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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 301

[REG-101652-10]

RIN 1545-BJ29

Elimination of Circular Adjustments to Basis; Absorption of Losses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the consolidated return regulations. These amendments would revise the rules concerning the use of a consolidated group's losses in a consolidated return year in which stock of a subsidiary is disposed of. The regulations would affect corporations filing consolidated returns.

DATES: Written or electronic comments, and a request for a public hearing, must be received by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE**

**FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-101652-10), room 5205,

Internal Revenue Service, PO Box 7604, 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 (REG-101652-10), Courier's Desk, Internal Revenue

Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-101652-10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Robert M. Rhyne, (202) 317-6848; concerning submissions of comments or to request a public hearing, Oluwafunmilayo (Funmi) Taylor, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

## **Background and Explanation of Provisions**

### 1. Introduction

This document contains proposed amendments to 26 CFR part 1 under section 1502 of the Internal Revenue Code (Code). Section 1502 authorizes the Secretary to prescribe regulations for corporations that join in filing consolidated returns to reflect clearly the income tax liability of the group and to prevent avoidance of such tax liability, and provides that these rules may be different from the provisions of chapter 1 of subtitle A of the Code that would apply if the corporations filed separate returns. Terms used in the consolidated return regulations generally are defined in §1.1502-1.

These proposed regulations would provide guidance regarding the absorption of members' losses in a consolidated return year, and provide guidance to eliminate the "circular basis problem" in a broader class of transactions than under current law.

This document also contains proposed conforming amendments to 26 CFR part 301 under section 6402. Section 6402 authorizes the Secretary to make credits and refunds. The proposed regulations would amend §301.6402-7(g) (relating to claims for refunds and application for tentative carryback adjustments involving consolidated groups that include financial institutions) by revising the definition of separate net

operating loss of a member in light of the proposed amendments to §1.1502-21 (relating to the determination and treatment of consolidated and separate net operating losses, carrybacks, and carryovers).

## 2. Allocation and Absorption of Members' Losses

In general, the consolidated taxable income (CTI) or consolidated net operating loss (CNOL) of a consolidated group is the sum of each member's separately computed taxable income or loss (computed pursuant to §1.1502-12) and certain items of income and deduction that are computed on a consolidated basis pursuant to §1.1502-11.

Section 1.1502-21(b)(2)(i) (relating to carryovers and carrybacks of CNOLs to separate return years) provides generally that if a group has a CNOL and a portion of the CNOL would be carried to a member's separate return year, the CNOL must be apportioned between the group and the member (or members) with the separate return year(s) in accordance with the amount of the CNOL attributable to those member(s). For this purpose, §1.1502-21(b)(2)(iv) employs a fraction to determine the percentage amount of the CNOL attributable to a member. The numerator of the fraction is the separate net operating loss of the member for the consolidated return year, and the denominator is the sum of the separate net operating losses of all members for that year. For this purpose, the separate net operating loss of a member is determined by computing the CNOL, taking into account only the member's items of income, gain, deduction, and loss. Although the current consolidated return regulations provide rules for apportioning a CNOL among members when a member's loss may be carried to a separate return year, the regulations do not expressly adopt the fraction-based methodology of §1.1502-21(b)(2)(iv) for computing the amount of each member's

absorbed loss that is used to offset the income of members with positive separate taxable income or net capital gain for the consolidated return year in which the loss is recognized.

Furthermore, although the method provided for apportioning a CNOL under current law generally yields appropriate results, the apportionment may produce anomalies if capital gains are present. For example, assume a stand-alone corporation, P, acquires the stock of corporation S, and P and S file a consolidated return for the first taxable year of P ending after the acquisition. For the consolidated return year, P generates \$100 of capital gain and incurs \$100 of deductible expenses. S incurs a \$100 capital loss. Thus, the group has a \$100 CNOL. Under current law, the percentage of the CNOL attributable to each member is determined by its relative separate net operating loss, taking into account only its items. The CNOL that the group would have if only P's items were taken into account is zero (\$100 of capital gain offset by \$100 of deductible expenses). If only S's items were taken into account the group would have a consolidated net capital loss, but the CNOL would also be zero. Accordingly, because neither P nor S has a separate net operating loss, the allocation of the group's \$100 CNOL is not clear.

Both to provide an absorption rule for apportioning ordinary and capital losses incurred in the same consolidated return year, and to address the CNOL apportionment issue, the proposed regulations would amend the current regulations in the following two ways. First, the proposed regulations add a new paragraph (e) to §1.1502-11 to clarify that the absorption of members' losses to offset income of other members in the consolidated return year is made on a pro rata basis, consistent with the pro rata

absorption of losses from taxable years ending on the same date that are carried back or forward under the rules of §§1.1502-21(b) and 1.1502-22(b) (relating to net capital loss carrybacks and carryovers). Second, to address apportionment anomalies that may arise if capital gains are present, the proposed regulations would provide that the separate net operating loss of a member, solely for apportionment purposes, is its loss determined without regard to capital gains (or losses) or amounts treated as capital gains. Thus, in the example in the preceding paragraph, P would be allocated the entire \$100 CNOL. Excluding capital gains and losses from the computation is consistent with excluding capital gains and losses in determining a member's separate taxable income under §1.1502-12, and taking capital gains and losses into account on a group, rather than a separate member, basis. A conforming amendment is made to §301.6402-7(g)(2)(ii) (relating to refunds to certain statutory or court-appointed fiduciaries of an insolvent financial institution), which contains a similar allocation rule.

### 3. Circular Adjustments to Basis

#### A. The circular basis problem and current regulations

To prevent the income, gain, deduction, or loss of a subsidiary from being reflected more than once in a consolidated group's income, the consolidated return regulations adjust an owning member's basis in a subsidiary's stock to reflect those items. As a group takes into account a subsidiary's items of income or gain, an owning member's basis in the subsidiary's stock increases. Likewise, as a group absorbs a subsidiary's deductions or losses, an owning member's basis in the subsidiary's stock decreases. These adjustments take place under what is generally referred to as the investment adjustment system. See §1.1502-32.

If a group absorbs a portion of a subsidiary's loss in the same consolidated return year in which an owning member disposes of that subsidiary's stock, the owning member's basis in the subsidiary's stock is reduced immediately before the disposition. Consequently, the amount of the owning member's gain or loss on the disposition may be affected. Any change in the amount of gain or loss resulting from the disposition may in turn affect the amount of the subsidiary's loss that the group absorbs. Any further absorption of the subsidiary's loss triggers further adjustments to the basis in the subsidiary's stock. These iterative computations, which may completely eliminate the benefit of the disposed of member's losses, are referred to as the circular basis problem.

For example, assume P owns all the stock of S, and the group has a \$100 consolidated net capital loss carryover, all of which is attributable to S. On December 31, P sells all of S's stock to a nonmember at a \$10 gain. Absent the current rules in §1.1502-11(b), P's \$10 capital gain on the sale of S's stock would be offset by \$10 of the consolidated net capital loss carryover (all of which is attributable to S). The use of the loss would cause P's basis in S's stock to be reduced by \$10 (immediately before the sale), causing P to recognize \$20 of gain on the sale of S's stock. Similarly, that \$20 gain would be offset by \$20 of S's consolidated net capital loss carryover, and so on, until the entire consolidated net capital loss carryover was depleted. At the end of these iterative calculations, the group would still report \$10 of consolidated net capital gain. The current regulations prevent this result.

The Treasury Department and the IRS have considered a variety of approaches to the circular basis problem since the introduction of the investment adjustment system

in 1966. The options considered, and either rejected or adopted in regulations to date, appear to have been motivated by differing views concerning the scope and severity of the circular basis problem. The circumstances in which the consolidated return regulations have provided relief to date have been limited to preventing the disposed of subsidiary's loss absorption from affecting the gain or loss recognized on the sale of that subsidiary. This is the case notwithstanding that many commentators have criticized the scope of relief as being too narrow, and have maintained that relief should be extended to, for example, the sales of brother-sister subsidiaries within the same consolidated return year.

Regulations promulgated in 1966 provided no relief from the circular basis problem, even though some relief was initially proposed. Section 1.1502-11(b), published in 1972, provided some relief from the circular basis problem, and those regulations were revised in 1994 into their current form (the circular basis rules).

To resolve the circular basis problem, the circular basis rules require that a tentative computation of CTI be made without taking into account any gain or loss on the disposition of a subsidiary's stock. The amount of the subsidiary's losses that would be absorbed under the tentative computation becomes a limitation on that subsidiary's losses that may be absorbed in the consolidated return year of disposition or as a carryback to a prior year. The limitation is intended to eliminate the circular basis adjustments to the subsidiary's stock and thus prevent iterative computations.

For example, assume a consolidated group consists of P, the common parent, and S, its wholly owned subsidiary, and neither P nor S had income or gain in a prior year. At the beginning of the consolidated return year, P has a \$500 basis in S's stock.

P sells S's stock for \$520 at the end of the year. For the year, P has \$30 of ordinary income (determined without taking into account P's gain or loss on the disposition of S's stock) and S has \$80 of ordinary loss. To determine the limitation on the amount of S's loss that the group may use during the consolidated return year or as a carryback to a prior year, CTI is tentatively determined without taking into account P's gain or loss on the disposition of S's stock. Accordingly, the use of S's loss in the consolidated return year of disposition is limited to \$30. The group is tentatively treated as having a CNOL of \$50 (P's \$30 of income minus S's \$80 loss). The absorption of \$30 of S's loss reduces P's basis in S's stock to \$470, and results in \$50 [ $\$520 - (\$500 - \$30)$ ] of gain to P on the disposition. Thus, iterative computations are avoided.

