

# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 1502.—Regulations

26 CFR 1.1502–21: Net operating losses.

T.D. 8823

### DEPARTMENT OF THE TREASURY

#### Internal Revenue Service

#### 26 CFR Parts 1, 301, and 602

### Consolidated Returns— Limitations on the Use of Certain Losses and Deductions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

**SUMMARY:** This document contains final regulations regarding certain deductions and losses, including built-in deductions and losses, of members who join a consolidated group. The regulations provide rules for computing the limitation with respect to separate return limitation year (SRLY) losses, and the carryover or carryback of losses to consolidated and separate return years. The regulations also eliminate the application of the SRLY rules in certain circumstances in which the rules of section 382 of the Internal Revenue Code also apply.

**DATES:** *Effective Dates:* These regulations are effective June 25, 1999.

*Applicability Dates:* For dates of applicability, see the “Dates of Applicability” portion of this preamble.

**FOR FURTHER INFORMATION CONTACT:** Jeffrey L. Vogel, or Marie Milnes-Vasquez at (202) 622-7770 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### *Paperwork Reduction Act*

The collection of information in this final rule has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1237.

The collection of information in this regulation is in §1.1502–21(b)(3). This information is required to ensure that an election to relinquish a carryback period is properly documented, and will be used for that purpose. The collection of information is required to obtain a benefit (relating to the carryover of losses which would otherwise be carried back). The likely respondents are consolidated groups.

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by August 31, 1999.

Comments are specifically requested concerning: Whether the collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Estimated total annual reporting burden: 2,000 hours.

Estimated average annual burden hours per respondent: 15 minutes. Estimated number of respondents: 8,000.

Estimated annual frequency of responses: On occasion.

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 a 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 and Explanation of Provisions*

On February 4, 1991, the Treasury and the IRS issued three notices of proposed rulemaking, CO–132–87 (56 F.R. 4194 [1991–1 C.B. 728]), CO–077–90 (56 F.R. 4183 [1991–1 C.B. 749]), and CO–078–90 (56 F.R. 4228 [1991–1 C.B. 757]), setting forth amendments to the rules regarding net operating losses, built-in deductions, and capital losses of consolidated groups. Those proposed regulations also included rules regarding the carryover and carryback of losses to consolidated return years and separate return years, and rules regarding the application of section 382 and 383 by consolidated groups and by controlled groups. A public hearing regarding the three sets of proposed regulations was held on April 8, 1991.

On June 27, 1996, the Treasury and the IRS published temporary regulations regarding the separate return limitation year (SRLY) limitation (T.D. 8677, 61 F.R. 33321 [1996–2 C.B. 119]). These regulations were substantially identical to the proposed regulations. A notice of proposed rulemaking cross-referencing the temporary regulations, the 1996 proposed SRLY regulations, was published in the **Federal Register** on the same day (CO–024–96, 61 F.R. 33393 [1996–2 C.B. 437]), and the proposed regulations published in 1991 were withdrawn. The Treasury and the IRS also published temporary regulations (T.D. 8678, 61 F.R. 33335 [1996–2 C.B. 134]) setting forth rules regarding the application of section 382 to affiliated groups of corporations filing consolidated returns, and controlled group losses (T.D. 8679, 61 F.R. 33313 [1996–2 C.B. 25]). Notices of proposed rulemaking cross-referencing these temporary regulations were published on the same day (CO–026–96, 61 F.R. 33391 [1996–2 C.B. 440] and CO–025–96, 61 F.R. 33395 [1996–2 C.B. 439]), and the

earlier proposed regulations published in 1991 were withdrawn.

On August 10, 1998, the Treasury and the IRS issued Notice 98-38 (1998-32 I.R.B. 4). The Notice requested comments about the advisability of adopting rules that would replace the existing SRLY rules with an approach modeled on section 382.

As companions to this Treasury decision, which adopts the 1996 proposed SRLY regulations with certain revisions and modifications, the Treasury and the IRS are also issuing final regulations relating to the application of sections 382 and 383 by members of consolidated and controlled groups. See T.D. 8824 on page 62, and T.D. 8825, 1999-28 I.R.B. 3.

On January 12, 1998, the Treasury and IRS issued temporary and proposed regulations governing the use of tax credits of a consolidated group and its members (T.D. 8751, 63 F.R. 1740 [1998-10 I.R.B. 23]). The Treasury and IRS intend to finalize those regulations at a later date.

#### *Operation of the Proposed and Temporary Regulations*

The 1991 proposed regulations generally retained the approach of the prior SRLY regulations in limiting a consolidated group's use of attributes arising in or attributable to a SRLY, but altered the manner in which the limitation is computed. While the pre-1991 regulations determined the limitation separately for each member (fragmentation), and under a year-by-year approach, the proposed regulations introduced two new concepts: subgrouping and the cumulative register.

