stock loss and S's $40 aggregate inside loss), allocable to the basis in S's asset. Accordingly, S's basis in its asset is reduced by $40, from $90 to $50, M takes its $30 intercompany stock loss into account, and M1 recognizes a $10 stock loss.

Example 2. Intercompany sale of built-in gain stock. (i) *Facts.* M owns the sole outstanding share of stock of S with a basis of $100. S's sole asset has a basis of $0. S sells its asset for $100 and recognizes a $100 gain that increases M's basis in its S share under §1.1502–32 to $200. M sells the S share to M1 for $100 and recognizes a $100 intercompany loss. Later, M1 sells the S share to X, an unrelated person, for $120.

(ii) *Analysis.* M's sale of the S share to M1 is a transfer of the share, but this section applies as of the time M's intercompany item is taken into account under §1.1502–13, as if M and M1 were divisions of a single corporation. If M and M1 were divisions of a single corporation, the S share's basis would be $200 ($100 increased by $100 for the gain recognized on the sale of the asset) and the group would recognize

an $80 loss on the sale of the share that is potentially subject to this section. Thus, the sale would be a transfer of a loss share (to the extent of $80) and would be subject to this section (to the extent of that $80). Although the transfer would be subject to this section, there would be no adjustment under paragraph (b) of this section (S has only one share outstanding and so there is no disparity in bases of common shares and no unrecognized gain or loss with respect to preferred). Thus, after the application of paragraph (b), the share would still be a loss share and would therefore be subject to paragraph (c) of this section. Under paragraph (c) of this section, the basis in the S share would be reduced, but not below its $120 value, by the lesser of the $100 disconformity amount and the $100 net positive adjustment that was applied to the share when held by M. Accordingly, the basis in the S share would be reduced by $80, to $120. Because the S share would not be a loss share after the application of paragraph (c) of this section, paragraph (d) of this section would not apply to the transfer. As a result, because the positive adjustment was applied to the share when held by M, M's intercompany item is adjusted to reflect what it would have been had M's basis in its S share been reduced by $80 immediately before its sale to M1. Thus, M's intercompany loss is reduced to $20 and M takes this loss into account, and M1 recognizes a gain of $20.

Example 3. Intercompany sale creates built-in gain stock. (i) *Facts.* M owns the sole outstanding share of stock of S with a basis of $0. S's sole asset has a basis of $0. M sells the S share to M1 for $100 and recognizes a $100 intercompany gain. While owned by M1, S sells its asset for $100, recognizing a $100 gain that increases M1's basis in the S share under §1.1502–32 to $200. Later, M1 sells the S share to X for $120.

(ii) *Analysis.* M's sale of its S share to M1 is a transfer of the share, but this section applies as of the time M's intercompany item is taken into account under §1.1502–13, as if M and M1 were divisions of a single corporation. If M and M1 were divisions of a single corporation, the S share's basis would be $100 ($0 increased by $100 for the gain recognized on the sale of the asset) and the group would recognize a $20 gain on the sale of the share. Thus, the sale would not be a transfer of a loss share and this section would not apply to the transfer. Accordingly, under this paragraph (e)(3), no portion of M1's $80 loss is subject to this section. M takes its $100 intercompany stock gain into account, and M1 recognizes an $80 loss.

Example 4. Disparate bases in members' shares. (i) *Facts.* M holds Share A, one of the two outstanding shares of S stock, with a basis of $50 and M1 holds Share B, the other outstanding share of S stock with a basis of $0. S has $50 cash and an asset with a basis of $0. S sells the asset for $50, recognizing a $50 gain that increases M's basis in its S share under §1.1502–32 by $25 (from $50 to $75) and increases M1's basis under §1.1502–32 by $25 (from $0 to $25). Later, M sells its Share A to M1 for $50 and recognizes a $25 intercompany loss. Later, M1 sells both S shares to X for $100.

(ii) *Analysis.* M's sale of its Share A to M1 is a transfer of the share, but this section applies as of the time M's intercompany item is taken into account under §1.1502–13, as if M and M1 were divisions of a single corporation. If M and M1 were divisions of a single corporation, the basis of Share A would be $75 ($50 increased by $25 for its share of the gain recognized on the sale of the asset), the basis of Share B would be $25, and the group would recognize a $25 loss on the sale of Share A that is potentially subject to this section and a $25 gain on the sale of Share B. Thus, the sale would be a transfer of a loss share (to the extent of $25) and would be subject to this section (to the extent of that $25). Although the transfer is subject to this section, there would be no adjustment under paragraph (b) of this section (all S shares held by members are transferred to a nonmember in one taxable transaction). Thus, after the application of paragraph (b), Share A would still be a loss share and therefore subject to paragraph (c) of this section. Under paragraph (c)(7) of this section, the basis of Share A would be treated as reduced by the gain recognized and taken into account with respect to the transfer of Share B in the same transaction, and so Share A would not be a loss share for purposes of paragraph (c) of this section. Although the share would be a loss share after the application of paragraph (c) of this section, no adjustment would be required under paragraph (d) of this section because there would be no net stock loss in the transaction. Because no adjustment would be made under this section if M and M1 were divisions of a single corporation, M takes its $25 intercompany stock loss into account and M1 recognizes a gain of $25. Alternatively, if the group elects to apply paragraph (b) of this section, M's intercompany item would be adjusted to reflect what it would have been had the $25 investment adjustment applied to Share A been reallocated to Share B, and M1's basis in Share B would be increased by that amount. If so, M's $25 intercompany loss would be reduced to zero, M1's basis in Share B would be increased from $25 to $50, and there would be no gain or loss recognized on either share.

Example 5. Subsidiary with built-in gain and built-in loss assets. (i) *Facts.* M owns the sole outstanding share of stock of S with a basis of $100. S has two assets, Asset 1 with a basis of $0 and Asset 2 with a basis of $80. M sells the S share to M1 for $90 and recognizes a $10 intercompany loss. While owned by M1, S sells Asset 1 for $60, recognizing a $60 gain that increases M1's basis in the S share under §1.1502–32 to $150. Later, M1 sells the S share to X for $90.

(ii) *Analysis.* M's sale of the S share to M1 is a transfer of the share, but this section applies as of the time M's intercompany item is taken into account under §1.1502–13, as if M and M1 were divisions of a single corporation. If M and M1 were divisions of a single corporation, the S share's basis would be $160 ($100 increased by $60 for the gain recognized on the sale of Asset 1) and the group would recognize a $70 loss on the sale of the share that is potentially subject to this section. Thus, the sale would be a transfer of a loss share (to the extent of $70) and would be subject to this section (to the extent of that $70). Although the transfer is subject to this section, there would be no adjustment under paragraph (b) of this section (S has only one share outstanding and so there is no disparity in bases of common shares and no unrecognized gain or loss with respect to preferred). Thus, after the application of paragraph (b), the share would still be a loss share and would therefore be subject to paragraph (c) of this section. Under paragraph (c) of this section, the basis in the S share would be reduced, but not below its $90 value, by the lesser of the $20 disconformity amount ($160 stock basis over $140 net inside attribute amount) and the $60 net positive adjustment that was applied to the share when held by M1. Accordingly, the basis in the S share would be reduced by $20, to $140. Because the S share would still be a loss share after the application of paragraph (c) of this section, paragraph (d) of this section would apply to the transfer. Under paragraph (d) of this section, S would have an attribute reduction amount of $50, the lesser of the $50 net stock loss ($140 basis over $90 value) and S's $50 aggregate inside loss (the excess of the sum of S's $80 basis in Asset 2 and S's $60 cash from the sale of Asset 1, over the $90 value of the S share). The adjustments required under this section are applied as follows: because the positive adjustment was applied to the share when held by M1, the $20 basis reduction required under paragraph (c) of this section is applied to M1's basis in its S share immediately before its sale to X, reducing it from $150 to $130. In addition, pursuant to paragraph (d) of this section, S's basis in Asset 2 is reduced by $50, from $80 to $30. M takes its $10 intercompany stock loss into account and M1 recognizes a loss of $40.

(iii) *Allocation of basis reduction.* Assume the same facts as in paragraph (i) of this *Example 5*, except that, while S is held by M, S earns $30 (consuming a portion of Asset 1) and, while S is held by M1, S earns $20 (consuming a portion of Asset 1) and sells Asset 1 for $10. Thus, M's basis in the S share immediately before the sale to M1 is $130, and M recognizes a $40 intercompany stock loss, and M1's basis in the S share immediately before the sale to X is $120. The analysis regarding the application of this section is the same as in paragraph (ii) of this *Example 5*. On a separate entity basis, M's basis in the S share would be subject to a $20 reduction under paragraph (c) of this section (at the time M transferred the S share the share had a $30 net positive adjustment and a $20 disconformity amount), and M1's basis in the S share would not be subject to reduction under paragraph (c) of this section (at the time M1 transferred the S share the share had a $30 net positive adjustment and a $20 negative disconformity amount). Therefore, the $20 basis reduction required under paragraph (c) of this section is allocated entirely to M. Accordingly, M's intercompany item is adjusted to reflect what it would have been had the entire $20 basis reduction been applied to the S share while held by M, and M1's basis in the S share is not reduced. Thus, M's intercompany stock loss is reduced by $20 to $20 and M takes this loss into account, and M1 recognizes a $30 loss. S's basis in Asset 2 is reduced by $50, from $80 to $30.

(4) *Limited application to multiple-member section 332 liquidations.* If more than one member owns shares of S stock, paragraphs (c) and (d) of this section do not apply to any transfer of S shares resulting from a liquidation of S to which section 332 applies.

(5) *Form and manner of election(s) under this section.* The elections provided in this section are irrevocable and made in the form of a statement titled "Section 1.1502–36 Statement." The statement

must be included on or with the group's timely filed return (original or amended, if filed by the due date for the return, including extensions) for the taxable year of the transfer of the subsidiary stock to which the election relates or, in the case of an intercompany transfer, the year in which the intercompany item from the transfer is taken into account. The statement must include—

(i) The name and employer identification number (E.I.N.) of each subsidiary with respect to which an election is being made;

(ii) If P is electing under paragraph (b)(1)(ii) of this section to redetermine basis with respect to the transfer of stock of one or more subsidiaries, a statement that members' bases in shares of [name of subsidiary or subsidiaries] stock are being redetermined notwithstanding that all members' shares of [name of subsidiary or subsidiaries] are being transferred to one or more nonmembers in one fully taxable transaction;

(iii) If P is electing under paragraph (d)(2)(ii) of this section (attribute reduction amount less than five percent of value) to apply the attribute reduction provisions, a statement that paragraph (d) of this section is being applied to the transfer of shares of stock of [names of all subsidiaries whose shares are transferred] notwithstanding that the aggregate attribute reduction amount in the transaction is less than five percent of the aggregate value of the stock of [names of all subsidiaries whose shares are transferred] transferred by members in the transaction;

(iv) If P is electing under paragraph (d)(4)(ii)(A)(*1*) of this section to specify the allocation of the attribute reduction amount, a statement (for each subsidiary for which the election is being made) that the attribute reduction amount of [name of subsidiary] is being applied (or not applied) to reduce [identify the attributes in Category A, Category B, and Category C, and the amount of each, with respect to which the election is being made];

(v) If P is electing under paragraph (d)(5)(v)(B) of this section not to apply the conforming limitation on tier-down attribute reduction with respect to one or more subsidiaries, a statement that the conforming limitation in paragraph (d)(5)(v)(B) of this section is not being applied with respect to [name of subsidiary or subsidiaries];

(vi) If P is electing under paragraph (d)(5)(vi)(B) of this section not to restore lower-tier subsidiary stock basis with respect to one or more subsidiaries, a statement that members' bases in [name of subsidiary or subsidiaries] is not being restored under paragraph (d)(5)(vi)(A) of this section;

(vii) If P is electing under paragraph (d)(6) of this section to reattribute attributes, a statement (for each subsidiary for which the election is being made) that [identify the attributes in Category A, Category B, and Category C, and the amount of each or the amount in excess of an amount, with respect to which the election is being made] of [name of subsidiary] are being reattributed (or not) to P;

(viii) If P is electing under paragraph (d)(6) of this section to reduce stock basis, a statement (for each subsidiary for which the election is being made) that members' bases in shares of stock of [name of subsidiary] are being reduced by [specify amount or the amount in excess of an amount];

(ix) If P is electing under paragraph (e)(3)(ii) of this section to apply paragraph (e)(3) of this section to an intercompany transfer that occurred before September 17, 2008, a statement that paragraph (e)(3) of this section is being elected to apply to the transfer of stock of [name of subsidiary] by [name of transferor subsidiary] to [name of transferee subsidiary] on [date of transfer]; and

(x) If P is electing under §1.1502–96(d)(5) to reattribute to itself all or any part of a section 382 limitation, a statement that P is electing to reattribute a section 382 limitation with respect to losses of [name of subsidiary or, if two or more subsidiaries are members of a loss subgroup, the name of each subsidiary in the loss subgroup]. A separate statement is made for each subsidiary or loss subgroup for which an election is being made. Each statement must include—

(A) The date of the ownership change giving rise to the separate section 382 limitation or subgroup section 382 limitation that is being apportioned;

(B) The amount of the separate (or subgroup) section 382 limitation for the taxable year in which the reattribution occurs (determined without reference to any apportionment under this section or §1.1502–95(c)); and

(C) The amount of each net operating loss carryover, capital loss carryover, or deferred deduction, and the year in which it arose, of the subsidiary (or subsidiaries) that is subject to the separate section 382 limitation or subgroup section 382 limitation that is being apportioned to the common parent, and the amount of the value element and adjustment element of that limitation that is apportioned to the common parent.

(f) *Definitions*. In addition to the definitions in other paragraphs of this section and in other provisions of the regulations under section 1502, the following definitions apply for purposes of this section.

(1) *Allocable portion* has the same meaning as in §1.1502–32(b)(4)(iii)(B). Thus, for example, within a class of stock, each share has the same allocable portion of the net inside attribute amount and, if there is more than one class of stock, the net inside attribute amount is allocated to each class by taking into account the terms of each class and all other facts and circumstances relating to the overall economic arrangement.

(2) *Deferred deduction* means any deduction for expenses or loss that would be taken into account under general tax accounting principles as of the time of the transfer of the share, but that is nevertheless not taken into account immediately after the transfer by reason of the application of a deferral provision. Such provisions include, for example, sections 267(f) and 469, and §1.1502–13. "Deferred deduction" also includes S's portion of such consolidated tax attributes, for example consolidated excess charitable contributions that would be apportioned to S under the principles of §1.1502–79(e) if S had a separate return year. Additionally, it includes amounts equivalent to deductions, such as negative adjustments under section 475 (mark to market accounting method for dealers in securities) and section 481 (adjustments required by changes in method of accounting).

(3) *Distribution* has the same meaning as in §1.1502–32(b)(3)(v).

(4) *Higher-tier, lower-tier*. A subsidiary (S1) (and its shares of stock) is "higher-tier" with respect to another subsidiary (S2) (and its shares of stock) if investment adjustments made to the bases

of shares of S2 stock under §1.1502–32 affect the investment adjustments made to the bases of shares of S1 stock. A subsidiary (S1) (and its shares of stock) is "lower-tier" with respect to another subsidiary (S) (and its shares of stock) if investment adjustments made to the bases of shares of S1 stock affect the investment adjustments made to the bases of shares of S stock. The term *lowest-tier subsidiary* generally refers to a subsidiary that owns no stock of another subsidiary. The term *highest-tier subsidiary* generally refers to a subsidiary the stock of which is not lower tier to any shares transferred in the transaction.

(5) *Liability* means a liability that has been incurred within the meaning of section 461(h), except to the extent otherwise provided in paragraph (d)(4)(ii)(C)(*1*) of this section.

(6) *Loss carryover* means any net operating or capital loss carryover that is attributable to S, including any losses that would be apportioned to S under the principles of §1.1502–21(b)(2) if S had a separate return year. However, solely for purposes of applying paragraph (d) of this section, loss carryovers do not include the amount of any losses waived under §1.1502–32(b)(4).

(7) *Loss share, gain share*. A *loss share* is a share of stock with a basis that exceeds its value. A *gain share* is a share of stock with a value that exceeds its basis.

(8) *Preferred stock, common stock*. *Preferred stock* and *common stock* have the same meanings as in §1.1502–32(d)(2) and (3), respectively.

(9) *Transaction* includes all the steps taken pursuant to the same plan or arrangement.

(10) *Transfer*—(i) *Definition*. Except as provided in paragraph (f)(10)(ii) of this section, for purposes of this section, M transfers a share of S stock on the earliest of—

(A) The date that M ceases to own the share as a result of a transaction in which, but for the application of this section (and notwithstanding the deferral of any amount recognized on the transfer, other than by reason of §1.1502–13), M would recognize income, gain, loss or deduction with respect to the share (see paragraph (e)(3) of this section in the case of a transfer in an intercompany transaction);

(B) The date that M and S cease to be members of the same group;

(C) The date that a nonmember acquires the share from M; and

(D) The last day of the taxable year during which the share becomes worthless under section 165 (taking into account the provisions of §1.1502–80(c)) if the share is treated as a capital asset, or the date the share becomes worthless (taking into account the provisions of §1.1502–80(c)) if the share is not treated as a capital asset.

(ii) *Excluded transactions*. Notwithstanding paragraph (f)(10)(i) of this section, M does not transfer a share of S stock if—

(A) M ceases to own the share as a result of a transaction to which section 381(a) applies and in which either a member acquires assets from S or S acquires assets from M, provided that—

(*1*) M recognizes no income, gain, loss, or deduction with respect to the share, and

(*2*) If the transaction is a liquidation to which section 332 applies, M is the only member that owns shares of S stock (if another member owns shares of S stock, see paragraph (e)(4) of this section for a limitation on the application of this section); or

(B) M ceases to own the share as a result of a distribution of the share to a nonmember in a transaction to which section 355 applies, and in which the share is treated as qualified property for purposes of section 355(c) or section 361(c).

(11) *Value* means the amount realized, if any, or otherwise the fair market value.

(g) *Anti-abuse rule*—(1) *General rule*. If a taxpayer acts with a view to avoid the purposes of this section or to apply the rules of this section to avoid the purposes of any other rule of law, appropriate adjustments will be made to carry out the purposes of this section or such other rule of law.

