

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8751]

RIN 1545-AV30

Consolidated returns--Limitations on the use of certain losses and credits; overall foreign loss accounts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary amendments to the consolidated return regulations. The temporary amendments govern the use of tax credits of a consolidated group and its members. They also concern the recharacterization of certain foreign source income because of a prior overall foreign loss. The text of the 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 of this issue of the **Federal Register**.

DATES: These amendments are effective January 12, 1998. For dates of application, see the **Effective Dates** portion of the preamble under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Concerning the temporary regulations in general, Roy A. Hirschhorn, (202) 622-7770; concerning amendments related to foreign tax credits and foreign losses, Seth Goldstein (202) 622-3850.

SUPPLEMENTARY INFORMATION:

Background and Explanation of ProvisionsA. In General

On June 27, 1996, the IRS and Treasury published in the **Federal Register** a Treasury decision containing temporary regulations which, in part, provide rules governing the absorption of certain tax attribute carryovers and carrybacks from separate return limitation years (SRLYs), terminate the consolidated return change of ownership rules, and make minor changes to the computation of net section 1231 gains and losses for a group. The Treasury decision adopted without substantive change rules that were proposed in 1991. The 1996 temporary regulations are effective for consolidated return years beginning on or after January 1, 1997.

The 1996 temporary regulations significantly modify SRLY loss rules which had been in place since 1966. The 1966 SRLY rules employed a member-by-member and year-by-year approach to determine the limitation on SRLY attributes. The 1996 temporary regulations adopted a subgroup and cumulative approach. See the preamble to NPRM for CO-078-90 (56 FR 4228), reprinted at 1991-1 C.B. 757. The 1996 temporary regulations, however, only apply the new approach to net operating loss and net capital loss carryovers and carrybacks. They do not change regulations containing limitations on the absorption of the following other tax attribute carryovers and carrybacks from SRLYs: general

business credits (§1.1502-3), foreign tax credits (§1.1502-4), and overall foreign losses (OFLs) (§1.1502-9).

On December 30, 1992, the IRS and Treasury published in the **Federal Register** a notice of proposed rulemaking containing rules regarding a group's computation of its alternative minimum tax and minimum tax credits. See 57 FR 62251, as corrected by 58 FR 8027, reprinted at 1993-1 C.B. 799. The proposed regulations (Prop. Reg. §1.1502-55) do not address the application of SRLY limitations to the minimum tax credit.

B. Extension of 1996 Principles

The IRS and Treasury believe that it is appropriate to apply a single set of SRLY principles to all attributes that are subject to SRLY limitations. Unnecessary complexity would result from applying different principles to different attributes. In addition, the IRS and Treasury believe that the subgroup and cumulative principles embodied in the 1996 temporary regulations more appropriately reflect the use of attributes brought into a consolidated group by SRLY members than do the member-by-member and year-by-year rules of the 1966 regulations. Accordingly, this document extends the principles of the 1996 temporary regulations to the general business credit and the minimum tax credit. In doing so, the IRS and Treasury have not attempted to address the issues which some commentators have raised with respect to the application of the SRLY limitations in general. Rather, those issues will be addressed in connection with a

review of comments received in response to the 1991 proposed regulations, the 1996 temporary regulations and to the temporary regulations contained in this document, prior to the expiration of the 1996 temporary regulations in 1999.

In general, a group may include a member's SRLY credits in the applicable consolidated section 38 credit or minimum tax credit for a consolidated return year based on the member's contributions to the consolidated section 38(c) or consolidated section 53(c) limitation for all consolidated return years. The contribution is based on the aggregate of the member's share of the group's tax liability for relevant years. Such share is measured under the principles of section 1552 and the percentage method under §1.1502-33(d)(3), assuming a 100% allocation of any decreased tax liability. The contribution may be a negative number, for example, for a year in which the overall loss of the member offsets the income of other members. In the case of the minimum tax credit, the temporary regulations provide an adjustment to avoid double counting for years in which the SRLY member contributes to the group's AMT liability.