Nevertheless, the circular basis rules do not prevent iterative computations in all cases -- not even all cases in which the stock of a single subsidiary with a loss is disposed of. For example, if a member other than the disposed of subsidiary also has a loss, and the sum of the losses of the disposed subsidiary and the other member exceeds the income of the group (without regard to gain on the disposed subsidiary's stock) a tentative computation applying a pro rata rule for absorption establishes a limitation on the use of the disposed of subsidiary's loss. That amount will be used to reduce the owning member's basis in the subsidiary's stock and determine the gain or loss on the stock disposition. If the stock disposition results in gain, that gain will be taken into account in an actual computation of CTI. If the sum of the other member's loss and the disposed of subsidiary's limited loss still exceeds the income and gain of other members, the pro rata absorption rule will be applied again. That computation will result in a lower amount for the absorption of the disposed of subsidiary's loss, which

will be different than the amount by which the owning member's stock basis was reduced. Accordingly, iterative computations would be required.

To illustrate, assume a consolidated group consists of P, the common parent, and its wholly owned subsidiaries, S1 and S2. At the beginning of the consolidated return year, P has a \$500 basis in S1's stock. P sells all of its S1 stock for \$500 at the end of the year. For the year, P has a \$60 capital gain (determined without taking into account P's gain or loss on the disposition of S1's stock), S1 has a \$40 net capital loss and S2 has an \$80 net capital loss. To determine the limitation on the amount of S1's capital loss that the group may use during the consolidated return year, CTI is tentatively determined without taking into account gain or loss on the disposition of S1's stock, but with regard to S2's net capital loss. Because S2 has an \$80 net capital loss in addition to S1's \$40 net capital loss, \$40 of S2's loss [ $\$60 \times (\$80/\$120)$ ] and \$20 of S1's loss [ $\$60 \times (\$40/\$120)$ ] will be used (assuming pro rata absorption of losses as described in section 2 of the Explanation of Provisions of this preamble). Accordingly, the group's use of S1's loss is limited to \$20. Thus, P's basis in S1's stock is reduced by \$20 before P disposes of the stock. Therefore, P is assumed to recognize \$20 [ $\$500 - (\$500 - \$20)$ ] of gain on the disposition of its S1 stock, which leaves P with a total capital gain for the year of \$80. Again, because S2 has an \$80 loss in addition to S1's \$20 usable loss, a pro rata portion of each subsidiary's losses will be absorbed in computing the P group's CTI. Assuming pro rata absorption of losses, P's \$80 capital gain is offset with \$16 of S1's capital loss [ $\$80 \times (\$20/\$100)$ ]. This amount, however, is less than the \$20 amount determined in the tentative computation by which P's basis in S1's stock was reduced. Thus, iterative computations would be required.

In considering the circular basis problem, the Treasury Department and the IRS have become aware that taxpayers have taken a broad range of approaches in cases in which the circular basis problem persists. Some taxpayers may undertake many iterative computations while, under similar facts, others will undertake few. Some commentators have suggested using simultaneous equations. That method can produce appropriate results in the simplest fact patterns, but becomes highly complex if both ordinary income and capital gains are present, or if the stock of more than one subsidiary is sold.

One approach that the Treasury Department and IRS considered but did not adopt in these proposed regulations was to disallow the absorption of any losses of a subsidiary in the year of disposition. Such a rule would have an adverse impact on any consolidated group with ordinary income that otherwise would be offset by the subsidiary's losses. Furthermore, a blanket prohibition on the use of a subsidiary's losses would be inappropriately harsh if a subsidiary's stock was sold at a loss and the unified loss rules required a stock basis reduction that was greater than the amount of S's loss. In such a case, the use of S's loss to offset income of other members allowed under current law reduces CTI, but the basis reduction that results from the absorption of the loss has no net effect on the owning member's basis in the subsidiary's stock. Prohibiting the use of the disposed of subsidiary's losses would simply increase the group's CTI.

The Treasury Department and IRS also considered but did not adopt an approach similar to the current rules that would compute a tentative amount of S's losses, and then require a reduction to P's basis in S's stock, regardless of whether S's

losses were actually absorbed. This approach could lead to non-economic consequences when another subsidiary's losses are actually absorbed instead of S's according to the general rules of the Code and regulations, but S's losses are nonetheless treated as absorbed for purposes of reducing P's basis in S's stock.

A third approach that the Treasury Department and IRS considered but did not adopt was to turn-off the investment adjustment rules for losses of a subsidiary used in the year of disposition. Such an approach would allow a double deduction and undermine a bedrock principle of consolidated returns as articulated by the Supreme Court in Charles Ilfeld Co. v. Hernandez, 292 U.S. 62 (1934).

## B. Proposed circular basis rules

### i. In general.

The proposed regulations would provide relief and certainty to cases in which the circular basis problem persists, yet adhere to underlying consolidated return concepts without undue complexity. To prevent iterative computations for a consolidated return year in which the stock of one or more subsidiaries is disposed of, these proposed regulations require a group to first determine the amount of each disposed subsidiary's loss that will be absorbed by computing CTI without regard to gain or loss on the disposition of the stock of any subsidiary (the absorbed amount). Once the amount of a subsidiary's absorbed loss is determined under that computation, the absorbed amount for each disposed of subsidiary is not redetermined. Determining each disposed of subsidiary's absorbed amount establishes an immutable number that will also be the amount of reduction to the basis of S's stock taken into account in computing the owning member's gain or loss on the disposition of S's stock. After the absorbed

amount is determined, the owning member's basis of the S stock is adjusted under §1.1502-32 (and §1.1502-36 as relevant). The actual computation of CTI can then be made, taking into account losses of each disposed of subsidiary equal to that amount. In some cases, however, applying the generally applicable rules of the Code and regulations would result in less than all of a disposed of subsidiary's absorbed amount being used.

For example, assume S has an ordinary loss of \$100 and P has capital gain net income of \$100 (unrelated to its disposition of S stock), then S's absorbed amount would be determined to be \$100. If after taking into account S's \$100 absorbed amount P would have a \$100 capital loss on a sale of S's stock, P's capital loss on its S stock would offset P's \$100 capital gain, and S's ordinary loss would not be used in that year and would become a CNOL carryover (assuming no ability to carry back the loss). If an amount of S's losses equal to its absorbed amount were not used, P's basis in its S stock would not be reduced by the absorbed amount, and the amount of P's loss on S's stock would be changed.

The proposed regulations prevent such a result by providing for an alternative four-step computation of CTI if, applying the general ordering rules of the Code and regulations, less than all of a disposed of subsidiary's absorbed amount would be used. See Examples 5, 6, 7, 8 and 9 of §1.1502-11(b)(2)(vi) as proposed herein.

Under the first step, any income, gain, or loss on any share of subsidiary stock is excluded from the computation of CTI and the group uses losses of each disposed of subsidiary equal in both amount and character and from the same taxable years as those used in the computation of its absorbed amount. Thus, by excluding any income,

gain, or loss on a stock disposition, and by giving priority to the losses of all disposed of subsidiaries, the proposed regulations would solve the circularity problem.

Under the second step, a disposing member offsets its gain on subsidiary stock with its losses on subsidiary stock (determined after applying §1.1502-36(b) and (c), and so much of §1.1502-36(d) as is necessary to give effect to an election actually made under §1.1502-36(d)(6)). If the disposing member has net income or gain on the subsidiary stock, and if the disposing member also has a loss of the same character (determined without regard to the stock net income or gain), the disposing member's loss is used to offset the net income or gain on the subsidiary stock to the extent of such income or gain. Any remaining net income or gain is added to the group's remaining income or gain as determined under the first step. Giving priority to S's losses ahead of other members' losses and excluding gain or loss on subsidiary stock are departures from the general rules that require a member to net its income and gain with its own losses before those amounts are combined in a consolidated computation. These departures may distort the amount of absorbed losses of a disposing member relative to the absorbed losses of other members. Thus, in order to put losses of a disposing member (unrelated to its loss on a stock disposition) on a par with losses of other members, the proposed regulations allow P's losses to offset the group's income before other members, but only to the extent of the gain (or income) on the disposed of subsidiary's stock.

Under the third step if, after the application of the second step of the alternative computation, the group has remaining income or gain and a disposing member has a net loss on subsidiary stock (determined after applying §1.1502-36(b) and (c), and so

much of §1.1502-36(d) as is necessary to give effect to an election actually made under §1.1502-36(d)(6)), that income or gain is then offset by the loss on the disposition of subsidiary stock, subject to generally applicable rules of the Code and regulations. The amount of the offset, however, is limited to the lesser of the total remaining ordinary income or capital gain of the group (determined after the application of the second step) or the amount of the disposing member's ordinary income or capital gain (determined without regard to the stock loss).

Finally, under the fourth step, if the group has remaining income or gain, the unused losses of all members are applied on a pro rata basis.

The Treasury Department and the IRS recognize that the special rules in these proposed regulations may in certain cases alter the general rule under section 1211(a) that allows the deduction of losses from the sale or exchange of capital assets to the extent of capital gains. However, giving priority to the absorption of a disposed subsidiary's losses will prevent the need for iterative computations.

