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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 8998

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Loss Limitation Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains amendments to temporary regulations issued under sections 337(d) and 1502. The amendments clarify certain aspects of the temporary regulations relating to the deductibility of losses recognized on dispositions of subsidiary stock by members of a consolidated group. The amendments in these temporary regulations apply to corporations filing consolidated returns, both during and after the period of affiliation, and also affect purchasers of the stock of members of a consolidated group. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective May 31, 2002.

Applicability Date: For dates of applicability see §1.337(d)-2T(g) and 1.1502-20T(i).

FOR FURTHER INFORMATION CONTACT: Sean P. Duffley (202) 622-7530 or Lola L. Johnson (202) 622-7550 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these regulations has been previously reviewed and approved by the Office of Management and Budget under control number 1545-1774. Responses to this collection of information are voluntary. No material changes to this collection of information are made by these regulations.

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

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

Background

On March 12, 2002, the IRS and Treasury published in the **Federal Register** at 67 FR 11034 (2002-13 I.R.B. 668) temporary regulations under sections 337(d) and 1502 (the temporary regulations). The temporary regulations set forth rules that limit the deductibility of loss recognized by a consolidated group on the disposition of stock of a subsidiary member and that require certain basis reductions on the deconsolidation of stock of a subsidiary member. Section 1.1502-20T(i) of the temporary regulations provides that, in the case of a disposition or deconsolidation of a subsidiary before March 7, 2002, and for such transactions effected pursuant to a

binding written contract entered into before March 7, 2002, that was in continuous effect until the disposition or deconsolidation, a consolidated group may determine the amount of allowable stock loss or basis reduction by applying §1.1502-20 in its entirety, §1.1502-20 without regard to the duplicated loss component of the loss disallowance rule, or §1.337(d)-2T. For dispositions and deconsolidations that occur on or after March 7, 2002, and that are not within the scope of the binding contract rule, §1.1502-20T(i) provides that allowable loss and basis reduction are determined under §1.337(d)-2T, not §1.1502-20.

Explanation of Provisions

Since the publication of the temporary regulations, several questions have been raised concerning the interpretation and application of the temporary regulations. In response to these questions, the IRS and Treasury are promulgating the regulations in this Treasury decision as temporary regulations to clarify and amend the temporary regulations as described below in this preamble. The following paragraphs describe these amendments.

Netting Rule

Commentators requested that §1.337(d)-2T be amended to provide a netting rule similar to that set forth in §1.1502-20(a)(4), pursuant to which gain and loss from certain dispositions of stock may be netted. This Treasury decision adds §1.337(d)-2T(a)(4) to provide such a rule and also adds §1.337(d)-2T(b)(4), which provides a similar netting rule for basis reductions on deconsolidations of subsidiary stock.

Time For Filing Election Described in §1.1502-20T(i)

Section 1.1502-20T(i) currently provides that an election to determine allowable loss by applying §1.1502-20 (without regard to the duplicated loss component of the loss disallowance rule) or §1.337(d)-2T must be made by including a statement with or as part of the original return for the taxable year that includes the later of March 7, 2002, and the date of the disposition or deconsolidation of the stock of the subsidiary, or with or as part of an amended return filed before the date the original return for the taxable year that includes March 7, 2002, is due. Commentators noted that this provision may not permit the election to be made on an original return for the 2001 taxable year where the disposition occurs during the 2001 taxable year. The IRS and Treasury believe that it is appropriate to permit the election to be made on such a return. Therefore, this Treasury decision amends §1.1502-20T(i) to provide that the statement may be filed with or as part of a timely filed (including any extensions) original return for any taxable year that includes any date on or before March 7, 2002. In addition, if the date of the disposition or deconsolidation of the stock of the subsidiary is after March 7, 2002, the statement may be filed with or as part of a timely filed (including any extensions) original return for the taxable year that includes such date. This latter alternative effectively permits the statement to be filed with the original return that includes the date of the disposition or deconsolidation if, as of March 7, 2002, the disposition or deconsolidation was subject to a binding written contract entered into before March 7, 2002, that was in continuous effect until the date of the disposition or deconsolidation.