(2) *Examples*. The following examples illustrate the principles of the anti-abuse rule in this paragraph (g). No implication is intended regarding the potential applicability of any other anti-abuse rules:

Example 1. Loss Trafficking. (i) *Facts*. M purchases the sole outstanding share of S stock for $100. At that time, S owns Asset 1 with a basis of $0. S sells Asset 1 for $100. Later, S purchases the sole outstanding share of X stock, a corporation with losses, with a view to liquidating X in a transaction to which section 332 applies in order to reduce S's disconformity amount. S purchases the X share for $1, and X has a $100 NOL and an asset with a basis of $1. Subsequently, M sells its S share for $100. After taking into account the effects of all applicable rules of law, M's basis in the S share is $200 (M's original $100 basis, increased under §1.1502–32 to reflect the $100 gain recognized on the sale of Asset 1). M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(ii) *Analysis*. Although M's transfer of the S share is subject to this section, there is no adjustment under paragraph (b) of this section (S has only one share outstanding and so there is no disparity in bases of common shares and no shares of S preferred stock outstanding (and so there is no unrecognized gain or loss on S preferred stock)). See paragraph (b)(1)(ii)(A) of this section. Accordingly, after the application of paragraph (b) of this section, M's sale of the S share is still a transfer of a loss share and therefore subject to paragraph (c) of this section. Under paragraph (c) of this section, M's $200 basis in the S share is reduced, but not below the share's $100 value, by the lesser of the share's net positive adjustment and disconformity amount. The share's net positive adjustment is $100, the positive adjustment attributable to the gain recognized on the sale of Asset 1. The share's disconformity amount is $0, the excess of M's $200 basis in the S share over S's $200 net inside attribute amount. Thus, the reduction to basis under paragraph (c) of this section would be $0. However, because S purchased the X stock and liquidated X with a view to avoiding the purposes of this section (by using X's attributes to minimize the disconformity amount of the S share), the attributes acquired from X are disregarded for purposes of applying this section. Accordingly, S's net inside attribute amount is limited to the $100 of attributes S would have had absent the purchase of the X stock, S's money ($100 from the sale of Asset 1). The loss share's disconformity amount is therefore the excess of $200 over $100, or $100. The lesser of the share's $100 net positive adjustment and $100 disconformity amount is $100. As a result, M's $200 basis in the S share is reduced by $100, to $100, and M recognizes no gain or loss on the sale of the S share.

Example 2. Use of a partnership to prevent current attribute reduction. (i) *Facts*. M owns all 5 outstanding shares of S common stock with a basis of $200 each. S owns Asset 1 with a basis of $1000. In year 1, with a view to preventing a current reduction in the basis of Asset 1, S contributes Asset 1 to a partnership in a transaction in which S recognizes no gain or loss. On December 31, year 2, M sells one S share for $20. After taking into account the effects of all applicable rules of law, M's basis in each S share is $200. M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(ii) *Analysis*. Although M's transfer of the S share is subject to this section, there is no basis redetermination under paragraph (b) of this section because there is no disparity among M's bases in its shares of S common stock and there are no shares of S preferred stock outstanding (and so there is no unrecognized gain or loss on S preferred stock). See paragraph (b)(1)(ii)(A) of this section. Accordingly, after the application of paragraph (b) of this section, M's sale of the S share is still a transfer of a loss share and therefore subject to paragraph (c) of this section. However, no adjustment is required under paragraph (c) of this section because both the disconformity amount and the net positive adjustment are $0.

See paragraph (c)(3) of this section. Under paragraph (d) of this section, S's attribute reduction amount is $180 (the lesser of the $180 net stock loss and S's $900 aggregate inside loss ($1000 of attributes over $100 value of all of the S shares)). Absent the application of this paragraph (g), the $180 attribute reduction amount would be applied to reduce S's basis in the partnership interest. However, because S acted with a view to avoiding a current reduction in the basis of Asset 1 under paragraph (d) of this section, this section is applied by treating S as if it held Asset 1 at the time of the stock sale. The basis of Asset 1 is reduced by $180, to $820, effective immediately before the transfer to the partnership and, as a result, S's basis in its partnership interest is $820.

Example 3. Creation of an intercompany receivable to mitigate attribute reduction. (i) *Facts.* M owns all five outstanding shares of S common stock each with equal basis that exceeds value. S holds cash and Asset 1 with a basis that exceeds value. In year 1, with a view to mitigating a reduction in the basis of Asset 1, S lends the cash to M1. Asset 1 and the intercompany note received from M1 are assets of the same class under §1.338–6(b)(2). On December 31, year 2, M sells one of its S shares and, without regard to this section, recognizes a loss. M's sale of the S share is a transfer of a loss share and therefore subject to this section.

(ii) *Analysis.* Although M's transfer of the S share is subject to this section, no adjustment is required under paragraph (b) of this section because there is no disparity among M's bases in shares of S common stock and there are no shares of S preferred stock outstanding (and so there is no unrecognized gain or loss on S preferred stock). See paragraph (b)(1)(ii)(A) of this section. Accordingly, after the application of paragraph (b) of this section, M's sale of the S shares is still a transfer of a loss share and therefore subject to paragraph (c) of this section. However, there is no adjustment under paragraph (c) of this section because the net positive adjustment is $0. See paragraph (c)(3) of this section. Under paragraph (d) of this section, S's attribute reduction amount would be applied to reduce S's basis in Asset 1 and the intercompany receivable in proportion to basis. However, because S acted with a view to mitigating the reduction in the basis of Asset 1 under paragraph (d) of this section, this section is applied without regard to the intercompany receivable. Accordingly, S's basis in Asset 1 is reduced by the full attribute reduction amount.

Example 4. Use of a partnership to reduce net stock loss. (i) *Facts.* M owns all ten outstanding shares of S common stock, one share (Share 1) has a basis of $0, and one share (Share 2) has a basis of $160. S has an aggregate inside loss of $80. In one transaction and with a view to mitigating a reduction in S's attributes, M contributes Share 1 to a partnership, recognizing no gain or loss, and sells Share 2 for $80. M's contribution of Share 1 to the partnership is a transfer, but the share is not a loss share and so the transfer is not subject to this section. M's sale of Share 2 is a transfer of a loss share and is therefore subject to this section.

(ii) *Analysis.* Although M's transfer of Share 2 is subject to this section, there is no adjustment under paragraph (b) of this section because there are no investment adjustments that have been applied to the shares. Accordingly, after the application of paragraph (b) of this section, M's sale of Share 2 is still a transfer of a loss share and therefore subject to paragraph (c) of this section. There is no adjustment under paragraph (c) of this section because the net positive adjustment is $0. See paragraph (c)(3) of this section. Accordingly, after the application of paragraph (c) of this section, M's sale of Share 2 is still a transfer of loss shares and therefore subject to paragraph (d) of this section. Under paragraph (d) of this section, the net stock loss would be determined to be $0, the excess of the $160 aggregate basis in all of the transferred shares over the $160 aggregate value of those shares. S's attribute reduction amount would be determined to be $0, the lesser of the $0 net stock loss and S's $80 aggregate inside loss. Thus, there would be no reduction of attributes under this paragraph (d) of this section. However, because M acted with a view to reducing the attribute reduction amount by transferring a gain share to a partnership while avoiding the recognition of the gain on the share, this section is applied without regard to the transfer of the gain share. Accordingly, the net stock loss is determined to be $80, and the attribute reduction amount is determined to be $80.

Example 5. Stuffing gain asset. (i) *Facts.* M owns the sole outstanding share of S stock (Share 1) with a basis of $100. S owns Asset 1 with a basis of $100 and a value of $20. With a view to avoid the purposes of this section, M transfers Asset 2 with a basis of $0 and a value of $80 to S in exchange for four additional shares of S stock (Share 2 through Share 5) in a transaction to which section 351 applies. M later sells Share 1 to X for $20. M's sale of Share 1 is a transfer of a loss share and therefore subject to this section.

(ii) *Analysis.* Although M's transfer of the Share 1 is subject to this section, there is no adjustment under paragraph (b) of this section because no investment adjustments have been applied to the basis of any S shares. Thus, after the application of paragraph (b) of this section, M's sale of the S share is still a transfer of a loss share and therefore subject to paragraph (c) of this section. There is no adjustment under paragraph (c) of this section because the net positive adjustment is $0. Accordingly, after the application of paragraph (c) of this section, M's sale of the S share is still a transfer of a loss share and therefore subject to paragraph (d) of this section. Under paragraph (d) of this section, S's attribute reduction amount would be $0, the lesser of the $80 net stock loss and S's $0 aggregate inside loss ($100 of attributes does not exceed the $100 value of all of the S shares). However, because M transferred Asset 2 to S with a view to avoid the purposes of this section, the application of this section to M's transfer of Share 1 is made without regard to the transfer of Asset 2. Accordingly, under paragraph (d) of this section, S's attribute reduction amount is $80, the lesser of the $80 net stock loss and S's $80 aggregate inside loss (computed without regard to Asset 2). S's basis in Asset 1 is therefore reduced by $80, from $100 to $20, under paragraph (d) of this section.

(iii) *Transfer of all S shares.* Assume the same facts as in paragraph (i) of this *Example 5*, except that M sells all five S shares to X, recognizing both the gain and the loss on the S shares. The transfer of Share 1 is still a transfer of a loss share and therefore subject to this section. However, because all the shares are transferred, the group's income is clearly reflected. Therefore, the purposes of this section are not avoided and this section applies without modification. S's attribute reduction amount is $0, the lesser of the $0 net stock loss and S's $0 aggregate inside loss.

(h) *Effective/applicability date.* This section applies to transfers of shares of subsidiary stock on or after September 17, 2008, unless the transfer was made pursuant to a binding agreement that was in effect prior to September 17, 2008, and at all times thereafter. For transfers of shares of subsidiary stock that are not subject to this section, see §§1.337(d)–2 and 1.1502–35.

Par. 19. Section 1.1502–75 is amended by:

1. Revising paragraph (d)(1).
2. Adding paragraph (l).

The revision and addition read as follows:

§1.1502–75 Filing of consolidated returns.

* * * * *

(d) *When a group remains in existence*—(1) *General rule.* A group remains in existence for a tax year if the common parent remains as the common parent and at least one subsidiary that was affiliated with it at the end of the prior year remains affiliated with it at the beginning of the year, whether or not one or more corporations have ceased to be subsidiaries at any time after the group was formed. Thus, for example, assume that corporation P acquires the sole outstanding share of stock of S on January 1, year 1, and that P and S file a consolidated return for the year 1 calendar year. On May 1, year 2, P acquires the sole outstanding share of stock of S1 and, on July 1, year 2, P sells the S share. The group (consisting originally of P and S) remains in existence in year 2 because P remained the common parent and, S, a subsidiary that was affiliated with P at the end of year 1, remained affiliated with P at the beginning of year 2.

* * * * *

(l) *Effective/applicability dates.* Paragraph (d)(1) of this section applies to taxable years for which the due date of the original return (without regard to extensions) is on or after September 17, 2008.

Par. 20. Section 1.1502–80 is amended by:

1. Revising paragraph (a) and (c)(2).
2. Adding paragraph (h).

The revisions and addition reads as follows:

§1.1502–80 Applicability of other provisions of law.

(a) *In general*—(1) *Application of other provisions.* The Internal Revenue Code (Code), or other law, shall be applicable to the group to the extent the regulations do not exclude its application. To the extent not excluded, other rules operate in addition to, and may be modified by, these regulations. Thus, for example, in a transaction to which section 381(a) applies, the acquiring corporation will succeed to the tax attributes described in section 381(c). Furthermore, sections 269 and 482 apply for any consolidated return year. However, in a recognition transaction otherwise subject to section 1001, for example, the rules of section 1001 continue to apply, but may be modified by the intercompany transaction regulations under §1.1502–13.

(2) *No duplicative adjustments.* Nothing in these regulations shall be interpreted or applied to require an adjustment, inclusion, or other item to the extent it would have the effect of duplicating any other adjustment, inclusion, or other item required under the Code or other rule of law, including other provisions of these regulations.

(3) *Application of single-entity principles.* If two or more adjustments, inclusions, or other items are subject to paragraph (a)(2) of this section, the determination of which adjustment, inclusion, or other item is treated as applied or taken into account is made by taking into account the purposes of the provisions and applying single-entity principles as appropriate.

(4) *Effective/applicability dates.* This paragraph (a) is applicable with respect to transactions and determinations on or after September 17, 2008.

* * * * *

(c) * * *

(2) *Cross reference.* See §1.1502–36 for additional rules relating to worthlessness of subsidiary stock on or after September 17, 2008.

* * * * *

(h) *Non-applicability of section 362(e)(2)*—(1) *General rule.* Section 362(e)(2) does not apply to any intercompany transaction occurring on or after September 17, 2008. Taxpayers may apply this paragraph (h) to intercompany transactions occurring on or after October 22, 2004, and in such case, any election made under section 362(e)(2)(C) will have no effect. The purpose of this paragraph (h) is to facilitate the application of the consolidated return provisions addressing the duplication of loss between members of a consolidated group.

(2) *Anti-abuse rule*—(i) *General rule.* If a taxpayer engages in a transaction to which section 362(e)(2) would apply but for the application of paragraph (h)(1) of this section, and acts with a view to prevent the consolidated return provisions from properly addressing loss duplication, appropriate adjustments will be made to clearly reflect the income of the group.

(ii) *Example.* The following example illustrates the principle of the anti-abuse rule in this paragraph (h)(2).

Example. (A) *Facts.* P, the common parent of a consolidated group, owns the four outstanding shares of S stock (Share 1 through Share 4) with an aggregate basis of $0 and value of $80. S owns Asset 1 with a basis of $0 and a value of $80. With a view to prevent the consolidated return provisions from addressing the duplication of loss, P transfers Asset 2 with a basis of $100 and a value of $20 to S in exchange for an additional share of S stock (Share 5) in a transaction to which section 351 applies. P later sells Share 5 to X, an unrelated person, for $20 at a time when S's basis in Asset 2 was still $100. The sale is a transfer of a loss share and therefore subject to §1.1502–36.

(B) *Analysis.* Although the sale would be subject to §1.1502–36, that section would not prevent the stock loss or reduce S's attributes (to prevent duplication of the stock loss) because neither §1.1502–36(b) nor §1.1502–36(c) would adjust the basis of the transferred share (because there are no investment adjustments) and §1.1502–36(d) would not reduce S's attributes (because S's aggregate inside loss is $0). However, because P acted with a view to prevent the consolidated return provisions from addressing the duplication of the loss on Asset 2, P's transfer of Asset 2 to S is subject to the anti-abuse rule in this paragraph (h)(2). Accordingly, effective immediately before the transfer of Share 5 to X, either P's basis in Share 5 or S's basis in Asset 2 must be adjusted to reflect what it would have been had section 362(e)(2) been applied at the time P transferred Asset 2 to S (taking into account the interim facts and circumstances). Accordingly, S must either reduce its basis in Asset 2 by $80 to $20 (eliminating the duplicated loss) or P must reduce its basis in Share 5 by $80 to $20 (eliminating the duplicated loss).

(C) *Transfer of all S shares.* Assume the same facts as those in paragraph (A) of this *Example*, except that P sells all five S shares to X. Although P's transfer of Asset 2 to S results in the duplication of an $80 loss, because all the shares are transferred, the transaction does not prevent the consolidated return provisions from properly addressing loss duplication. P's $80 duplicated loss is offset by an $80 duplicated gain, and the group recognizes the offsetting stock gain and loss. Accordingly, this paragraph (h)(2) does not apply to P's transfer of Asset 2 to S.

Par. 21. Section 1.1502–91 is amended by revising paragraph (h)(2) to read as follows:

§1.1502–91 Application of section 382 with respect to a consolidated group.

* * * * *

(h) * * *

(2) *Disposition of stock or an intercompany obligation of a member.* Gain or loss recognized by a member on the disposition of stock (including stock described in section 1504(a)(4) and §1.382–2T(f)(18)(ii) and (iii)) of another member is treated as a recognized gain or loss for purposes of section 382(h)(2) (unless disallowed) even though gain or loss on such stock was not included in the determination of a net unrealized built-in gain or loss under paragraph (g)(1) of this section. Gain or loss recognized by a member with respect to an intercompany obligation is treated as recognized gain or loss only to the extent (if any) the transaction gives rise to aggregate income or loss within the consolidated group. The first sentence of this paragraph (h)(2) is applicable on or after September 17, 2008.

* * * * *

Par. 22. Section 1.1502–95 is amended by revising paragraph (d)(3), *Example 6* to read as follows:

§1.1502–95 Rules on ceasing to be a member of a consolidated group (or loss subgroup).

* * * * *

(d) * * *

(3) * * *

Example 6. Reattribution of net operating loss carryover under §1.1502–36(d)(6). The facts are the same as in *Example 3*, except that, instead of distributing the L2 stock to M, P sells that stock to B, and, under §1.1502–36(d)(6), M reattributes $10 of L2's net operating loss carryover to itself. Under §1.1502–36(d)(6)(iv)(A), M succeeds to the reattributed loss as if the loss were succeeded to in a transaction to which section 381(a) applies. M, as successor to L2, does not cease to be a member of the P loss subgroup.

* * * * *

Par. 23. Section 1.1502–96 is amended by revising paragraph (d) to read as follows:

§1.1502–96 Miscellaneous rules.

* * * * *

(d) *Losses reattributed under §1.1502–36(d)(6)*—(1) *In general.* This paragraph (d) contains rules relating to net operating carryovers, capital loss carryovers, and deferred deductions (collectively, loss or losses) that are reattributed to the common parent under §1.1502–36(d)(6). References in this paragraph (d) to a subsidiary are references to the subsidiary (or lower-tier subsidiary) whose loss is reattributed to the common parent.

(2) *Deemed section 381(a) transaction.* Under §1.1502–36(d)(6)(iv)(A), the common parent succeeds to the reattributed losses as if the losses were succeeded to in a transaction to which section 381(a) applies. In general, §§1.1502–91 through 1.1502–95, this section, and §1.1502–98 are applied to the reattributed losses in accordance with that characterization. See generally, §1.382–2(a)(1)(ii) (relating to distributor or transferor loss corporations in transactions under section 381), §1.1502–1(f)(4) (relating to the definition of predecessor and successor) and §1.1502–91(j) (relating to predecessor and successor corporations). For example, if the reattributed loss is a pre-change attribute subject to a section 382 limitation, it remains subject to that limitation following the reattribution. In certain cases, the limitation applicable to the reattributed loss is zero unless the common parent apportions all or part of the limitation to itself. (See paragraph (d)(4) of this section.)

(3) *Rules relating to owner shifts*—(i) *In general.* Any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(l)(3)) in connection with the disposition of the stock of the subsidiary is not taken into account in determining whether there is an ownership change with respect to the reattributed loss. However, any owner shift with respect to the successor corporation that is treated as continuing in existence under §1.382–2(a)(1)(ii) must be taken into account for such purpose if such owner shift is effected by the reattribution and an owner shift of the stock of the subsidiary not held directly or indirectly by the common parent would have been taken into account if such shift had occurred immediately before the reattribution. See paragraph (d)(3)(ii) *Example 2* of this section.

(ii) *Examples.* The following examples illustrate the principles of this paragraph (d)(3):

Example 1. No owner shift for reattributed loss. (i) *Facts.* P, the common parent of a consolidated group, owns 60% of the stock of L, and B owns the remaining 40%. L has a net operating loss carryover of $100 from year 1 that it carries over to years 2, 3, and 4. At the beginning of year 2, P purchases 40% of the L stock from B, which does not cause an ownership change of L. On December 31, year 3, P sells all of the L stock to M. Pursuant to §1.1502–36(d)(6), P reattributes $10 of L's $100 net operating loss carryover to itself, and L carries $90 of its net operating loss carryover to its year 4.

(ii) *Analysis.* The sale of the L stock to M does not cause an owner shift that is taken into account in determining if there is an ownership change with respect to the $10 reattributed loss. Following the reattribution, §1.1502–94(b) continues to apply to determine if there is an ownership change with respect to the $10 reattributed loss, until, under paragraph (a) of this section, the loss is treated as described in §1.1502–91(c)(1)(i). In applying §1.1502–94(b), the 40 percentage point increase by the P shareholders prior to the reattribution is taken into account. The sale of the L stock to M does cause an ownership change of L with respect to the $90 of its net operating loss that it carries over to year 4.