The Treasury Department and the IRS also recognize that the proposed regulations may increase the number of cases in which the general ordering rules for the absorption of members' losses will be altered and may in certain cases result in more gain (or less loss) on the sale of a subsidiary's stock than under current law. However, the Treasury Department and the IRS believe that the benefits derived from the certainty that the proposed rules achieve generally outweigh the potential detriments of these deviations from the general rules. Comments are requested on whether there are alternative approaches that would both eliminate the circular basis problem and preserve the general rule for the absorption of capital and ordinary losses.

ii. Higher-tier subsidiaries.

Under §1.1502-11(b)(4)(ii) of the current regulations, if S is a higher-tier subsidiary of another subsidiary (T), the use of T's losses is subject to the circular basis rules upon a disposition of S's stock, but only if 100 percent of T's items of income, gain, deduction, and loss would be reflected in the basis of S's stock in the hands of the owning member (100-percent requirement). If another member of S's consolidated group or a nonmember owns any stock of either S or T, the circular basis rules do not apply.

These proposed regulations would remove the 100-percent requirement. Thus, if any stock of a higher-tier subsidiary is disposed of, the absorption of losses of a lower-tier subsidiary is subject to the proposed circular basis rules by treating the lower-tier subsidiary as if its stock had been disposed of. The Treasury Department and the IRS request comments regarding whether, and under what circumstances, the 100-percent requirement should be retained.

C. Other Provisions

Ordinary income and deductions are generally taken into account on a separate company basis before the computation of CTI occurs. A member's separate taxable income under §1.1502-12 is computed in accordance with the provisions of the Code subject to certain modifications. These modifications generally relate to items that are determined on a consolidated basis (for example, the use of capital losses and the limitation on charitable contribution deductions). Although gain or loss on the disposition of a subsidiary's stock is usually capital, a worthless stock deduction could be ordinary if the conditions of section 165(g)(3) are satisfied. In addition, a gain on the

disposition of such stock can be ordinary if the recapture rules of section 1017(d) apply. Under these proposed regulations, gain and loss on the disposition of subsidiary stock are disregarded in determining the subsidiary's absorbed amount, and in an alternative computation of CTI. Consequently, if stock of a subsidiary is disposed of, these proposed regulations may require a departure from the general rules for the computation of an owning member's separate taxable income. The Treasury Department and the IRS believe that this departure from the general rules is necessary to avoid iterative computations and request comments as to whether an alternative methodology would be preferable.

These proposed regulations clarify the interaction of the Unified Loss Rule of §1.1502-36 with the circular basis rules. Adjustments under §1.1502-36(b), (c), and (d)(6) (if an election is made to reattribute losses or reduce stock basis) will affect the computation of CTI. Therefore, these proposed regulations contain guidance as to the point in the computation that those adjustments are made.

The proposed regulations also contain a rule to prevent iterative computations in determining the amount of deductions that are determined by reference to or are limited by the group's CTI, for example, the consolidated charitable contributions deduction under §1.1502-24 and a member's percentage depletion deduction with respect to oil or gas property for independent producers and royalty owners under §1.1502-44. The amount of those deductions is taken into account in determining the group's CTI and may affect the computation of a disposed of subsidiary's absorbed amount. The absorbed amount will reduce the stock basis and affect the amount of gain or loss on the disposition of the subsidiary's stock, which will change the amount of CTI, and thus

the amount of the group's deduction. To prevent these iterative computations, the proposed regulations provide that the amount of those deductions is determined without regard to gain or loss on the disposition of a subsidiary's stock.

As a result of the later addition of §1.1502-11(c), current §1.1502-11(b) does not apply if a member realizes discharge of indebtedness income that is excluded from gross income under section 108(a). The rules applicable in that case, contained in paragraph (c) of §1.1502-11, are generally not addressed by these proposed regulations, but to the extent that paragraph (c) uses the absorbed amount described in §1.1502-11(b)(2) as a starting point, the computation will be affected. Comments are requested regarding appropriate additional changes to §1.1502-11(c).

Finally, the proposed regulations include modifications to §§1.1502-11(a), 1.1502-12, 1.1502-22(a), and 1.1502-24 of the current regulations and removal of §§1.1502-21A, 1.1502-22A and 1.1502-23A. These modifications are not changes to current substantive law; they are intended solely to update the regulations to reflect certain statutory changes and remove cross-references to outdated regulatory provisions.

### **Proposed Effective Date**

These regulations are proposed to be effective for consolidated return years beginning on or after the date these regulations are published as final regulations in the

### **Federal Register.**

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive

Order 13563. Therefore, a regulatory assessment is not required. These proposed regulations would not impose a collection of information on small entities. Further, under the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that these proposed regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these proposed regulations would primarily affect members of consolidated groups that tend to be large corporations. Accordingly, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original with eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS request comments on all aspects of the proposed regulations.

All comments will be available for public inspection and copying at [www.regulations.gov](http://www.regulations.gov) or upon request. A public hearing may be scheduled if requested by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal author of these regulations is Robert M. Rhyne, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

## **List of Subjects**

### **26 CFR Part 1**

Income taxes, Reporting and recording keeping requirements.

### **26 CFR Part 301**

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recording requirements.

## **Proposed Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by adding an entry for §1.1502-24 to read in part as follows:

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

\* \* \* \* \*

Section 1.1502-24 also issued under 26 U.S.C. 1502.

\* \* \* \* \*

Par. 2. Section 1.1502-11 is amended by:

1. Revising paragraphs (a) introductory text, (a)(2), (a)(3), and (a)(4).
2. Removing and reserving paragraph (a)(6).
3. Revising paragraphs (b), (c)(2)(i), and (c)(2)(ii).
4. Removing in paragraph (c)(2)(vi) the phrase “unlimited deductions and losses

that are absorbed” and adding “S’s absorbed amount of losses” in its place.

5. Revising paragraph (c)(4).

6. Revising the heading of paragraph (c)(7) and adding a sentence at the end of the paragraph.

7. Adding paragraph (e).

The revisions and additions read as follows:

§1.1502-11 Consolidated taxable income.

(a) In general. The consolidated taxable income (CTI) for a consolidated return year shall be determined by taking into account--

\* \* \* \* \*

(2) Any consolidated net operating loss (CNOL) deduction (see §1.1502-21 for the computation of the CNOL deduction);

(3) Any consolidated capital gain net income (see §1.1502-22 for the computation of the consolidated capital gain net income);

(4) Any consolidated section 1231 net loss (see §1.1502-23 for the computation of the consolidated section 1231 net loss);

\* \* \* \* \*

(6) [Reserved]

\* \* \* \* \*

(b) Elimination of circular basis adjustments if there is no excluded COD income--

(1) In general. If a member (P) disposes of a share of stock of one or more subsidiaries (S), this paragraph (b) applies to determine the amount of S’s losses that will be used in the consolidated return year of disposition and in a carryback year. The purpose of these rules is to prevent P’s income, gain, deduction, or loss from the disposition of a

share of S's stock from affecting the amount of S's deductions and losses that are absorbed. A change to the amount of S's absorbed losses would affect P's basis in S's stock under §1.1502-32, which in turn affects P's gain or loss on the disposition of S's stock. For purposes of this section, P is treated as disposing of a share of a subsidiary's stock if any event described in §1.1502-19(c) occurs or, if for any reason, a member recognizes gain or loss (including an excess loss account included in income) with respect to the share. However, to the extent income, gain, deduction, or loss from a disposition of a share of S's stock is deferred under any rule of law (for example, §1.1502-13 and section 267(f)), the taxable year in which the deferred amount is taken into account is treated as the taxable year of disposition. This paragraph (b) does not apply if any member realizes discharge of indebtedness income that is excluded from gross income under section 108(a) during the consolidated return year of the disposition. If a member realizes such income, see paragraph (c) of this section. For purposes of this section, S's ordinary loss means its separate net operating loss (as defined in §1.1502-21(b)(2)(iv)(B)). Solely for purposes of this section, any reference to a member's capital gain includes amounts treated as capital gain. Furthermore, for those purposes, a member's capital loss means a consolidated net capital loss determined by reference to only that member's capital gain and capital loss items.

(2) Deductions and losses of disposed subsidiaries--(i) Determination of absorbed amounts. If P disposes of a share of S's stock in a transaction to which this paragraph (b) applies, the extent to which S's ordinary loss and capital loss (including losses carried over from a prior year) that are absorbed in the consolidated return year of the disposition or in a prior year as a carryback (the absorbed amount) is determined

under this paragraph (b)(2). S's absorbed amount is the amount that would be absorbed in a computation of the group's consolidated taxable income (CTI) for the consolidated return year of the disposition (and any taxable year to which losses may be carried back) without taking into account any member's income, gain, deduction, or loss from the disposition of any share of any subsidiary's stock in that year. S's absorbed amount is determined after first applying other applicable limitations and ordering rules (for example, limitations imposed by section 382(a) and §1.1502-21 and the ordering rules of section 382(l)(2)) to S's deductions and losses. Any election that the group makes on its actual return for the consolidated return year (for example, an election to relinquish a carryback under §1.1502-21(b)(3)) must be used in this computation. Once S's absorbed amount is determined, that amount is not redetermined. Except as provided in paragraph (b)(2)(iii)(B)(1) of this section, the amount determined under this paragraph (b)(2)(i) fixes only the amount of S's losses that will be absorbed. Thus, under paragraph (b)(2)(iii)(A) of this section, the character of the losses that are absorbed in the actual computation of the group's CTI for the year (or as a carryback to a prior year) may not be the same as the character of the losses that are absorbed in determining the absorbed amount. However, if the alternative computation of paragraph (b)(2)(iii)(B)(1) of this section is required, the character of the absorbed amount as determined under this paragraph (b)(2)(i) is retained.

