

account at the beginning of Year 6 for purposes of applying paragraph (c)(1)(iii)(A) of this section. Consequently, S is treated as worthless at the beginning of Year 6, and P's \$110 excess loss account is taken into account.

(h) *Effective date*—(1) *Application*. This section applies with respect to determinations of the basis of (including an excess loss account in) the stock of a member in consolidated return years beginning on or after January 1, 1995. If this section applies, basis (and excess loss accounts) must be determined or redetermined as if this section were in effect for all years (including, for example, the consolidated return years of another consolidated group to the extent adjustments during those consolidated return years are still reflected). Any such determination or redetermination does not, however, affect any prior period.

(2) *Dispositions of stock before effective date*—(i) *In general*. If P was treated as disposing of stock of S in a tax year beginning before January 1, 1995 (including, for example, a deemed disposition because S was worthless) under the rules of this section then in effect, the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount, are not redetermined under paragraph (h)(1) of this section. See paragraph (h)(3) of this section for the applicable rules.

(ii) *Intercompany amounts*. For purposes of this paragraph (h)(2), a disposition does not include a transaction to which § 1.1502-13, § 1.1502-13T, § 1.1502-14, or § 1.1502-14T applies. Instead, the transaction is deemed to occur as the income, gain, deduction, or loss (if any) is taken into account.

(3) *Prior law*. For prior determinations, see prior regulations under section 1502 as in effect with respect to the determination. See, e.g., § 1.1502-19 as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

[T.D. 8560, 59 FR 41677, Aug. 15, 1994, as amended by T.D. 8597, 62 FR 12097, Mar. 14, 1997]

**§ 1.1502-20 Disposition or
deconsolidation of subsidiary stock.**

(a) *Loss disallowance*—(1) *General rule*. No deduction is allowed for any loss recognized by a member with respect

to the disposition of stock of a subsidiary. See also §§ 1.1502-11(c) (stock losses attributable to certain pre-1966 distributions) and 1.1502-80(c) (deferring the treatment of stock of members as worthless under section 165(g)).

(2) *Disposition*. *Disposition* means any event in which gain or loss is recognized, in whole or in part.

(3) *Coordination with loss deferral and other disallowance rules*—(i) *In general*. Loss with respect to the stock of a subsidiary may be deferred or disallowed under other applicable provisions of the Code and regulations, including section 267(f). Paragraph (a)(1) of this section does not apply to loss that is disallowed under any other provision. If loss is deferred under any other provision, paragraph (a)(1) of this section applies when the loss is taken into account. However, if an overriding event described in paragraph (a)(3)(ii) of this section occurs before the deferred loss is taken into account, paragraph (a)(1) of this section applies to the loss immediately before the event occurs even though the loss may not be taken into account until a later time. Any loss not disallowed under paragraph (a)(1) of this section is subject to disallowance or deferral under other applicable provisions of the Code and regulations.

(ii) *Overriding events*. For purposes of paragraph (a)(3)(i) of this section, the following are overriding events:

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

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

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

(4) *Netting*. Paragraph (a)(1) of this section does not apply to loss with respect to the disposition of stock of a subsidiary, to the extent that, as a consequence of the same plan or arrangement, gain is taken into account by members with respect to stock of the same subsidiary having the same material terms. If the gain to which this paragraph (a)(4) applies is less than the amount of the loss with respect to the disposition of the subsidiary's stock, the gain is applied to offset loss with respect to each share disposed of as a

consequence of the same plan or arrangement in proportion to the amount of the loss deduction that would have been disallowed under paragraph (a)(1) of this section with respect to such share before the application of this paragraph (a)(4). If the same item of gain could be taken into account more than once in limiting the application of paragraphs (a)(1) and (b)(1) of this section, the item is taken into account only once.

(5) *Examples.* For purposes of the examples in this section, unless otherwise stated, all corporations have only one class of stock outstanding, all groups file consolidated returns on a calendar-year basis, the facts set forth the only corporate activity, all transactions are between unrelated persons, and tax liabilities are disregarded. The basis of each asset is the same for determining earnings and profits adjustments and taxable income. References to the investment adjustment system are references to the rules of §§ 1.1502-19, 1.1502-32 and 1.1502-33. The principles of this paragraph (a) are illustrated by the following examples.

Example 1. Loss attributable to recognized built-it gain. P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases to \$200. Five years later, P sells all the T stock for \$100 and recognizes a loss of \$100. Under paragraph (a)(1) of this section, no deduction is allowed to P for the \$100 loss.

Example 2. Effect of post-acquisition appreciation. P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases to \$200. T reinvests the proceeds of the sale in an asset that appreciates in value to \$180. Five years after the sale, P sells all the stock of T for \$180 and recognizes a \$20 loss. Under paragraph (a)(1) of this section, no deduction is allowed to P for the \$20 loss.

Example 3. Disallowance of duplicated loss. P forms S with a contribution of \$100 in exchange for all of the S stock, and S becomes a member of the P group. S has an operating loss of \$60. The group is unable to use the loss, and the loss becomes a consolidated net operating loss carryover attributable to S. Five years later, P sells the stock of S for \$40, recognizing a \$60 loss. Under paragraph

(a)(1) of this section, P's \$60 loss on the sale of the S stock is disallowed. (See paragraph (g) of this section for the elective reattribution of S's \$60 net operating loss to P in connection with the sale.)

Example 4. Deemed asset sale election. (i) P forms S with a contribution of \$100 in exchange for all of the S stock, and S becomes a member of the P group. S buys an asset for \$100, and the value of the asset declines to \$40. P sells all the S stock to P1 for \$40. Under paragraph (a)(1) of this section, P's \$60 loss on the sale of the S stock is disallowed.

(ii) If P and P1 instead elect deemed asset sale treatment under section 338 (h) (10), S is treated as selling all of its assets, and no loss is recognized by P on its sale of the S stock. As a result of the recharacterization of the stock sale as an asset sale, the \$60 loss in the asset is recognized. Under section 338 (h)(10), S's \$60 loss is included in the consolidated return of the P group, and S is treated as liquidating into P under section 332 following the deemed asset sale. Paragraph (a)(1) of this section does not apply to S's \$60 loss.

Example 5. Gain and loss recognized with respect to stock as a consequence of the same plan or arrangement. P, the common parent of a group, owns 50 shares of the stock of T with an aggregate basis of \$50, and S, a wholly owned subsidiary of P, owns the remaining 50 shares of T's stock with an aggregate basis of \$100. All of the stock has the same terms. P and S sell all the T stock to the public for \$140 pursuant to a single public offering. P therefore recognizes a gain of \$20 and S recognizes a loss of \$30. For purposes of paragraph (a)(4) of this section, the gain and loss recognized by P and S is considered to be a consequence of the same plan or arrangement. Accordingly, the amount of S's \$30 loss disallowed under paragraph (a)(1) of this section is limited to \$10 (the \$30 reduced by P's \$20 gain).

Example 6. Deferred loss and recognized gain. (i) P is the common parent of a consolidated group, S is a wholly owned subsidiary of P, and T is a recently purchased, wholly owned subsidiary of S. S has a \$100 basis in the T stock, and T has an asset with a basis of \$40 and a value of \$100. T sells the asset for \$100, recognizing a \$60 gain. Under the investment adjustment system, S's basis in the T stock increases from \$100 to \$160. S sells its T stock to P for \$100 in an intercompany transaction, recognizing a \$60 intercompany loss that is deferred under section 267(f) and § 1.1502-13. P subsequently sells all the stock of T for \$100 to X, a member of the same controlled group (as defined in section 267(f)) as P but not a member of the P consolidated group.

(ii) Under paragraph (a)(3)(i) of this section, the application of paragraph (a)(1) of this section to S's \$60 intercompany loss on the sale of its T stock to P is deferred, because S's intercompany loss is deferred under section 267(f) and § 1.1502-13. P's sale of

the T stock to X ordinarily would result in S's intercompany loss being taken into account under the matching rule of § 1.1502-13(c). The deferred loss is not taken into account under § 1.267(f)-1, however, because P's sale to X (a member of the same controlled group as P) is a second intercompany transaction for purposes of section 267(f). Nevertheless, paragraph (a)(3)(ii) of this section provides that paragraph (a)(1) of this section applies to the intercompany loss as a result of P's sale to X because the T stock ceases to be owned by a member of the P consolidated group. Thus, the loss is disallowed under paragraph (a)(1) of this section immediately before P's sale and is therefore never taken into account under section 267(f).