Requirements for Perfecting Election Described in §1.1502-20T(i)

Commentators questioned whether an election to determine allowable loss by applying §1.1502-20 (without regard to the duplicated loss component of the loss disallowance rule) or §1.337(d)-2T was valid only if a statement of allowed loss described in §1.337(d)-2T(c) or 1.1502-20(c), as appropriate, was or is filed with respect to the disposition or deconsolidation of subsidiary stock. The amendments to the temporary regulations in this Treasury decision clarify that no statement other than the one described in §1.1502-20T(i)(4) is necessary to perfect an election to compute allowable loss or basis reduction by applying the provisions described in §1.1502-20T(i)(2)(i) or (ii). Therefore, an election pursuant to §1.1502-20T(i) may be made regardless of whether a statement of allowed loss described in §1.337(d)-2T(c) or 1.1502-20(c) was or is filed with respect to the disposition or deconsolidation.

In addition, taxpayers determining allowable loss under §1.1502-20 in its entirety will generally be treated as having satisfied the requirement to file a statement of allowed loss otherwise imposed by §1.1502-20(c) even if no such statement is filed. Nothing in the temporary regulations or these amendments to the temporary regulations, however, affects the filing requirements regarding the election provided in §1.1502-20(g).

Effect of Election

Finally, a number of questions have been raised regarding the extent to which the election described in §1.1502-20T(i) affects a taxpayer's items of income, gain, deduction, or loss other than the loss allowed on a disposition of subsidiary stock. In response to these questions, the temporary regulations are amended to explain that if,

pursuant to an election under §1.1502-20T(i), the loss allowed with respect to a disposition of subsidiary stock is increased, but the year of the disposition (or the year to which such loss would have been carried back or carried forward) is closed, to the extent that the absorption of such excess loss in such year would have affected the tax treatment of another item (e.g., another loss that was absorbed in such year) that has an effect in an open year, the election will affect the treatment of such other item.

In addition, the regulations provide a special rule for situations in which a subsidiary of the group (the disposing member) recognized a loss on the disposition of stock of a lower-tier subsidiary member of the group, the loss was disallowed under §1.1502-20, and, as a result, a group member's basis in the stock of the disposing member was reduced pursuant to §1.1502-32 (because the disallowed loss was treated as a noncapital, nondeductible expense). In such cases, to the extent that all or some portion of the disallowed loss is allowed as a result of an election under §1.1502-20T(i), but such loss would have been properly absorbed or expired in a closed year, the basis in the stock of the disposing member may be increased. This adjustment is to be made for purposes of determining the group's or the shareholder-member's Federal income tax liability for all open years.

Special Analyses

In light of the Federal Circuit's decision in Rite Aid Corp. v. United States, 255 F.3d 1357 (Fed. Cir. 2001), the temporary regulations were necessary to provide taxpayers with immediate guidance regarding allowable loss and basis reductions in connection with dispositions and deconsolidations of subsidiary stock and to carry out

the principles of General Utilities repeal pending the issuance of further guidance.

These amendments to the temporary regulations clarify those rules and simplify their application in order to ease taxpayer compliance. Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b)(B) and with a delayed effective date pursuant to 5 U.S.C. 553(d)(1) and (3). It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

Drafting Information

The principal authors of these regulations are Sean P. Duffley and Lola L. Johnson, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

Paragraph 1. The authority citation for part 1 is amended by removing the entry for “Section 1.1502-20T(i)” and adding an entry in numerical order to read in part as follows:

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

Section 1.1502-20T also issued under the authority of 26 U.S.C. 337(d) and 1502. * * *

Par. 2. In §1.337(d)-2T, paragraphs (a)(4) and (b)(4) are added to read as follows:

§1.337(d)-2T Loss limitation window period (temporary).

(a) * * *

(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 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.

(b) * * *

(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, 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 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).

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Par. 3. Section 1.1502-20T is amended by revising paragraphs (i)(3)(v) and (i)(4) to read as follows:

§1.1502-20T Disposition or deconsolidation of subsidiary stock (temporary).