Example 2. Owner shift for reattributed loss. The facts are the same as in *Example 1*, except that P only purchases 20% of the L stock from B and sells 80% of the L stock to M. L is a new loss member, and, under §1.1502–94(b)(1), an owner shift of the stock of L not held directly or indirectly by the common parent (the 20% of L stock still held by B) would have been taken into account if such shift had occurred immediately before the reattribution. Following the reattribution, §1.1502–94(b) continues to apply to determine if there is an ownership change with respect to the $10 reattributed loss, until, under paragraph (a) of this section, the loss is treated as described in §1.1502–91(c)(1)(i). With respect to the $10 reattributed loss, the P shareholders have increased their percentage ownership interest by 40 percentage points. The P shareholders have increased their ownership interests by 20 percentage points as a result of P's purchase of stock from B, and, under §1.382–2(a)(1)(ii), are treated as increasing their interests by an additional 20 percentage points as a result of the reattribution. (The acquisition of the L stock by M does not, however, effect an owner shift for the $10 of reattributed loss.) The sale of the L stock to M causes an ownership change of L with respect to the $90 of net operating loss that L carries over to Year 4.

(4) *Rules relating to the section 382 limitation*—(i) *Reattributed loss is a pre-change separate attribute of a new loss member.* If the reattributed loss is a pre-change separate attribute of a new loss member that is subject to a separate section 382 limitation prior to the disposition of subsidiary stock, the common parent's limitation with respect to that loss is zero, except to the extent that the common parent apportions to itself, under paragraph (d)(5) of this section, all or part of such limitation. A separate section 382 limitation is the limitation described in §1.1502–94(b) that applies to a pre-change separate attribute.

(ii) *Reattributed loss is a pre-change subgroup attribute.* If the reattributed loss is a pre-change subgroup attribute subject to a subgroup section 382 limitation prior to the disposition of subsidiary stock, and, immediately after the reattribution, the common parent is not a member of the loss subgroup, the section 382 limitation with respect to that loss is zero, except to the extent that the common parent apportions to itself, under paragraph (d)(5) of this section, all or part of the subgroup section 382 limitation. See, however, §1.1502–95(d)(3) *Example 6,* for an illustration of a case where the common parent, as successor to the subsidiary, is a member of the loss subgroup immediately after the reattribution.

(iii) *Potential application of section 382(l)(1).* In general, the value of the stock of the common parent is used to determine the section 382 limitation for an ownership change with respect to the reattributed loss that occurs at the time of, or after, the reattribution. For example, if the loss is a pre-change consolidated attribute, the value of the stock of the common parent is used to determine the section 382 limitation, and no adjustment to that value is required because of the deemed section 381(a) transaction. However, if the loss is a pre-change separate attribute of a new loss member (or is a pre-change attribute of a loss subgroup member and the common parent was not the loss subgroup parent immediately before the reattribution), the deemed section 381(a) transaction is considered to constitute a capital contribution with respect to the new loss member (or loss subgroup member) for purposes of section 382(l)(1). Accordingly, if that section applies because the deemed capital contribution is (or is considered under section 382(l)(1)(B) to be) part of a plan described in section 382(l)(1)(A), the value of the stock of the common parent after the deemed section 381(a) transaction must be adjusted to reflect the capital contribu-

tion. Ordinarily, this will require the value of the stock of the common parent to be reduced to an amount that represents the value of the stock of the subsidiary (or loss subgroup of which the subsidiary was a member) when the reattribution occurred.

(iv) *Duplication or omission of value*. In determining any section 382 limitation with respect to the reattributed loss and with respect to other pre-change losses, appropriate adjustments must be made so that value is not improperly omitted or duplicated as a result of the reattribution. For example, if the subsidiary has an ownership change upon its departure, and the common parent (as successor) has an ownership change with respect to the reattributed pre-change separate attribute upon its reattribution under paragraph (d)(3)(i) of this section, proper adjustments must be made so that the value of the subsidiary is not taken into account more than once in determining the section 382 limitation for the reattributed loss and the loss that is not reattributed.

(v) *Special rule for continuity of business requirement*. If the reattributed loss is a pre-change attribute of new loss member and the reattribution occurs within the two-year period beginning on the change date, then, starting immediately after the reattribution, the continuity of business requirement of section 382(c)(1) is applied with respect to the business enterprise of the common parent. Similar principles apply if the reattributed loss is a pre-change subgroup attribute and, on the day after the reattribution, the common parent is not a member of the loss subgroup.

(5) *Election to reattribute section 382 limitation*—(i) *Effect of election*. The common parent may elect to apportion to itself all or part of any separate section 382 limitation or subgroup section 382 limitation to which the loss is subject immediately before the reattribution. However, no net unrealized built-in gain of the member (or loss subgroup) whose loss is reattributed can be apportioned to the common parent. The principles of §1.1502–95(c) apply to the apportionment, treating, as the context requires, references to the former member as references to the common parent, and references to the consolidated section 382 limitation as references to the separate section 382 limitation (or subgroup section 382 limitation) that is being apportioned. Thus, for example, the common parent can reattribute to itself all or part of the value element or adjustment element of the limitation, and any part of such element that is apportioned requires a corresponding reduction in such element of the separate section 382 limitation of the subsidiary whose loss is reattributed (or in the subgroup section 382 limitation if the reattributed loss is a pre-change subgroup attribute). Appropriate adjustments must be made to the separate section 382 limitation (or subgroup section 382 limitation) for the consolidated return year in which the reattribution is made to reflect that the reattributed loss is an attribute acquired by the common parent during the year in a transaction to which section 381(a) applies. The election is made by the common parent as part of the election to reattribute the loss. See §1.1502–36(e)(5)(x) for the time and manner of making the election.

(ii) *Examples*. The following examples illustrate the principles of this paragraph (d)(5):

Example 1. Consequence of apportionment. (i) *Facts*. P, the common parent of a consolidated group, purchases all of the stock of L on December 31, year 1. L carries over a net operating loss arising in year 1 to each of the next 5 taxable years. The purchase of the L stock causes an ownership change of L, and results in a separate section 382 limitation of $10 for L's net operating loss carryover based on the value of the L stock. On July 2, year 3, P sells 30% of the L stock to A. Under §1.1502–36(d)(6), P elects to reattribute to itself $110 of L's $200 net operating loss carryover. P also elects to apportion to itself $6 of the $10 value element of the separate section 382 limitation.

(ii) *Analysis*. (A) *P's separate section 382 limitation*. For the consolidated return years ending after December 31, year 3, P's separate section 382 limitation with respect to the reattributed net operating loss carryover is $6, adjusted as appropriate for any short taxable year, unused section 382 limitation, or other adjustment. For the P group's consolidated return year ending December 31, year 3, the separate section 382 limitation for L's net operating loss carryover is $8, the sum of $5 and $3. Five dollars of the limitation is the amount that bears the same relationship to $10 as the number of days in the period ending with the deemed section 381(a) transaction, 183 days, bears to 365. Three dollars of the limitation is the amount that bears the same relationship to $6 as the number of days in the period between July 3 and December 31, 182 days, bears to 365.

(B) *L's separate section 382 limitation*. For L's taxable years ending after December 31, year 3, L's separate section 382 limitation for its $90 of net operating loss carryover that was not reattributed to P is $4, adjusted as appropriate for any short taxable year, unused section 382 limitation, or other adjustment. For L's short taxable year ending December 31, year 3, the section 382 limitation for its $90 of net operating loss carryover is $2, the amount that bears the same relationship to $4 (the portion of the value element that was not apportioned to P), as the number of days during the short taxable year, 182 days, bears to 365. See §1.382–5(c).

Example 2. No apportionment required for consolidated pre-change attribute. (i) *Facts*. P, the common parent of a consolidated group, forms L. For year 1, L has an operating loss of $70 that is not absorbed and is included in the group's consolidated net operating loss that is carried over to subsequent years. On January 1 of year 3, A buys all of the P stock and the P group has an ownership change. The consolidated section 382 limitation based on the value of the P stock is $10.

(ii) *Analysis*. On April 13 of year 4, P sells all of the stock of L to B and, under §1.1502–36(d)(6), elects to reattribute to itself $45 of L's net operating loss carryover. Following the reattribution, the $45 portion of the year 1 net operating loss carryover retains its character as a pre-change consolidated attribute, and remains subject to so much of the $10 consolidated section 382 limitation as P does not elect to apportion to L under §1.1502–95(c).

* * * * *

Par. 24. Section 1.1502–99 is amended by revising the section heading and paragraph (b)(4) to read as follows:

§1.1502–99 Effective/applicability dates.

* * * * *

(b) * * *

(4) *Reattribution of losses under §1.1502–36(d)(6).* Section 1.1502–96(d) applies to reattributions of net operating loss carryovers, capital loss carryovers, and deferred deductions in connection with a transfer of stock to which §1.1502–36 applies, and the election under §1.1502–96(d)(5) (relating to an election to reattribute section 382 limitation) can be made with an election under §1.1502–36(d)(6) to reattribute a loss to the common parent that is filed at the time and in the manner provided in §1.1502–36(e)(5)(x).

* * * * *

Par. 25. For each section listed in the tables, remove the language in the "Remove" column and add in its place the language in the "Add" column as set forth below:

Section	Remove	Add
§1.267(f)–1(k)	For additional rules applicable to the disposition or deconsolidation of the stock of members of consolidated groups, see §§1.337(d)–2, 1.1502–13(f)(6), and 1.1502–35.	For additional rules applicable to the disposition, deconsolidation, or transfer of the stock of members of consolidated groups, see §§1.337(d)–2, 1.1502–13(f)(6), 1.1502–35, and 1.1502–36.
§1.597–4(g)(2)(v), second parenthetical	§§1.337(d)–2 and 1.1502–35(f)	§1.337(d)–2, §1,1502–35(f), and §1.1502–36
§1.1502–11(b)(3)(ii), paragraph (c) in *Example*	§§1.337(d)–2 and 1.1502–35	§§1.337(d)–2, 1.1502–35, and 1.1502–36
§1.1502–12(r)	§§1.337(d)–2 and 1.1502–35(f) for rules relating to basis adjustments and allowance of stock loss on dispositions of stock of a subsidiary member.	§§1.337(d)–2, 1.1502–35, and 1.1502–36 for rules relating to basis adjustments and allowance of stock loss on dispositions or transfers of subsidiary stock.
§1.1502–15(b)(2)(iii)	§§1.337(d)–2, 1.1502–35, or	§1.337(d)–2, §1.1502–35, §1.1502–36, or
§1.1502–21(b)(2)(iv)(B)(*2*)(*i)*	(b)(2)(iv)(B)(*2*)(*iv*)	(b)(2)(iv)(B)(*2*)(*v*)
§1.1502–21(b)(2)(iv)(B)(*2*)(*ii*)	(b)(2)(iv)(B)(*2*)(*iv*)	(b)(2)(iv)(B)(*2*)(*v*)
§1.1502–21(b)(2)(iv)(B)(*2*)(*iii*)	(b)(2)(iv)(B)(*2*)(*iv*)	(b)(2)(iv)(B)(*2*)(*v*)
§1.1502–90 Table of Contents, under §1.1502–96(d)	§1.1502–20(g)	§1.1502–36(d)(6)
§1.1502–90 Table of Contents, under §1.1502–99(b)(4)	§1.1502–20(g)	§1.1502–36(d)(6)

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 26. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 27. In §602.101, paragraph (b) is amended as follows:

1. The following entries to the table are removed:

§602.101 OMB Control Numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB Control No.
* * * * *	
§1.1502–20	1545–1160
	1545–1218
§1.1502–20T	1545–1774
§1.1502–32T	1545–1774
§1.1502–35T	1545–2019
* * * * *	

2. The following entry is added in numerical order to the table:

§602.101 OMB Control Numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB Control No.
* * * * *	
§1.1502–36	1545–2096
* * * * *	

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

Approved September 4, 2008.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on September 9, 2008, 4:15 p.m., and published in the issue of the Federal Register for September 17, 2008, 73 F.R. 53933)

Section 6401.—Amounts Treated as Overpayments

To the extent that taxpayer is allowed the business credit or alternative minimum tax credit in an amount allocable to the aggregate increases in the business credit limitation and the alternative minimum tax credit limitation that result from the §168(k)(4) election, such amount(s) are treated as overpayments within the meaning of § 6041(b) that are refundable to the taxpayer. See Rev. Proc. 2008-65, page 1082.

Part III. Administrative, Procedural, and Miscellaneous

Guidance for Sections 162(m)(5) and 280G(e) of the Internal Revenue Code

Notice 2008–94

I. PURPOSE

This notice provides guidance on certain executive compensation provisions of the Emergency Economic Stabilization Act of 2008, Div. A of Pub. Law No. 110–343 (EESA), which was enacted on October 3, 2008. Section 302 of EESA added new §§ 162(m)(5) and 280G(e) to the Internal Revenue Code. Section 162(m) generally limits the deductibility of compensation paid to certain corporate executives and § 280G provides that a corporate executive's excess parachute payments are not deductible and imposes (under § 4999) an excise tax on the executive for those amounts.

New §§ 162(m)(5) and 280G(e) provide additional limitations on the deductibility of compensation paid to certain executives by employers who sell "troubled assets" in the "troubled assets relief program" included in EESA. Section 162(m)(5) generally reduces the $1 million deduction limitation to $500,000 for certain taxable years and provides that certain exceptions to the deduction limitation, including the exception for performance-based compensation, are not applicable. Section 280G(e) generally expands the definition of a parachute payment to include certain payments made contingent on severance from employment.

II. BACKGROUND RELATING TO EESA EXECUTIVE COMPENSATION PROVISIONS

Section 101(a) of EESA authorizes the Secretary of the Treasury to establish a Troubled Assets Relief Program (TARP) to "purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and policies and procedures developed and published by the Secretary." Section 120 of EESA provides that the TARP authorities terminate on December 31, 2009, unless extended upon certification by the Secretary of the Treasury to Congress, but in no event later than two years from the date of enactment (October 3, 2008) (the TARP authorities period). Thus, the TARP authorities period is the period from October 3, 2008 to December 31, 2009 or, if extended, the period from October 3, 2008 to the date so extended, but no later than October 3, 2010.

EESA includes two sections that directly address executive compensation. Section 302 of EESA enacted tax provisions as amendments to §§ 162(m) and 280G that address compensation paid to certain executive officers employed by financial institutions that sell assets under TARP. This notice addresses these tax provisions.

Section 111 of EESA subjects certain financial institutions that sell assets to the Treasury Department to specified executive compensation standards. In the case of a direct purchase the standards under section 111(b) of EESA include: (a) limits on compensation that exclude incentives on senior executive officers of financial institutions to take unnecessary and excessive risks that threaten the value of the financial institution during the period that the Treasury Department holds an equity or debt position, (b) recovery of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate, and (c) a prohibition on making any golden parachute payment to any of its senior executive officers during the period that the Treasury Department holds an equity or debt position. In the case of a financial institution that has sold assets under TARP in sales that are not solely direct purchases and the amount sold (including direct purchases) exceeds $300 million in the aggregate, the financial institution is prohibited under section 111(c) during the TARP authorities period from entering into any new employment contract with a senior executive officer that provides a golden parachute in the event of involuntary termination from employment, bankruptcy filing, insolvency, or receivership. See Interim final regulations issued by the Treasury under section 111(b) of EESA at 31 CFR part 30, Notice 2008–PSSFI under section 111(b) of EESA, and Notice 2008–TAAP under section 111(c) of EESA.

III. SECTION 302(a) OF EESA ADDING NEW § 162(m)(5)

A. Section 162(m) Background

Section 162(m) generally limits the otherwise allowable deduction for compensation paid or accrued with respect to a covered employee of a publicly held corporation to no more than $1 million per year.[1] Section 162(m)(3) defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year, or (2) one of the four most highly compensated officers for the taxable year (other than the chief executive officer) required to be reported to the shareholders under the Securities Exchange Act of 1934 (the Exchange Act).

In 2006, the Securities and Exchange Commission amended the rules related to executive compensation disclosure. In response to the 2006 amendment, the Treasury Department and the Service issued Notice 2007–49, 2007–25 I.R.B. 1429, which provides that "covered employee" means any employee who is (1) the principal executive officer (or an individual acting in such capacity) defined by reference to the Exchange Act or (2) among the three most highly compensated officers for the taxable year (other than the principal executive officer or the principal financial officer), again defined by reference to the Exchange Act. Section 1.162–27(c)(2) of the Treasury Regulations provides that the individual must meet the criteria of chief executive officer or be among the highest compensated officers as of the last day of the taxable year in order to be a covered employee.

If an individual is a covered employee for a taxable year, then a deduction limit applies to all compensation not explicitly excluded from the deduction limit, regard-

[1] A corporation is treated as publicly held if it has a class of equity securities that is required to be registered under section 12 of Securities Exchange Act of 1934.

less of whether the compensation is for services as a covered employee and regardless of when the compensation was earned. The $1 million limit is reduced by excess parachute payments (as defined in § 280G) that are not deductible by the corporation. Under § 162(m) as in effect prior to the amendment included in EESA, the following types of compensation generally are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million: (1) remuneration payable on a commission basis; (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met ("performance-based compensation"); (3) payments to a tax-qualified retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive's gross income; and (5) any remuneration payable under a written binding contract that was in effect on February 17, 1993 and that was not materially modified thereafter. Because remuneration generally does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee, the deduction limit does not apply to compensation that is deferred until after termination of employment.

B. Section 302(a) of EESA: Amendment adding § 162(m)(5)

Section 302(a) of EESA amended § 162(m) to add § 162(m)(5), which reduces the deduction limit to $500,000 in the case of "executive remuneration" and "deferred deduction executive remuneration." This limit applies only to certain employers (an "applicable employer") for remuneration paid to certain executives ("covered executives) during certain taxable years (an "applicable taxable year"). Employers covered under § 162(m)(5) are not limited to publicly held corporations (nor even to corporations). The exception for performance-based compensation and certain other exceptions do not apply in the case of executive compensation covered under § 162(m)(5).

Q&A–1 and Q&A–2 of this notice provide guidance on when an employer is an applicable employer, Q&A–3 provides guidance on when a taxable year is an applicable taxable year, Q&A–4 provides guidance on the determination of who is a covered executive, Q&A–5 provides guidance on mergers and acquisitions, Q&A–6 provides guidance on executive remuneration, and Q&A–7 through Q&A–10 provide guidance on deferred deduction executive remuneration.

Q–1: What is an applicable employer under § 162(m)(5)?

A–1: (a) *General definition*. An "applicable employer" is any financial institution that is an employer from whom one or more troubled assets are acquired under TARP, but only if the aggregate amount of the assets acquired exceeds $300 million. The assets that are counted for the $300 million threshold include assets that are acquired under TARP in accordance with section 101(a) of EESA. However, if the only such acquisitions from a financial institution are through a direct purchase, the financial institution is not an applicable employer. (For special rules with respect to employers that sell assets through a direct purchase, see section 111(b) of EESA, Interim final regulations issued by the Treasury under section 111(b) of EESA at 31 CFR part 30, and Notice 2008–PSSFI under section 111(b) of EESA.)

(b) *Controlled group rules*. For purposes of § 162(m)(5), including the determination of whether the aggregate amount of assets acquired from an employer exceeds $300 million, two or more persons who are treated as a single employer under § 414(b) (employees of a controlled group of corporations) and § 414(c) (employees of partnerships, proprietorships, etc., that are under common control) are treated as a single employer. However, for purposes of applying the aggregation rules to determine an applicable employer, the rules for brother-sister controlled groups and combined groups are disregarded (including disregarding the rules in § 1563(a)(2) and (a)(3) with respect to corporations and the parallel rules that are in § 1.414(c)–2(c) of the Treasury Regulations with respect to other organizations conducting trades or businesses). See Q&A–4 of this notice regarding the determination of a covered executive in a controlled group, and see Q&A–5 of this notice for special rules where a financial institution has acquired another financial institution through an acquisition.