(ii) Stock basis reduction and gain or loss on disposition. After the determination of S's absorbed amount, P reduces its basis in S's stock under the investment adjustment rules of §1.1502-32(b)(2) by the absorbed amount. If any share is a loss share, P then adjusts its basis in S's stock by applying paragraphs (b) and (c) of

§1.1502-36, and, if an election is actually made under §1.1502-36(d)(6), by applying §1.1502-36(d) to the extent necessary to give effect to the election. P then computes its gain or loss on the disposed of shares after taking into account those adjustments.

(iii) Actual computation of CTI--(A) In general. The group's CTI and any carryback of a portion of a CNOL are determined under applicable provisions of the Internal Revenue Code (Code) and regulations, taking into account gain or loss on any subsidiary's stock, and taking into account losses of disposed of subsidiaries equal to each such subsidiary's absorbed amount.

(B) Alternative computation. If the computation of the group's CTI under paragraph (b)(2)(iii)(A) of this section would result in an absorption of less than all of any disposed of subsidiary's absorbed amount, then the group's CTI is computed by applying the following steps, rather than the computation under that paragraph:

(1) First, losses of each disposed of subsidiary equal in both amount and character and from the same taxable years as losses used in the computation of its absorbed amount under paragraph (b)(2)(i) of this section offset income and gain of other members without taking into account any gain or loss on any share of subsidiary stock and without regard to net losses of other members.

(2) Second, a disposing member offsets its gain on subsidiary stock with its losses on subsidiary stock of the same character. For this purpose, a loss on subsidiary stock is determined after applying §1.1502-36(b) and (c), and so much of §1.1502-36(d) as is necessary to give effect to an election actually made under §1.1502-36(d)(6). If the disposing member has net income or gain on subsidiary stock, and if the member also has a loss of the same character (determined without regard to the net income,

gain, deduction or loss on subsidiary stock), the loss offsets that net income or gain and any remaining income or gain is added to the amount determined after the application of paragraph (b)(2)(ii)(B)(1) of this section. For example, if P has a net capital loss on portfolio stock, that net loss is not taken into account in applying paragraph (b)(2)(iii)(B)(1). However, under this paragraph (b)(2)(iii)(B)(2), that net capital loss is absorbed to the extent of that member's net capital gain on subsidiary stock.

(3) Third, if, after the application of paragraph (b)(2)(iii)(B)(2) of this section, the group has remaining income or gain and a disposing member has a net loss on subsidiary stock (determined after applying §1.1502-36(b) and (c), and so much of §1.1502-36(d) as is necessary to give effect to an election actually made under §1.1502-36(d)(6)), that remaining income or gain is then offset by a loss on the disposition of subsidiary stock, subject to the applicable rules of the Code and regulations. The amount of the offset, however, is limited to the lesser of the total remaining ordinary income or capital gain of the group (determined after the application of paragraph (b)(2)(iii)(B)(2) of this section), or the amount of the disposing member's ordinary income or capital gain of the same character (determined without regard to the stock loss). If the preceding sentence applies to more than one disposing member, and the sum of the amounts determined under that sentence exceeds the group's remaining ordinary or capital gain, the amounts offset capital gain or ordinary income on a pro rata basis under the principles of paragraph (e) of this section.

(4) Fourth, if, after application of paragraph (b)(2)(iii)(B)(3) of this section, the group has remaining ordinary income or capital gain, those amounts are offset by the unused losses of all members on a pro rata basis under paragraph (e) of this section.

(C) Priority of rules. The computation of CTI under this paragraph (b)(2)(iii) applies notwithstanding other rules for the absorption of a portion of a member's current year loss, such as paragraphs (a) and (e) of this section, §§1.1502-12 and 1.1502-22(a), and the absorption of a member's portion of a CNOL or consolidated net capital loss carryover from a prior year under §§1.1502-21(b) and 1.1502-22(b), respectively. For example, in some circumstances, an ordinary loss of a disposed of subsidiary may offset capital gain of another member notwithstanding that under general rules a capital loss of another member would be allowed to the extent of capital gains before an ordinary loss is taken into account. Similarly, an ordinary loss with respect to a subsidiary's stock, which would generally offset ordinary income of the owning member and be included in determining that member's separate taxable income, may become a loss carryover if use of that loss would cause less than all of a disposed of subsidiary's absorbed amount to be used.

(D) Deductions determined by reference to CTI. In the case of any deduction of any member that is determined by reference to or limited by the amount of CTI (for example, a charitable contribution deduction under §1.1502-24(c) and a percentage depletion deduction under §1.1502-44(b)), the amount of the deduction is determined without regard to any gain or loss on subsidiary stock.

(iv) Losses not absorbed. To the extent S's losses in the consolidated return year of the disposition of its stock do not offset income or gain by reason of the rules of this paragraph (b), S ceases to be a member, and S's losses are not reattributed under §1.1502-36(d)(6), the losses are carried over to its separate return years (if any) under the applicable principles of the Code and regulations thereunder. Those losses are not

taken into account in determining the percentage of CNOL or consolidated net capital loss attributable to members under §1.1502-21(b)(2)(iv) or §1.1502-22(b)(3), respectively. If S remains a member, its unused losses are included in the CNOL or consolidated net capital loss carryovers and are subject to the allocation rules of those sections.

(v) Disposition of stock of a higher-tier subsidiary. If a subsidiary (T) is a lower-tier subsidiary (as described in §1.1502-36(f)(4)) of a higher-tier subsidiary (S), and S's stock is disposed of during a consolidated return year, T's losses are subject to this paragraph (b) as if T's stock had been disposed of. Thus, T's absorbed amount is determined by disregarding any gain or loss (for example, an excess loss account taken into account under §1.1502-19(b)) on a deemed disposition of T's stock as provided under this paragraph (b), as well as any gain or loss on the disposition of a share of any other subsidiary's stock.

(vi) Examples. For purposes of the examples in this paragraph (b)(2)(vi), unless otherwise stated, P is the common parent of a calendar-year consolidated group and owns all of the only class of stock of subsidiaries S, S1, S2, M, M1, and M2 for the entire year; S, S1, S2, M, M1, M2, and T own no stock of lower-tier subsidiaries; all persons use the accrual method of accounting; the facts set forth the only corporate activity; all transactions are between unrelated persons; tax liabilities are disregarded; and §1.1502-36 will not cause P to adjust its basis in S's stock immediately before a disposition. The rules of this paragraph (b)(2) are illustrated by the following examples:

Example 1. Absorption of disposed of subsidiary's losses. (i) Facts. P has a \$500 basis in S's stock. P sells S's stock for \$520 at the close of Year 1. For Year 1, P has ordinary income of \$30 (determined without taking into account P's gain or loss from the disposition of S's stock) and S an \$80 ordinary loss.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its losses under §1.1502-32(b)(2) on P's basis in S's stock, the group's taxable income is computed without taking into account P's gain or loss from the disposition of S's stock. The P group is treated as having a CNOL of \$50 (P's \$30 of income minus S's \$80 separate net operating loss). Accordingly, S's absorbed amount determined under paragraph (b)(2)(i) of this section is \$30.

(iii) Loss absorption and basis reduction. Under paragraph (b)(2)(ii) of this section, P's basis in S's stock is reduced by S's \$30 absorbed amount from \$500 to \$470 immediately before the disposition. Consequently, P recognizes a \$50 gain from the sale of S's stock, and the P group has CTI of \$50 for Year 1 (P's \$30 of ordinary income plus its \$50 of gain from the sale of S's stock, minus \$30 of S's ordinary loss equal to its absorbed amount). In addition, S's \$50 of unabsorbed loss is carried to S's first separate return year.

Example 2. Carrybacks and carryovers. (i) Facts. For Year 1, the P group has CTI of \$30 (all of which is attributable to P) and a consolidated net capital loss of \$100 (\$50 attributable to P and \$50 to S), which cannot be carried back. At the beginning of Year 2, P has a \$300 basis in S's stock. P sells S's stock for \$280 at the close of Year 2. For Year 2, P has ordinary income of \$30, and a \$20 capital gain (determined without taking into account the consolidated net capital loss carryover from Year 1 or P's gain or loss from the disposition of S's stock), and S has a \$100 ordinary loss.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its losses under §1.1502-32(b)(2) on P's basis in S's stock, the group's taxable income for Year 2 is computed without taking into account P's gain or loss from the disposition of S's stock. Under section 1212(a)(1)(B), P's \$20 capital gain for Year 2 would be offset by \$20 of the group's consolidated capital loss carryover from Year 1 (\$10 attributable to P and \$10 attributable to S). P's \$30 of ordinary income in Year 2 would be offset by \$30 of S's \$100 ordinary loss in that year. P's \$30 of ordinary income in Year 1 would be offset by a \$30 CNOL carryback from Year 2, all of which is attributable to S. Accordingly, S's absorbed amount under paragraph (b)(2)(i) of this section is \$70 (\$10 of S's portion of the consolidated capital loss carryover from Year 1 plus \$60 of S's loss from Year 2).