This document also adds an example to §1.1502-21T(c)(1) and §1.1502-23T(b). The examples assist taxpayers in computing their cumulative registers by illustrating the concept of cumulative contribution to consolidated net capital gain and consolidated taxable income and the character of section 1231 items for purposes of the relevant registers.

C. Treatment of Foreign Tax Credits, OFLs and SLLs

In considering the application of the new SRLY principles in the temporary regulations to credits in general, the IRS and Treasury considered extending these principles to foreign tax credits (FTCs), and to those losses associated with the FTC regime, namely, overall foreign losses (OFLs) and separate limitation losses (SLLs). The IRS and Treasury were concerned that continued application of the principles of the 1966 regulations (member-by-member and year-by-year) to these foreign attributes, and especially to OFL and SLL accounts, could lead to inappropriate results. Taxpayers might adopt structures in an attempt to achieve indefinite postponement of the recapture of SRLY OFLs and SLLs. Such postponement would frustrate the neutrality principle that the SRLY rules are intended to serve (i.e., that the decision to join a new affiliated group should generally be unaffected by considerations relating to the absorption of pre-affiliation attributes).

While it was clear that application of the 1966 principles to OFLs and SLLs should not continue, it was less clear that application of the subgroup and cumulative principles of the temporary regulations would address all concerns. The subgroup and cumulative principles are meant to more closely parallel the absorption that would have taken place had the member (or subgroup) continued filing separate returns. The interaction of the FTC regime (with its multiple baskets) and other provisions

of the Internal Revenue Code affecting international transactions, such as, for example, section 864(e)(1) which allocates the interest expense of a member to income in various baskets based on the group's asset allocation, can make it difficult to determine what the member has contributed to the group. Furthermore, even with the adoption of the subgroup and cumulative principles, taxpayers would likely have the ability to transfer controlled foreign corporations to new members or to cause operations to be assumed by new members, thereby delaying indefinitely the recapture of OFLs and SLLs subject to SRLY.

The IRS and Treasury have decided, therefore, that the principles of SRLY are not served by applying SRLY limitations to OFL and SLL accounts of corporations joining a group. Thus, this document amends portions of §1.1502-9 to eliminate SRLY restrictions on OFL recapture. A new member's SRLY OFL account will be added to the similar consolidated OFL account of the group. For similar reasons, and to avoid an imbalance in the application of the FTC regime, the IRS and Treasury have decided that SRLY limitations should not apply to FTCs of corporations joining a group. This document also amends §1.1502-4(f) such that, in the future, there will be no SRLY limitation on the use of a member's separate year FTCs by the group. Other limitations on the use of separate year FTCs continue to apply. See, for example, section 383.

These amendments apply to corporations becoming members of

a group. They do not address the apportionment of attributes to corporations that cease to members of a group. Therefore, they only partially address the issues presented in applying the OFL and SLL rules to groups. In particular, the IRS and Treasury recognize that the retention of the notional account system of §1.1502-9 for members that cease to be members is inconsistent with the rationale for removing the SRLY limitation for FTCs and OFL accounts. The notional account system may result in a member's taking from the group an OFL or SLL account that is unrelated to the member's activities and future income. Accordingly, the IRS and Treasury expect in the near future to issue additional amendments to §1.1502-9. One approach under consideration would replace the notional account system with a new system that apportions accounts to a departing member based on the member's share of group assets that would produce income subject to recapture.

Effective Date

The temporary amendments are applicable to consolidated return years beginning on or after January 1, 1997.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is

based on the fact that these regulations principally affect persons filing consolidated federal income tax returns that have carryover or carryback of credits from separate return limitation years. Available data indicates that many consolidated return filers are large companies (not small businesses). In addition, the data indicates that an insubstantial number of consolidated return filers that are smaller companies have credit carryovers or carrybacks, and thus even fewer of these filers have credit carryovers or carrybacks that are subject to the separate return limitation year rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking accompanying these regulations is being sent to the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of these regulations is Roy A. Hirschhorn of the Office of Assistant Chief Counsel (Corporate). Other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of 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 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.1502-3T also issued under 26 U.S.C. 1502.