(c) *Example*. Bank holding company X is the sole owner of banks A, B, and C. In December of 2008, bank A sells $150 million of assets under a TARP auction purchase. In February of 2009, bank B sells $100 million of assets under a TARP auction purchase. On August 14, 2009, bank C sells $100 million of assets under a TARP auction purchase. Bank holding company X, along with banks A, B, and C, plus any other entity that is treated as the same employer under the rules described in paragraph (b) of this Q&A–1, constitute a single applicable employer that has sold in excess of $300 million of assets under a TARP auction purchase. As provided in Q&A–4 of this notice, the chief executive officer and chief financial officer of bank holding company X and the three other most highly compensated officers of the bank holding company X controlled group are "covered executives."

Q–2: Can a corporation that is not publicly traded, or an entity that is not a corporation, be an "applicable employer"?

A–2: (a) *General rule*. Yes. An applicable employer for purposes of § 162(m)(5) is not limited to a publicly traded corporation or even to the corporate business form. Thus, an entity, whether or not publicly traded, is an applicable employer if the entity is described in Q&A–1 of this notice regardless of whether the entity is a corporation, a partnership (or taxed as a partnership for federal tax purposes), or a trust.

(b) *Special rule for partnerships, grantor trusts, and similar entities*. In the case of a partnership, grantor trust, or similar entity, the determination of whether more than $300 million of assets has been sold is generally made at the level of the selling entity (taking into account all entities that are treated as the same employer under the controlled group rules described in Q&A–1(b) of this notice). However, if the selling entity has no employees who are officers (or acting in the capacity of an officer), then the owner of the entity that manages the selling entity's assets is the entity that may be the applicable employer (along with all entities that are treated as the same employer as the selling entity under the controlled group rules described in Q&A–1(b) of this notice).

Q–3: What is an applicable taxable year to which the $500,000 deduction limit imposed by § 162(m)(5) applies?

A–3: Section 162(m)(5) does not apply to an employer unless, during a taxable year of the employer that includes any portion of the TARP authorities period, the aggregate amount of the troubled assets acquired under TARP from the employer in that taxable year, when added to the

amount acquired from the employer under TARP for all preceding taxable years, exceeds $300 million (unless all such acquisitions are through a direct purchase. If the condition in the preceding sentence is satisfied, then § 162(m)(5) applies to that taxable year and to any subsequent taxable year of the employer that includes any portion of the TARP authorities period. (See Q&A–10 regarding the applicability of § 162(m)(5) to deferred deduction executive compensation after the TARP authorities period.) If the entities that are treated as a single applicable employer under the controlled group rules described in Q&A–1(b) of this notice do not have the same taxable year, the relevant taxable year is the taxable year of the parent entity in the controlled group.

Q–4: Who is a covered executive under § 162(m)(5)?

A–4: (a) *General definition.* A "covered executive" means an individual described in the following sentence who is employed by a financial institution that is an applicable employer at any time during an applicable taxable year. Covered executives are limited to: (i) the chief executive officer (CEO) and the chief financial officer (CFO) (or an individual acting in either of those capacities) of the applicable employer during the taxable year that includes any portion of the TARP authorities period, and (ii) the three highest compensated officers of the applicable employer (including the entire controlled group) other than the CEO or CFO, taking into account only employees employed during the taxable year that includes any portion of the TARP authorities period (the high three officers).

(b) *Determination of high three officers.* For corporations that are subject to the Exchange Act (as defined in section III.A. of this notice), the high three officers are determined on the basis of the shareholder disclosure rules under the Exchange Act with one difference. In accordance with the Exchange Act disclosure rules, the term "officer" means those "executive officers" whose compensation is subject to reporting under the Exchange Act. For the purpose of determining the high three officers, compensation is defined as it is in the Exchange Act disclosure rules to include total compensation without regard to whether the compensation is includible in an executive officer's gross income. However, unlike the Exchange Act disclosure rules that determine the high three officers by reference to total compensation for the last completed fiscal year, the measurement period for purposes of determining the high three officers for an applicable taxable year is that taxable year.

(c) *Application to private employers and noncorporate entities.* Rules analogous to the rules in paragraphs (a) and (b) of this Q&A–4 apply to employers that are not subject to the Exchange Act disclosure rules, including employers whose stock is not publicly traded and employers that are not corporations.

(d) *Time period as a covered executive.* If an employee is a covered executive with respect to an applicable employer for any applicable taxable year, the executive is a covered executive for any subsequent applicable taxable year, including being a covered executive in any later taxable year for purposes of the special rule for deferred deduction executive remuneration (described in Q&A–10 of this notice). (See Q&A–5 of this notice for special rules that apply in connection with an acquisition.)

Q–5: How do the rules apply in connection with an acquisition, merger, or reorganization?

A–5: (a) *Special rules for acquisitions, mergers, or reorganizations.* In the event that a financial institution (target) that sold troubled assets under TARP is acquired by an entity that is not related to target (acquirer) in an acquisition of any form, the troubled assets sold under TARP by target prior to the acquisition are not aggregated with any assets sold by acquirer prior to or after the acquisition. For this purpose, acquirer is related to target if stock or other interests of target are treated (under § 318(a) other than paragraph (4) thereof) as owned by acquirer.

If, after an acquisition, troubled assets of target are sold by acquirer's controlled group (including target in the case of a stock acquisition), those assets must be aggregated with any assets sold by acquirer, whether prior to or after the acquisition, for purposes of determining whether acquirer is an applicable employer.

If target was an applicable employer at the time of the acquisition, acquirer will not become an applicable employer merely as a result of the acquisition. Further, if target was an applicable employer at the time of the acquisition, a covered executive of target will continue to be a covered executive during the TARP authorities period if he or she is employed by the controlled group of which target is a member, regardless of whether acquirer is an applicable employer and regardless of whether the target covered executive is a covered executive of the acquirer. However, if, after an acquisition, a target covered executive ceases employment with the controlled group of which target is a member, no new executive of target will be a covered executive merely because of such termination, unless such executive is a covered executive of acquirer.

(b) *Example.* In 2008, financial institution A sells $100 million of troubled assets under TARP and financial institution B sells $350 million of troubled assets under TARP. In January 2009, financial institution A acquires financial institution B in a stock purchase transaction, with the result that financial institution B becomes a wholly-owned subsidiary of financial institution A. In February 2009, financial institution A sells an additional $100 million of its troubled assets under TARP, and in March 2009 financial institution B (when it is a wholly owned subsidiary of A) sells an additional $150 million of troubled assets. Neither the sale of troubled assets by financial institution A nor the sale of troubled assets by financial institution B are solely through direct purchases. Based on the rules in paragraph (a) of this Q&A–5, financial institution A is not an applicable employer as a result of the acquisition of B, or as a result of the assets sold in February 2009, because the $350 million of troubled assets sold by financial institution B prior to the acquisition are not aggregated with the troubled assets sold by financial institution A's controlled group prior to and after the acquisition of financial institution B. However, financial institution A becomes an applicable employer in March 2009 when the amount of troubled assets sold by financial institution A's controlled group (without regard to the sales by financial institution B prior to the acquisition of B by A) total $350 million. Further, because 2009 is an applicable taxable year with respect to financial institution B, the officers of financial institution B who are covered executives on the date financial institution B was acquired continue to be covered executives during any subsequent applicable taxable year that includes any portion of the TARP authorities period, as long as they are employed by financial institution A's controlled group. Similarly, the CEO, CFO, and high three officers of financial institution A become covered executives in 2009 when financial institution A becomes an applicable employer.

Q–6: What constitutes executive remuneration to which the $500,000 limit imposed by § 162(m)(5) applies?

A–6: (a) *General definition.* For the purposes of the § 162(m)(5) $500,000 deduction limit, except as provided in paragraph (b) of this Q&A–6, executive remuneration means applicable em-

ployee remuneration, as determined under § 162(m)(4), but without regard to the following subparagraphs of § 162(m)(4): (B) (remuneration payable on a commission basis), (C) (performance-based compensation), or (D) (exception for existing binding contracts). Under § 162(m)(4), applicable employee remuneration for a year is based on the year in which the remuneration is deductible (whether or not the remuneration is paid in that year or is includible in the employee's income in that year). For example, payments that are deductible by the employer in an applicable taxable year, but are paid to the covered executive by the 15th day of the third month after the end of that year (as described in § 1.404(b)–1T, Q&A–2(b)(1) of the Treasury Regulations), are executive remuneration for that applicable taxable year.

(b) *Remuneration only for the applicable taxable year*. The $500,000 deduction limit in § 162(m)(5)(A) applies to executive remuneration and deferred deduction executive remuneration attributable to services performed by a covered executive during an applicable taxable year. Under this rule, payments of remuneration that are deductible in an applicable taxable year for services performed by the covered executive in a prior taxable year are not treated as executive remuneration for purposes of § 162(m)(5). (See Q&A–7 through Q&A–10 of this notice for rules related to deferred deduction executive remuneration.)

Q–7: How does the $500,000 deduction limitation imposed by § 162(m)(5) apply with respect to deferred deduction executive remuneration?

A–7: (a) *General rule*. No deduction is allowed for any taxable year for deferred deduction executive remuneration for services performed during any applicable taxable year by a covered executive, to the extent that the amount of the deferred deduction executive remuneration exceeds $500,000, minus the sum of: (i) the executive remuneration for that applicable taxable year, plus (ii) the portion of the deferred deduction executive remuneration for such services taken into account in a preceding taxable year. Under this rule, the unused portion (if any) of the $500,000 limit for the applicable taxable year that has not been taken into account (and so is unused) is carried forward until the year in which the deferred deduction executive remuneration allocable to that applicable taxable year is otherwise deductible, and the remaining unused limit is then applied to the payment of the deferred deduction executive remuneration.

(b) *Examples*. (1) Covered executive A is paid $400,000 in salary by an applicable employer in 2009 (an applicable taxable year) and A obtains a legally binding right attributable to services performed in 2009 to receive a payment of $250,000 in 2015. The full $400,000 in cash salary is deductible under the $500,000 limit in 2009. In 2015, the employer's deduction with respect to the $250,000 is limited to $100,000, which represents the unused portion of the $500,000 limit from 2009 (and no deduction will be allowed for the remaining $150,000).

(2) Covered executive B is paid $400,000 salary by an applicable employer in 2009 (an applicable taxable year) and B obtains a legally binding right attributable to services performed in 2009 to be paid $250,000 in 2010 (which is also an applicable taxable year), and B is paid $500,000 in salary in 2010. Accordingly, the employer's deduction in 2010 for the $250,000 payment made in 2010 (attributable to services performed in 2009) is limited to $100,000. The entire $500,000 of salary earned in 2010 is deductible in 2010 (assuming other deduction requirements are satisfied).

Q–8: What is "deferred deduction executive remuneration" for purposes of § 162(m)(5)?

A–8: Deferred deduction executive remuneration means remuneration that would be executive remuneration for services performed by a covered executive in an applicable taxable year but for the fact that the deduction is allowable in a subsequent taxable year (determined without regard to § 162(m)(5)). The amount paid as deferred deduction executive remuneration is taken into account, without distinction between the amount deferred in the taxable year in which the services were performed and earnings thereon.

Q–9: How are the services to which deferred deduction executive remuneration is allocable determined?

A–9: (a) *Period during which services are performed*. For purposes of the $500,000 limit on the deductibility of deferred deduction executive remuneration under § 162(m)(5)(A), the period during which the services are performed by a covered executive to which the remuneration is allocable is determined in accordance with this Q&A–9. (See Q&A–7 of this notice regarding the application of the deduction limits to deferred deduction executive remuneration.)

(b) *Services to which deferred deduction executive remuneration is allocable. (1) General rule: Remuneration allocable to a service period based on plan formula*. If an employee obtains a legally binding right to remuneration under a plan, agreement, or arrangement (plan) and that plan provides for benefit payments under a formula that relates to a specific period of service in a year (such as relating to compensation paid during that period), the deferred deduction executive remuneration is generally allocable to that specific period. To the extent that, based on the terms of the plan, deferred deduction executive remuneration is not allocable to services performed in a particular taxable year, then the remuneration generally is for services performed during the taxable year in which the employee obtains the legally binding right to the remuneration.

(2) *Legally binding right*. Deferred deduction executive remuneration is not allocable to a period prior to the date the employee is employed by the employer and obtains a legally binding right to the remuneration. An employee does not have a legally binding right to remuneration to the extent that compensation may be reduced unilaterally or eliminated by the employer or other person after the services creating the right to the remuneration have been performed. However, if the facts and circumstances indicate that the discretion to reduce or eliminate the remuneration is available or exercisable only upon a condition, or the discretion to reduce or eliminate the compensation lacks substantive significance, then the employee has a legally binding right to the remuneration. For this purpose, remuneration is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, such as the application of a nondiscretionary, objective provision creating a substantial risk of forfeiture. (See §§ 1.409A–1(b)(1) and 31.3121(v)(2)–1(b)(3)(i) of the Treasury Regulations for additional rules regarding when an employee obtains a legally binding right to remuneration.)

(3) *Substantial risk of forfeiture*. To the extent that an employee's right to remuneration is subject to a substantial risk of forfeiture (as determined in accordance with the rules under § 1.409A–1(d) of the Treasury Regulations) in the form of a re-

quirement to continue to perform substantial future services for the employer, the remuneration generally is for services performed over the period of time that the employee is required to continue to perform substantial future services for the employer and is allocated to that period on a *pro rata* basis, unless the remuneration is allocable to a different period under the rule in paragraph (b)(1) of this Q&A–9. If the substantial risk of forfeiture lapses early (such as due to death or disability), then the allocation is prorated over the period from when the employee obtained the legally binding right to the payment to the date that the substantial risk of forfeiture lapses. The only substantial risk of forfeiture taken into account for purposes of this paragraph (b)(3) is a requirement that the employee perform substantial future services. Any other condition related to the purpose of the remuneration that may constitute a substantial risk of forfeiture is disregarded.

(c) *Examples*. (1) Employee A obtains on January 1, 2006 a legally binding right to be paid $400,000 at the end of December, 2010, but only if A continues to be employed on the date of payment. In this case, a *pro rata* portion of the remuneration is for services performed during 2006, 2007, 2008, 2009, and 2010 ($80,000 per year). If 2009 and 2010 are applicable taxable years for A's employer and A is a covered executive in those years, then, for purposes of the $500,000 deductible limitation for 2009 and 2010, $80,000 of the $400,000 paid in 2010 would be deferred deduction executive remuneration allocable to services rendered in 2009 and $80,000 of the $400,000 paid in 2010 would be allocable to services rendered in 2010.

(2) Employee B obtains a legally binding right in 2008 to receive a payment of $100,000 in 2012 (without regard to continued employment) in the event that an asset is sold by that date for a price at or above a specified dollar amount, which, under the circumstances is a substantial risk of forfeiture. The risk of forfeiture is disregarded and the $100,000 payment is for services performed in 2008. The $100,000 payment made in 2012 is deferred deduction executive remuneration allocable to 2008 and is subject to the 2008 $500,000 deduction limitation.

(3) Employee C obtains on December 31, 2008 a legally binding right to be paid on February 1, 2011 an amount equal to 10 percent of employee C's salary during the period from January 1, 2009 through December 31, 2010, and employee C's salary is $400,000 for each of 2009 and 2010. Under the terms of the plan in this case, the remuneration is allocable *pro rata* to services performed in 2009 and 2010, so that half of the $80,000 payment made on February 1, 2011 is for services performed in 2009 and the other half is for services performed in 2010.

(4) Employee D obtains on December 31, 2008 a legally binding right to be paid on January 1, 2015 an amount equal to 20 percent of D's highest annual salary times the number of years of service completed by D before January 1, 2011, but only if D remains employed through December 31, 2010. Employee D remains employed through December 31, 2010 and has an annual salary of $400,000 in 2009 and $450,000 in 2010. Accordingly, Employee D receives a payment of $180,000 on January 1, 2015 (20 percent times 2 years of service times $450,000, D's highest annual salary). Under the terms of the plan in this case, under the rule in paragraph (b)(1) of this Q&A–9, the remuneration allocable to services performed in 2009 is $80,000 (20 percent of Employee D's annual salary in 2009 times 1 year of service). The remuneration allocable to services performed in 2010 is $100,000 (20 percent of $450,000, times 2 years of service, reduced by the remuneration allocable to services performed in 2009).

(5) Employee E obtains on December 31, 2008 a legally binding right to be paid $400,000 on February 1, 2011 (without any requirement of continued employment). Under these facts and circumstances, the remuneration is not allocable to services performed in a period of time after December 31, 2008, so that the $400,000 paid on February 1, 2011 is for services performed during the taxable year that includes December 31, 2008.

(6) Employee F obtains on December 31, 2008 a legally binding right to acquire stock (a stock option) with an exercise price equal to the fair market value of the stock on December 31, 2008 (without any requirement of continued employment in order to be able to exercise the right and retain the shares). The remuneration is not allocable to services performed in a period of time after December 31, 2008, so that the remuneration resulting from exercise of the stock option is for services performed in the taxable year that includes December 31, 2008.

(7) Employee G obtains on January 1, 2009 a legally binding right to acquire stock (a stock option) over the next 10 years with an exercise price equal to the fair market value of the stock on January 1, 2009, but the stock option can be exercised only after the employee has continued his or her employment for three more years (through December 31, 2011). The employee exercises the right in 2014 resulting in income of $210,000. In this case, the payment of $210,000 is allocable to services performed from January 1, 2009 through December 31, 2011, of which $70,000 is allocable to services rendered in 2009, $70,000 is allocable to services rendered in 2010, and $70,000 is allocable to services performed in 2011.

Q–10: How long does the limit imposed by § 162(m)(5) apply?

A–10: While the limit imposed by § 162(m)(5) only applies to remuneration for services performed in an applicable taxable year, the limit with respect to deferred deduction executive remuneration for services performed in an applicable taxable year applies for deductions in all subsequent taxable years (until the deferred deduction executive remuneration for services performed in that applicable taxable year is completely paid).

IV. SECTION 302(b) OF EESA ADDING NEW § 280G(e)

A. Section 280G Background

Section 280G, as in effect prior to the addition of § 280G(e) made by section 302(b) of EESA, provides that certain payments in excess of certain limits, referred to as "excess parachute payments," are not deductible by a corporation. In addition, § 4999 imposes an excise tax on the recipient of any excess parachute payment equal to 20 percent of the amount of such payment.

Subject to certain exceptions, § 280G(b)(2) defines a "parachute payment" as any payment in the nature of compensation to (or for the benefit of) a disqualified individual that is contingent on a change in the ownership or effective control of a corporation or on a change in the ownership of a substantial portion of the assets of a corporation ("acquired corporation") if the aggregate present value of all such payments made or to be made to the disqualified individual equals or exceeds three times the individual's "base amount." Section 280G(b)(3) defines the individual's base amount as the average annual compensation payable by the acquired corporation and includible in the individual's gross income over the five taxable years of such individual preceding the individual's taxable year in which the change in ownership or control occurs.