* * * * *

(i) * * *

(3) * * *

(v) Items taken into account in open years--(A) General rule. An election under paragraph (i)(2) of this section affects a taxpayer's items of income, gain, deduction, or loss only to the extent that the election gives rise, directly or indirectly, to items or amounts that would properly be taken into account in a year for which an assessment of deficiency or a refund of overpayment, as the case may be, is not prevented by any law or rule of law. Under this paragraph, if the election increases the loss allowed with respect to a disposition of subsidiary stock, but the year of the disposition (or the year to which such loss would have been carried back or carried forward) is a year for which a refund of overpayment is prevented by law, to the extent that the absorption of such excess loss in such year would have affected the tax treatment of another item (e.g., another loss that was absorbed in such year) that has an effect in a year for which a refund of overpayment is not prevented by any law or rule of law, the election will affect the treatment of such other item. Therefore, if the absorption of the excess loss in the

year of the disposition (which is a year for which a refund of overpayment is prevented by law) would have prevented the absorption of another loss (the second loss) in such year and such loss would have been carried to and used in a year for which a refund of overpayment is not prevented by any law or rule of law (the other year), the election makes the second loss available for use in the other year.

(B) Special rule. If a member's basis in stock of a subsidiary was reduced pursuant to §1.1502-32 because a loss with respect to stock of a lower-tier subsidiary was treated as disallowed under §1.1502-20, then, to the extent such disallowed loss is allowed as a result of an election under paragraph (i) of this section but would have been properly absorbed or expired in a year for which a refund of overpayment is prevented by law or rule of law, the member's basis in the subsidiary stock may be increased for purposes of determining the group's or the shareholder-member's Federal income tax liability in all years for which a refund of overpayment is not prevented by law or rule of law.

* * * * *

(4) Time and manner of making the election. An election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) or (ii) of this section is made by including the statement required by this paragraph with or as part of any timely filed (including any extensions) original return for a taxable year that includes any date on or before March 7, 2002, or, if the date of the disposition or deconsolidation of the stock of the subsidiary is after March 7, 2002, then such date, or with or as part of an amended return filed before the date the original return for the

taxable year that includes March 7, 2002, is due (including any extensions). Filing a statement in accordance with the provisions of this paragraph satisfies the requirement to file a "statement of allowed loss" otherwise imposed under §1.1502-20(c)(3) or §1.337(d)-2T(c)(3). The statement required by this paragraph satisfies the requirement that a statement be filed in order to claim allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) or (ii). The statement filed under this paragraph shall be entitled "Allowed Loss under Section [Specify Section under Which Allowed Loss Is Determined] Pursuant to Section 1.1502-20T(i)" and must include the following information--

(i) The name and employer identification number (E.I.N.) of the subsidiary and of the member(s) that disposed of the subsidiary stock;

(ii) In the case of an election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(i) of this section, a statement that the taxpayer elects to determine allowable loss or basis reduction by applying such provisions;

(iii) In the case of an election to determine allowable loss or basis reduction by applying the provisions described in paragraph (i)(2)(ii) of this section, a statement that the taxpayer elects to determine allowable loss or basis reduction by applying such provisions;

(iv) If an election described in §1.1502-20(g) was made with respect to the disposition of the stock of the subsidiary, the amount of losses originally treated as

reattributed pursuant to such election and the amount of losses treated as reattributed pursuant to paragraph (i)(3)(i) or (ii) of this section;

(v) If an apportionment of a separate section 382 limitation, a subgroup section 382 limitation, or a consolidated section 382 limitation is adjusted pursuant to paragraph (i)(3)(iii)(A), (B), or (C) of this section, the original and redetermined apportionment of such limitation; and

(vi) If the application of paragraph (i)(3)(i) or (ii) of this section results in a reduction of the amount of losses treated as reattributed pursuant to an election described in §1.1502-20(g), a statement that the notification described in paragraph (i)(3)(iv) of this section was sent to the subsidiary and, if the acquirer was a member of a consolidated group at the time of the stock sale, to the person that was the common

parent of such group at such time, as required by paragraph (i)(3)(iv) of this section.

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Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved: May 20, 2002

Pamela F. Olson,
Acting Assistant Secretary of the Treasury.