Section 1.1502-9T also issued under 26 U.S.C. 1502. * * *

Section 1.1502-55T also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502-3 is amended by adding paragraphs (c)(3) and (e)(3) and by designating the text following the heading of paragraph (d) as paragraph (d)(1) and adding paragraph (d)(2) to read as follows:

§1.1502-3 Consolidated investment credit.

* * * * *

(c) * * *

(3) Special effective date. This paragraph (c) applies to consolidated return years beginning before January 1, 1997. See §1.1502-3T(c) for the rule that limits the group's use of a section 38 credit carryover or carryback from a SRLY for a consolidated return year beginning on or after January 1, 1997. For taxable years not subject to §1.1502-3T(c), prior law applies. See §1.1502-3(c) in effect prior to January 12, 1998, (§1.1502-3(c) as contained in the 26 CFR part 1 edition revised April 1, 1997) for prior law.

(d) Examples. (1) * * *

(2) Examples (2) and (3) of this paragraph (d) do not apply to consolidated return years beginning on or after January 1, 1997. For consolidated return years beginning on or after January 1, 1997, see §1.1502-3T(d).

(e) * * *

(3) Special effective date. This paragraph (e) applies to a consolidated return change of ownership that occurred before January 1, 1997.

* * * * *

Par. 3. Section 1.1502-3T is added to read as follows:

§1.1502-3T Consolidated investment credit (temporary).

(a) and (b) [Reserved]. For further guidance, see §1.1502-3(a) and (b).

(c) Limitation on tax credit carryovers and carrybacks from separate return limitation years--(1) General rule. The aggregate of a member's unused section 38 credits arising in SRLYs that are included in the consolidated section 38 credits for all consolidated return years of the group may not exceed--

(i) The aggregate for all consolidated return years of the member's contributions to the consolidated section 38(c) limitation for each consolidated return year; reduced by

(ii) The aggregate of the member's section 38 credits arising and absorbed in all consolidated return years (whether or not absorbed by the member).

(2) Computational rules--(i) Member's contribution to the consolidated section 38(c) limitation. If the consolidated section 38(c) limitation for a consolidated return year is determined by reference to the consolidated tentative minimum tax (see section 38(c)(1)(A)), then a member's contribution to the consolidated section 38(c) limitation for such year equals the member's share of the consolidated net income tax minus the member's share of the consolidated tentative minimum tax. If the consolidated section 38(c) limitation for a consolidated return year is determined by reference to the consolidated net regular tax liability (see section 38(c)(1)(B)), then a member's contribution to the consolidated section 38(c) limitation for such year equals the member's share of the consolidated net income tax minus 25 percent of the quantity which is equal to so much of the member's share of the consolidated net regular tax liability less its portion of the \$25,000 amount specified in section 38(c)(1)(B). The group computes the member's shares by applying to the respective consolidated amounts the principles of section 1552 and the percentage method under §1.1502-33(d)(3), assuming a 100% allocation of any decreased tax liability. The group must make proper adjustments so that taxes and credits not taken into account in computing the limitation under section 38(c) are not taken into account in computing the member's share of the consolidated net income tax, etc. (See, for example, the taxes described in section 26(b) that are disregarded in

computing regular tax liability.) Also, the group may apportion all or a part of the \$25,000 amount (or lesser amount if reduced by section 38(c)(3)) for any year to one or more members.

(ii) Years included in computation. For purposes of computing the limitation under this paragraph (c), the consolidated return years of the group include only those years, including the year to which a credit is carried, that the member has been continuously included in the group's consolidated return, but exclude--

(A) For carryovers, any years ending after the year to which the credit is carried; and

(B) For carrybacks, any years ending after the year in which the credit arose.

(iii) Subgroups and successors. The SRLY subgroup principles under §1.1502-21T(c)(2) apply for purposes of this paragraph (c). The predecessor and successor principles under §1.1502-21T(f) also apply for purposes of this paragraph (c).