A disqualified individual is any individual who is an employee, independent contractor, or other person specified in Treasury regulations who performs personal services for the corporation and who is an officer, shareholder, or highly compensated individual of the corporation.

B. Section 302(b) OF EESA: Amendment of § 280G

Section 302(b) of EESA amended § 280G by expanding the definition of a parachute payment to include certain severance payments made to a covered executive of an applicable employer participating in TARP. As defined in § 280G(e)(2)(B), an applicable severance from employment is any severance from employment of a covered executive: (1) by reason of an involuntary termination

of the executive by the employer or (2) in connection with a bankruptcy, liquidation, or receivership of the employer.

New § 280G(e) is effective for payments made during an applicable taxable year with respect to severances occurring during the TARP authorities period.

Q–11: Who is subject to the special rules in § 280G(e)?

A–11: The special rules in § 280G(e) apply to any covered executive of an applicable employer who has a severance from employment during an applicable taxable year that is treated as an "applicable severance from employment," as defined in Q&A–12 of this notice. For purposes of § 280G(e), the terms "applicable employer," "applicable taxable year," and "covered executive" have the same meaning as under § 162(m)(5) (as those terms are described in Q&A–1 through Q&A–4 of this notice, and taking into account the special rule in Q&A–5 of this notice). However, § 280G(d)(5) (treatment of affiliated groups) and other provisions do not apply.

Q–12: What is an applicable severance from employment of a covered executive for purposes of § 280G(e)?

A–12: (a) *Applicable severance from employment defined.* An applicable severance from employment means any covered executive's severance from employment with the applicable employer: (1) by reason of involuntary termination of employment with an entity that is an applicable employer or (2) in connection with any bankruptcy, liquidation, or receivership of an entity that is an applicable employer.

(b) *Involuntary termination.* (i) An involuntary termination from employment means a severance from employment due to the independent exercise of the unilateral authority of the applicable employer to terminate the covered executive's services, other than due to the covered executive's implicit or explicit request, where the covered executive was willing and able to continue performing services. An involuntary termination from employment may include the applicable employer's failure to renew a contract at the time such contract expires, provided that the covered executive was willing and able to execute a new contract providing terms and conditions substantially similar to those in the expiring contract and able to continue providing such services. In addition, a covered executive's voluntary termination from employment constitutes an involuntary termination from employment if the termination from employment constitutes a termination for good reason due to a material negative change in the covered executive's employment relationship. See § 1.409A–1(n)(2) of the Treasury Regulations.

(ii) A severance from employment by a covered executive is by reason of involuntary termination even if the covered executive has voluntarily terminated employment in any case where the facts and circumstances indicate that absent such voluntary termination the applicable employer would have terminated the covered executive's employment and the covered executive had knowledge that he or she would be so terminated. (See § 280G(e)(2)(C)(ii)(III).)

Q–13: What is a "parachute payment" for purposes of § 280G(e)?

A–13: (a) *General definition.* For purposes of § 280G(e), a "parachute payment" means any payment in the nature of compensation to (or for the benefit of) a covered executive made during an applicable taxable year on account of an applicable severance from employment during the TARP authorities period if the aggregate present value of such payments equals or exceeds an amount equal to three times the covered executive's base amount. (See Q&A–14 of this notice for a definition of an excess parachute payment.)

(b) *Payment on account of an applicable severance from employment.* A payment on account of an applicable severance from employment means a payment that would not have been payable if no applicable severance from employment had occurred (including amounts that would otherwise have been forfeited due to severance from employment) and amounts that are accelerated on account of the applicable severance from employment. (See § 1.280G–1, Q&A–24(b) of the Treasury Regulations for rules regarding the determination of the amount that is on account of an acceleration.) Further, for purposes of § 280G(e), the exclusions under § 280G(b)(2)(C) (payments under certain contracts entered into within 1 year of the change); § 280G(b)(4) (payment of amount determined to be reasonable compensation); § 280G(b)(5) (exceptions for small business corporations); and § 280G(d)(5) (treatment of affiliated groups) do not apply.

(c) *Excluded amounts.* Payments on account of an applicable severance from employment do not include amounts paid to a covered executive under a tax-qualified retirement plan.

(d) *Base amount defined.* For purposes of § 280G(e), the "base amount" for a covered executive has the meaning set forth in § 280G(b)(3) and § 1.280G–1, Q&A–34, of the Treasury Regulations, except that references to "change in ownership or control" are treated as referring to an "applicable severance from employment."

Q–14: What is an "excess parachute payment" for purposes of § 280G(e)?

A–14: For purposes of § 280G(e), an excess parachute payment is any parachute payment (as defined in Q&A–13 of this notice) in excess of the base amount allocated to the payment.

Q–15: What are the consequences of an excess parachute payment?

A–15: (a) *General rule.* No deduction is allowed for an excess parachute payment. Further, a tax equal to 20 percent of the excess parachute payment is imposed on a covered executive who receives an excess parachute payment.

(b) *Example.* In 2008, which is an applicable taxable year for the employer, a covered executive has an applicable severance from employment. The covered executive's base amount is $1 million and the covered executive receives a lump sum payment of $5 million on account of an involuntary termination of employment. The lump sum payment qualifies as a parachute payment since the amount of the lump sum payment ($5 million) is not less than three times the covered executive's base amount (3 times $1 million equals $3 million). The amount of the excess parachute payment is equal to $4 million ($5 million payment less the covered executive's $1 million base amount). Thus, under § 280G(e), the $4 million excess parachute payment is not deductible by the applicable employer. Further, the $4 million excess parachute payment is subject to a 20 percent tax payable by the covered executive.

Q–16: What if a payment treated as a parachute payment under § 280G(e) is also determined to be a parachute payment under § 280G without regard to § 280G(e)?

A–16: If a payment treated as a parachute payment under § 280G(e) is a parachute payment under § 280G on account of a change in control without regard to § 280G(e), then § 280G(e) does not apply to the payment.

Q–17: To which years does the deduction limit imposed by § 280G(e) apply?

A–17: The limit imposed by § 280G(e) applies to remuneration paid in an applicable taxable year. (See Q&A–3 of this notice for additional information, including the definition of an applicable taxable year.)

REQUEST FOR COMMENTS

The Treasury Department and the Service anticipate issuing additional guidance with respect to §§ 162(m)(5) and 280G(e). The Treasury Department and the Service request comments on the topics addressed in this notice. All materials submitted will be available for public inspection and copying.

Comments may be submitted to Internal Revenue Service, CC:PA:LPD:PR (Notice 2008–94), Room 5203, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:PR (Notice 2008–94), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2008–94) in the subject line.

EFFECTIVE DATE

Until further guidance is issued, taxpayers may rely on the rules in this notice for purposes of §§ 162(m)(5) and 280G(e) effective from October 3, 2008 (the date of enactment of EESA). Further guidance will be prospective to the extent that it is more restrictive.

CONTACT INFORMATION

For further information regarding this notice, contact Ilya Enkishev of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities) at (202) 622–6030 (not a toll-free call).

Notice to Address Amended Returns for Hurricane-Related Casualty Losses and Subsequent Grants Reimbursing Such Losses

Notice 2008–95

The purpose of this notice is to inform taxpayers how to file an amended return to take advantage of section 3082(a) of the Housing and Economic Recovery Act of 2008, Public Law 110–289 (the Act). Section 3082 of the Act permits taxpayers to elect to file an amended return to reduce certain previously taken casualty losses when the taxpayers receive certain hurricane relief grants (referenced below) in a later year.

SCOPE

This notice and section 3082(a) of the Act apply only to casualty losses taken as a result of damage to or the destruction of a taxpayer's principal residence caused by Hurricane Katrina, Wilma, or Rita for which grants were authorized under Public Laws 109–148, 109–234, and 110–116 (hurricane relief grants), including the Louisiana Road Home Grants and the Mississippi Development Authority Hurricane Katrina Homeowner Grants. Section 3082(a) of the Act gives taxpayers the option to amend their returns to reduce their previously deducted casualty losses and pay the resulting tax, rather than include grant amounts in income in the year of receipt.

This notice applies to all relevant amended returns, including those that may have been filed before the passage of section 3082(a) or the publication of this notice.

BACKGROUND

Section 165(a) of the Internal Revenue Code (the Code) generally permits a taxpayer to deduct "any loss sustained during the taxable year and not compensated for by insurance or otherwise." Section 1.165–1(d)(2)(iii) of the Income Tax Regulations provides that if a taxpayer deducts a loss and in a subsequent tax year receives reimbursement for the loss, the taxpayer does not recompute the tax for the year in which the deduction was taken, but includes the amount of the reimbursement in gross income for the year in which the reimbursement was received, subject to the provisions of section 111 of the Code. *See Montgomery v. Commissioner*, 65 T.C. 511, 519 (1975) (requiring a taxpayer who deducted a casualty loss and then received an insurance payment in a later year to report, pursuant to §1.165–1(d)(2)(iii), the insurance reimbursement in the tax year received and not to amend the prior loss-year return). Section 111(a) provides that the recovery of an amount deducted in a prior tax year is not included in gross income, but only to the extent the deducted amount did not reduce the amount of tax imposed. Therefore, if a taxpayer claims a deduction and in a subsequent year recovers all or part of the amount previously deducted, the general rule is that the taxpayer must report the recovered amount as income in the year of the recovery to the extent the prior deduction reduced the amount of tax owed for any year.

On July 30, 2008, section 3082(a) of the Act was enacted to provide an exception to the above rules in certain limited circumstances. Section 3082(a)(1) provides that, notwithstanding any provision of the Code, if a taxpayer claims a deduction for any tax year with respect to a casualty loss to a principal residence (within the meaning of section 121 of the Code) resulting from Hurricane Katrina, Rita, or Wilma, and in a subsequent tax year receives a hurricane relief grant as reimbursement for the loss, the taxpayer may elect to file an amended income tax return for the tax year in which the deduction was allowed (and for any tax year to which the deduction was carried) and reduce (but not below zero) the amount of the deduction by the amount of the reimbursement.

Section 3082(a)(2) requires taxpayers who elect to amend their returns in this way to file the amended returns by the later of: (A) the due date for filing the return for the year in which the taxpayer receives the grant; or (B) July 30, 2009, which is one year after the date section 3082 was enacted. If a taxpayer chooses to file an amended return reducing the prior deduction, section 3082(a)(3) of the Act provides that any underpayment of tax resulting from the reduced deduction shall not be subject to any penalty or interest under the

Code so long as the additional tax is paid not later than one year after the filing of the amended return.

FILING PROCEDURE

Required form. Taxpayers should use Form 1040X, *Amended U.S. Individual Income Tax Return,* to adjust a previously taken casualty loss. The amended return must be filed for the tax year in which a prior casualty loss was claimed and must reduce (but not below zero) the casualty loss deduction by the amount of the grant received as reimbursement for the loss.

Where to file. Form 1040X should be filed with the Austin Campus. Mail properly labeled forms to:

Department of the Treasury
Internal Revenue Service Center
Austin, TX 73301–0255

Label. To ensure proper processing consistent with this notice, taxpayers must identify amended returns as being filed under the terms of this notice. Label the top of the Form 1040X: "Hurricane Grant Relief" in dark, bold letters.

Materials to be submitted with the amended return. Taxpayers must include the following materials with their amended returns:

1. Proof of the amount of any hurricane relief grant received;

2. A completed Form 2848, *Power of Attorney and Declaration of Representative*, if a taxpayer wishes to designate a representative.

Time for filing. An amended return pursuant to this notice must be filed by the later of the due date for the return for the year in which the hurricane relief grant was received, as extended, or July 30, 2009. Solely for purposes of determining eligibility for the waiver of penalties and interest for purposes of section 3082, the Service will treat any amended return filed before July 30, 2009, as filed on July 30, 2009.

Payment of balance due. To avoid interest and penalties, payment of the balance due on the amended return must be made within one year of the timely filing of the amended return. Payments made subsequent to the filing of the amended return should clearly designate that the payment is to be applied to reduce the balance due as reflected on the amended return per this notice. The Service will not take action to collect the balance due reflected on the amended return for the one year period following the filing of the amended return.

Assessment of balance due. Upon the filing of an amended return, the Service immediately will assess the balance due resulting from the reduction in the casualty loss claimed. This assessment will be reflected on the taxpayer's accounts as an outstanding liability.

Limitations. No other adjustments may be taken on the amended return filed for purposes of this notice unless the period of limitation for making an assessment under section 6501 is open for the tax year without regard to section 3082(a).

SPECIAL RULE FOR PREVIOUSLY FILED AMENDED RETURNS

If a taxpayer previously filed an amended return for the casualty loss year that reduced the previously claimed casualty loss deduction by the grant amount or reported any of the grant amount as income, the taxpayer must notify the Service to receive the benefits provided by this notice. The taxpayer must send a copy of the previously filed Form 1040X, or submit a Form 843, to the address listed above. The Form 1040X or Form 843 should include the taxpayer's own contact information as well as a properly executed power of attorney, if applicable. The taxpayer also must provide (1) copies of the original return for the year of the casualty loss deduction and any other amended returns for that year that were filed prior to publication of this notice, and (2) copies of the original return and amended returns, if any, for the year of receipt of the grant if any portion of the grant was previously reported as income in the year of receipt. These documents must be sent by the later of the due date for the return for the year in which the hurricane relief grant was received, as extended, or July 30, 2009. The Service will contact the taxpayer or the taxpayer's representative, as appropriate, to discuss any necessary adjustments.

ADDITIONAL CONSIDERATIONS

The option to file an amended return is permissive. Taxpayers are not required to amend a prior year's return and may, instead, include amounts received as a hurricane relief grant in gross income in the year in which the grant was received to the extent the prior casualty loss deduction reduced the amount of tax owed for any year pursuant to § 1.165–1(d)(2)(iii). Taxpayers and their representatives must consider carefully which option is best under their particular circumstances.

EFFECTIVE DATE

This notice is effective as of the date it is published in the Internal Revenue Bulletin.

DRAFTING INFORMATION

The principal author of this notice is Cynthia McGreevy of the Office of Associate Chief Counsel (Procedure and Administration). For further information regarding this notice, contact Ms. McGreevy at (202) 622–4910 (not a toll-free call).

Qualifying Advanced Coal Project Program

Notice 2008–96

SECTION 1. PURPOSE

This notice updates and amplifies the procedures for the allocation of credits under the qualifying advanced coal project program of § 48A of the Internal Revenue Code. Except as specifically provided in this notice, the allocation round for 2008–09 will be conducted in the same manner and under the same procedures as provided under Notice 2007–52 (including Appendices A, B, and C), 2007–26 I.R.B. 1456. To be considered in the allocation round for 2008–09, applications must be submitted to the Department of Energy (DOE) on or before October 31, 2008, and to the Internal Revenue Service (Service) on or before March 2, 2009. See section 3 of this notice for additional rules regarding applications for § 48A and the DOE certification.

This notice does not reflect amendments made by the Energy Improvement and Extension Act of 2008, which expanded and modified the advanced coal project credit. The Service intends to issue guidance on these amendments in the near future.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 46 provides that the amount of the investment credit for any taxable year is the sum of the credits listed in § 46. That list includes the qualifying advanced coal project credit.

.02 The qualifying advanced coal project credit is provided under § 48A. Section 48A(a) provides that the qualifying advanced coal project credit for a taxable year is an amount equal to (1) 20 percent of the qualified investment (as defined in § 48A(b)) for that taxable year in certified qualifying advanced coal projects (as defined in § 48A(c)(1) and (e)) using an integrated gasification combined cycle (IGCC) (as defined in § 48A(c)(7)), and (2) 15 percent of the qualified investment for that taxable year in other certified qualifying advanced coal projects.

.03 Section 48A(d)(3)(A) provides that the aggregate credits allowed under § 48A(a) may not exceed $1.3 billion. Section 48A(d)(3)(B) provides that (i) $800 million of credits are to be allocated to IGCC projects, and (ii) $500 million of credits are to be allocated to projects that use other advanced coal-based generation technologies (as defined in § 48A(c)(2) and (f)).

.04 Section 48A(e)(3)(A) provides that the credits for IGCC projects must be allocated in accordance with the procedures set forth in § 48A(d), and in relatively equal amounts to (i) projects using bituminous coal as a primary feedstock, (ii) projects using subbituminous coal as a primary feedstock, and (iii) projects using lignite as a primary feedstock. Further, § 48A(e)(3)(B) provides that IGCC projects that include (i) greenhouse gas capture capability (as defined in § 48A(c)(5)), (ii) increased by-product utilization, and (iii) other benefits must be given high priority in the allocation of credits for IGCC projects.

.05 Section 48A(d)(1) provides that the Secretary, in consultation with the Secretary of Energy, shall establish a qualifying advanced coal project program for the deployment of advanced coal-based generation technologies. The Treasury Department and the Service established this program in Notice 2006–24, 2006–1 C.B. 595, as modified and updated by Notice 2007–52.

.06 Notice 2007–52 provides that the Service will consider a project under the qualifying advanced coal project program only if the DOE provides a certification ("DOE certification") and ranking (if any) for the project. Accordingly, a taxpayer must submit, for each qualifying advanced coal project: (1) an application for certification by the DOE ("application for DOE certification"), and (2) an application for certification under § 48A(d)(2) by the Service ("application for § 48A certification"). Both applications may be submitted only during the 3-year period beginning on March 13, 2006. Certifications will be issued and credits will be allocated to projects in annual allocation rounds. An initial allocation round was conducted in 2006. A second allocation round was conducted in 2007–08, and a special allocation round was conducted in 2008.

.07 Section 6.02 of Notice 2007–52 requires that within 2 years from the date that the Service accepts the taxpayer's application for § 48A certification, the taxpayer must submit to the Service documentation establishing that the requirements of § 48A(e)(2) are satisfied. See also sections 7.01 and 7.02 of Notice 2007–52 for other requirements that must be satisfied. The taxpayer should mark the package "SECTION 48A CERTIFICATION REQUIREMENTS" and send it to the appropriate address listed in section 5.04 of Notice 2007–52 or listed in later guidance published in the Internal Revenue Bulletin.

.08 This notice modifies the qualifying advanced coal project program under Notice 2007–52 in the following respects:

(1) The three-year period described in § 48A(d)(2)(A) (relating to the period during which applications may be submitted) is modified by treating March 13, 2006 (the date Notice 2006–24 was published in the Internal Revenue Bulletin) as the date on which the qualifying advanced coal project program was established and the first day of the three-year period. Section 2.06 of this notice reflects this change.

(2) A taxpayer must submit to the Service both an electronic and a paper copy of the documentation establishing that the requirements of § 48A(e)(2) are satisfied. Section 3.11 of this notice reflects this change.

SECTION 3. 2008–09 ALLOCATION ROUND

.01 Except as otherwise specifically provided in this notice, this allocation round will be conducted in the same manner and under the same procedures as provided under Notice 2007–52 including Appendices B and C. This notice restates or references provisions in Notice 2007–52 as a convenience to taxpayers. The restatement or referencing of these provisions does not diminish the effect of provisions that are not restated or referenced.

.02 The qualifying advanced coal project credits of $1.3 billion and the applications for certification are separated into the following four pools:

(1) Projects using an advanced coal-based generation technology other than IGCC. The aggregate amount of qualifying advanced coal project credit for this pool is $500 million. The maximum amount of credits that will be allocated to a project is $125 million. In prior allocation rounds, $375 million of credits was allocated from this pool. Therefore, $125 million of credits is available for allocation from this pool in 2008–09.