(iii) Loss absorption and basis reduction. Under paragraph (b)(2)(ii) of this section, P's basis in S's stock is reduced by S's \$70 absorbed amount from \$300 to \$230, immediately before the disposition, resulting in \$50 of capital gain to P from the sale of S's stock for \$280 in Year 2. Thus, for Year 2 P will have \$70 of capital gain (\$50 from the stock sale plus \$20 from its other capital gain for that year), which will be offset by \$70 of the consolidated capital loss carryover from Year 1, \$35 of which is attributable to P and \$35 of which is attributable to S. Another \$30 of S's ordinary loss offsets P's \$30 of ordinary income in Year 2. An amount of S's ordinary loss equal to its remaining \$5 absorbed amount may be carried back to Year 1 to offset \$5 of the group's CTI in that year. P will have a \$15 (\$50 - \$35) capital loss carryover from

Year 1, and S will carry over a \$15 (\$50 - \$35) capital loss from Year 1 and a \$65 (\$100 - \$35) NOL to its first separate return year.

Example 3. Chain of subsidiaries. (i) Facts. P has a \$500 basis in the stock of S and S has a \$500 basis in the stock of T, its wholly owned subsidiary. P sells all of its S stock for \$520 at the close of Year 1. For Year 1, P has ordinary income of \$30, S has no income or loss, and T has an \$80 ordinary loss.

(ii) Determination of absorbed amount, basis reduction, and loss absorption. Under §1.1502-19(c)(1)(ii), T's stock is treated as disposed of when it becomes a nonmember, and its losses are subject to paragraph (b) of this section. Thus, T's absorbed amount is determined by taking into account P's \$30 of ordinary income but without taking into account any gain or loss on P's disposition of S's stock. Accordingly, T's absorbed amount determined under paragraph (b)(2)(i) of this section is \$30. Under paragraph (b)(2)(ii) of this section, S's basis in T's stock is reduced by \$30, from \$500 to \$470. Furthermore, under §1.1502-32(a)(3)(iii), P's basis in S's stock is reduced by \$30, from \$500 to \$470, immediately before the sale. Consequently, P recognizes a \$50 gain from the sale of S's stock (\$520 - \$470), and T will have a \$50 (\$80 - \$30) NOL carryover to its first separate return year.

(iii) Excess loss account in lower-tier stock. The facts are the same as in paragraph (i) of this Example 3, except that S has a \$10 excess loss account (ELA) in T's stock (rather than a \$500 basis). Under paragraph (b)(1) of this section, T's stock is treated as disposed of and its absorbed amount is determined under paragraph (b)(2)(i) of this section. Thus, T's absorbed amount is determined by taking into account P's \$30 of ordinary income but without taking into account P's gain or loss on the disposition of S's stock and S's inclusion of its ELA with respect to T's stock under §1.1502-19(b)(1). Accordingly, T's absorbed amount determined under paragraph (b)(2)(i) of this section is \$30. Under paragraph (b)(2)(ii) of this section, S's ELA in its T stock is increased by \$30, from \$10 to \$40, immediately before the disposition of T's stock. Under §1.1502-19(b), the ELA is included in S's income. Moreover, under §1.1502-32(b)(2), P's basis in S's stock is increased immediately before the sale by a net \$10 (S's \$40 inclusion of T's ELA under §1.1502-19(b) minus T's \$30 absorbed loss that tiers up under §1.1502-32(a)(3)(iii)) from \$500 to \$510. Thus, P recognizes \$10 of gain on the sale of S's stock (\$520 - \$510), and S takes into account \$40 of gain from the inclusion of its ELA in T's stock. T will have a \$50 (\$80 - \$30) NOL carryover to its first separate return year.

Example 4. Sale of S's stock and S remains in the group. (i) Facts. For Year 1, the P group has CTI of \$100 (all of which is attributable to P). At the beginning of Year 2, P has a \$40 basis in each of the 10 shares of S's stock. P sells 2 shares of S's stock for \$85 each at the close of Year 2. For Year 2, P has an \$80 ordinary loss (determined without taking into account P's gain or loss from the sale of S's stock), and S has an \$80 ordinary loss.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its losses under §1.1502-32(b)(2) on P's basis in S's

stock, the group's CTI for Year 2 is computed without taking into account P's gain or loss from the sale of S's stock. Thus, the group would have a \$160 CNOL for Year 2, \$100 of which is carried back to Year 1 (\$50 attributable to S and \$50 attributable to P) and offsets \$100 of CTI in that year. Accordingly, S's absorbed amount determined under paragraph (b)(2)(i) of this section is \$50.

(iii) Loss absorption and basis reduction. Under paragraph (b)(2)(ii) of this section, P's basis in all of S's stock is reduced by \$50. Each of P's 10 shares of S stock is reduced by \$5 from \$40 to \$35. Consequently, on the sale of each of the 2 shares of S's stock, P recognizes a \$50 gain (\$85 - \$35). The losses available to offset the \$100 gain on the sale of S's 2 shares consist of P's \$80 ordinary loss and \$50 of S's ordinary loss equal its absorbed amount. Under paragraph (e) of this section, P's and S's losses are absorbed on a pro rata basis. Therefore, the group absorbs approximately \$62 ( $\$100 \times 80/80 + 50$ ) of P's ordinary loss from Year 2, and approximately \$38 ( $\$100 \times 50/80 + 50$ ) of S's ordinary loss in that year. P's remaining \$18 ( $\$80 - \$62$ ) of ordinary loss in Year 2 and S's remaining \$12 ( $\$50 - \$38$ ) of ordinary loss equal to its remaining absorbed amount may be carried back to Year 1 to offset \$30 of the \$100 of CTI in that year. For Year 2, the P group has \$30 remaining of its CNOL (all of which is attributable to S) which is carried to the P group's Year 3 consolidated return year.

(iv) Lower-tier subsidiary. The facts are the same as in paragraph (i) of this Example 4, except that S has no income or loss for Year 2, but S's wholly owned subsidiary, T, has an \$80 ordinary loss. Under paragraph (b)(2)(v) of this section, T's loss is subject to paragraph (b) of this section as if T's stock had been disposed of. To determine T's absorbed amount, and the effect of the absorption of its losses under §1.1502-32 on S's basis in its T stock and P's basis in its S stock, the group's taxable income is computed without taking into account P's gain or loss from the sale of S's stock. Of the group's \$160 CNOL for Year 2, \$100 is carried back to Year 1 (\$50 attributable to P and \$50 attributable to T) and offsets \$100 of CTI in that year. Accordingly, T's absorbed amount determined under paragraph (b)(2)(i) of this section is \$50. Under paragraph (b)(2)(ii) of this section, S's basis in T's stock is reduced by \$50. Under §1.1502-32(a)(3)(iii), the \$50 reduction to S's basis in T's stock tiers up and reduces P's basis in its 10 shares of S stock by \$50. Consequently, P's basis in each of the 10 shares of S stock will be decreased by \$5 from \$40 to \$35. On the sale of each of the 2 shares of S's stock, P recognizes a \$50 gain ( $\$85 - \$35$ ). Under the actual computation, the group has P's \$80 ordinary loss and \$50 of T's \$80 ordinary loss (limited by its absorbed amount) available to offset P's \$100 gain on the sale of S's stock. Under paragraph (e) of this section, P's gain is offset on a pro rata basis by approximately \$62 ( $\$100 \times 80/(\$80 + \$50)$ ) of P's ordinary loss in Year 2, and approximately \$38 ( $\$100 \times (\$50/(\$80 + \$50))$ ) of T's ordinary loss in that year. P's remaining \$18 of ordinary loss in Year 2 and \$12 of T's ordinary loss equal to its remaining absorbed amount may be carried back to Year 1 to offset \$30 of the \$100 of CTI in that year. For Year 2, the P group has \$30 remaining of its CNOL (all of which is attributable to T) which is carried to the P group's Year 3 consolidated return year.

Example 5. Alternative Computation. (i) Facts. At the beginning of Year 1, P has a \$200 basis in S's stock. P sells all of its S stock for \$100 at the close of Year 1. For Year 1, P has \$10 capital gain on portfolio stock. In addition to S, P has two other subsidiaries, M1 and M2. M1 has capital gain of \$50; M2 has a capital loss of \$30, and S has a capital loss of \$60.

(ii) Determination of absorbed amount. To determine S's absorbed amounts and the effect of the absorption of its loss under §1.1502-32(b)(2) on P's basis in S's stock, the group's taxable income is computed without taking into account P's gain or loss from the disposition of S's stock. Under that computation, S's capital loss would offset \$40 ( $\$60 \times \$60/\$90$ ) of the group's \$60 of capital gain. Accordingly, S's absorbed amount is \$40.

(iii) Basis reduction. Under paragraph (b)(2)(ii) of this section, S's \$40 absorbed amount reduces P's basis in S's stock by \$40 from \$200 to \$160. On the sale of S's stock, P recognizes a capital loss of \$60 ( $\$100 - \$160$ ).