(3) Effective date. This paragraph (c) applies to consolidated return years beginning on or after January 1, 1997. However, a group does not take into account a consolidated taxable year beginning before January 1, 1997, in determining a member's (or subgroup's) contributions to the consolidated section 38(c) limitation under this paragraph (c). See also §1.1502-3(c).

(d) Example. (1) The following example illustrates the

provisions of paragraph (c) of this section:

Example. (i) P, the common parent of the P group, acquires all the stock of T at the beginning of Year 2. T carries over an unused section 38 general business credit from Year 1 of \$100,000. The table below shows the group's net consolidated income tax, consolidated tentative minimum tax, and consolidated net regular tax liabilities, and T's share of such taxes computed under the principles of section 1552 and the percentage method under §1.1502-33(d)(3), assuming a 100% allocation of any decreased tax liability, for Year 2. (The effects of the lower section 11 brackets are ignored, there are no other tax credits affecting a group amount or member's share, and \$1,000s are omitted.)

| Year 2 | Group | P's share of col. 1 | T's share of col. 1 |
|---|---------|------------------------------|------------------------------|
| 1. consolidated taxable income | \$2,000 | \$1,200 | \$800 |
| 2. consolidated net regular tax | \$700 | \$420 | \$280 |
| 3. consolidated alternative minimum taxable income | \$4,000 | \$3,200 | \$800 |
| 4. consolidated tentative minimum tax | \$800 | \$640 | \$160 |
| 5. consolidated net income tax | \$800 | \$520 | \$280 |
| 6. greater of line 4 or 25% of (line 2 minus \$25,000) <u>for the group</u> | \$800 | | |
| 7. consolidated §38(c) limitation (line 5 minus line 6) | \$0 | | |

(ii) The amount of T's unused section 38 credits from Year 1 that are included in the consolidated section 38 credits for Year 2 may not exceed T's contribution to the consolidated section 38(c) limitation. For Year 2, the group determines the consolidated section 38(c) limitation by reference to consolidated tentative minimum tax for Year 2. Therefore, T's contribution to the consolidated section 38(c) limitation for Year 2 equals its share of consolidated net income tax minus its share of consolidated tentative minimum tax. T's contribution is \$280,000 minus \$160,000, or \$120,000. However, because the group has a consolidated section 38 limitation of zero, it may not include any of T's unused section 38 credits in the consolidated section 38 credits for Year 2.

(iii) The following table shows similar information for the group for Year 3:

| Year 3 | Group | P's share of col. 1 | T's share of col. 1 |
|---|---------|---------------------|---------------------|
| 1. consolidated taxable income | \$1,200 | \$1,500 | \$(300) |
| 2. consolidated net regular tax | \$420 | \$525 | \$(105) |
| 3. consolidated alternative minimum taxable income | \$1,500 | \$1,700 | \$(200) |
| 4. consolidated tentative minimum tax | \$300 | \$340 | \$(40) |
| 5. consolidated net income tax | \$420 | \$525 | \$(105) |
| 6. greater of line 4 or 25% of (line 2 minus \$25,000) <u>for the group</u> | \$300 | | |
| 7. consolidated §38(c) limitation (line 5 minus line 6) | \$120 | | |

(iv) The amount of T's unused section 38 credits from Year 1 that are included in the consolidated section 38 credits for Year 3 may not exceed T's aggregate contribution to the consolidated section 38(c) limitation for Years 2 and 3. For Year 3, the group determines the consolidated section 38(c) limitation by reference to the consolidated tentative minimum tax for Year 3. Therefore, T's contribution to the consolidated section 38(c) limitation for Year 3 equals its share of consolidated net income tax minus its share of consolidated tentative minimum tax. Applying the principles of section 1552 and §1.1502-33(d) (taking into account, for example, that T's positive earnings and profits adjustment under §1.1502-33(d) reflects its losses actually absorbed by the group), T's contribution is \$(105,000) minus \$(40,000), or \$(65,000). T's aggregate contributions to the consolidated section 38(c) limitation for Years 2 and 3 is \$120,000 + \$(65,000), or \$55,000. The group may include \$55,000 of T's Year 1 unused section 38 credits in its consolidated section 38 tax credit in Year 3.