(2) IGCC projects using bituminous coal as a primary feedstock. The aggregate amount of qualifying advanced coal project credit for this pool is $267 million. The maximum amount of credits that will be allocated to a project is $133.5 million. In prior allocation rounds, $267 million of credits was allocated from this pool. Accordingly, no allocation round for this pool will be conducted in 2008–09.

(3) IGCC projects using subbituminous coal as a primary feedstock. The aggregate amount of qualifying advanced coal project credit for this pool is $267 million. The maximum amount of credits that will be allocated to a project is $133.5 million. In prior allocation rounds, $133.5 million of credits were allocated from this pool. Therefore, $133.5 million of credits is available for allocation from this pool in 2008–09.

(4) IGCC projects using lignite as a primary feedstock. The aggregate amount of qualifying advanced coal project credit for this pool is $266 million. The maximum amount of credits that will be allocated to a project is $133 million. In prior allocation rounds, $133 million of credits was al-

located from this pool. Accordingly, $133 million of credits is available for allocation from this pool in 2008–09.

.03 For the allocation round conducted in 2008–09, the application period begins on March 4, 2008 and ends on March 2, 2009, and any completed application for § 48A certification received by the Service after March 3, 2008, and before March 3, 2009, will be deemed to be submitted by the taxpayer on March 2, 2009. During the application period, an application for § 48A certification and a separate application for DOE certification must be submitted for each qualifying advanced coal project. See section 3.07 for the date by which the application for DOE certification must be submitted to the DOE. For purposes of this notice, an application that is submitted by U.S. mail will be treated as received by the Service on the date of the postmark and an application submitted by a private delivery service will be treated as received by the Service on the date recorded or the date marked in accordance with § 7502(f)(2)(C).

.04 For this allocation round, the Service will consider a project only if the application for § 48A certification for the project is submitted during the application period for this round and the DOE provides the DOE certification and the DOE ranking (if any) for the project before March 2, 2009.

.05 If an application for DOE certification does not include all of the information required by section 5.02 of Notice 2007–52 and meet the requirements in sections 7.01 and 7.02 of Notice 2007–52, the DOE may decline to accept the application. If an application for § 48A certification does not include all of the information listed in section 5.03 of Notice 2007–52 and meet the requirements in sections 7.01 and 7.02 of Notice 2007–52, the application will not be accepted by the Service.

.06 An application for § 48A certification must be submitted in the manner provided in section 5.04 of Notice 2007–52.

.07 For this allocation round, the DOE will consider an application for DOE certification only if the application is postmarked on or before October 31, 2008. See section 5.02 of Notice 2007–52 and Appendix B to Notice 2007–52 for the information to be submitted to the DOE in an application for DOE certification. Appendix B to Notice 2007–52 also provides the instructions and address for filing the application for DOE certification. The DOE will determine the feasibility of the project and, if the project is determined to be feasible, will provide a DOE certification for the project to the Service. If the DOE certifies two or more projects in a pool described in section 3.02 of this notice, the DOE also will rank each of the projects it certifies (for example, first, second, third, etc.) relative to other certified projects in the same pool. The DOE will provide the DOE certification for projects determined to be feasible and the DOE ranking (if any) to the Service by March 1, 2009.

.08 By April 30, 2009, the Service will accept or reject the taxpayer's application for § 48A certification and will notify the taxpayer, by letter, of its decision.

.09 If the taxpayer's application for § 48A certification is accepted, the acceptance letter will state the amount of the credit allocated to the project. If a credit is allocated to a taxpayer's project, the taxpayer will be required to execute a closing agreement in the form set forth in Appendix A to Notice 2007–52. By June 30, 2009, the taxpayer must execute and return the closing agreement to the Service at the appropriate address listed in section 5.04 of Notice 2007–52 or listed in later guidance published in the Internal Revenue Bulletin. The Service will execute and return the closing agreement to the taxpayer by August 31, 2009. The executed closing agreement applies only to the accepted taxpayer.

.10 Section 48A(d)(2)(D) provides that a taxpayer shall have 2 years from the date of acceptance of the § 48A application during which to provide evidence that the criteria set forth in § 48A(e)(2) have been met. To satisfy this requirement, the taxpayer must submit to the Service before the end of the 2-year period both a paper copy and an electronic version on a floppy disc or a CD of the documentation establishing that the requirements of § 48A(e)(2) are satisfied. The electronic version of the documentation must be formatted in one of the following software applications: Microsoft Word™ 2002 or later edition; Microsoft Excel™ 2002 or later edition; or Adobe Acrobat™ PDF 6.0 or later edition. See section 6 of Notice 2007–52 for further information about the issuance of certification.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Notice 2007–52 is updated and amplified.

SECTION 5. EFFECTIVE DATE

This notice is effective October 10, 2008.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–2003.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this notice are in section 3 of this notice. This information is required to obtain an allocation of qualifying advanced coal project credits. This information will be used by the Service to verify that the taxpayer is eligible for the qualifying advanced coal project credits. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 4,950 hours.

The estimated annual burden per respondent varies from 70 to 150 hours, depending on individual circumstances, with an estimated average of 110 hours. The estimated number of respondents is 45.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. § 6103.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Jaime Park of the Office of Associate Chief

Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Park at (202) 622–3110 (not a toll-free call). For further information regarding the application for § 48A certification, the documentation to be submitted to the Service establishing that the requirements of § 48A(e)(2) are satisfied, and the issuance of the certification that the requirements of § 48A(e)(2) are satisfied, contact Kimberly Edwards, Executive Assistant, Office of the Industry Director, Natural Resources and Construction, at (713) 209–3615 (not a toll-free number).

Qualifying Gasification Project Program

Notice 2008–97

PURPOSE

This notice informs taxpayers that the entire amount of credit available under the qualifying gasification project program of § 48B of the Internal Revenue Code has been allocated in the allocation rounds conducted in 2006 and in 2007–08. Accordingly, no allocation of credits will be conducted in 2008–09 under the qualifying gasification project program. The purpose of the qualifying gasification project program is to consider and award certifications for qualified investment eligible for credits under § 48B to qualifying gasification project sponsors.

This notice does not reflect amendments made by the Energy Improvement and Extension Act of 2008, which expanded and modified the qualifying gasification project credit. The Service intends to issue guidance on these amendments in the near future.

BACKGROUND

Section 46 provides that the amount of the investment credit for any taxable year is the sum of the credits listed in § 46. That list includes the qualifying gasification project credit.

The qualifying gasification project credit is provided under § 48B. Section 48B(a) provides that the qualifying gasification project credit for a taxable year is an amount equal to 20 percent of the qualified investment (as defined in § 48B(b)) for that taxable year in qualifying gasification projects.

Section 48B(d)(1) provides that the Secretary, in consultation with the Secretary of Energy, shall establish a qualifying gasification project program to consider and award certifications for qualified investment eligible for credits under § 48B to qualifying gasification project sponsors. The Treasury Department and the Internal Revenue Service established this program in Notice 2006–25, 2006–1 C.B. 609, as modified and updated by Notice 2007–53, 2007–26 I.R.B. 1474.

QUALIFYING GASIFICATION PROJECT PROGRAM

Notice 2007–53 provides that the Service will consider a project under the qualifying gasification project program only if the DOE provides a certification and ranking (if any) for the project. Certifications will be issued and credits will be allocated to projects in annual allocation rounds. The initial allocation round was conducted in 2006. An additional allocation round was conducted in 2007–08.

Section 48B(d)(1) provides that the total amounts of credit that may be allocated under the program shall not exceed $350,000,000. In the 2006 allocation round, $349,663,000 of credit was allocated. In the 2007–08 allocation round, $337,000 of credit (the entire amount remaining) was allocated. Accordingly, no allocation round will be conducted in 2008–09 under the qualifying gasification project program.

EFFECT ON OTHER DOCUMENTS

Notice 2007–53 is updated.

DRAFTING INFORMATION

The principal author of this notice is Jaime C. Park of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Jaime C. Park at (202) 622–3110 (not a toll-free call).

Extension of Effective Date of Normal Retirement Age Regulations for Governmental Plans

Notice 2008–98

I. Purpose

The Service and Treasury intend to extend the date by which a governmental plan must comply with final regulations on distributions from a pension plan upon attainment of normal retirement age, which were published in the Federal Register as T.D. 9325, 2007–24 I.R.B. 1386 [72 FR 28604] on May 22, 2007 ("the 2007 final regulations"). Under the extension, the 2007 final regulations will be effective for a governmental plan (as defined in § 414(d) of the Internal Revenue Code) for plan years beginning on or after January 1, 2011. This notice does not change the effective date of the 2007 final regulations for a plan that is not a governmental plan or modify the relief previously provided in Notice 2007–69, 2007–35 I.R.B. 468.

II. Background

Section 411(a)(8) provides that the term "normal retirement age" means the earlier of (A) the time a plan participant attains normal retirement age under the plan or (B) the later of age 65 or the fifth anniversary of the time a plan participant commenced participation in the plan. A plan's normal retirement age is relevant for a number of purposes, including for purposes of determining the date at which a participant is eligible to receive his or her normal retirement benefit and calculating the amount of the benefit received.

Prior to being amended by the 2007 final regulations, § 1.401(a)–1(b)(1)(i) of the Income Tax Regulations required a pension plan to be maintained primarily to provide systematically for the payment of definitely determinable benefits after retirement. The 2007 final regulations amended § 1.401(a)–1(b)(1)(i) to provide an exception to the rule that pension benefits be paid only after retirement by permitting a pension plan to commence payment of retirement benefits to a participant after the participant has attained normal retirement age even if the participant has not yet had a severance from

employment with the employer maintaining the plan.

The 2007 final regulations require a pension plan's normal retirement age to be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. The 2007 final regulations provide that a normal retirement age of 62 or later (or age 50 or later, in the case of a plan in which substantially all of the participants are qualified public safety employees (within the meaning of § 72(t)(10)(B))) is deemed to satisfy this requirement, and a normal retirement age lower than 55 is presumed not to satisfy the requirement unless the Commissioner determines otherwise on the basis of facts and circumstances. Whether a normal retirement age that is at least 55 but below 62 satisfies the requirement is based on facts and circumstances.

The 2007 final regulations are generally effective May 22, 2007, with a later effective date for governmental plans and certain collectively bargained plans. For governmental plans, the 2007 final regulations are effective for plan years beginning on or after January 1, 2009.

Notice 2007–69 provided temporary relief for certain plans that may have to change their definition of normal retirement age to satisfy the 2007 final regulations. The relief is available to certain plans that might otherwise be required to be amended to raise the plan's normal retirement age effective before the first day of the first plan year beginning after June 30, 2008. Because the 2007 final regulations are not effective for governmental plans until 2009, the relief in Notice 2007–69 does not apply to governmental plans.

Notice 2007–69 pointed out that the 2007 final regulations do not contain a safe harbor or other guidance with respect to a normal retirement age conditioned on the completion of a stated number of years of service, stating that a plan under which a participant's normal retirement age changes to an earlier date upon completion of a stated number of years of service typically will not satisfy the vesting or accrual rules of § 411. The notice asked for comments from sponsors of plans that are not subject to the requirements of § 411, such as governmental plans, on whether such a plan may define normal retirement age based on years of service. Specifically, comments were requested on whether and how a pension plan with a normal retirement age conditioned on the completion of a stated number of years of service satisfies the requirement in § 1.401(a)–1(b)(1)(i) that a pension plan be maintained primarily to provide for the payment of definitely determinable benefits after retirement or attainment of normal retirement age and how such a plan satisfies the pre-ERISA vesting rules.

III. Extension of Effective Date of 2007 Final Regulations for Governmental Plans

The Service and Treasury intend to amend the 2007 final regulations to change the effective date for governmental plans to plan years beginning on or after January 1, 2011. Governmental plan sponsors may rely on this notice with respect to the extension until such time as the 2007 final regulations are so amended.

DRAFTING INFORMATION

The principal author of this notice is James P. Flannery of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact Mr. Flannery via e-mail at *retirementplanquestions@irs.gov.*

Application of Section 382 to Loss Corporations Whose Instruments Are Acquired by The Treasury Department Under The Capital Purchase Program Pursuant to The Emergency Economic Stabilization Act of 2008

Notice 2008–100

This notice provides guidance regarding the application of section 382 to loss corporations whose instruments are acquired by the Treasury Department (Treasury) under the Capital Purchase Program (CPP) pursuant to the Emergency Economic Stabilization Act of 2008, P.L. 110–343 (the "Act").

I. PURPOSE

The Internal Revenue Service (Service) and Treasury intend to issue regulations regarding the application of section 382 with respect to the CPP pursuant to the Act. Pending the issuance of further guidance, taxpayers may rely on the rules set forth in this notice to the extent provided herein.

II. BACKGROUND

Section 382(a) of the Internal Revenue Code (Code) provides that the taxable income of a loss corporation for a year following an ownership change that may be offset by pre-change losses cannot exceed the section 382 limitation for such year. An ownership change occurs with respect to a corporation if it is a loss corporation on a testing date and, immediately after the close of the testing date, the percentage of stock of the corporation owned by one or more 5-percent shareholders has increased by more than 50 percentage points over the lowest percentage of stock of such corporation owned by such shareholders at any time during the testing period. *See* § 1.382–2T(a)(1) of the Income Tax Regulations.

Section 101(a)(1) of the Act authorizes the Secretary to establish the Troubled Asset Relief Program. Under the CPP, Treasury will acquire preferred stock and warrants from qualifying financial institutions.

Section 101(c)(5) of the Act provides that the Secretary is authorized to issue such regulations and other guidance as may be necessary or appropriate to carry out the purposes of the Act. Section 382(m) of the Code provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of sections 382 and 383.

Except as otherwise provided, any definitions and terms used herein have the same meaning as they do in section 382 of the Code and the regulations thereunder or in the CPP.

III. GUIDANCE REGARDING THE APPLICATION OF SECTION 382 TO LOSS CORPORATIONS WHOSE INSTRUMENTS ARE ACQUIRED BY TREASURY PURSUANT TO THE CPP

The Service and Treasury intend to issue regulations that set forth rules described in this Section III. Taxpayers may

rely on the rules described in this Section III to the extent provided below.

RULES:

A. *General rule*. With respect to any shares of stock of a loss corporation acquired by Treasury pursuant to the CPP (either directly or upon the exercise of an option), the ownership represented by such shares on any date on which they are held by Treasury shall not be considered to have caused Treasury's ownership in the loss corporation to have increased over its lowest percentage owned on any earlier date. Except as provided in Sections III.B and III.C below, such shares are considered outstanding for purposes of determining the percentage of loss corporation stock owned by other 5-percent shareholders on a testing date.

B. *Redemptions of stock owned by Treasury*. For purposes of measuring shifts in ownership by any 5-percent shareholder on any testing date occurring on or after the date on which the loss corporation redeems shares of its stock held by Treasury that were acquired pursuant to the CPP, the shares so redeemed shall be treated as if they had never been outstanding.

C. *Treatment of preferred stock acquired by Treasury pursuant to the CPP*. For all Federal income tax purposes, any preferred stock of a loss corporation acquired by Treasury pursuant to the CPP, whether owned by Treasury or another person, shall be treated as stock described in section 1504(a)(4) of the Code.

D. *Treatment of warrants acquired by Treasury pursuant to the CPP*. For all Federal income tax purposes, any warrant to purchase stock of a loss corporation that is acquired by Treasury pursuant to the CPP, whether held by Treasury or another person, shall be treated as an option (and not as stock).

E. *Options held by Treasury not deemed exercised*. For purposes of § 1.382–4(d), any option (within the meaning of § 1.382–4(d)(9)) held by Treasury that is acquired pursuant to the CPP will not be deemed exercised under § 1.382–4(d)(2).

F. *Section 382(l)(1) not applicable with respect to capital contributions made by Treasury to a loss corporation pursuant to the CPP*. For purposes of section 382(l)(1) of the Code, any capital contribution made by Treasury to a loss corporation pursuant to the CPP shall not be considered to have been made as part of a plan a principal purpose of which was to avoid or increase any section 382 limitation.

IV. RELIANCE ON NOTICE

The Service and Treasury intend to issue regulations that set forth rules described in Section III of this notice. Taxpayers may rely on the rules described in Section III for purposes of applying section 382 with respect to loss corporations whose instruments are acquired by Treasury pursuant to the CPP. These rules will continue to apply unless and until there is additional guidance. Any future contrary guidance will not apply to instruments (i) held by Treasury that were acquired pursuant to the CPP prior to the publication of that guidance, or (ii) issued to Treasury pursuant to the CPP under written binding contracts entered into prior to the publication of that guidance.

DRAFTING INFORMATION

The principal author of this notice is Keith E. Stanley of the Office of Associate Chief Counsel (Corporate). For further information regarding this notice, contact Keith E. Stanley at (202) 622–7700 (not a toll-free call).

Clarification of Troubled Asset Relief Program Funds Under Section 597

Notice 2008–101

The purpose of this notice is to provide clarification on the treatment under section 597 of the Internal Revenue Code (Code) of amounts furnished to a financial institution pursuant to the Troubled Asset Relief Program (TARP) of the Emergency Economic Stabilization Act of 2008, Div. A of Pub. Law No. 110–343 (EESA), which was enacted on October 3, 2008.

Unless and until guidance is issued by the Department of the Treasury and the Internal Revenue Service to the contrary, no amount furnished by the Department of the Treasury to a financial institution pursuant to the TARP established by the Secretary under EESA will be treated as the provision of Federal financial assistance within the meaning of section 597 of the Code and the regulations thereunder. Any future contrary guidance will not apply to transactions with the Department of the Treasury, or to securities issued by financial institutions to the Department of the Treasury, prior to the publication of that guidance, or pursuant to written binding contracts entered into prior to that date.

Except with respect to the treatment of amounts furnished pursuant to TARP as expressly described in this notice, no inference should be drawn from this notice regarding the treatment under section 597 of the Code or the regulations thereunder of any other program or payments.

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26 CFR 1.168(k)–1: Additional first year depreciation deduction.
(Also: §§ 38, 41, 52, 53, 168, 6401.)

Rev. Proc. 2008–65

SECTION 1. PURPOSE

This revenue procedure provides guidance under § 3081 of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110–289, 122 Stat. 2654 (July 30, 2008) (Housing Act). Section 3081(a) of the Housing Act amends § 168(k) of the Internal Revenue Code by adding § 168(k)(4), allowing corporations to elect not to claim the 50-percent additional first year depreciation for certain new property acquired after March 31, 2008, and placed in service generally before January 1, 2009, and instead to increase their business credit limitation under § 38(c) or alternative minimum tax (AMT) credit limitation under § 53(c). This revenue procedure clarifies the rules regarding the effects of making the § 168(k)(4) election, the property eligible for the election, and the computation of the amount by which the business credit limitation and AMT credit limitation may be increased if the election is made. The Internal Revenue Service (IRS) and Treasury Department intend to publish future guidance regarding the time and manner for making the § 168(k)(4) election, for allocating the credit limitation increases allowed by the election, and for making the election to apply § 3081(b) of the Housing Act by certain automotive partnerships, and regarding the procedures applicable to partnerships with corporate

partners that make the § 168(k)(4) election (*see* § 168(k)(4)(G)(ii)).