(iv) Computation of CTI under generally applicable rules. In the actual computation under paragraph (b)(2)(iii)(A) of this section, P is treated as having a \$50 capital loss ( $\$60$  capital loss on the sale of S's stock plus  $\$10$  capital gain). Therefore, the only capital gain in the actual computation is M1's \$50. There is a total of \$120 of capital loss in the computation: S's \$40 of capital loss (equal to its absorbed amount), as well as P's \$50 and M2's \$30 capital losses. M1's \$50 of capital gain would be offset on a pro rata basis by approximately \$16.50 of S's loss ( $\$50 \times \$40/\$120$ ), approximately \$21.00 ( $\$50 \times \$50/\$120$ ) of P's \$50 capital loss, and \$12.50 ( $\$50 \times \$30/\$120$ ) of M2's capital loss. Because less than all of S's absorbed amount of \$40 would be used, the group's CTI is determined under the alternative computation of paragraph (b)(2)(iii)(B) of this section.

(v) Alternative computation of CTI. Under paragraph (b)(2)(iii)(B)(1) of this section, S's \$40 capital loss (the amount and character of S's absorbed amount) first offsets \$40 of the \$60 of capital gain (determined without taking into account any gain or loss on P's sale of S stock and without regard to M2's capital loss of \$30) generated by other members. Accordingly, \$20 of capital gain (P's \$10 capital gain determined without regard to its loss on S's stock plus M1's \$50 capital gain minus S's \$40 absorbed amount) remains. Because P has no net stock gain, paragraph (b)(2)(iii)(B)(2) of this section is inapplicable. Under paragraph (b)(2)(iii)(B)(3) of this section, \$10 (the amount of P's capital loss on S's stock limited by the amount of its income included in the computation under paragraph (b)(2)(i) of this section) of P's capital loss offsets the group's \$20 remaining capital gain. Under paragraph (b)(2)(iii)(B)(4) of this section, capital losses of members other than S offset the group's remaining \$10 of capital gain on a pro rata basis. Therefore, the group will use \$3.75 of M2's \$30 capital loss ( $\$10 \times \$30/\$80$ ) and \$6.25 of P's \$50 remaining capital loss ( $\$10 \times \$50/\$80$ ). The group will have a \$70 consolidated net capital loss carryover to Year 2 ( $\$43.75$  attributable to P and  $\$26.25$  attributable to M2). Paragraphs (b), (c), and (d)(6) of § 1.1502-36 will not cause P to adjust its basis in S's stock immediately before P's

sale of the S stock. However, S's \$20 unabsorbed capital loss that may be carried to its first separate return year may be reduced under the attribute reduction rule of §1.1502-36(d)(2).

Example 6. Loss disposition. (i) Facts. For Year 1, the P group has a consolidated net capital loss of \$100, all of which is attributable to S, and P and M have no income or loss. At the beginning of Year 2, P has a \$300 basis in S's stock. P sells all of S's stock for \$100 at the close of Year 2. For Year 2, P and S have no income or loss (determined without taking into account P's gain or loss from the disposition of S's stock) and the group has consolidated capital gain net income of \$100 attributable solely to M.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its losses under §1.1502-32(b)(2) on P's basis in S's stock, the group's taxable income for Year 2 is computed without taking into account P's gain or loss from the disposition of S's stock. The \$100 consolidated net capital loss carryover from Year 1 attributable to S offsets the group's \$100 of consolidated capital gain net income in Year 2. Accordingly, S's absorbed amount determined under paragraph (b)(2)(i) of this section is \$100.

(iii) Loss absorption and basis reduction. Under paragraph (b)(2)(ii) of this section, P's basis in S's stock is reduced from \$300 to \$200 immediately before the disposition. Consequently, P recognizes a \$100 capital loss on the sale of S's stock. In an actual computation of CTI, P's \$100 capital loss on S's stock in Year 2 would offset M's \$100 capital gain in Year 2 before the consolidated capital loss carryover from Year 1 and, as a result, S's \$100 absorbed amount would not be used. Because less than all of S's absorbed amount of \$100 would be used, the group's CTI is determined under the alternative computation of paragraph (b)(2)(iii)(B) of this section.

(iv) Alternative Computation of CTI. Under paragraph (b)(2)(iii)(B)(1) of section, S's \$100 consolidated net capital loss carryover from Year 1 first offsets M's \$100 of capital gain in Year 2. Because P has no net stock gain to be added to the computation, the amount under paragraph (b)(2)(iii)(B)(2) of this section is zero. Because there is no remaining income to offset, paragraphs (b)(2)(iii)(B)(3) and (b)(2)(iii)(B)(4) of this section are inapplicable. Therefore, P's \$100 loss on S's stock becomes a consolidated net capital loss carryover to the group's Year 3 consolidated return year.

Example 7. Netting of Disposing Member's Gains and Losses. (i) Facts. At the beginning of Year 1, P has a \$120 basis in S's stock. P sells all of S's stock for \$80 at the close of Year 1. In addition, P has \$60 capital loss on the sale of portfolio stock. S has a capital loss of \$180. M1 has a capital gain of \$100 and M2 has a capital loss of \$120.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its loss under §1.1502-32(b)(2) on P's basis in S's stock,

the group's taxable income is computed without taking into account P's gain or loss from the disposition of S's stock. Under that computation, S's capital loss would offset \$50 ( $\$100 \times \$180 / (\$180 + \$120 + \$60)$ ) of M1's \$100 capital gain. Accordingly, S's absorbed amount is \$50.

(iii) Basis reduction and computation of CTI under generally applicable rules. Under paragraph (b)(2)(ii) of this section, P's basis in S's stock is reduced by \$50 from \$120 to \$70 immediately before the sale. Consequently, P recognizes a \$10 capital gain on the sale of S's stock. In an actual computation of CTI, P's \$10 capital gain on the sale of S's stock would be offset by \$10 of P's \$60 capital loss. M1's \$100 capital gain would be offset by \$22.73 ( $\$100 \times \$50 / (\$50 + \$120 + \$50)$ ) of P's \$50 of net capital loss, \$ 54.54 ( $\$100 \times \$120 / \$220$ ) of M2's \$120 capital loss and \$22.73 ( $\$100 \times \$50 / \$220$ ) of S's \$50 capital loss. Because less than all of S's absorbed amount of \$50 would be used, the group's CTI is determined under the alternative computation of paragraph (b)(2)(iii)(B) of this section.

(iv) Alternative computation of CTI. Under paragraph (b)(2)(iii)(B)(1) of this section, \$50 of S's capital loss (the amount and character of S's absorbed amount) first offsets \$50 of the \$100 capital gain (determined without taking into account any gain or loss on P's sale of S stock and without regard to P's and M2's capital losses). Therefore, after the absorption of S's loss equal to its absorbed amount, there is \$50 of remaining capital gain. P will have a \$10 capital gain on the sale of S's stock, a \$60 capital loss on portfolio stock, and M2 will have a \$120 capital loss. Under paragraph (b)(2)(iii)(B)(2) of this section, \$10 of P's \$60 loss on portfolio stock offsets its \$10 gain on S's stock before M2's \$120 capital loss is taken into account. No member has a net loss on subsidiary stock, and therefore paragraph (b)(2)(iii)(B)(3) of this section does not apply. Under paragraph (b)(2)(iii)(B)(4) of this section, the remaining capital gain of \$50 after the application of paragraph (b)(2)(iii)(B)(3) is offset pro rata by \$14.70 ( $\$50 \times \$50 / (\$50 + \$120)$ ) of P's capital loss and \$35.30 ( $\$50 \times \$120 / \$170$ ) of M2's capital loss. P's unused capital loss of \$35.30 and M2's unused capital loss of \$84.70 become a \$120 consolidated net capital loss carryover to the group's Year 2 consolidated return year.

Example 8. Character of Absorbed Amount. (i) Facts. At the beginning of Year 1, P has a \$550 basis in S's stock. P sells all of S's stock for \$50 at the close of Year 1. In addition, P has a capital gain of \$200 (without regard to gain or loss on the sale of S's stock). S has an ordinary loss of \$50 and M has an ordinary loss of \$25.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its losses under §1.1502-32(b)(2) on P's basis in S's stock, the group's taxable income is computed without taking into account P's gain or loss from the disposition of S's stock. Under that computation, S's \$50 ordinary loss and M's \$25 ordinary loss offset \$75 of P's \$200 capital gain. Accordingly, S's absorbed amount determined under paragraph (b)(2)(i) of this section is \$50.

(iii) Basis reduction and computation of CTI under generally applicable rules. Under paragraph (b)(2)(ii) of this section, P's basis in S's stock is reduced by \$50 from

\$550 to \$500 immediately before the sale. Consequently, P recognizes a \$450 capital loss on the sale of S's stock. In an actual computation of CTI, \$200 of P's \$450 capital loss on its sale of S's stock would offset its \$200 capital gain and none of S's absorbed amount would be used. Because less than all of S's absorbed amount of \$50 would be used, the group's CTI is determined under the alternative computation of paragraph (b)(2)(iii)(B) of this section.

(iv) Alternative computation of CTI. Under paragraph (b)(2)(iii)(B)(1) of this section, S's \$50 ordinary loss first offsets \$50 of P's \$200 capital gain. Therefore, after the absorption of S's loss equal to its absorbed amount, the group will have \$150 (\$200 - \$50) of remaining capital gain. Because P has no net stock gain to be added to the computation, paragraph (b)(2)(iii)(B)(2) of this section is inapplicable. Under paragraph (b)(2)(iii)(B)(3) of this section, \$150 of P's \$450 loss on S's stock (the lesser of P's \$200 capital gain or the group's \$150 remaining capital gain) offsets the group's remaining \$150 of capital gain. Because there is no more income in the group for M's loss to offset, the amount under paragraph (b)(2)(iii)(B)(4) of this section is zero. Therefore, P's remaining unused capital loss on S's stock of \$300 and M's \$25 ordinary loss become carryovers to the group's Year 2 consolidated return year.