(2) This paragraph (d) applies to consolidated return years beginning on or after January 1, 1997. See also §1.1502-3(d) for years prior to January 1, 1997.

(e) and (f) [Reserved]. For further guidance, see §1.1502-3(e) and (f).

Par. 4. Section 1.1502-4 is amended by adding new paragraphs (f)(3) and (g)(3) to read as follows:

§1.1502-4 Consolidated foreign tax credit.

* * * * *

(f) * * *

(3) Special effective date ending SRLY limitation. See §1.1502-4T(f) for the rule that ends the SRLY limitation with respect to foreign tax credits for consolidated return years beginning on or after January 1, 1997.

(g) * * *

(3) Special effective date for CRCO limitation. See §1.1502-4T(g)(3) for the rule that ends the CRCO limitation with respect to a consolidated return change of ownership that occurred on or after January 1, 1997.

* * * * *

Par. 5. Section 1.1502-4T is added to read as follows:

§1.1502-4T Consolidated foreign tax credit (temporary).

(a) through (e) [Reserved]. For further guidance, see §1.1502-4(a) through (e).

(f) Limitation on unused foreign tax carryover or carryback from separate return limitation years. Section 1.1502-4(f) does not apply to consolidated return years beginning on or after January 1, 1997. For consolidated return years beginning on or after January 1, 1997, a group shall include an unused foreign tax of a member arising in a SRLY without regard to the contribution of the member to consolidated tax liability for the consolidated return year.

(g)(1) and (2) [Reserved]. For further guidance, see §1.1502-4(g)(1) and (2).

(g)(3) Special effective date for CRCO limitation. Section 1.1502-4(g) applies to a consolidated return change of ownership that occurred before January 1, 1997.

Par. 6. In §1.1502-9, paragraph (a) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.1502-9 Application of overall foreign loss recapture rules to

corporations filing consolidated returns.

(a) In general. * * * See §1.1502-9T(b)(1)(v) for the rule that ends the separate return limitation year limitation for consolidated return years beginning on or after January 1, 1997.

* * * * *

Par. 7. Section 1.1502-9T is added to read as follows:

§1.1502-9T Application of overall foreign loss recapture rules to corporations filing consolidated returns (temporary).

(a) and (b) introductory text through (b)(1)(iv) [Reserved]. For further guidance, see §1.1502-9(a) and (b) introductory text through (b)(1)(iv).

(b)(1)(v) Special effective date for SRLY limitation.

Sections 1.1502-9(b)(1)(iii) and (iv) apply only to consolidated return years beginning before January 1, 1997. For consolidated return years beginning on or after January 1, 1997, the rules of §1.1502-9(b)(1)(ii) shall apply to overall foreign losses from separate return years that are separate return limitation years. For purposes of applying §1.1502-9(b)(1)(ii) in such years, the group treats a member with a balance in an overall foreign loss account from a separate return limitation year on the first day of the first consolidated return year beginning on or after January 1, 1997, as a corporation joining the group on such first day. An overall foreign loss that is part of a net operating loss or net capital loss carryover from a separate return limitation year of a member that is absorbed in a consolidated

return year beginning on or after January 1, 1997, shall be added to the appropriate consolidated overall foreign loss account in the year that it is absorbed. For consolidated return years beginning on or after January 1, 1997, similar principles apply to overall foreign losses when there has been a consolidated return change of ownership (regardless of when the change of ownership occurred).

(b)(2) through (f) [Reserved]. For further guidance, see §1.1502-9(b)(2) through (f).

Par. 8. In §1.1502-21T, paragraph (c)(1)(iii) is amended by adding Example 5 to read as follows:

§1.1502-21T Net operating losses (temporary).