(iii) The facts are the same as in (i) of this *Example*, except that S is liquidated after its sale of the T stock to P, but before P's sale of the T stock to X, and P sells the T stock to X for \$110. Under §§ 1.1502-13(j) and 1.267(f)-1(b), P succeeds to S's intercompany loss as a result of S's liquidation. Thus, paragraph (a)(3)(i) of this section continues to defer the application of paragraph (a)(1) of this section until P's sale to X. Under paragraph (a)(4) of this section, the amount of S's \$60 intercompany loss disallowed under paragraph (a)(1) of this section is limited to \$50 because P's \$10 gain on the disposition of the T stock is taken into account as a consequence of the same plan or arrangement.

(iv) The facts are the same as in (i) of this *Example*, except that P sells the T stock to A, a person related to P within the meaning of section 267(b)(2). Although S's intercompany loss is ordinarily taken into account under the matching rule of § 1.1502-13(c) as a result of P's sale, § 1.267(f)-1(c)(2)(ii) provides that none of the intercompany loss is taken into account because A is a nonmember that is related to P under section 267(b). Under paragraph (a)(3)(i) of this section, paragraph (a)(1) of this section does not apply to loss that is disallowed under any other provision. Because § 1.267(f)-1(c)(2)(ii) and section 267(d) provide that the benefit of the intercompany loss is retained by A if the property is later disposed of at a gain, the intercompany loss is not disallowed for purposes of paragraph (a)(3)(i) of this section. Thus, the intercompany loss is disallowed under paragraph (a)(1) of this section immediately before P's sale and is therefore never taken into account under section 267(d).

(b) *Basis reduction on deconsolidation—*

(1) *General rule.* If a member's basis in a share of stock of a subsidiary exceeds its value immediately before a deconsolidation of the share, the basis of the share is reduced at that time to an amount equal to its value. If both a disposition and a deconsolidation occur with respect to a share in the same

transaction, paragraph (a) of this section applies and, to the extent necessary to effectuate the purposes of this section, this paragraph (b) applies following the application of paragraph (a) of this section.

(2) *Deconsolidation.* Deconsolidation means any event that causes a share of stock of a subsidiary that remains outstanding to be no longer owned by a member of any consolidated group of which the subsidiary is also a member.

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

(4) *Netting.* Paragraph (b)(1) of this section does not apply to reduce the basis of stock of a subsidiary, to the extent that, as a consequence of the same plan or arrangement as that giving rise to the deconsolidation, gain is taken into account by members with respect to stock of the same subsidiary having the same material terms. If the gain to which this paragraph (b)(4) applies is less than the amount of basis reduction with respect to shares of the subsidiary's stock, the gain is applied to offset basis reduction with respect to each share deconsolidated as a consequence of the same plan or arrangement in proportion to the amount of the reduction that would have been required under paragraph (b)(1) of this section with respect to such share before the application of this paragraph (b)(4). If the same item of gain could be taken into account more than once in limiting the application of paragraphs (a)(1) and (b)(1) of this section, the time is taken into account only once.

(5) *Loss within 2 years after basis reduction—*(i) *In general.* If a share is deconsolidated and a direct or indirect disposition of the share occurs within 2 years after the date of the deconsolidation, a separate statement entitled "Statement Pursuant to Section § 1.1502-20(b)(5)" must be filed with the taxpayer's return for the year of disposition. If the taxpayer fails to file the statement as required, no deduction is allowed for any loss recognized with respect to the disposition. A disposition after the 2-year period described in this paragraph (b)(5) that is pursuant to an agreement, option, or other arrangement entered into within

the 2-year period is treated as a disposition within the 2-year period for purposes of this section.

(ii) *Contents of statement.* The statement required under paragraph (b)(5)(i) of this section must contain—

(A) The name and employer identification number (E.I.N.) of the subsidiary.

(B) The amount of prior basis reduction (if any) with respect to the stock of the subsidiary under paragraph (b)(1) of this section.

(C) The basis of the stock of the subsidiary immediately before the disposition.

(D) The amount realized on the disposition.

(E) The amount of the loss recognized on the disposition.

(6) *Examples.* The principles of this paragraph (b) are illustrated by the following examples.

Example 1. Simultaneous application of loss disallowance rule and basis reduction rule to stock of the same subsidiary. (i) P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases to \$200. Five years later, P sells 60 shares of T stock for \$60 and recognizes \$60 loss on the sale. The sale causes a deconsolidation of the remaining 40 shares of T stock held by P.

(ii) P's \$60 loss on the sale of T stock is disallowed under paragraph (a)(1) of this section. Under paragraph (b)(1) of this section, P must reduce the basis of the 40 shares of T stock it continues to own from \$80 to \$40, the value of the shares immediately before the deconsolidation.

(iii) Although P's disposition of the 60 shares also causes a deconsolidation of these shares, paragraph (b)(1) of this section provides that, if both paragraph (a) and paragraph (b) of this section apply to a share in the same transaction, paragraph (a) of this section applies first and this paragraph (b) applies only to the extent necessary to effectuate the purposes of this section. Under paragraph (a)(1) of this section, P's \$60 loss on the sale of the 60 shares is disallowed. Under the facts of this example, it is not necessary to also apply this paragraph (b) to the 60 shares in order to effectuate the purposes of this section.

Example 2. Deconsolidation of subsidiary stock on contribution to a partnership. (i) P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment

adjustment system, P's basis in the T stock increases to \$200. Five years later, P transfers all the stock of T to partnership M in exchange for a partnership interest in M, in a transaction to which section 721 applies.

(i) At the time of the exchange, P's basis in the T stock is \$200 and the T stock's value is \$100. Under paragraph (b) of this section, the transfer to M causes a deconsolidation of the T stock, and P must reduce its basis in the T stock, immediately before the transfer to M, from \$200 to the stock's \$100 value at the time of the transfer. As a result, P has a basis of \$100 in its interest in M, and M has a basis of \$100 in the stock of T.

Example 3. Simultaneous application of loss disallowance and basis reduction to stock of different subsidiaries. (i) P owns all the stock of S, which in turn owns all the stock of S1, and S and S1 are members of the P group. P's basis in the S stock is \$100 and S's basis in the S1 stock is \$100. S1 buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, S1's basis in the T stock, S's basis in the S1 stock, and P's basis in the S stock each increase from \$100 to \$200. S then sells all the S1 stock for \$100 and recognizes a loss of \$100.

(ii) Under paragraph (a)(1) of this section, S's \$100 loss on the sale of the S1 stock is disallowed.

(iii) If S1 and T are not members of a consolidated group immediately after the sale of the stock of S1, the T stock is deconsolidated and, under paragraph (b)(1) of this section, S1 must reduce the basis of the T stock to its \$100 value immediately before the sale.

(iv) If S1 and T are members of a consolidated group immediately after the sale of the S1 stock, the T stock is not deconsolidated, and no reduction is required under paragraph (b)(1) of this section.

Example 4. Extending the time period for dispositions. (i) In Year 1, P, the common parent of a group, buys all 100 shares of the stock of T for \$100. T's only asset has a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases from \$100 to \$200. At the beginning of Year 5, P causes T to issue 30 additional shares of stock to the public for \$30. This issuance causes a deconsolidation of the T stock owned by P, and paragraph (b)(1) of this section requires P to reduce its basis in the T stock from \$200 to \$100.

(ii) Within 2 years after the date of the basis reduction, P agrees to sell all of its T stock for \$90 at the end of Year 7. Under paragraph (b)(5) of this section, P's disposition of the T stock at the end of Year 7 is treated as occurring within the 2-year period following the basis reduction, because the disposition is pursuant to an agreement

reached within 2 years after the basis reduction. Accordingly, P's \$10 loss may not be deducted unless P files the statement required under paragraph (b)(5) of this section. This result is reached whether or not the agreement is in writing. P's disposition would also have been treated as occurring within the 2-year period if the disposition were pursuant to an option issued within the period.

Example 5. Deferred loss and subsequent basis reduction. (i) P is the common parent of a consolidated group, S is a wholly owned subsidiary of P, and T is a recently purchased, wholly owned subsidiary of S. S has a \$100 basis in the T stock, and T has an asset with a basis of \$40 and a value of \$100. T sells the asset for \$100, recognizing \$60 of gain. Under the investment adjustment system, S's basis in the T stock increases from \$100 to \$160. S sells its T stock to P for \$100 in an intercompany transaction, recognizing a \$60 intercompany loss that is deferred under section 267(f) and § 1.1502-13. T issues 30 additional shares of stock to the public for \$30 which causes a deconsolidation of the T stock owned by P.

(ii) Under paragraph (a)(3)(i) of this section, the application of paragraph (a)(1) of this section to S's intercompany loss on the sale of its T stock to P is deferred because S's loss is deferred under section 267(f) and § 1.1502-13. Because the fair market value of the T stock owned by P is \$100 immediately before the deconsolidation and P has a \$100 basis in the stock at that time, no basis reduction is required under paragraph (b)(1) of this section.