SECTION 2. BACKGROUND

.01 Section 168(k), amended by § 103 of the Economic Stimulus Act of 2008, Pub. L. No. 110–185, 122 Stat. 613 (February 13, 2008) (Stimulus Act), allows a 50-percent additional first year depreciation deduction (Stimulus additional first year depreciation deduction) for certain new property acquired by a taxpayer after 2007 and placed in service by the taxpayer before 2009 (before 2010 in the case of property described in § 168(k)(2)(B) or (C)).

.02 Section 3081(a) of the Housing Act added § 168(k)(4) to the Code. If a corporation elects to apply § 168(k)(4), § 168(k)(4)(A) provides that, for the corporation's first taxable year ending after March 31, 2008, and for any subsequent taxable year, the corporation forgoes the Stimulus additional first year depreciation deduction allowable under § 168(k) for eligible qualified property placed in service by the taxpayer and increases each of the limitations described in § 38(c) (relating to the general business credit) and § 53(c) (relating to the AMT credit). As a result, the corporation will be able to claim unused credits from taxable years beginning before January 1, 2006, that are allocable to research expenditures or AMT liabilities. This revenue procedure clarifies which depreciable property is eligible qualified property (see section 3 of this revenue procedure) and clarifies the effects of making the election to apply § 168(k)(4) (see section 4 of this revenue procedure).

.03 Section 38(c)(1) limits the general business credit allowed under § 38(a) to the excess (if any) of the taxpayer's net income tax (generally, the sum of the taxpayer's regular tax liability and AMT liability less certain credits) over the greater of (i) the tentative minimum tax for the taxable year or (ii) 25 percent of so much of the taxpayer's net regular tax liability (generally, the taxpayer's regular tax liability less certain credits) as exceeds $25,000. Under § 38(b)(4), the general business credit includes the research credit determined under § 41. Section 53(c) provides that the amount of the minimum tax credit allowed for any taxable year shall not exceed the excess (if any) of the regular tax liability of the taxpayer (reduced by certain credits) over the tentative minimum tax for the taxable year. In general, a taxpayer that makes the election to apply § 168(k)(4) increases the limitations under §§ 38(c) and 53(c) by the bonus depreciation amount. In general, the amount by which the bonus depreciation amount increases each of the credit limitations under §§ 38(c) and 53(c) is determined by the portion of the bonus depreciation amount that the taxpayer allocates to each credit limitation for the taxable year. This revenue procedure clarifies the computation of the bonus depreciation amount (see section 5 of this revenue procedure) and the limitations on a taxpayer's allocation of the bonus depreciation amount between §§ 38(c) and 53(c) (see section 6 of this revenue procedure).

.04 To the extent that a taxpayer is allowed the business credit or AMT credit in an amount allocable to the aggregate increases in the business credit limitation and the AMT credit limitation that result from the § 168(k)(4) election, such amount(s) are treated as overpayments within the meaning of § 6401(b) that are refundable to the taxpayer. *See* § 168(k)(4)(F).

.05 Section 168(m), added by § 308(a) of the Energy Improvement and Extension Act of 2008, Pub. L. No. 110–343, ___ Stat. ___ (October 3, 2008), allows a 50-percent additional first year depreciation deduction for qualified reuse and recycling property placed in service after August 31, 2008. Section 168(n), added by § 710(a) of the Heartland Disaster Tax Relief Act of 2008, Pub. L. No. 110–343, ___ Stat. ___ (October 3, 2008), allows a 50-percent additional first year depreciation deduction for qualified disaster assistance property placed in service after December 31, 2007, with respect to federally declared disasters occurring after 2007 and before 2010. Both new Code provisions provide that property described in such provisions does not include property to which § 168(k) applies. Therefore, eligible qualified property for which a taxpayer makes the § 168(k)(4) election does not qualify for the 50-percent additional first year depreciation deduction allowed under § 168(m) and (n).

SECTION 3. ELIGIBLE QUALIFIED PROPERTY

.01 *In General*. With the exception of revised dates, eligible qualified property for purposes of § 168(k)(4) is qualified property under § 168(k)(2). Consequently, the property must be placed in service by the taxpayer before January 1, 2009. *See* § 168(k)(4)(D)(i) and (k)(2)(A)(iv). The placed-in-service-date deadline is extended to before January 1, 2010, for property that meets the requirements of § 168(k)(2)(B) (long production period property) and property that meets the requirements of § 168(k)(2)(C) (certain aircraft). *See* § 168(k)(4)(D)(i) and (k)(2)(A)(iv). Pursuant to section 5.01 of Rev. Proc. 2008–54, 2008–38 I.R.B. 722, 723, rules similar to the rules in § 1.168(k)–1 of the Income Tax Regulations for "qualified property" or for "30-percent additional first year depreciation deduction" apply for determining whether depreciable property is qualified property under § 168(k)(2).

.02 *Application of Revised Dates*. In applying § 168(k)(2) to determine whether depreciable property is eligible qualified property for purposes of § 168(k)(4), § 168(k)(4)(D)(i) provides that "March 31, 2008" is substituted for "December 31, 2007" each place it appears in § 168(k)(2)(A) and § 168(k)(2)(E)(i) and (ii). Accordingly, the affected requirements of § 168(k)(2) are modified as follows for determining whether depreciable property that is qualified property under § 168(k)(2) also is eligible qualified property for purposes of § 168(k)(4):

(1) Original use of the property commences with the taxpayer after March 31, 2008. Section 168(k)(4)(D)(i) and (k)(2)(A)(ii);

(2) The property (a) is acquired by the taxpayer after March 31, 2008, and before January 1, 2009, but only if no written binding contract for the acquisition was in effect before January 1, 2008, or (b) is acquired by the taxpayer pursuant to a written binding contract which was entered into after March 31, 2008, and before January 1, 2009. Section 168(k)(4)(D)(i) and (k)(2)(A)(iii). However, see section 3.03 of this revenue procedure for an exception to this rule;

(3) In the case of a taxpayer manufacturing, constructing, or producing property

for the taxpayer's own use, the requirements of section 3.02(2) of this revenue procedure are treated as met if the taxpayer begins manufacturing, constructing, or producing the property after March 31, 2008, and before January 1, 2009. Section 168(k)(4)(D)(i) and (k)(2)(E)(i); and

(4) If new property is originally placed in service by a person after March 31, 2008, and is sold to a taxpayer and leased back to the person by the taxpayer within three months after the date the property was originally placed in service by the person, the taxpayer-lessor is considered the original user of the property under section 3.02(1) of this revenue procedure and, for purposes of the placed-in-service date requirement in § 168(k)(2)(A)(iv), the property is treated as originally placed in service by the taxpayer-lessor not earlier than the date on which the property is used by the lessee under the leaseback. Section 168(k)(4)(D)(i) and (k)(2)(E)(ii); *see also* § 1.168(k)–1(b)(3)(iii)(A) and (b)(5)(ii)(A).

.03 *Passenger Aircraft*. For passenger aircraft, the binding contract requirement in § 168(k)(2)(A)(iii)(I) does not apply for determining whether the passenger aircraft is eligible qualified property. Section 168(k)(4)(G)(iii). Accordingly, a passenger aircraft is eligible qualified property if the aircraft is acquired by the taxpayer (1) after March 31, 2008, and before January 1, 2009, or (2) pursuant to a written binding contract entered into after March 31, 2008, and before January 1, 2009 (assuming all other requirements for qualified property under § 168(k)(2) are met).

SECTION 4. SECTION 168(k)(4) ELECTION

.01 *In General*. Except as provided in § 3081(b) of the Housing Act (relating to certain automotive partnerships), only a corporation may elect to apply § 168(k)(4). This election is made by the corporate taxpayer for its first taxable year ending after March 31, 2008. If the election to apply § 168(k)(4) is made, the election applies to all eligible qualified property placed in service by the taxpayer in the taxpayer's first taxable year ending after March 31, 2008, and in any subsequent taxable year. Even if a taxpayer does not place in service any eligible qualified property in its first taxable year ending after March 31, 2008, the taxpayer must make the election to apply § 168(k)(4) for that taxable year if it wishes to apply the election to eligible qualified property placed in service in a subsequent taxable year.

.02 *Controlled Group of Corporations*. All corporations which are treated as a single employer under § 52(a) (generally any controlled group of corporations within the meaning of § 1563(a), determined by substituting "more than 50 percent" for "more than 80 percent" each place it appears in that section) shall be treated as one taxpayer for purposes of § 168(k)(4) and as having elected to apply § 168(k)(4) if any such corporation so elects. Section 168(k)(4)(C)(iv). For example, if the common parent of an affiliated group of corporations filing a consolidated return makes the election to apply § 168(k)(4) for one member of the affiliated group, then all members of the affiliated group are treated as one taxpayer for purposes of § 168(k)(4) and as having made the election.

.03 *Applicable Depreciation Method*. If a taxpayer elects to apply § 168(k)(4), the applicable depreciation method under § 168(b) for all eligible qualified property is the straight line method. Section 168(k)(4)(A)(ii).

.04 *Ordering Rules for Applying Elections under § 168(k)*. Under § 168(k), there are two elections: the election not to claim the Stimulus additional first year depreciation for all property in a particular class of property (*see* § 168(k)(2)(D)(iii)) and the election to apply § 168(k)(4) for all eligible qualified property. If a taxpayer makes both elections, the taxpayer applies § 168(k)(2)(D)(iii) first. Any class of property (as defined in § 1.168(k)–1(e)(2)) for which a § 168(k)(2)(D)(iii) election has been made is not qualified property under § 168(k)(2) nor eligible qualified property under § 168(k)(4). For example, if a calendar-year taxpayer for its taxable year ending December 31, 2008, makes the election to apply § 168(k)(4) and also elects not to claim the Stimulus additional first year depreciation deduction for 7-year property, the taxpayer first applies § 168(k)(2)(D)(iii) to all of its 7-year property acquired and placed in service in 2008. All eligible qualified property (excluding the 7-year property) will be included in the taxpayer's § 168(k)(4) election.

.05 *Time and Manner for Making Election*. The IRS and Treasury intend to publish separate guidance on the time and manner of making the election.

.06 *Revocation of Election*. Once made, the election to apply § 168(k)(4) may be revoked only with the written consent of the Commissioner of Internal Revenue. *See* § 168(k)(4)(G)(i). To seek the Commissioner's consent, the taxpayer must submit a request for a letter ruling. *See* Rev. Proc. 2008–1, 2008–1 I.R.B. 1 (or any successor).

SECTION 5. BONUS DEPRECIATION AMOUNT

01. *In General*. Except as limited by section 5.03, the bonus depreciation amount for any taxable year is equal to 20 percent of the excess (if any) of —

(1) the aggregate amount of depreciation that would be allowable under § 168 for eligible qualified property placed in service by the taxpayer during the taxable year if the Stimulus additional first year depreciation deduction applied to all such property, over

(2) the aggregate amount of depreciation that would be allowable under § 168 for eligible qualified property placed in service by the taxpayer during the taxable year if the Stimulus additional first year depreciation deduction did not apply to any such property. Section 168(k)(4)(C)(i)(I) and (II).

.02 *Special Rules for Determining Bonus Depreciation Amount*. For purposes of sections 5.01(1) and (2) of this revenue procedure, the following rules apply:

(1) The aggregate amounts of depreciation computed under sections 5.01(1) and (2) of this revenue procedure are made without regard to any election made under § 168(b)(2)(C) (relating to the 150 percent declining balance method), § 168(b)(3)(D) (relating to the straight line method election), § 168(g)(7) (relating to the alternative depreciation system election), and the requirement under section 4.03 of this revenue procedure that eligible qualified property must be depreciated using the straight line method if the taxpayer makes the election to apply § 168(k)(4). Section 168(k)(4)(C)(i).

(2) If a corporation makes the election to apply § 168(k)(4) and is a partner in a

partnership, property placed in service by the partnership is not taken into account in determining the corporation's aggregate amounts of depreciation computed under sections 5.01(1) and (2) of this revenue procedure.

(3) The applicable convention rules under § 168(d) (including the mid-quarter convention for property placed in service during the last three months of a taxable year) apply in determining the aggregate depreciation amounts under sections 5.01(1) and (2) of this revenue procedure.

(4) For passenger aircraft, the binding contract requirement in § 168(k)(2)(A)(iii)(I) does not apply for determining the aggregate depreciation amount under section 5.01(1) of this revenue procedure. Section 168(k)(4)(G)(iii). Accordingly, for determining the aggregate depreciation amount under section 5.01(1) of this revenue procedure, a passenger aircraft is taken into account if the aircraft is acquired by the taxpayer (1) after March 31, 2008, and before January 1, 2009, or (2) pursuant to a written binding contract entered into after March 31, 2008, and before January 1, 2009 (assuming all other requirements for qualified property under § 168(k)(2) are met).

(5) With respect to long production period property, only the adjusted basis of such property attributable to manufacture, construction, or production after March 31, 2008, and before January 1, 2009, is taken into account in determining the aggregate depreciation amounts under sections 5.01(1) and (2) of this revenue procedure. Section 168(k)(4)(D)(ii). The amounts of adjusted basis of the property attributable to manufacture, construction, or production after March 31, 2008, and before January 1, 2009, are referred to as "progress expenditures." For purposes of determining progress expenditures under this section 5.02(5), rules similar to the rules in section 4.02(1)(b) of Notice 2007–36, 2007–17 I.R.B. 1000, 1001 (relating to progress expenditures for GO Zone extension real property), apply.

.03 *Maximum Amount*. The bonus depreciation amount for any taxable year shall not exceed the maximum increase amount (as computed under section 5.04 of this revenue procedure) reduced (but not below zero) by the sum of the bonus depreciation amounts determined under § 168(k)(4)(C) for all preceding taxable years. Section 168(k)(4)(C)(i) and (ii).

.04 *Maximum Increase Amount*. For purposes of section 5.03 of this revenue procedure, the maximum increase amount for any taxpayer means the lesser of (1) $30,000,000, or (2) 6 percent of the sum of the business credit increase amount (as computed under section 5.05 of this revenue procedure) and the AMT credit increase amount (as computed under section 5.06 of this revenue procedure). Section 168(k)(4)(C)(iii)(I) and (II).

.05 *Business Credit Increase Amount*. The business credit increase amount means the portion of the credit allowable under § 38 (without regard to § 38(c)) for the first taxable year ending after March 31, 2008, that is allocable to business credit carryforwards to such taxable year that are (1) from taxable years beginning before January 1, 2006, and (2) properly allocable (considering the application of § 38(d) to credits used in prior taxable years) to the research credit determined under § 41(a). Section 168(k)(4)(E)(iii). For purposes of this section 5.05, a business credit carryforward allocable to the research credit that was from a taxable year beginning before January 1, 2006, but has expired before the first taxable year ending after March 31, 2008, is not taken into account in determining the business credit increase amount.

.06 *AMT Credit Increase Amount*. The AMT credit increase amount means the portion of the minimum tax credit under § 53(b) for the first taxable year ending after March 31, 2008, determined by taking into account only the adjusted minimum tax for taxable years beginning before January 1, 2006. Section 168(k)(4)(E)(iv). For purposes of this section 5.06, minimum tax credits shall be treated as allowed on a first-in, first-out basis. Section 168(k)(4)(E)(iv).

SECTION 6. ALLOCATION OF BONUS DEPRECIATION AMOUNTS

.01 *In General*. Except as limited by section 6.02 of this revenue procedure, the taxpayer shall specify the portion (if any) of the bonus depreciation amount for the taxable year that is to be allocated to each of the business credit limitation under § 38(c) and the AMT credit limitation under § 53(c).

.02 *Limitation on Allocations*.

(1) For any taxable year, the portion of the bonus depreciation amount that may be allocated to the business credit limitation under § 38(c) shall not exceed the excess of the business credit increase amount (determined under section 5.05 of this revenue procedure) over the bonus depreciation amount allocated by the taxpayer to such limitation for all preceding taxable years.

(2) For any taxable year, the portion of the bonus depreciation amount that may be allocated to the AMT credit limitation under § 53(c) shall not exceed the excess of the AMT tax credit increase amount (determined under section 5.06 of this revenue procedure) over the bonus depreciation amount allocated by the taxpayer to such limitation for all preceding taxable years.

.03 *Time and Manner for Specifying Allocation*. The IRS and Treasury intend to publish separate guidance on the time and manner for specifying the allocation.

.04 *Example*. Y, a calendar-year corporation, makes the election to apply § 168(k)(4) for its taxable year ending December 31, 2008. Because § 168(k)(4) was not available prior to 2008, Y has no bonus depreciation amounts (as defined in § 168(k)(4)(C)) for preceding taxable years. Assume that (1) under section 5.01 of this revenue procedure, Y's bonus depreciation amount is $100 million, (2) under section 5.05 of this revenue procedure, Y's business credit increase amount is $10 million, and (3) under section 5.06 of this revenue procedure, Y's AMT credit increase amount is $590 million. Consequently, under section 5.04 of this revenue procedure, Y's maximum increase amount is $30 million (the lesser of (1) $30 million and (2) .06 X ($10 million + $590 million), or $36 million). Therefore, under section 5.03 of this revenue procedure, Y's bonus depreciation amount that may be allocated to increase the credit limitations under §§ 38(c) and 53(c) is $30 million. Pursuant to section 6.01 of this revenue procedure, as limited by section 6.02 of this revenue procedure, the portion of the bonus depreciation amount ($30 million) that Y allocates to the credit limitation under § 38(c) is $10 million (the maximum amount that Y may allocate to its § 38(c) credit limitation under section 6.02(1) of this revenue procedure) and the portion of the bonus depreciation amount that Y allocates to the credit limitation under § 53(c) is $20 million.

In addition, during its taxable year ending December 31, 2009, Y places in service long production period property or certain aircraft that is eligible qualified property. Y's 2008 § 168(k)(4) election remains in effect. For the 2009 taxable year, assume that (1) under section 5.01 of this revenue procedure, Y's bonus depreciation amount is $100 million and (2) under section 5.04 of this revenue procedure, Y's maximum increase amount is $30 million. Therefore, under section 5.03 of this revenue procedure, Y's bonus depreciation amount for the taxable year

ending December 31, 2009, is $0 ($30 million (maximum increase amount) less $30 million (the bonus depreciation amount that Y allocated to increase its §§ 38(c) and 53(c) credit limitations for 2008)).

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective October 10, 2008.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Jeffrey T. Rodrick of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Jeffrey T. Rodrick at (202) 622–4930 (not a toll-free call).

Part IV. Items of General Interest

Partial Withdrawal of Notice of Proposed Rulemaking

Unified Rule for Loss on Subsidiary Stock

REG–157711–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws proposed regulations relating to the application of section 362(e)(2) to intercompany transactions and to certain modifications to the investment adjustment rules.

FOR FURTHER INFORMATION CONTACT: Marcie P. Barese, (202) 622–7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On January 23, 2007, the IRS and Treasury Department published a notice of proposed rulemaking in the **Federal Register** (REG–157711–02, 2007–8 I.R.B. 537 [72 FR 2964]) under §1.1502–36 (Unified Loss Rule). The proposed regulations provided rules under §1.1502–13(e)(4) that would suspend the application of section 362(e)(2) in the case of intercompany transactions. The proposed regulations also provided rules under §1.1502–32(c)(1)(ii) relating to the treatment of items attributable to property transferred in an intercompany section 362(e)(2) transaction.

After consideration of the comments received responding to the notice of proposed rulemaking, the IRS and Treasury Department have concluded that the proposed rules would not be promulgated and, instead, that final regulations would make section 362(e)(2) generally inapplicable to intercompany transactions. Accordingly, §§1.1502–13(e)(4) and 1.1502–32(c)(1)(ii) of the proposed regulations are hereby withdrawn.