* * * * *

(c) * * *

(1) * * *

(iii) * * *

Example 5. Dual SRLY registers and accounting for SRLY losses actually absorbed. (i) In Year 1, T sustains a \$100 net operating loss and a \$50 net capital loss. At the beginning of Year 2, T becomes a member of the P group. Both of T's carryovers from Year 1 are subject to SRLY limits under this paragraph (c) and §1.1502-22T(c). The members of the P group contribute the following to the consolidated taxable income for Years 2 and 3 (computed without regard to T's CNOL deduction under §1.1502-21T or net capital loss carryover under §1.1502-22T):

| | | P | T |
|------------------|----------|----|-------|
| Year 1 (SRLY) | ordinary | | (100) |
| | capital | | (50) |
| Year 2 | ordinary | 30 | 60 |
| | capital | 0 | (20) |
| Year 3 | ordinary | 10 | 40 |
| | capital | 0 | 30 |

(ii) For Year 2, the group computes separate SRLY limits for each of T's SRLY carryovers from Year 1. Under normal Internal Revenue Code rules, it determines its ability to use its capital loss carryover before it determines its ability to use its ordinary loss carryover. Under section 1211, because the group has no Year 2 capital gain, it cannot absorb any capital losses in Year 2. T's Year 1 net capital loss and the group's Year 2 consolidated net capital loss (all of which is attributable to T) are carried over to Year 3.

(iii) Under this section, the aggregate amount of T's \$100 NOL carryover from Year 1 that may be included in the CNOL deduction of the group for Year 2 may not exceed \$60 -- the amount of the consolidated taxable income computed by reference only to T's items, including losses and deductions to the extent actually absorbed (i.e., \$60 of ordinary income for Year 2). Thus, the group may include \$60 of T's ordinary loss carryover from Year 1 in its Year 2 CNOL deduction. T carries over its remaining \$40 of its Year 1 loss to Year 3.

(iv) For Year 3, the group again computes separate SRLY limits for each of T's SRLY carryovers from Year 1. The group has consolidated net capital gain (without taking into account a net capital loss carryover deduction) of \$30. Under §1.1502-22T(c), the aggregate amount of T's \$50 capital loss carryover from Year 1 that may be included in computing the group's consolidated net capital gain for all years of the group (here Years 2 and 3) may not exceed \$30 (the aggregate consolidated net capital gain computed by reference only to T's items, including losses and deductions actually absorbed (i.e., \$30 of capital gain in Year 3)). Thus, the group may include \$30 of T's Year 1 capital loss carryover in its computation of consolidated net capital gain for Year 3, which offsets the group's capital gains for Year 3. T carries over its remaining \$20 of its Year 1 loss to Year 4. The group carries over the Year 2 consolidated net capital loss to Year 4.

(v) Under this section, the aggregate amount of T's NOL carryover from Year 1 that may be included in the CNOL deduction of the group for Years 2 and 3 may not exceed \$100, which is the amount of the aggregate consolidated taxable income for Years 2 and 3 determined by reference only to T's items, including losses and deductions actually absorbed (i.e., \$60 of ordinary income in Year 2 plus \$40 of ordinary income, \$30 of capital gain, and \$30 of SRLY capital losses actually absorbed in Year 3). The group included \$60 of T's ordinary loss carryover in its Year 2 CNOL deduction. It may include the remaining \$40 of the carryover in its Year 3 CNOL deduction.

* * * * *

Par. 9. In §1.1502-23T, paragraphs (b) and (c) are redesignated as paragraphs (c) and (d), and a new paragraph (b) is added to read as follows:

§1.1502-23T Consolidated net section 1231 gain or loss (temporary).