(iii) T's issuance of additional shares to the public results in S's intercompany loss being taken into account under the acceleration rule of § 1.1502-13(d) because there is no difference between P's \$100 basis in the T stock and the \$100 basis the T stock would have had if P and S had been divisions of a single corporation. S's loss taken into account is disallowed under paragraph (a)(1) of this section.

Example 6. Gain and basis reduction with respect to the same plan or arrangement. (i) P, the common parent of a group, owns 50 shares of T stock with an aggregate basis of \$50, and S, a wholly owned subsidiary of P, owns the remaining 50 shares of T stock with an aggregate basis of \$100. All of the stock has the same terms. P sells all of its T stock to the public for \$70 and recognizes a \$20 gain. The sale causes a deconsolidation of S's 50 shares of T stock.

(ii) Under paragraph (b)(1) of this section, S must reduce the basis of its 50 shares of T stock from \$100 to \$70, the value of the shares immediately before the deconsolidation. However, under paragraph (b)(4) of this section, because P's \$20 gain is recognized as a consequence of the same plan or arrangement as that giving rise to the deconsolidation, S's basis reduction is elimi-

nated to the extent of \$20. Thus, S must reduce the basis of its T stock from \$100 to \$90.

Example 7. Netting allocated between loss disallowance and basis reduction. (i) P is the common parent of a group and S is its wholly owned subsidiary. P and S each own 50 shares of T stock and each has an aggregate basis of \$50. All of the stock has the same terms. S recently purchased its T stock from S1, a lower tier subsidiary, in an intercompany transaction in which S1 recognized a \$30 intercompany gain that was deferred under § 1.1502-13. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100, recognizing \$100 of gain. Under the investment adjustment system, P and S each increase the basis of their T stock to \$100. S sells all of its T stock to the public for \$50 and recognizes a \$50 loss. The sale causes a deconsolidation of P's T stock.

(ii) S's \$50 loss on the sale of T stock is disallowed under paragraph (a)(1) of this section. Under paragraph (b)(1) of this section, P must reduce its \$100 basis in the T stock to the \$50 value immediately before the deconsolidation.

(iii) Under the matching rule of § 1.1502-13, S's sale of its T stock results in S1's \$30 intercompany gain being taken into account. Under paragraphs (a)(4) and (b)(4) of this section, the gain may be taken into account by P and S in limiting the application of paragraphs (a)(1) and (b)(1) of this section, but it may be taken into account only once. Under paragraph (a)(4) of this section, S may apply the gain to decrease the amount of loss disallowed under paragraph (a)(1) of this section from \$50 to \$20. None of the gain remains to decrease the \$50 of P's basis reduction under paragraph (b)(1) of this section. (P may instead apply the gain to decrease the basis reduction under paragraph (b)(1) of this section instead of S decreasing its disallowed loss, but if the T stock is sold within 2 years, the statement described in paragraph (b)(5) of this section must be filed if a deduction is to be allowed for any loss recognized on the disposition.)

(c) *Allowable loss—(1) General rule.* The amount of loss disallowed under paragraph (a)(1) of this section and the amount of basis reduction under paragraph (b)(1) of this section with respect to a share of stock shall not exceed the sum of the following amounts—

(i) *Extraordinary gain dispositions.* The amount of income or gain (or its equivalent), net of directly related expenses, that is allocated to the share from extraordinary gain dispositions.

(ii) *Positive investment adjustments.* The amount of the positive adjustment (if any) with respect to the share under § 1.1502-32 for each consolidated return

year, but only to the extent the amount exceeds the amount described in paragraph (c)(1)(i) of this section for the year.

(iii) *Duplicated loss.* The amount of duplicated loss with respect to the share.

(2) *Operating rules.* For purposes of applying paragraph (c)(1) of this section—

(i) *Extraordinary gain dispositions.* An “extraordinary gain disposition” is—

(A) An actual or deemed disposition of—

(1) A capital asset as defined in section 1221 (determined without the application of any other rules of law).

(2) Property used in a trade or business as defined in section 1231(b) (determined without the application of any holding period requirement).

(3) An asset described in section 1221 (1), (3), (4), or (5), if substantially all the assets in such category from the same trade or business are disposed of in one transaction (or series of related transactions).

(4) Assets disposed of in an applicable asset acquisition under section 1060(c).

(B) A positive section 481(a) adjustment.

(C) A discharge of indebtedness.

(D) Any other event (or item) identified in guidance published in the Internal Revenue Bulletin.

An extraordinary gain disposition is taken into account under paragraph (c)(1)(i) of this section only if it occurs on or after November 19, 1990. For this purpose, federal income taxes may be directly related to extraordinary gain dispositions only to the extent of the excess (if any) of the group’s income tax liability actually imposed under subtitle A of the Internal Revenue Code for the taxable year of the extraordinary gain dispositions over the group’s income tax liability for the taxable year redetermined by not taking into account the extraordinary gain dispositions. For this purpose, the group’s income tax liability actually imposed and its redetermined income tax liability are determined without taking into account the foreign tax credit under section 27(a) of the Code.

(ii) *Positive investment adjustments.* For purposes of paragraph (c)(1)(ii) of this section, a positive adjustment

under §1.1502-32 is the sum of the amounts under §1.1502-32(b)(2) (i) through (iii) for the consolidated return year (the adjustment determined without taking distributions into account). However, amounts included in any loss carryover are taken into account in the year they arise rather than the year absorbed.

(iii) *Applicable amounts.* Amounts are described in paragraphs (c)(1)(i) and (ii) of this section only to the extent they are reflected in the basis of the share, directly or indirectly, immediately before the disposition or deconsolidation. For this purpose, an amount is reflected in the basis of a share if the share’s basis would have been different without the amount. However, amounts included in any loss carryover are taken into account in the year they arise rather than the year absorbed.

(iv) *Related party rule.* The amounts described in paragraphs (c)(1) (i) and (ii) of this section are not reduced or eliminated by reason of an acquisition of the share from a person related within the meaning of section 267(b) or section 707(b)(1), substituting “10 percent” for “50 percent” each place that it appears, even if the share is not transferred basis property as defined in section 7701 (a)(43).

(v) *Pre-September 13, 1991 positive investment adjustments—(A) In general.* The amount determined under paragraph (c)(1)(ii) of this section is limited for tax years of the subsidiary ending on or before September 13, 1991. The amount may not exceed the net increase, if any, in the basis of the share from—

(1) The date the share was first acquired by a member (whether or not a member at that time); to

(2) The end of the last taxable year ending on or before September 13, 1991 (or, if earlier, the date of the disposition or deconsolidation). If the share is transferred basis property (within the meaning of section 7701 (a)(43) from a prior consolidated group, the date under paragraph (c)(2)(v)(A)(1) of this section is the date the share was first acquired by a member of the prior group. For purposes of this paragraph (c)(2)(v)(A), an increase in an excess loss account is treated as a decrease in stock basis and a decrease in an excess

loss account is treated as an increase in stock basis.

(B) *Cessation of netting.* If a lower amount would result under paragraph (c)(1)(ii) of this section by determining the amount under this paragraph (c)(2)(v) as of the end of an earlier taxable year ending after December 31, 1986—

(1) The amount under this paragraph (c)(2)(v) is determined as of the earlier year end; and

(2) The amount determined under paragraph (c)(1)(ii) of this section is not limited for tax years of the subsidiary ending after the earlier year end.

(vi) *Duplicated loss.* “Duplicated loss” is determined immediately after a disposition or deconsolidation, and equals the excess (if any) of—

(A) The sum of—

(1) The aggregate adjusted basis of the assets of the subsidiary other than any stock and securities that the subsidiary owns in another subsidiary, and

(2) Any losses attributable to the subsidiary and carried to the subsidiary’s first taxable year following the disposition or deconsolidation, and

(3) Any deferred deductions (such as deductions deferred under section 469) of the subsidiary, over

(B) The sum of—

(1) The value of the subsidiary’s stock, and

(2) Any liabilities of the subsidiary, and

(3) Any other relevant items.

The amounts determined under this paragraph (c)(2)(vi) with respect to a subsidiary include its allocable share of corresponding amounts with respect to all lower tier subsidiaries. If 80 percent or more in value of the stock of a subsidiary is acquired by purchase in a single transaction (or in a series of related transactions during any 12-month period), the value of the subsidiary’s stock may not exceed the purchase price of the stock divided by the percentage of the stock (by value) so purchased. For this purpose, stock is acquired by purchase if the transferee is not related to the transferor within the meaning of sections 267(b) and 707(b)(1), substituting “10 percent” for “50 percent” each place that it appears, and the transferee’s basis in the stock is

determined wholly by reference to the consideration paid for such stock.

(vii) *Disallowance amounts applied only once.* The amounts described in paragraph (c)(1) of this section are not applied more than once to disallow a loss, reduce basis, or reattribute loss under this section.