Example 9. Worthless Stock Loss. (i) Facts. At the beginning of Year 1, P has a \$120 basis in S's stock. For Year 1, P has \$100 of ordinary income (determined without taking into account P's gain or loss on the disposition of S's stock) and S generates an \$80 ordinary loss. At the close of Year 1, S issues stock to its creditors in a bankruptcy proceeding, and P's stock in S is canceled. The aggregate of S's historic gross receipts meets the requirements of section 165(g)(3)(B), which allows P to claim an ordinary loss with respect to S's stock.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption under §1.1502-32(b)(2) on P's basis in S's stock, the group's CTI is computed without taking into account P's gain or loss from the disposition of S's stock. Under that computation, S's \$80 ordinary loss would offset \$80 of P's \$100 of ordinary income. Accordingly, S's absorbed amount under paragraph (b)(2)(i) of this section is \$80.

(iii) Basis reduction and computation of CTI under generally applicable rules. Under paragraph (b)(2)(ii) of this section, S's \$80 absorbed amount reduces P's basis in S's stock from \$120 to \$40. Therefore, P's worthless stock deduction with respect to S's stock is \$40. In an actual computation of CTI, P's separate taxable income under §1.1502-12 would be determined by offsetting P's \$100 of ordinary income with its \$40 worthless stock deduction with respect to S's stock, leaving \$60 of ordinary income that would be offset by S's ordinary loss. However, that computation would result in the absorption of only \$60 of S's losses. Because less than all of S's absorbed amount of \$80 would be used, the group's CTI is determined under the alternative computation of paragraph (b)(2)(iii)(B) of this section.

(iv) Alternative computation of CTI. Under paragraph (b)(2)(iii)(B)(1) of this section, S's \$80 ordinary loss first offsets \$80 of P's \$100 of ordinary income.

Therefore, after the absorption of S's loss equal to its absorbed amount, the group will have \$20 of remaining ordinary income. Because P has no net stock gain to be added to the computation, the amount under paragraph (b)(2)(iii)(B)(2) of this section is zero. Under paragraph (b)(2)(iii)(B)(3) of this section, the group uses \$20 of P's \$40 ordinary loss on S's stock to offset the remaining \$20 income of the group. Because there remains no more income in the group, the amount under paragraph (b)(2)(iii)(B)(4) of this section is zero. P's remaining \$20 ordinary loss becomes a CNOL carryover to the group's Year 2 consolidated return year.

Example 10. Charitable Contributions. (i) Facts. At the beginning of Year 1, P has a \$1,000 basis in S's stock. P sells all of its S stock for \$900 at the close of Year 1. For Year 1, P has \$1,000 of ordinary income (determined without taking into account P's gain or loss on the disposition of S's stock). For Year 1, S makes a \$100 charitable contribution and incurs \$200 of ordinary and necessary business expenses that are deductible under section 162(a). In addition, P has a subsidiary M, which also makes a \$100 charitable contribution.

(ii) Determination of S's portion of consolidated charitable contributions deduction. Under §1.1502-24(a), a group's consolidated charitable contributions deduction is limited to ten percent of its adjusted consolidated taxable income as defined in §1.1502-24(c). Under paragraph (b)(2)(iii)(D) of this section, S's portion of the group's consolidated charitable contributions deduction is determined by computing the group's taxable income without regard to P's gain or loss on S's stock. Thus, for purposes of determining the consolidated charitable contributions deduction for Year 1, the group's CTI would be \$800 (P's \$1,000 of income minus S's \$200 of section 162 expenses). Accordingly, the consolidated charitable contributions deduction for Year 1 is limited to \$80 ( $\$800 \times 10\%$ ), \$40 attributable to S and \$40 attributable to M. Accordingly, S's ordinary loss for Year 1 is \$240 ( $\$200 + \$40$ ).

(iii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its losses under §1.1502-32(b)(2) on P's basis in S's stock, the group's CTI is computed without taking into account P's gain or loss from the disposition of S's stock. S's \$240 ordinary loss offsets \$240 of P's \$1,000 of ordinary income. Accordingly, S's absorbed amount is \$240.

(iv) Loss absorption and basis reduction. Under paragraph (b)(2)(ii) of this section, S's \$240 absorbed amount reduces P's basis in S's stock from \$1,000 to \$760. On the sale of S's stock, P recognizes capital gain of \$140 ( $\$900 - \$760$ ). P's ordinary income is offset by \$240 of S's ordinary loss and \$40 of M's portion of the group's consolidated charitable contributions deduction, resulting in CTI of \$860 ( $\$1,000 + \$140 - \$280$ ). Of the group's excess charitable contributions of \$120, \$60 will be apportioned to S and carried to its first separate return year. The remaining \$60 of excess consolidated charitable contributions is the group's consolidated charitable contribution carryover under §1.1502-24(b).

Example 11. Application of Unified Loss Rule. (i) Facts. In Year 1, P purchases the sole share of S's stock for \$500. At the time of the purchase, S owns Land with a basis of \$420. During Year 1, P incurs a \$100 ordinary loss and S earns \$100 in rental income, which increases P's basis in S's stock to \$600. For Year 2, P has ordinary income of \$30 (determined without taking into account P's gain or loss from the disposition of S's stock) and S incurs an ordinary loss of \$80. At the close of Year 2, S has \$20 of cash in addition to Land. In addition to S, P has another subsidiary M, which has an ordinary loss of \$40 for Year 2. At the close of Year 2, when the value of Land has declined, P sells the sole share of S's stock for \$480. No election is made under §1.1502-36(d)(6) to reduce P's basis in S's stock or reattribute S's attributes to P.

(ii) Determination of absorbed amount. To determine S's absorbed amount and the effect of the absorption of its losses under §1.1502-32(b)(2) on P's basis in S's stock, the group's CTI is computed without taking into account P's gain or loss from the disposition of S's stock. Under paragraph (e)(1) of this section, P's \$30 of ordinary income would be offset by \$10 ( $\$30 \times \$40/\$120$ ) of M's ordinary loss for Year 2 and \$20 ( $\$30 \times \$80/\$120$ ) of S's ordinary loss for Year 2. Accordingly, S's absorbed amount determined under paragraph (b)(2)(i) of this section is \$20.

(iii) Loss absorption and basis reduction. Under paragraph (b)(2)(ii) of this section, S's \$20 absorbed amount reduces P's basis in S's stock from \$600 (P's \$500 purchase price plus the \$100 positive adjustment in Year 1) to \$580. After taking into account the effects of all applicable rules of law, including paragraph (b)(2)(ii) of this section, P would recognize a \$100 ( $\$480 - \$580$ ) loss on the sale of S's stock. Thus, P's sale of the S share is a transfer of a loss share and therefore subject to §1.1502-36. Under §1.1502-36(b)(1)(ii), P's basis in its sole share of S's stock is not subject to redetermination. Under §1.1502-36(c), P's basis in the S share (\$580) is reduced, but not below value, 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 §1.1502-36(b)(1)(iii)) applied to the basis of the share. The net positive adjustment applied to the basis of the share is \$80, S's \$100 income for Year 1 and its \$20 absorbed amount for Year 2. The share's disconformity amount is the excess, if any, of its basis (\$580) over its allocable portion of S's net inside attribute amount. S's net inside attribute amount of \$500 is the sum of S's \$20 cash, S's basis in Land of \$420, and S's \$60 loss carryover ( $\$80 - \$20$ ). Thus, the share's disconformity amount is \$80 ( $\$580 - \$500$ ). The lesser of the net positive adjustment (\$80) and the share's disconformity amount (\$80) is \$80. Accordingly, under §1.1502-36(c), P's basis in S's share is reduced by \$80 from \$580 to \$500, and after taking into account the adjustments under paragraphs (b) and (c) of §1.1502-36, the transferred S share is still a loss share ( $\$480$  sale price minus \$500 basis).

(iv) Computation of CTI. In an actual computation of CTI, P's \$30 of ordinary income would be offset on a pro rata basis by \$20 ( $\$30 \times \$40/\$60$ ) of M's ordinary loss and \$10 ( $\$30 \times \$20/\$60$ ) of S's ordinary loss. Because less than all of S's absorbed amount of \$20 would be used, the group's CTI is determined under the alternative computation of paragraph (b)(2)(iii)(B) of this section. Under paragraph (b)(2)(iii)(B)(1)

of this section, the computation of CTI is made by first computing the group's taxable income without taking into account P's loss on the disposition of S's stock and using only S's loss equal to its \$20 absorbed amount. Accordingly, the group's \$30 of ordinary income is reduced by \$20 of S's ordinary loss, leaving \$10 of remaining ordinary income. Because P has no net stock gain to be added to the computation, paragraph (b)(2)(iii)(B)(2) of this section is inapplicable. Under paragraph (b)(2)(iii)(B)(3) of this section, the group's remaining \$10 of ordinary income is offset by a loss on the disposition of subsidiary stock, subject to applicable principles of the Code and regulations. The group's remaining \$10 of income may not be offset by P's capital loss on the sale of S's stock, because P has no income of the same character on its loss on S's stock. Under paragraph (b)(2)(iii)(B)(4) of this section, the group's remaining \$10 of ordinary income is offset by \$10 of M's ordinary loss. M's \$30 unabsorbed loss is carried over as a CNOL and P's remaining \$20 capital loss from the sale of S's stock is carried over as a consolidated net capital loss to the group's Year 3 consolidated return year. S's \$60 unused loss would be carried over to its separate return year subject to §1.1502-36(d). Under §1.1502-36(d)(2), S's attributes are reduced by S's attribute reduction amount. Under §1.1502-36(d)(3), 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 \$500 basis of the transferred share over the \$480 value of the transferred share. S's aggregate inside loss is \$20, the excess of its \$500 net inside attribute amount over the \$480 value of the S share. Therefore, the attribute reduction amount is \$20, the lesser of the \$20 net stock loss and the \$20 aggregate inside loss. Accordingly, S's \$20 attribute reduction amount is applied to reduce from \$60 to \$40 the amount of S's NOL carryover to its separate return year.