* * * * *

(b) Example. The following example illustrates the provisions of this section:

Example. Use of SRLY registers with net gains and net losses under section 1231. (i) In Year 1, T sustains a \$20 net capital loss. At the beginning of Year 2, T becomes a member of the P group. T's capital loss carryover from Year 1 is subject to SRLY limits under §1.1502-22T(c). The members of the P group contribute the following to the consolidated taxable income for Year 2 (computed without regard to T's net capital loss carryover under §1.1502-22T):

| | | P | T |
|------------------|----------|------|------|
| Year 1 (SRLY) | ordinary | | |
| | capital | | (20) |
| Year 2 | ordinary | 10 | 20 |
| | capital | 70 | 0 |
| | §1231 | (60) | 30 |

(ii) Under section 1231, if the section 1231 losses for any taxable year exceed the section 1231 gains for such taxable year, such gains and losses are treated as ordinary gains or losses. Because the P group's section 1231 losses, \$(60), exceed the section 1231 gains, \$30, the P group's net loss is treated as an ordinary loss. T's net section 1231 gain has the same character as the P group's consolidated net section 1231 loss, so T's \$30 of section 1231 income is treated as ordinary income for purposes of applying §1.1502-22T(c). Under §1.1502-22T(c), the group's consolidated net capital gain determined by reference only to T's items is \$0. None of T's capital loss carryover from Year 1 may be taken into account in Year 2.

Par. 10. Section 1.1502-55T is added under the undesignated center heading "Special Taxes and Taxpayers" to read as follows:

§1.1502-55T Computation of alternative minimum tax of consolidated groups (temporary).

(a) through (h)(3) [Reserved].

(h)(4) Separate return year minimum tax credit.

(i) and (ii) [Reserved].

(iii)(A) Limitation on portion of separate return year minimum tax credit arising in separate return limitation years.

The aggregate of a member's minimum tax credits arising in SRLYs that are included in the consolidated minimum tax credits for all consolidated return years of the group may not exceed--

(1) The aggregate for all consolidated return years of the member's contributions to the consolidated section 53(c) limitation for each consolidated return year; reduced by

(2) The aggregate of the member's minimum tax credits arising and absorbed in all consolidated return years (whether or not absorbed by the member).

(B) Computational rules--(1) Member's contribution to the consolidated section 53(c) limitation. Except as provided in the special rule of paragraph (h)(4)(iii)(B)(2) of this section, a member's contribution to the consolidated section 53(c) limitation for a consolidated return year equals the member's share of the consolidated net regular tax liability minus its share of consolidated tentative minimum tax. The group computes the member's shares by applying to the respective consolidated amounts the principles of section 1552 and the percentage method under §1.1502-33(d)(3), assuming a 100% allocation of any decreased tax liability. The group makes proper adjustments so that taxes and credits not taken into account in computing the limitation under section 53(c) are not taken into account in computing the member's share of the consolidated net regular tax, etc. (See, for example, the taxes described in section 26(b) that are disregarded in computing regular tax liability.)

(2) Adjustment for year in which alternative minimum tax is paid. For a consolidated return year for which consolidated tentative minimum tax is greater than consolidated regular tax liability, the group reduces the member's share of the consolidated tentative minimum tax by the member's share of the consolidated alternative minimum tax for the year. The group determines the member's share of consolidated alternative minimum tax for a year using the same method it uses to determine the member's share of the consolidated minimum tax credits for the

year.

(3) Years included in computation. For purposes of computing the limitation under this paragraph (h)(4)(iii), the consolidated return years of the group include only those years, including the year to which a credit is carried, that the member has been continuously included in the group's consolidated return, but exclude any years after the year to which the credit is carried.

(4) Subgroup principles. The SRLY subgroup principles under §1.1502-21T(c)(2) apply for purposes of this paragraph (h)(4)(iii). The predecessor and successor principles under §1.1502-21T(f) also apply for purposes of this paragraph (h)(4)(iii).

(C) Effective date. This paragraph (h)(4)(iii) applies to consolidated return years beginning on or after January 1, 1997. However, a group does not take into account a consolidated taxable year beginning before January 1, 1997, in determining a

member's (or subgroup's) contributions to the consolidated section 53(c) limitation under paragraph (h)(4)(iii) of this section.

/s/ Michael P. Dolan

Deputy Commissioner of Internal Revenue

Approved:

/s/ Donald C. Lubick

Acting Assistant Secretary of the Treasury