(3) *Statement of allowed loss.* Paragraph (c)(1) of this section applies only if the separate statement required under this paragraph (c)(3) is filed with the taxpayer’s return for the year of the disposition or deconsolidation. The statement must be entitled “ALLOWED LOSS UNDER SECTION 1.1502-20(c)” and must contain—

(i) The name and employer identification number (E.I.N.) of the subsidiary.

(ii) The basis of the stock of the subsidiary immediately before the disposition or deconsolidation.

(iii) The amount realized on the disposition and the amount of fair market value on the deconsolidation.

(iv) The amount of the deduction not disallowed under paragraph (a)(1) of this section by reason of this paragraph (c) and the amount of basis not reduced under paragraph (b)(1) of this section by reason of this paragraph (c).

(v) The amount of loss disallowed under paragraph (a)(1) of this section and the amount of basis reduced under paragraph (b)(1) of this section.

(4) *Examples.* For purposes of the examples in this paragraph, unless otherwise stated, the group files the statement required under paragraph (c)(3) of this section. The principles of this paragraph (c) are illustrated by the following examples.

Example 1. Allowable loss attributable to lost built-in gain. (i) Individual A forms T. P buys all the stock of T from A for \$100, and T becomes a member of the P group. T has a capital asset with a basis of \$0 and a value of \$100. The value of the asset declines, and T sells the asset for \$40. Under the investment adjustment system, P’s basis in the T stock increases to \$140. P then sells all the stock of T for \$40 and recognizes a loss of \$100.

(ii) The amount of the \$100 loss disallowed under paragraph (a)(1) of this section may not exceed the amount determined under paragraph (c)(1) of this section. Under paragraphs (c)(2) (i) and (iii) of this section, T’s \$40 gain is from an extraordinary gain disposition and the amount is reflected in the

basis of the T stock under § 1.1502-32 immediately before the disposition. Thus, the gain is described in paragraph (c)(1)(i) of this section. Because this amount is the only amount described in paragraph (c)(1) of this section, the amount of P's \$100 loss that is disallowed under paragraph (a)(1) of this section is limited to \$40. (No amount is described in paragraph (c)(1)(ii) of this section because the amount of T's positive investment adjustments does not exceed the amount included under paragraph (c)(1)(i) of this section.)

(iii) The results would be the same if the asset, instead of being owned by T, is owned by a partnership in which T is a partner and T is allocated the \$40 of gain under section 704(b). Under paragraphs (c)(2)(i) and (iii) of this section, T's \$40 gain is from an extraordinary gain disposition, and the gain is reflected in the basis of the T stock under § 1.1502-32 immediately before the disposition.

Example 2. Extraordinary gain dispositions.

(i) Individual A forms T. P buys all the stock of T from A for \$100 in Year 1, and T becomes a member of the P group. T owns a capital asset, asset 1, with a basis of \$0 and a value of \$100. T sells asset 1 for \$100 in Year 1 and invests the proceeds in a trade or business asset, asset 2. For Year 2, asset 2 produces \$30 of gross operating income and \$20 of cost recovery deductions. On December 31 of Year 2, asset 2 has an \$80 adjusted basis and T disposes of asset 2 for \$85; however, because T incurs \$20 of expenses directly related to the sale of asset 2, the disposition produces a \$15 loss that is taken into account in the determination of taxable income or loss under § 1.1502-32(b)(2)(i) (the loss offsets T's \$10 of operating income for Year 2, as well as \$5 of operating income of P in that year). Under the investment adjustment system, P's basis in the T stock increases by \$95, to \$195, because T has \$110 of income and a \$15 loss. P sells the T stock for \$95 in Year 5 and recognizes a \$100 loss.

(ii) Under paragraphs (c)(2)(i) and (iii) of this section, the \$100 gain from the disposition of asset 1 is from an extraordinary gain disposition and is reflected in the basis of the T stock. Thus, the gain is described in paragraph (c)(1)(i) of this section. The sale of asset 2 is not taken into account under paragraph (c)(1)(i) of this section because, net of directly related expenses, T does not have income or gain from the sale. (No amount is described under paragraph (c)(1)(ii) of this section because T's positive investment adjustments are taken into account under paragraph (c)(1)(i) of this section.) Because the \$100 amount described under paragraph (c)(1)(i) of this section equals P's \$100 loss from the disposition of the T stock, all of the loss is disallowed.

Example 3. Positive investment adjustments.

(i) Individual A forms T. S, a member of the

P group, buys all the stock of T from A for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. The asset earns \$100 of operating income in Year 1 and declines in value to \$0. T invests the operating income in another asset that produces a \$25 operating loss for Year 2. Under the investment adjustment system, S's basis in the T stock increases to \$200 at the end of Year 1, and decreases to \$175 at the end of Year 2. S sells all the stock of T for \$75 in Year 5 and recognizes a loss of \$100.

(ii) Under paragraph (c)(1)(ii) of this section, the \$100 of income from Year 1 is a positive investment adjustment. The amount is not reduced by the \$25 operating loss for Year 2. Because the \$100 amount described under paragraph (c)(1)(ii) of this section equals S's \$100 loss from the disposition of the T stock, all of the loss is disallowed.

Example 4. Treatment of net operating income as attributable to built-in gain.

(i) Individual A forms T. P buys all the stock of T from A for \$100, and T becomes a member of the P group. T has a capital asset with a basis of \$0 and a value of \$100. The asset declines in value to \$40. The asset earns \$100 of operating income unrelated to its \$60 decline in value. Under the investment adjustment system, P's basis in the T stock increases to \$200. P then sells all the stock of T for \$140 (the asset worth \$40 and \$100 cash) and recognizes a loss of \$60.

(ii) The \$100 adjustment to the basis of the T stock is an amount described in paragraph (c)(1)(ii) of this section. Because this amount exceeds the amount of loss otherwise disallowed under paragraph (a)(1) of this section, P's entire \$60 loss from the disposition of T stock is disallowed.

Example 5. Carryover basis transactions—amounts attributable to separate return years.

(i) Individual A forms T. S purchases all the stock of T from A for \$100, and T becomes a member of the S group. T has a capital asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, S's basis in the T stock increases to \$200. P buys all of the stock of S for \$100, and both S and T become members of the P group. S then sells the T stock for \$100 and recognizes a loss of \$100.

(ii) Under paragraph (c)(2)(iii) of this section, the \$100 adjustment to S's basis in the T stock while a member of the S group is an amount described in paragraph (c)(1)(i) of this section with respect to the P group because it continues to be reflected in the basis of the T stock immediately before the stock is disposed of. Because this amount equals the loss otherwise disallowed under paragraph (a)(1) of this section, S's \$100 loss from the disposition of T stock is disallowed.

Example 6. Cost basis for subsidiary stock. (i) In Year 1, individual A forms T. T's assets appreciate in value from \$0 to \$100, and T

recognizes \$100 of gain in an extraordinary gain disposition. T reinvests the sale proceeds in assets that appreciate in value to \$150. In Year 3, A sells all of the T stock to P for \$150, and T becomes a member of the P group. While a member of the P group, T's assets decline in value to \$130 and P sells the T stock in Year 7 for \$130 and recognizes a \$20 loss.

(ii) Although T has a \$100 gain from extraordinary gain dispositions, the gain is not reflected in P's basis in the T stock within the meaning of paragraph (c)(2)(iii) of this section. P's basis reflects the stock's value at the time of P's purchase, and is determined without regard to whether T recognized the gain before the purchase. Thus, no part of T's gain is described in paragraph (c)(1) of this section, and no part of the \$20 loss is disallowed under paragraph (a) of this section. (For rules that apply if A and P are related persons, see paragraph (c)(2)(iv) of this section.)

Example 7. Adjustments to stock basis under applicable rules of law. (i) Individual A forms T, and T's assets subsequently appreciate. T borrows \$100 on a nonrecourse basis secured by the appreciated assets. P buys all of the stock of T from A for \$150. After becoming a member of the P group, T has a \$100 operating loss that is absorbed in the determination of consolidated taxable income and P's basis in the T stock is reduced to \$50 under § 1.1502-32. Because T's assets have declined in value, T's creditors discharge \$60 of T's indebtedness. The \$60 discharge is not included in T's gross income under section 108(a), but no attributes are reduced under section 108(b).

(ii) Under paragraph (c)(2)(i) of this section, the discharge of indebtedness is an extraordinary gain disposition. Under § 1.1502-32(b)(3)(ii), however, the \$60 discharge of indebtedness is not treated as tax-exempt income that increases P's basis in the T stock. Consequently, under paragraph (c)(2)(iii) of this section, T's discharge of indebtedness income is not reflected in P's basis in the T stock. Thus, there is no amount under paragraph (c)(1) of this section.