(v) Election to reduce stock basis. The facts are the same as in paragraph (i) of this Example 11 except that P elects under §1.1502-36(d)(6)(i)(B) to reattribute S's losses to the full extent of the attribute reduction amount (\$20). Accordingly, P is treated as succeeding to \$20 of S's losses as if acquired in a transaction described in section 381(a) (see §1.1502-36(d)(6)(i)(B) and (iv)(A)) and, as a result, P's basis in the S share is reduced from \$500 to \$480. After giving effect to the election, P will have no loss on S's stock, the group will have a \$50 CNOL carryover to Year 3 (\$30 attributable to M and \$20 attributable to P), and S will have a \$40 NOL carryover to its separate return year.

(3) Effective/applicability date. This paragraph (b) applies to dispositions of subsidiary stock occurring in consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register**.

(c) \* \* \*

(2) \* \* \*

(i) Limitation on deductions and losses to offset income or gain. First, the determination of the extent to which S's deductions and losses for the consolidated return year of the disposition (and its deductions and losses carried over from prior years) may offset income and gain is made pursuant to paragraph (b)(2) of this section.

(ii) Tentative adjustment of stock basis. Second, §1.1502-32 is tentatively applied to adjust the basis of the S stock to reflect the amount of S's income and gain included, and S's absorbed amount of losses, in the computation of consolidated taxable income or loss for the year of disposition (and any prior years) that is made pursuant to paragraph (b)(2) of this section, but not to reflect the realization of excluded COD income and the reduction of attributes in respect thereof.

\* \* \* \* \*

(4) Definition of lower-tier corporation. For purposes of this paragraph (c), lower-tier corporation means a lower-tier subsidiary described in §1.1502-36(f)(4).

\* \* \* \* \*

(7) Effective/applicability date. \* \* \* However, paragraphs (c)(2) and (4) of this section apply to consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

(e) Absorption rule--(1) Pro rata absorption of ordinary losses. If the group has a CNOL for a consolidated return year, the amount of each member's separate net operating loss, as defined in §1.1502-21(b)(2)(iv)(B)(1), for the year that offsets the income or gain of other members is determined on a pro rata basis under the principles of §1.1502-21(b)(2)(iv). For example, if, for the consolidated return year, P and S1 have

a separate net operating loss of \$60 and \$30, respectively, and S2 (the only other member of the P group) has \$21 of income, \$14 of P's net operating loss and \$7 of S1's net operating loss offset S2's \$21 of income and are absorbed in the year.

(2) Pro-rata absorption of capital losses. If the group has a consolidated net capital loss for a consolidated return year and any member has capital gain net income for the year (taking into account only its capital gains and losses), the amount of each member's capital loss (as defined in paragraph (b)(1) of this section) that offsets the sum of the capital gain net income of other members (computed separately for each member) is determined on a pro rata basis under the principles of §1.1502-21(b)(2)(iv). For purposes of this paragraph (e)(2), the character of each member's gains and losses is first determined on a consolidated basis. See §§1.1502-22 and 1.1502-23.

(3) Effective/applicability date. This paragraph (e) applies to consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register**.

Par. 3. Section 1.1502-12 is amended by:

1. Revising paragraphs (b) and (e).
2. Removing and reserving paragraph (m).

The revisions read as follows:

§1.1502-12 Separate taxable income.

\* \* \* \* \*

(b) Any deduction that is disallowed under §1.1502-15 shall be taken into account as provided in that section;

\* \* \* \* \*

(e) If a member disposes of a share of a subsidiary's stock, the member's deduction or loss (if any) on the stock that will be used in the consolidated return year of the disposition and as a carryback to prior years is computed in accordance with §1.1502-11(b) or (c), as appropriate.

\* \* \* \* \*

(m) [Reserved]

\* \* \* \* \*

Par. 4. Section 1.1502-21 is amended by:

1. Revising paragraph (b)(2)(iv)(B).
2. Adding paragraphs (b)(3)(vi) and (h)(1)(iv).

The revision and additions read as follows:

§1.1502-21 Net operating losses.

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(iv) \* \* \*

(B) Percentage of CNOL attributable to a member--(1) In general. Except as provided in paragraph (b)(2)(iv)(B)(2) of this section, the percentage of the CNOL attributable to a member shall equal the separate net operating loss of the member for the consolidated return year divided by the sum of the separate net operating losses of all members having such losses for that year. For this purpose, the separate net operating loss of a member is determined by computing the CNOL by reference to only the member's items of income, gain, deduction, and loss (excluding capital gains and amounts treated as capital gains), including the member's losses and deductions

actually absorbed by the group in the consolidated return year (whether or not absorbed by the member).

(2) Recomputed percentage. If, for any reason, a member's portion of a CNOL is absorbed or reduced on a non pro rata basis (for example, under §§1.1502-11(b) or (c), 1.1502-28, 1.1502-36(d), or as the result of a carryback to a separate return year), the percentage of the CNOL attributable to each member is recomputed. In addition, if a member with a separate net operating loss ceases to be a member, the percentage of the CNOL attributable to each remaining member is recomputed under paragraph (b)(2)(iv)(B)(1) of this section. The recomputed percentage of the CNOL attributable to each member shall equal the remaining CNOL attributable to the member at the time of the recomputation divided by the sum of the remaining CNOL attributable to all of the remaining members at the time of the recomputation.

\* \* \* \* \*

(3) \* \* \*

(vi) Amount of subsidiary's absorbed deductions and losses if subsidiary's stock is disposed of. For special rules regarding the amount of a subsidiary's deductions and losses that is absorbed if a member disposes of a share of the subsidiary's stock, see §1.1502-11(b) and (c).

\* \* \* \* \*

(h) \* \* \*

(1) \* \* \*

(iv) Paragraphs (b)(2)(iv)(B) and (b)(3)(vi) of this section apply to consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

§1.1502-21A [Removed]

Par. 5. Section 1.1502-21A is removed.

Par. 6. Section 1.1502-22 is amended by:

1. Revising paragraphs (a)(2) and (3).
2. Adding paragraph (a)(4).

The revisions and addition read as follows:

§1.1502-22 Consolidated capital gain and loss.

\* \* \* \* \*

(a) \* \* \*

(2) The consolidated net section 1231 gain for the year (determined under §1.1502-23);

(3) The net capital loss carryovers or carrybacks to the year; and

(4) Applying the ordering rules of §1.1502-11(b) if stock of a subsidiary is disposed of.

\* \* \* \* \*

§1.1502-22A [Removed]

Par. 7. Section 1.1502-22A is removed.

§1.1502-23A [Removed]

Par. 8. Section 1.1502-23A is removed.

§1.1502-24 [Amended]

Par. 9. Section 1.1502-24 is amended by:

1. Removing the words “Five percent” in paragraph (a)(2) and adding “The percentage limitation on the total charitable contribution deduction provided in section 170(b)(2)(A)” in its place.
2. Removing “section 242,” and “§1.1502-25,” in paragraph (c).

**PART 301--PROCEDURE AND ADMINISTRATION**

Par. 10. The authority citation for part 301 is amended by revising the entry for §301.6402-7 to read in part as follows:

Authority: 26 U.S.C. 7805.

\* \* \* \* \*

Section 301.6402-7 also issued under 26 U.S.C. 6402(k).

\* \* \* \* \*

Par. 11. Section 301.6402-7 is amended by revising the last sentence of paragraph (g)(2)(ii) and paragraph (l) to read as follows:

§301.6402-7 Claims for refund and applications for tentative carryback adjustments involving consolidated groups that include insolvent financial institutions.

\* \* \* \* \*

(g) \* \* \*

(2) \* \* \*

(ii) \* \* \* For this purpose, the separate net operating loss of a member is determined by computing the consolidated net operating loss by reference to only the member’s items of income, gain, deduction, and loss (excluding capital gains and

amounts treated as capital gains), including the member's losses and deductions actually absorbed by the group in the consolidated return year (whether or not absorbed by the member).

\* \* \* \* \*

(l) Effective/applicability dates. This section applies to refunds and tentative carryback adjustments paid after December 30, 1991. However, the last sentence of paragraph (g)(2)(ii) of this section applies to separate net operating losses of members incurred in consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register**.

John M. Dalrymple,  
Deputy Commissioner for Services and Enforcement.  
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