

T.D. 9155

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Guidance Under Section 1502; Treatment of Loss Carryovers From Separate Return Limitation Years

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 1502 that provide guidance regarding the treatment of certain losses available to acquired subsidiaries as a result of an election made under the section 1502 regulations. The text of these temporary regulations also serves as the text of the proposed regulations (REG-129274-04) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin. These regulations apply to corporations filing consolidated returns.

DATES: *Effective Date:* These regulations are effective August 18, 2004.

Applicability Date: For dates of applicability, see §1.1502-32T(b)(4)(v)(C).

FOR FURTHER INFORMATION CONTACT: Sean McKeever at (202) 622-7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Under §1.1502-32(b)(4), if a subsidiary of a consolidated group has a loss

carryover from a separate return limitation year when it becomes a member of the group, the group may make an irrevocable election to treat all or any portion of the loss carryover as expiring for all Federal income tax purposes immediately before the subsidiary becomes a member of the group. If the subsidiary was a member of another group immediately before it became a member of the group, the expiration is also treated as occurring immediately after it ceases to be a member of the prior group. Waiving losses of an acquired subsidiary is desirable in cases in which it is anticipated that the losses of the subsidiary may expire unused in that it prevents a negative basis adjustment in the stock of the subsidiary.

In March of 2002, in response to the decision of the United States Court of Appeals for the Federal Circuit in *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), the Treasury Department and the IRS issued guidance regarding the treatment of certain losses realized on dispositions and deconsolidations of stock of a member of a consolidated group. Those rules permitted groups to calculate allowable loss on the sale of subsidiary stock by applying §1.1502-20 in its entirety, §1.1502-20 without regard to the duplicated loss factor of the loss disallowance formula, or §1.337(d)-2T. If a group that made an election described in §1.1502-20(g) to reattribute to the common parent losses of the subsidiary elected to determine allowable loss by applying either §1.1502-20 without regard to the duplicated loss factor of the loss disallowance formula, or §1.337(d)-2T, the amount of loss treated as reattributed could be reduced. As a result, losses that were previously treated as reattributed would be treated as available for use by the subsidiary or any other group of which the subsidiary is a member, subject to any applicable limitations (e.g., section 382). To prevent a purchasing consolidated group from being unfairly disadvantaged in the event that the amount of losses treated as reattributed to the common parent of the selling group were decreased and the amount of losses treated as available to the subsidiary were increased (excess losses), §1.1502-32T(b)(4)(v) was added to provide that, to the extent that the subsidiary's loss carryovers are increased by reason of an election to apply one of the

alternative regimes and such loss carryovers expire, or would have been properly used to offset income, in a closed year, the purchasing group will be deemed to have made an election to treat all of such expired loss carryovers as expiring for all Federal income tax purposes immediately before the subsidiary became a member of the purchasing group (the deemed waiver rule). Accordingly, no basis reduction under §1.1502-32 would result from the expiration of, or failure to use, such losses.

The Treasury Department and the IRS have become aware that the deemed waiver rule may deny the use of excess losses in cases in which such denial was not intended, particularly in cases in which the excess losses would have been properly used to offset income in a closed year and the use of such losses in the closed year would make losses that were used in the closed year available to offset income in an open year. Accordingly, one commentator has asked that relief from the deemed waiver rule be afforded in these cases. These temporary regulations provide that relief by making the application of the deemed waiver rule optional. This relief is applicable on and after August 18, 2004. In addition, groups may apply this relief before August 18, 2004, and on and after March 7, 2002.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. These temporary regulations are necessary to provide taxpayers with immediate guidance regarding the treatment of certain subsidiary losses. Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b) and with a delayed effective date pursuant to 5 U.S.C. 553(d)(3). For applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

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

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.1502-32T is amended by revising paragraph (b)(4)(v)(A) and (C).

§1.1502-32T Investment adjustments (temporary).

* * *

(b) * * *

(4) * * *

(v) *Special rule for loss carryovers of a subsidiary acquired in a transaction for which an election under §1.1502-20T(i)(2) is made—(A) Expired losses.*

Notwithstanding §1.1502-32(b)(4)(iv), unless a group otherwise chooses, to the extent that S's loss carryovers are increased by reason of an election under §1.1502-20T(i)(2) and such loss carryovers expire or would have been properly used to offset income in a taxable year for which the refund of an overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which S receives the notification described in §1.1502-20T(i)(3)(iv) and at all times thereafter, the group will be deemed to have made an election under §1.1502-32(b)(4) to treat all of such loss carryovers as expiring for all Federal income tax purposes immediately before S became a member of the consolidated group. A group may choose not to apply the rule of the previous sentence to all

of such loss carryovers of S by taking a position on an original or amended tax return for each relevant taxable year that is consistent with having made such choice.

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(C) *Effective date.* Paragraph (b)(4)(v)(A) of this section is applicable on and after August 18, 2004. Groups, however, may apply paragraph (b)(4)(v)(A) of this section before August 18, 2004, and on and after March 7, 2002. Otherwise, see paragraph (b)(4)(v)(A) of §1.1502-32. Paragraph (b)(4)(v)(B) of this section is applicable on and after March 7, 2002.

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Mark E. Matthews,
*Deputy Commissioner for
Services and Enforcement.*

Approved July 29, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 17, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 18, 2004, 69 F.R. 51175)