(iii) The facts are the same as in paragraph (i) of this *Example*, except that \$60 of T's operating loss is not absorbed and is included in a consolidated net operating loss that is carried over under §§ 1.1502-21A or 1.1502-21, and the \$60 is eliminated from the carryover under section 108(b) as a result of T's discharge of indebtedness. The absorption of \$40 of T's loss reduces P's basis in the T stock from \$150 to \$110. The \$60 discharge of indebtedness is treated as tax-exempt income that increases P's basis in the T stock, and the \$60 attribute reduction is treated as a noncapital, nondeductible expense that reduces P's basis in the T stock. Thus, P's basis in T's stock remains \$110 following the discharge and attribute reduction. Because P's basis is

\$110, rather than \$50, the discharge of indebtedness income is reflected in P's basis for purposes of paragraph (c)(2)(iii) of this section. Thus, the amount under paragraph (c)(1)(i) of this section is \$60.

Example 8. Duplicated loss. (i) Individual A forms T with a contribution of \$100 in exchange for all of the T stock. Individual B forms T1 with a contribution of land that has a \$90 basis and \$100 value. T buys all the stock of T1 from B for \$100. P buys all the stock of T from A for \$100, and both T and T1 become members of the P group. The value of T1's land declines to \$40. P sells all of the T stock for \$40 and recognizes a loss of \$60.

(ii) Under paragraph (c)(1)(iii) of this section, P's amount of duplicated loss is \$50. This is computed under paragraph (c)(2)(vi) of this section immediately after the disposition as the excess of—

(A) The \$90 aggregate adjusted basis of the assets of T and T1 (other than stock and securities of T1 owned by T), over

(B) The \$40 fair market value of the T stock (determined under paragraph (c)(2)(vi) of this section). Because this amount is the only amount described in paragraph (c)(1) of this section, the amount of P's \$60 loss disallowed under paragraph (a)(1) of this section is limited to \$50.

(iii) The result would be the same if the value of T1's property did not decline and T1 instead had an operating loss of \$60 (attributable to borrowed funds) which the P group was unable to use. In that case, the \$50 excess of the sum of—

(A) The \$90 aggregate adjusted basis of the assets of T and T1 (other than stock and securities of members of the P group), plus the \$60 net operating loss attributable to T1 and carried to its first taxable year following the disposition, over

(B) The sum of the \$40 fair market value of the T stock, plus the \$60 of T1 liabilities, is an amount described in paragraph (c)(2)(vi) of this section. (See paragraph (g) of this section for the elective reattribution of T1's \$60 net operating loss to P in connection with the sale.)

Example 9. Intercompany stock sales.

(i) P is the common parent of a consolidated group, S is a wholly owned subsidiary of P, and T is a wholly owned recently purchased subsidiary of S. S has a \$100 basis in the T stock, and T has a capital asset with a basis of \$0 and a value of \$100. T's asset declines in value to \$60. Before T has any positive investment adjustments or extraordinary gain dispositions, S sells its T stock to P for \$60. T's asset reappreciates and is sold for \$100, and T recognizes \$100 of gain. Under the investment adjustment system, P's basis in the T stock increases to \$160. P then sells all of the T stock for \$100 and recognizes a loss of \$60.

(ii) S's sale of the T stock to P is an intercompany transaction. Thus, S's \$40 loss is

deferred under section 267(f) and § 1.1502-13. Under paragraph (a)(3) of this section, the application of paragraph (a)(1) of this section to S's \$40 loss is deferred until the loss is taken into account. Under the matching rule of § 1.1502-13(c), the loss is taken into account to reflect the difference for each year between P's corresponding items taken into account and P's recomputed corresponding items (the corresponding items that P would take into account for the year if S and P were divisions of a single corporation). If S and P were divisions of a single corporation and the intercompany sale were a transfer between the divisions, P would succeed to S's \$100 basis and would have a \$200 basis in the T stock at the time it sells the T stock (\$100 of initial basis plus \$100 under the investment adjustment system). S's \$40 loss is taken into account at the time of P's sale of the T stock to reflect the \$40 difference between the \$60 loss P takes into account and P's recomputed \$100 loss.

(iii) Under the matching rule of § 1.1502-13(c), the attributes of S's \$40 loss and P's \$60 loss are redetermined to produce the same effect on consolidated taxable income (and consolidated tax liability) as if S and P were divisions of a single corporation. Under § 1.1502-13(b)(6), attributes of the losses include whether they are disallowed under this section. Because the amount described in paragraph (c)(1) of this section is \$100, both S's \$40 loss and P's \$60 loss are disallowed.

(d) *Successors*—(1) *General rule.* This section applies, to the extent necessary to effectuate the purposes of this section, to any property the basis of which is determined, directly or indirectly, in whole or in part, by reference to the basis of a subsidiary's stock.

(2) *Examples.* The principles of this paragraph (d) are illustrated by the following examples.

Example 1. Status of successor as member. (i) P, the common parent of a group, buys all the stock of T for \$100. T's only asset has a basis of \$0 and a value of \$100. T sells the asset for \$100, and buys another asset for \$100. Under the investment adjustment system, P's basis in the T stock increases to \$200, and the earnings and profits of P increase by \$100. P later transfers all the stock of T to an unrelated consolidation group in exchange for 10 percent of the stock of X, the common parent of that group, in a transaction described in section 368(a)(1)(B). At the time of the exchange, the value of the X stock received by P is \$80.

(ii) Under section 358, P has a basis of \$200 in the X stock it receives in exchange for T. Under section 362, X has a \$200 basis in the T stock.

(iii) Neither paragraph (a)(1) nor (b)(1) of this section applies to the stock of T on P's transfer of the stock to the X group, because no gain or loss is recognized on the transfer, and the transfer is not a deconsolidation of the stock of T under paragraph (b)(2) of this section.

(iv) The X stock owned by P after the reorganization is a successor interest to the T stock because P's basis in the X stock is determined by reference to P's basis in the T stock. The purposes of this section require that the reorganization exchange be treated as a deconsolidation event with respect to P's interest in the X stock. Because X is not a member of the P group, a failure to reduce the basis of the X stock owned by P to its fair market value would permit the P group to recognize and deduct the loss attributable to the T stock. However, because T is a member of the X group, a reduction in the basis of the T stock is not necessary to prevent the X group from recognizing and deducting the loss arising in the P group. The transfer of T stock to X therefore constitutes a deconsolidation of the X stock but not the T stock. Therefore, P must reduce its basis in the X stock from \$200 to its \$80 value at that time. However, X's basis in the T stock remains \$200.

Example 2. Continued application after deconsolidation. (i) P, the common parent of a group, buys all the stock of T for \$100. T's only asset has a basis of \$0 and a value of \$100. T sells the asset for \$100, and buys another asset for \$100. Under the investment adjustment system, P's basis in the T stock increases to \$200. P later transfers all the stock of T to partnership M in exchange for a partnership interest in M, in a transaction to which section 721 applies. The value of the T stock immediately before the transfer to M is \$100. Less than 2 years later, P sells its interest in M for \$80.

(ii) Under paragraph (b)(1) of this section, because the stock of T is deconsolidated on the transfer to M, P reduces its basis in the T stock to the stock's \$100 value immediately before the transfer. As a result, P has a basis of \$100 in its interest in M, and M has a basis of \$100 in the T stock.

(iii) When P sells its interest in M for \$80, it recognizes a \$20 loss. Because the basis of P's interest in M is determined by reference to P's basis in the T stock, and the reporting requirements could otherwise be circumvented, P's partnership interest in M is a successor interest to the T stock. Under paragraph (b)(5) of this section, P is required to file a statement with its return for the year of its disposition of its interest in M in order to deduct its loss. If P does not file the required statement described in paragraph (b)(5) of this section, P's loss on the disposition of its interest in M is disallowed.

(e) *Anti-avoidance rules*—(1) *General rule.* The rules of § 1.1502-20 must be applied in a manner that is consistent with and reasonably carries out their purposes. If a taxpayer acts with a view to avoid the effect of the rules of this section, adjustments must be made as necessary to carry out their purposes.

(2) *Anti-stuffing rule*—(i) *Application.* This paragraph (e)(2) applies if—

(A) A transfer of any asset (including stock and securities) on or after March 9, 1990 is followed within 2 years by a direct or indirect disposition or a deconsolidation of stock, and

(B) The transfer is with a view to avoiding, directly or indirectly, in whole or in part—

(1) The disallowance of loss on the disposition or the basis reduction on the deconsolidation of stock of a subsidiary, or

(2) The recognition of unrealized gain following the transfer.

A disposition or deconsolidation after the 2-year period described in this paragraph (e)(2)(i) that is pursuant to an agreement, option, or other arrangement entered into within the 2-year period is treated as a disposition or deconsolidation within the 2-year period for purposes of this section.