* * * * *

Partial Withdrawal of Proposed Regulations

Accordingly, under the authority of 26 U.S.C. 7805, proposed §§1.1502–13(e)(4) and 1.1502–32(c)(1)(ii) published in the **Federal Register** on January 23, 2007 are withdrawn.

Linda E. Stiff,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 9, 2008, 4:15 p.m., and published in the issue of the Federal Register for September 17, 2008, 73 F.R. 53793)

Proposed Amendments to Qualified Intermediary Withholding Agreement and to Audit Guidance for External Auditors of Qualified Intermediaries

Announcement 2008–98

PURPOSE

This announcement sets forth, and solicits public comments regarding, proposed amendments that the IRS intends to make to the Qualified Intermediary Agreement, Appendix, Rev. Proc. 2000–12, 2000–1 C.B. 387 (QI agreement), and to the Guidance for External Auditors of Qualified Intermediaries, Appendix, Rev. Proc. 2002–55, 2002–2 C.B. 435 (QI Audit Guidance). These amendments are intended to ensure that qualified intermediaries (QIs) are taking the steps necessary to comply fully with their obligations under the QI agreement. These amendments are proposed to be effective for calendar years beginning after December 31, 2009.

BACKGROUND

In Treasury Decision 8734, 1997–2 C.B. 109 [62 FR 533871], the Treasury Department and the IRS issued comprehensive regulations under chapter 3 (sections 1441–1464) and subpart G of Subchapter A of chapter 61 (sections 6041–6050S) of the Internal Revenue Code (the 1441 regulations). A key element of the 1441 regulations was the QI system. A QI is a foreign financial institution that has agreed with the IRS to undertake certain U.S. withholding and reporting responsibilities and has agreed to audits by an external auditor. Currently, several thousand foreign financial institutions have become QIs.

The 1441 regulations generally became effective January 1, 2001. Since that time, the IRS, U.S. withholding agents, QIs and external auditors have gained experience in applying those regulations.

In light of this experience, the IRS intends to amend the QI agreement and the QI audit guidance as follows:

(1) *Notice of Material Failure of Internal Controls*. A QI's compliance with the QI agreement depends in large part upon the QI's internal controls, *i.e.*, the QI's own oversight of its performance under the agreement. To ensure compliance with the QI agreement, the QI must ensure that specific employees are responsible for oversight of the QI's performance under the agreement, and those employees must take steps to prevent, deter, detect and correct failures in performance.

Accordingly, the QI agreement will be amended to provide that a QI must notify the IRS whenever the QI becomes aware of a material failure of internal controls relating to its performance under the QI agreement, any employee allegations of such failures, or any investigation by regulatory authorities of such failures. Although any such failure may represent a significant change in circumstances that would give the IRS the right to terminate the QI agreement, the IRS does not contemplate automatically terminating a QI agreement by reason of such notice. Instead, the IRS expects prompt notification to enable the IRS and the QI to work together to remedy such failures so that consideration of termination will not be necessary.

(2) *Phase 1 Fact Finding for Evaluation of Risk*. While the external auditor's initial fact finding in phase 1 of the QI audit provides much information that would enable an IRS examiner to evaluate risk, certain additional information is necessary to enable the IRS to assess the risk that

foreign accounts may be subject to control by U.S. persons. Additional information is also needed to enable the IRS more accurately to assess the risk of a material failure of internal controls.

Accordingly, the QI audit guidance will be amended to add an audit procedure testing certain accounts for characteristics that suggest that a U.S. person has authority over the account. This information would enable the IRS in phase 2 of the audit process to evaluate the risk of any failure of controls and if necessary to request that the external auditor perform additional audit procedures.

The QI audit guidance will also be amended to add additional procedures for fact gathering by the external auditor relating to the IRS's evaluation of the risk of a material failure of internal controls. These procedures will include, for instance, identifying the persons charged with oversight of performance under the QI agreement and the authority given them to prevent, deter, detect and correct such failures on the part of other operational personnel. The external auditor will be required to report any facts or circumstances observed in the course of its audit that reasonably relate to the evaluation by the IRS of the risk of a material failure of internal controls.

(3) *Audit Oversight and Review by U.S. Auditor*. The QI system relies upon external auditors. The reliability of the external auditor depends upon the internal controls embedded within the audit process. A key feature of such controls is oversight and review by persons that are objective, accountable and knowledgeable about U.S. withholding rules.

Accordingly, the QI audit guidance will be amended to require the external auditor to associate a U.S. auditor with the audit and to require the U.S. auditor to accept joint responsibility for performance of the procedures under the audit guidance. The aim in joining a U.S. auditor is to ensure appropriate application of U.S. withholding rules and to enhance accuracy and accountability in the audit process.

AMENDMENTS TO QI AGREEMENT

Pursuant to section 12.02 of the QI agreement, the IRS proposes to amend sections 11 of the QI agreement as follows:

(1) Section 11.03 of the QI agreement to add new section 11.03(F) to read as follows:

* * * * *

Sec. 11.03. Significant Change in Circumstances. * * *

(F) A material failure of internal controls relating to its performance under the QI agreement, any employee allegations relating to such material failures, or any investigation by any regulatory authorities relating to such material failures. The term "internal controls" refers to the activities of QI personnel charged with oversight of performance under the QI agreement and the authority given them to prevent, deter and detect intentional or unintentional errors in performance on the part of other operational personnel. The term "material failure of internal controls" refers to lack of such activities, personnel or authority, to any intentional errors in performance of the QI agreement detected by such personnel, and to unintentional errors detected by such personnel that appear to have originated with or been initiated by operational personnel charged with directly conferring with and providing financial services to customers.

(2) Section 11.04 of the QI to add new section 11.04(X) to read as follows:

* * * * *

Sec.11.04. Events of Default. * * *

(X) QI fails to notify the IRS of any material failure of internal controls described in section 11.03(F) within 60 days of discovery of its occurrence.

* * * * *

AMENDMENTS TO QI AUDIT GUIDANCE

The IRS proposes to amend sections 10.02, 10.03(A)(5), and 10.03(E) of the QI Audit Guidance as follows:

(1) Section 10.02 of the QI Audit Guidance to add new section 10.02.3 to read as follows:

* * * * *

10.02.3 *Associating U.S. Auditor*. Any external auditor that is a foreign person or foreign accounting firm or foreign branch or associated accounting firm of a U.S. accounting firm and that conducts an audit or any part of an audit under section 10 of the QI Agreement must associate a U.S. accounting firm or a U.S. branch or U.S. associated accounting firm with the QI audit, and the U.S. accounting firm, U.S. branch or associated U.S. accounting firm must accept joint and several liability for the conduct of the QI audit and must cosign the audit report. The U.S. auditor shall footnote in the phase 1 external auditor's report any facts or circumstances observed in the course of its oversight and review that reasonably relate to the evaluation by the IRS of the risk of a material failure of internal controls.

* * * * *

(2) Section 10.03(A)(5).1 to revise the first sentence of Step 9, to add new Step 9(e) and new Step 10(c); section 10.03(A)(5).2 to add new Report 10(e); section 10.3(E).1 to add new Steps 2 and 3; and section 10.03(E).2 to add new Reports 2 and 3 and to revise Report 11 to read as follows:

* * * * *

10.03(A)(5).1 * * *

Step 9: For each account determined to be documented under Steps 3 through 8, examine the most recently updated information for the audit year drawn from the account opening statement, any other account documents or memoranda, any account correspondence associated with the account, any documents, reports or other information generated or received for purposes of anti-money laundering, know-your-customer, tax or other laws, and any other account information (for purposes of this section, "the account holder's file"). * * *

(e) The account holder's file shows that a U.S. person or a person within the United States has signature or other authority (including authority to withdraw funds, trade, give instructions, or receive account statements, confirmations or other information, notices, advice or solicitations with respect to the account), or has given or received a power granting such authority to or from a foreign person.

Step 10: * * *

(c) For each account included in Step 10 (a) and (b), determine whether the account holder's file shows that a U.S. person or a person within the United States has signature or other authority (including authority to withdraw funds, trade, give instructions, or receive account statements, confirmations or other information, notices, advice or solicitations with respect to the account), or has given or received a power

granting such authority to or from a foreign person.

* * * * *

10.03(A)(5).2: * * *

Report 10: * * *

(e) Described in Step 9(e).

Report 11: The number of accounts described in each of (a), (b) and (c) of Step 10.

* * * * *

(3) Section 10.03(E) to add new section 10.03(E).1 Step 2 and new section 10.03(E).2 to add new Report 2 to read as follows:

* * * * *

10.03(E).1 * * *

Step 2: Identify the QI personnel charged with oversight of performance under the QI agreement, their posts of duty, job descriptions and the persons to whom they report and the positions of those persons within the QI's organization. Determine the extent of the authority of such QI personnel over other operational personnel of the QI. Identify any significant actions to prevent, deter, detect and correct errors in performance of the QI agreement (including examinations, auditing and testing procedures, investigations, and training conducted) taken by such QI personnel since the last QI audit year. Determine whether QI has any procedures in place for receiving and investigating allegations of material failures of internal control by QI employees.

Step 3: Review whether any facts or circumstances observed in the course of its audit reasonably relate to the evaluation by the IRS of the risk of a material failure of internal controls.* * *

10.03(E).2 * * *

Report 2: Report the information collected in Step 2 in list format.

Report 3: List and describe any facts or circumstances observed in the course of its audit that reasonably relate to the evaluation by the IRS of the risk of a material failure of internal controls.

* * * * *

REQUEST FOR COMMENTS

The IRS and Treasury Department request comments regarding the proposed amendments to the QI Agreement and the proposed amendments to the QI Audit Guidance.

Comments should be submitted on or before February 28, 2009, and should include a reference to Announcement 2008–98. Send submissions to CC:PA:LPD:PR (Announcement 2008–98), Room 5203, Internal Revenue Service, P.O. Box 78604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Announcement 2008–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044, or sent electronically, via the following e-mail address: *notice.comments@irscounsel.treas.gov*. Please include "Announcement 2008–98" in the subject line of any electronic communication. All material submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Kay Holman of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Kay Holman at (202) 622–3840 (not a toll-free call).

Income, Excise, and Estate and Gift Taxes; Effective Dates and Other Issues Arising Under the Employee Benefit Provisions of the Tax Reform Act of 1984; Correction

Announcement 2008–99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains a correction to temporary regulations (T.D. 8073, 1986–1 C.B. 45) that were published in the **Federal Register** on Tuesday, February 4, 1986 (51 FR 4312) relating to effective dates and certain other issues arising under sections 91, 223, and 511–561 of the Tax Reform Act of 1984. This action is necessary because of changes to the applicable tax law made by the Tax Reform Act of 1984. The temporary regulations will affect qualified employee benefit plans, welfare benefit funds and employees receiving benefits through such plans.

DATES: This correction is effective October 9, 2008, and is applicable after December 31, 1985.

FOR FURTHER INFORMATION CONTACT: Melissa A. D'Ambrose, (202) 622–6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations that are the subject of this document are under sections 72, 79, 125, 133, 402, 404, 419, 461, 463, 505, 512, and 1042 of the Internal Revenue Code.

Need for Correction

As published, temporary regulations (T.D. 8073) contain an error that may prove to be misleading and is in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendment:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.512(a)–5T A–3: (b) is amended by revising the second sentence to read as follows:

§1.512(a)–5T Questions and answers relating to the unrelated business taxable income of organizations described in paragraphs (9), (17) or (20) of section 501(c) (temporary).

* * * * *

A–3: * * *

(b) * * * For purposes of section 512(a)(3)(B), member contributions include both employee contributions and

employer contributions to the VEBA, SUB, or GLSO.

* * * * *

LaNita Van Dyke,
Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on October 8, 2008, 8:45 a.m., and published in the issue of the Federal Register for October 9, 2008, 73 F.R. 59501)

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2008–100

The Internal Revenue Service has revoked its determination that the organizations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on November 3, 2008, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Gordon Space Foundation
Detroit, MI

Announcement of Disciplinary Sanctions From the Office of Professional Responsibility

Announcement 2008-101

The Office of Professional Responsibility (OPR) announces recent disciplinary sanctions involving attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and appraisers. These individuals are subject to the regulations governing practice before the Internal Revenue Service (IRS), which are set out in Title 31, Code of Federal Regulations, Part 10, and which are published in pamphlet form as Treasury Department Circular No. 230. The regulations prescribe the duties and restrictions relating to such practice and prescribe the disciplinary sanctions for violating the regulations.

The disciplinary sanctions to be imposed for violation of the regulations are:

Disbarred from practice before the IRS—An individual who is disbarred is not eligible to represent taxpayers before the IRS.

Suspended from practice before the IRS—An individual who is suspended is not eligible to represent taxpayers before the IRS during the term of the suspension.

Censured in practice before the IRS—Censure is a public reprimand. Unlike disbarment or suspension, censure does not affect an individual's eligibility to represent taxpayers before the IRS, but OPR may subject the individual's future representations to conditions designed to promote high standards of conduct.

Monetary penalty—A monetary penalty may be imposed on an individual who engages in conduct subject to sanction or on an employer, firm, or entity if the individual was acting on its behalf and if it knew, or reasonably should have known, of the individual's conduct.

Disqualification of appraiser—An appraiser who is disqualified is barred from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or the IRS.

Under the regulations, attorneys, certified public accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents may not assist, or accept assistance from, individuals who are suspended or disbarred with respect to matters constituting practice (*i.e.*, representation) before the IRS, and they may not aid or abet suspended or disbarred individuals to practice before the IRS.

Disciplinary sanctions are described in these terms:

Disbarred by decision after hearing, Suspended by decision after hearing, Censured by decision after hearing, Monetary penalty imposed after hearing, and Disqualified after hearing—An administrative law judge (ALJ) conducted an evidentiary hearing upon OPR's complaint alleging violation of the regulations and issued a decision imposing one of these sanctions. After 30 days from the issuance of the decision, in the absence of an appeal, the ALJ's decision became the final agency decision.

Disbarred by default decision, Suspended by default decision, Censured by default decision, Monetary penalty im-

posed by default decision, and Disqualified by default decision—An ALJ, after finding that no answer to OPR's complaint had been filed, granted OPR's motion for a default judgment and issued a decision imposing one of these sanctions.

Disbarment by decision on appeal, Suspended by decision on appeal, Censured by decision on appeal, Monetary penalty imposed by decision on appeal, and Disqualified by decision on appeal—The decision of the ALJ was appealed to the agency appeal authority, acting as the delegate of the Secretary of the Treasury, and the appeal authority issued a decision imposing one of these sanctions.

Disbarred by consent, Suspended by consent, Censured by consent, Monetary penalty imposed by consent, and Disqualified by consent—In lieu of a disciplinary proceeding being instituted or continued, an individual offered a consent to one of these sanctions and OPR accepted the offer. Typically, an offer of consent will provide for: suspension for an indefinite term; conditions that the individual must observe during the suspension; and the individual's opportunity, after a stated number of months, to file with OPR a petition for reinstatement affirming compliance with the terms of the consent and affirming current eligibility to practice (*i.e.*, an active professional license or active enrollment status). An enrolled agent or an enrolled retirement plan agent may also offer to resign in order to avoid a disciplinary proceeding.

Suspended by decision in expedited proceeding, Suspended by default decision in expedited proceeding, Suspended by consent in expedited proceeding—OPR instituted an expedited proceeding for suspension (based on certain limited grounds, including loss of a professional license and criminal convictions).

OPR has authority to disclose the grounds for disciplinary sanctions in these situations: (1) an ALJ or the Secretary's delegate on appeal has issued a decision on or after September 26, 2007, which was the effective date of amendments to the regulations that permit making such decisions publicly available; (2) the individual has settled a disciplinary case by signing OPR's "consent to sanction" form, which requires consenting individuals to admit to one or more violations of the regulations and to consent to the disclosure of the individual's own return information related to the admitted violations (for example, failure to file Federal income tax returns); or (3) OPR has issued a decision in an expedited proceeding for suspension.

Announcements of disciplinary sanctions appear in the Internal Revenue Bulletin at the earliest practicable date. The sanctions announced below are alphabetized first by the names of states and second by the last names of individuals. Unless otherwise indicated, section numbers (*e.g.*, §10.51) refer to the regulations.

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
Arizona				
Temple	Rodriguez, Gilbert D.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from August 6, 2008
California				
Irvine	Azavedo, Anthony J.	CPA	Suspended by default decision in expedited proceeding under §10.82 (suspension of CPA license)	Indefinite from August 8, 2008
Georgia				
Atlanta	Roberts, Barry B.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (conviction under 18 U.S.C. § 1001 false statements to the IRS)	Indefinite from August 26, 2008

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
Illinois				
Lynwood	Brown, Roger L.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 8, 2008
Wheaton	Coplien, Sandra K.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 8, 2008
Chicago	Olis, Jamie	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license in Texas)	Indefinite from September 10, 2008
Evanston	Paden, Betty B.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from August 8, 2008
Downers Grove	Vera, Jorge J.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (stricken from attorney license roll)	Indefinite from August 8, 2008
Indiana				
Bloomington	Colman, David J.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 27, 2008
Iowa				
Lost Nation	Fulmer, Joseph C.	Enrolled Agent	Suspended by consent for admitted violation of § 10.51 (practitioner touched a client in an offensive manner)	Indefinite from September 22, 2008
Des Moines	Rauch, Allan H.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (revocation of attorney license)	Indefinite from August 6, 2008
Maryland				
Bethesda	Callihan, Jr., Herbert A.	Attorney	Suspended by decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from September 5, 2008

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
Massachusetts				
Pittsfield	Fuster, Robert M.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 26, 2008
Cambridge	Himmelstein, John	Attorney	Suspended by decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from September 10, 2008
New Jersey				
Deptford	Angelucci, John S.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 26, 2008
Hamilton	Boyer, David W.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 26, 2008
Wyckoff	Giamanco, Thomas A.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 26, 2008
Glenwood	Payne, David M.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from August 26, 2008
New Mexico				
Las Vegas	Martinez, Melaquias J.	CPA	Suspended by consent for admitted violations of § 10.51 (failure to timely file Federal tax returns)	Indefinite from September 22, 2008
New York				
Binghamton	Crumb, Edward F.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from August 26, 2008
Brooklyn	Grossman, Israel G.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from August 26, 2008

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
New York (Continued)				
Dix Hills	Hussain-El, Amin, aka, Hanks, Andre P.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from August 26, 2008
Smithtown	Shuster, Robert A.	Attorney	Suspended by decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from August 15, 2008
Ithaca	Sullivan, William P., aka, Sullivan, Jr., William P.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from August 26, 2008
North Carolina				
Fayetteville	Balogun, Jacob O.	CPA	Suspended by decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008
Concord	Brown, Thomas D.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from August 26, 2008
Ohio				
Lakewood	Heck, John W.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008
N. Royalton	Herman, Terry B.	CPA	Suspended by decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008
Centerville	Marovich, Jennifer L.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008
Texas				
Dallas	Buck, John R.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
Texas (Continued)				
Amarillo	Casey, Laurence C.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008
Rockport	Huffmeyer, II, Andrew F.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008
	Olis, Jamie, see Illinois			
Whichita Falls	Sink, Richard T.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from September 10, 2008

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

Numerical Finding List[1]

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