(ii) *Basis reduction.* If this paragraph (e)(2) applies, the basis of the stock is reduced, immediately before the disposition or deconsolidation, to cause the disallowance of loss, the reduction of basis, or the recognition of gain, otherwise avoided by reason of the transfer.

(3) *Examples.* The principles of this paragraph (e) are illustrated by the following examples.

Example 1. Shifting of value. (i) P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. With the view described in paragraph (e)(1) of this section, P transfers land with a value of \$100 and a basis of \$100 to T in exchange for preferred stock with a \$200 redemption price and liquidation preference. The \$100 redemption premium (the excess of the \$200 redemption price over the \$100 issue price) ultimately increases the value of the preferred stock from \$100 to \$200 (and decreases the value of the common stock). T sells the built-in gain asset for \$100, and P's aggregate basis in S's common and preferred stock increases to \$300. In addition, as a result of a cumulative redetermination under § 1.1502-32(c)(4), P's

basis in the T preferred stock increases from \$100 to \$200 and P's basis in the common stock remains \$100. P subsequently sells the common stock at a loss.

(ii) Under section 305, the redemption premium is treated as a distribution of property to which section 301 and § 1.1502-13(f)(2) apply. Under §§ 1.1502-13 and 1.1502-32, P's aggregate basis in the preferred and common stock is unaffected by the deemed distributions.

(iii) P's loss on the sale of the common stock is disallowed under paragraph (e)(1) of this section. This disallowance prevents the preferred stock from shifting value and stock basis adjustments from the common stock to avoid the disallowance of loss under this section.

Example 2. Basic stuffing case. (i) In Year 1, P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases from \$100 to \$200. In Year 5, P transfers to T an asset with a basis of \$0 and a value of \$100 in a transaction to which section 351 applies, with the view described in paragraph (e)(2)(i) of this section. In Year 6, P sells all the stock of T for \$200.

(ii) Under paragraph (e)(2)(ii) of this section, P must reduce the basis in its T stock by \$100 immediately before the sale. This basis reduction causes a \$100 gain to be recognized on the sale.

(iii) The \$100 basis reduction also would be required if the T stock is deconsolidated in Year 6 instead of being sold. P must reduce the basis in its T stock by \$100 immediately before the deconsolidation.

(iv) The \$100 basis reduction also would be required if the P stock were acquired at the beginning of Year 6 by the M consolidated group, even though the asset transfer took place outside the M group. Paragraph (e)(2)(i) of this section requires only that the transferor have the view at the time of the transfer.

Example 3. Stacking rules. (i) In Year 1, P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases from \$100 to \$200. In Year 5, when the value of the T stock remains \$100, P transfers to T an asset with a basis of \$0 and a value of \$100 in a transaction to which section 351 applies, with the view described in paragraph (e)(2)(i) of this section. Thereafter, the value of the contributed asset declines to \$10. In Year 6, P sells all the T stock for \$110 and recognizes a \$90 loss.

(ii) Because the transferred asset declined in value by \$90, the transfer enabled P to avoid the disallowance of loss by the sale of T only to the extent of \$10. Under paragraph

(e)(2)(ii) of this section, P must reduce the basis in its T stock immediately before the sale to cause recognition of gain in an amount equal to the loss disallowance otherwise avoided by reason of the transfer. The amount of this basis reduction is \$100, causing a \$10 gain to be recognized on the sale.

(iii) The facts are the same as in (i) of this *Example*, except that the transferred asset does not decline in value and that T reinvests the \$100 in proceeds from the asset sale in another asset that appreciates in value to \$190. In Year 6, P sells T for \$290. Because the new asset appreciated in value by \$90, the transfer enabled P to avoid the disallowance of loss on the sale of T only to the extent of \$10. Under paragraph (e)(2)(ii) of this section, P must reduce the basis in its T stock immediately before the sale to cause recognition of gain in an amount equal to the loss disallowance otherwise avoided by reason of the transfer. The amount of this basis reduction is \$10, causing a \$100 gain to be recognized on the sale.

Example 4. Contribution of built-in loss asset.

(i) In Year 1, P forms S with a contribution of \$100 in exchange for all of S's stock, and S becomes a member of the P group. S buys an asset for \$100, and the asset appreciates in value to \$200. P then buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100, and under the investment adjustment system P's basis in the T stock increases from \$100 to \$200. In Year 5, when the value of the T stock remains \$100, P transfers the T stock to S in a transaction to which section 351 applies, with the view described in paragraph (e)(2)(i) of this section. The transfer causes P's basis in the S stock to increase from \$100 to \$300 and the value of S to increase from \$200 to \$300. In Year 6, P sells the S stock for \$300.

(ii) Under paragraph (e)(2)(ii) of this section, P must reduce the basis in its S stock immediately before the sale to cause recognition of gain in an amount equal to the gain recognition otherwise avoided by reason of the transfer. The amount of this basis reduction is \$100, causing a \$100 gain to be recognized on the sale.

Example 5. Absence of a view. (i) In Year 1, P buys all the stock of T for \$100, and T becomes a member of the P group. T has 2 historic assets, asset 1 with a basis of \$40 and value of \$90, and asset 2 with a basis of \$60 and value of \$10. In Year 2, T sells asset 1 for \$90. Under the investment adjustment system, P's basis in the T stock increases from \$100 to \$150. Asset 2 is not essential to the operation of T's business, and T distributes asset 2 to P in Year 5 with a view to having the group retain its \$50 loss inherent in the asset. Under §1.1502-13(f)(2), and the application of the principles of this rule in section 267(f), T has a \$50 intercompany loss that is deferred. Under §1.1502-32(b)(3)(iv), the dis-

tribution reduces P's basis in the T stock by \$10 to \$140 in Year 5. In Year 6, P sells all the T stock for \$90. Under the acceleration rule of §1.1502-13(d), and the application of the principles of this rule in section 267(f), T's intercompany loss is ordinarily taken into account immediately before P's sale of the T stock. Assuming that the loss is absorbed by the group, P's basis in T's stock would be reduced from \$140 to \$90 under §1.1502-32(b)(3)(i), and there would be no gain or loss from the stock disposition. (Alternatively, if the loss is not absorbed and the loss is reattributed to P under paragraph (g) of this section, the reattribution would reduce P's basis in T's stock from \$140 to \$90.)

(ii) A \$50 loss is reflected both in T's basis in asset 2 and in P's basis in the T stock. Because the distribution results in the loss with respect to asset 2 being taken into account before the corresponding loss reflected in the T stock, and asset 2 is an historic asset of T, the distribution is not with the view described in paragraph (e)(2) of this section.

Example 6. Extending the time period for dispositions. (i) In Year 1, P buys all the stock of T for \$100, and T becomes a member of the P group. T has an asset with a basis of \$0 and a value of \$100. T sells the asset for \$100. Under the investment adjustment system, P's basis in the T stock increases from \$100 to \$200. At the beginning of Year 5, P transfers to T an asset with a basis of \$0 and a value of \$100 in a transaction to which section 351 applies, with the view described in paragraph (e)(2)(i) of this section. Within 2 years, P agrees to sell all the stock of T for \$200 at the end of Year 7.

(ii) Under paragraph (e)(2)(i) of this section, P's disposition of the T stock at the end of Year 7 is treated as occurring within the 2-year period following P's transfer of the asset to T, because the disposition is pursuant to an agreement reached within 2 years after the transfer. Accordingly, under paragraph (e)(2)(ii) of this section, P must reduce the basis in its T stock by \$100 immediately before the sale. This result is reached whether or not the agreement is in writing. P's disposition would also have been treated as occurring within the 2-year period if the disposition were pursuant to an option issued within the period.

(f) *No tiering up of certain adjustments—(1) General rule.* If the basis of stock of a subsidiary (S) owned by a another member (P) is reduced under this section on the deconsolidation of the S stock, no corresponding adjustment is made under §1.1502-32 to the basis of the stock of P if there is a disposition or deconsolidation of the P stock in the same transaction. If there is a disposition or deconsolidation in

the same transaction of less than all the stock of P, appropriate adjustments must be made under §1.1502-32 with respect to P (and any higher-tier members).

(2) *Example.* The principles of this paragraph (f) are illustrated by the following example.

Example. (i) P, the common parent of a group, owns all the stock of S, S owns all the stock of S1, and S1 owns all the stock of S2. P's basis in the S stock is \$100, S's basis in the S1 stock is \$100, and S1's basis in the S2 stock is \$100. In Year 1, S2 buys all the stock of T for \$100. T has an asset with a basis of \$0 and a value of \$100. In Year 2, T sells the asset for \$100. Under the investment adjustment system, the basis of each subsidiary's stock increases from \$100 to \$200. In Year 6, S sells all the stock of S1 for \$100 to A, an individual, and recognizes a loss of \$100. S1, S2, and T are not members of a consolidated group immediately after the sale because the new S1 group does not file a consolidated return for its first tax year.

(ii) Under paragraph (a)(1) of this section, no deduction is allowed to S for its loss from the sale of the S1 stock. Under §1.1502-32(b)(3)(iii), S's disallowed loss is treated as a noncapital, nondeductible expense for Year 6 that reduces P's basis in the S stock. (Under §1.1502-33, S's earnings and profits for Year 6 are reduced by the amount of S's disallowed loss for earnings and profits purposes and, under §1.1502-33(b), this reduction is reflected in P's earnings and profits.)

(iii) Under paragraphs (b)(1) and (f)(1) of this section, because the stock of T and S2 are deconsolidated as a result of S's sale of the S1 stock, the basis of their stock must be reduced immediately before the sale from \$200 to \$100 (the value immediately before the deconsolidation). Under §1.1502-32(b)(3)(iii), the basis reductions are treated as noncapital, nondeductible expenses for Year 6. Under paragraph (f)(2) of this section, however, because the S2 stock is deconsolidated in the same transaction, the basis reduction to the T stock does not tier up under §1.1502-32(a)(3). Similarly, because the S1 stock is disposed of in the same transaction, the basis reduction to the S2 stock also does not tier up. (Comparable treatment applies for purposes of earnings and profits under §1.1502-33.)

(g) *Reattribution of subsidiary's losses to common parent—(1) Reattribution rule.* If a member disposes of stock of a subsidiary and the member's loss would be disallowed under paragraph (a)(1) of this section, the common parent may make an irrevocable election to reattribute to itself any portion of the

net operating loss carryovers and net capital loss carryovers attributable to the subsidiary (and any lower tier subsidiary) without regard to the order in which they were incurred. The amount reattributed may not exceed the amount of loss that would be disallowed if no election is made under this paragraph (g). For this purpose, the amount of loss that would be disallowed is determined by applying paragraph (c)(1) of this section (without taking into account the requirement under paragraph (c)(3) of this section that a statement be filed) and by not taking the reattribution into account. The amount of loss that would be disallowed and the losses that may be reattributed are determined immediately after the disposition, but the reattribution is deemed to be made immediately before the disposition. The common parent succeeds to the reattributed losses as if the losses were succeeded to in a transaction described in section 381(a). Any owner shift of the subsidiary (including any deemed owner shift resulting from section 382(g)(4)(D) or 382(1)(3)) in connection with the disposition is not taken into account under section 382 with respect to the reattributed losses. See §1.1502-96(d) for rules relating to section 382 and the reattribution of losses under this paragraph (g).

(2) *Insolvency limitation.* If the subsidiary whose losses are to be reattributed, or any higher tier subsidiary, is insolvent within the meaning of section 108(d)(3) at the time of the disposition, losses of the subsidiary may be reattributed only to the extent they exceed the sum of the separate insolvencies of any subsidiaries (taking into account only the subsidiary 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 disposition.

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

Example 1. Basic reattribution case. (i) P, the common parent of a group, forms S with a \$100 contribution. For Year 1, S has a \$60 operating loss that is not absorbed and is included in the group's consolidated net operating loss that is carried over under §§ 1.1502-21A or 1.1502-21. Under § 1.1502-32(b)(3)(i), P's basis in the S stock is not reduced to reflect S's loss because the loss is not absorbed. Under § 1.1502-33(b), S's deficit in earnings and profits is reflected in P's earnings and profits even though the loss is not absorbed for tax purposes. During Year 2, S's remaining assets appreciate in value and P sells the S stock for \$55. But for an election to reattribute losses under paragraph (g) of this section, P would have a \$45 loss from the sale that would be disallowed.

(ii) P elects under paragraph (g)(1) of this section to reattribute to itself \$45 of S's losses (the maximum amount permitted). As a result, \$45 of the \$60 net operating loss carryover attributable to S is reattributed to P. This reattributed loss may be included in the net operating loss carryover to subsequent consolidated return years of the P group. P succeeds to these losses as if the losses were succeeded to in a transaction described in section 381(a) and they retain their character as ordinary losses. The remaining \$15 of net operating loss carryover attributable to S is carried over to the first separate return year of S.

(iii) Under § 1.1502-32(b)(3)(iii), the reattribution of \$45 of loss is a noncapital, non-deductible expense that reduces P's basis in the S stock from \$100 to \$55 immediately before the disposition. Consequently, P does not recognize any gain or loss from the disposition.

(iv) Assume that \$20 of S's losses arose in Year 1 and \$40 in Year 2, and that P elects to reattribute all \$40 from Year 2 and \$5 from Year 1. P succeeds to these losses as if the losses were succeeded to in a transaction described in section 381(a), and the losses retain their character as ordinary losses arising in Years 1 and 2. The losses continue to be subject to any limitations originally applicable to S, but P succeeds to them and may absorb the losses independently of S. (For example, P's use of the Year 2 losses does not depend on S's use of the Year 1 losses that were not reattributed to P.)

Example 2. Lower tier subsidiary. (i) P, the common parent of a group, forms S with a \$100 contribution. S then forms T with a \$40 contribution and T borrows \$60. For Year 1, S has a \$30 operating loss and T has a \$55 operating loss. The losses are not absorbed and are included in the group's consolidated net operating loss that is carried over under §§ 1.1502-21A or 1.1502-21. Under § 1.1502-

32(b)(3)(i), P's basis in the S stock, and S's basis in the T stock, are not reduced to reflect the S and T losses because the group is unable to absorb the losses. (Under § 1.1502-33(b), the deficits in earnings and profits of S and T are tiered up for earnings and profits purposes even though not absorbed for tax purposes.) During Year 2, P sells the S stock for \$30 (\$100 invested, minus S's \$30 loss and \$40 unrealized loss from its investment in the T stock). But for an election to reattribute losses under paragraph (g) of this section, P would have a \$70 loss from the sale, which would be disallowed.

(ii) S's \$30 portion of the net operating loss carryover may be reattributed to P under paragraph (g)(1) of this section. Because T is insolvent by \$15, paragraph (g)(2) of this section provides that only \$40 of its \$55 portion of the net operating loss carryover may be reattributed to P under paragraph (g)(1) of this section. There is no limitation, however, on which \$40 of T's \$55 loss may be reattributed.

(iii) P elects under paragraph (g)(1) of this section to reattribute to itself \$40 of T's losses (the maximum amount permitted). P does not elect, however, to reattribute to itself any of S's losses. As a result, \$40 of the \$85 net operating loss carryover is reattributed to P. This reattributed loss may be included in the net operating loss carryover to subsequent consolidated return years of the P group. Of the \$45 remaining net operating loss carryover, the \$15 attributable to T and \$30 attributable to S are carried over to their first separate return years.

(iv) Under § 1.1502-32(b)(3)(iii), the reattribution of loss is a noncapital, non-deductible expense that reduces P's basis in the S stock to \$60 immediately before the disposition. Consequently, P recognizes only a \$30 loss from the disposition of its S stock (\$30 sale proceeds and \$60 basis), and this loss is disallowed.

Example 3. Separate return limitation year losses. (i) P, the common parent of a group, buys the stock of S for \$100. S has a net operating loss carryover of \$40 from a separate return limitation year, and assets with a value and basis of \$100. The assets of S decline in value by \$40, and P sells all the stock of S for \$60. But for an election to reattribute losses under this paragraph (g), P would have a \$40 loss on the sale of S that would be disallowed.

(ii) S's \$40 loss carryover from a separate return limitation year may be reattributed to P under paragraph (g)(1) of this section.

(iii) P elects under paragraph (g)(1) of this section to reattribute to itself S's \$40 (loss the maximum amount permitted). Following the reattribution, the loss is included in the net operating loss carryover to subsequent consolidated return years of the P group.

(iv) Under §1.1502-32(b)(3)(iii), the reattribution of loss is a noncapital, non-deductible expense that reduces P's basis in the S stock to \$60 immediately before the disposition. Consequently, P recognizes no gain or loss from the disposition of its S stock. For P's treatment of the \$40 reattributed loss, see §1.1502-1(f).

(4) *Time and manner of making the election*—(i) *In general.* The election described in paragraph (g)(1) of this section must be made in a separate statement entitled “this is an election under §1.1502-20(g)(1) To reattribute losses of [insert names and employer identification numbers (E.I.N.) of each subsidiary whose losses are reattributed] to [insert name and employer identification number of common parent].” The statement must include the following information—

(A) For each subsidiary, the amount of each net operating loss and net capital loss, and the year in which each arose, that is reattributed to the common parent;

(B) If a subsidiary ceases to be a member, the name and employer identification number of the person acquiring the subsidiary's stock; and

(C) If the common parent is reattributing to itself all or any part of a section 382 limitation pursuant to §1.1502-96(d)(5), the information required by paragraph (g)(4)(ii) of this section.

The statement must be signed by the common parent, and by each subsidiary with respect to which loss is reattributed under this paragraph (g) that does not remain a member of the common parent's group immediately following the disposition. The statement must be filed with the group's income tax return for the tax year of the disposition and a copy of the statement must be retained by the subsidiary. If the acquirer is a subsidiary in a consolidated group, the name and employer identification number of the common parent of the group must be included in the statement, and a copy of the statement must also be delivered to the common parent.

(ii) *Reattribution of section 382 limitation.* The information required by this paragraph (g)(4)(ii) is a separate list for each subsidiary (or a separate list for two or more subsidiaries that are members of a loss subgroup whose pre-change subgroup losses are being re-

attributed) with respect to which an apportionment of a separate section 382 limitation or subgroup section 382 limitation is being made, setting forth—

(A) The name and E.I.N. of the subsidiary (or subsidiaries that were members of a loss subgroup);

(B) A statement entitled “THIS IS AN ELECTION UNDER §1.1502-96(d)(5) TO APPORTION ALL OR PART OF [insert A SEPARATE or A SUBGROUP or BOTH A SEPARATE AND A SUBGROUP] SECTION 382 LIMITATION TO [insert name and E.I.N. of the common parent]”;

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

(D) 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));

(E) The amount of each net operating loss carryover or capital loss carryover, 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.

(iii) *Filing of subsidiary's copy of statement.* The subsidiary whose losses are reattributed (or the common parent of any consolidated group that acquires the subsidiary or lower tier subsidiary) must attach its copy of the statement described in paragraph (g)(5)(i) of this section to its income return for the first tax year ending after the due date, including extensions, of the return in which the election required by paragraph (g)(5)(i) of this section is to be filed.

(h) *Effective dates*—(1) *General rule.* Except as otherwise provided in this paragraph (h), this section applies with respect to dispositions and deconsolidations on or after February 1, 1991. For this purpose, dispositions deferred under §1.1502-13 are deemed to occur at the time the deferred gain or loss is taken into account unless the

stock was deconsolidated before February 1, 1991. If stock of a subsidiary became worthless during a taxable year including February 1, 1991, the disposition with respect to the stock is treated as occurring on the date the stock became worthless.

(2) *Election to accelerate effective date*—(i) *In general.* A group may make an irrevocable election to apply this section to all its members, instead of § 1.337(d)-2, with respect to all dispositions and deconsolidations on or after November 19, 1990.

(ii) *Time and manner of making the election*—*in general.* The election described in paragraph (h)(2)(i) of this section must be made in a separate statement entitled “this is an election under § 1.1502-20(h)(2) to accelerate the application of § 1.1502-20 to the consolidated group of which [insert name and employer identification number of common parent] is the common parent.” The statement must be signed by the common parent and filed with the group’s income tax return for the tax year of the first disposition or deconsolidation to which the election applies. If the separate statement required under this paragraph (h) (2) (ii) is to be filed with a return the due date (including extensions) of which is before April 16, 1991, the statement may be filed with an amended return for the year of the disposition or deconsolidation. Any other filings required under this § 1.1502-20, such as the statement required under § 1.1502-20(c)(3), which ordinarily cannot be made with an amended return, must be made at such time and in such manner as permitted by the Commissioner.

(3) *Binding contract rule.* For purposes of this paragraph (h), if a disposition or deconsolidation is pursuant to a binding written contract entered into before March 9, 1990, and in continuous effect until the disposition or deconsolidation, the date the contract became binding is treated as the date of the disposition or deconsolidation.

(4) *Application of § 1.1502-20T to certain transactions*—(i) *In general.* If a group files the certification described in paragraph (h)(4)(ii) of this section, it may apply § 1.1502-20T (as contained in the CFR edition revised as of April 1, 1990), to all of its members with respect

to all dispositions and deconsolidations by the certifying group to which § 1.1502-20T otherwise applied by its terms occurring—

(A) On or after March 9, 1990 (but only if not pursuant to a binding contract described in § 1.337(d)-1T(e)(2) (as contained in the CFR edition revised as of April 1, 1990) that was entered into before March 9, 1990); and

(B) Before November 19, 1990 (or thereafter, if pursuant to a binding contract described in § 1.1502-20T(g)(3) that was entered into on or after March 9, 1990 and before November 19, 1990).

The certification under this paragraph (h)(4)(i) with respect to the application of § 1.1502-20T to any transaction described in this paragraph (h)(4)(i) may not be withdrawn and, if the certification is filed, § 1.1502-20T must be applied to all such transactions on all returns (including amended returns) on which such transactions are included.

(ii) *Time and manner of filing certification.* The certification described in paragraph (h)(4)(i) of this section must be made in a separate statement entitled “[insert name and employer identification number of common parent] hereby certifies under § 1.1502-20 (h)(4) that the group of which it is the common parent is applying § 1.1502-20T to all transactions to which that section otherwise applied by its terms.” The statement must be signed by the common parent and filed with the group’s income tax return for the taxable year of the first disposition or deconsolidation to which the certification applies. If the separate statement required under this paragraph (h)(4) is to be filed with a return the due date (including extensions) of which is before November 16, 1991, the statement may be filed with an amended return for the year of the disposition or deconsolidation that is filed within 180 days after September 13, 1991. Any other filings required under § 1.1502-20T, such as the statement required under § 1.1502-20T(f)(5), may be made with the amended return, regardless of whether § 1.1502-20T permits such filing by amended return.

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(5) *Cross reference.* For transitional loss limitation rules, see §§ 1.337(d)-1 and 1.337(d)-2.

[T.D. 8364, 56 FR 47392, Sept. 19, 1991; 57 FR 53550, Nov. 12, 1992, as amended by T.D. 8560, 59 FR 41680, Aug. 15, 1994; T.D. 8597, 60 FR 36709, July 18, 1995; T.D. 8677, 61 FR 33323, June 27, 1996; T.D. 8597, 62 FR 12098, Mar. 14, 1997; T.D. 8823, 64 FR 36099, July 2, 1999; T.D. 8824, 64 FR 36127, July 2, 1999]

COMPUTATION OF CONSOLIDATED ITEMS

§ 1.1502-21 Net operating losses.

(a) *Consolidated net operating loss deduction.* The consolidated net operating loss deduction (or CNOL deduction) for any consolidated return year is the aggregate of the net operating loss carryovers and carrybacks to the year. The net operating loss carryovers and carrybacks consist of—

(1) Any CNOLs (as defined in paragraph (e) of this section) of the consolidated group; and

(2) Any net operating losses of the members arising in separate return years.

(b) *Net operating loss carryovers and carrybacks to consolidated return and separate return years.* Net operating losses of members arising during a consolidated return year are taken into account in determining the group's CNOL under paragraph (e) of this section for that year. Losses taken into account in determining the CNOL may be carried to other taxable years (whether consolidated or separate) only under this paragraph (b).

(1) *Carryovers and carrybacks generally.* The net operating loss carryovers and carrybacks to a taxable year are determined under the principles of section 172 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they arose, and losses carried from taxable years ending on the same date, and which are available to offset consolidated taxable income for the year, generally are absorbed on a pro rata basis. Additional rules provided under the Internal Revenue Code or regulations also apply. See, e.g., section 382(1)(2)(B) (if losses are carried from the same taxable year, losses subject to limitation under section 382 are absorbed before losses that are not sub-

ject to limitation under section 382). See *Example 2* of paragraph (c)(1)(iii) of this section for an illustration of pro rata absorption of losses subject to a SRLY limitation.

(2) *Carryovers and carrybacks of CNOLs to separate return years—(i) In general.* If any CNOL that is attributable to a member may be carried to a separate return year of the member, the amount of the CNOL that is attributable to the member is apportioned to the member (apportioned loss) and carried to the separate return year. If carried back to a separate return year, the apportioned loss may not be carried back to an equivalent, or earlier, consolidated return year of the group; if carried over to a separate return year, the apportioned loss may not be carried over to an equivalent, or later, consolidated return year of the group. For rules permitting the reattribution of losses of a subsidiary to the common parent when loss is disallowed on the disposition of subsidiary stock, see § 1.1502-20(g).

(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, and only the amount so attributable that is not absorbed by the group in that year is 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.

(B) *Offspring rule.* In the case of a member that has been a member continuously since its organization (determined without regard to whether the member is a successor to any other corporation), the CNOL attributable to the member is included in the carrybacks to consolidated return years before the member's existence. If the group did not file a consolidated return for a carryback year, the loss may be carried back to a separate return year of the common parent under paragraph (b)(2)(i) of this section, but only if the common parent was not a member of a different consolidated group or of an affiliated group filing separate returns for the year to which the loss is carried or any subsequent year in the