Subgrouping was added because fragmentation is in many ways inconsistent with the single entity approach to the use of losses under the consolidated return regulations. For example, if an entire consolidated group were acquired by another group, under the fragmentation approach, none of the losses of a former member of the target group could be used to offset income of another former member of the target group. However, had no acquisition occurred, those losses could have been used to offset income within the target group.

The 1991 proposed regulations also introduced the concept of a cumulative register to address certain issues resulting

from the year-by-year approach. The prior SRLY regulations based the limitation on the SRLY member's annual contribution to the group's consolidated taxable income. The SRLY limitation was computed by taking the difference between the group's consolidated taxable income "with" the SRLY member and "without" the SRLY member. This resulted in certain anomalies. For example, if a SRLY member produced income in a tax year but the group as a whole did not have income, the SRLY loss could not be absorbed in that year. Because the member's contribution to income was not carried over to later years, the SRLY losses also could not be absorbed in a later year unless the member also contributed to the group's taxable income in that year.

The cumulative register, rather than looking to a member's contribution for the year, includes in the limitation computation a member's complete income history while it is a member of a consolidated group. The cumulative register is determined by aggregating a member's net contribution of income in excess of losses absorbed during the entire period the member was in the consolidated group. To the extent that the cumulative register for a member is positive, that member's SRLY net operating losses can be absorbed in a consolidated return year (provided the group otherwise has taxable income) even though the member might not have contributed to taxable income in that year. On the other hand, if the cumulative register is negative, the absorption of losses is precluded even though the member might have contributed to taxable income in that consolidated return year.

Much of the complexity of the SRLY rules results from the subgroup and cumulative register concepts. In fact, the preamble to the proposed SRLY regulations acknowledged that the subgrouping approach was more complex than the fragmentation approach and solicited comments about whether the benefits provided by subgrouping outweigh and justify the additional burdens required, and whether the fragmentation approach should be retained. 1991-1 C.B. 759. No comments received in response to this request advocated the elimination of subgrouping or the cumulative register, and it was ultimately decided that these principles would be retained.

#### *Comments*

Comments were received in response to the 1991 proposed regulations, the 1996 temporary regulations and Notice 98-38. Some comments addressed whether the SRLY rules should be retained. Other comments addressed issues about the technical operation of the proposed rules.

All of the comments were evaluated in finalizing these regulations. Several suggestions were adopted while others were not. This preamble describes some of the decisions that were made in finalizing the regulations.

#### *Elimination or Retention of SRLY*

The preliminary issue considered in finalizing these regulations was the extent, if any, to which the SRLY rules should be retained. The comments were divided about whether to retain or eliminate SRLY. Some commentators asserted that the amendment to section 382 in 1986 adequately addressed Congressional concerns regarding loss trafficking. Therefore, it was argued, the SRLY rules should be eliminated because they have become superfluous, add unwarranted complexity to the consolidated return system, and are easily avoided. Other commentators asserted that the SRLY rules should be retained because in their view, policing loss trafficking is incidental to SRLY's function of resolving a single entity/separate entity conflict in applying the consolidated return regulations. A third group suggested a middle position by urging the elimination of SRLY only in those circumstances in which the rules of section 382 also apply.

#### *Arguments for Elimination of SRLY*

Some commentators urged elimination of the SRLY rules (either in whole or in part) because, in their view, section 382 provides sufficient protection against loss trafficking transactions. They asserted that the rules of section 382 provide greater precision and predictability about the consequences of a transfer of tax losses, and that section 382 promotes neutrality between a buyer and seller of tax benefits in a more efficient and more equitable way than do the SRLY rules.

Section 382 and SRLY overlap to a large extent, and the rules applying sec-

tion 382 to consolidated groups are even more complex than the SRLY rules. Thus, these commentators asserted that requiring a taxpayer to run the SRLY gauntlet in addition to the section 382 gauntlet is unwarranted because any additional revenue that might be gained from retaining a dual limitation is outweighed by the added complexity of the SRLY rules.

These commentators argued that the complexity of the SRLY rules is unwarranted because the impact of the SRLY rules is easily avoided by various “self-help” techniques. For example, taxpayers can contribute income-producing assets or built-in gain assets to the SRLY member to minimize the effect of a SRLY limitation. They also argued that the SRLY rules impose a meaningful limitation only in those cases in which, for regulatory or other reasons, loss corporations cannot be combined with other profitable businesses. Some commentators also argued that the SRLY rules improperly discriminate between stock and asset acquisitions. Other arguments urging the elimination of SRLY asserted that section 382 supercedes the SRLY rules as a Congressionally mandated rule for policing loss trafficking and that the SRLY rules are inconsistent with treating the consolidated group as a single entity.

#### *Arguments for Retention of SRLY*

Notwithstanding the substantial area of overlap between section 382 and SRLY, section 382 does not always apply when SRLY does. In fact, most commentators expressed concern about loss trafficking through carryback transactions (to which section 382 does not apply) and acknowledged the need for a rule to police those transactions. Many urged retention of the existing SRLY rules at least for that purpose. Moreover, some commentators speculated that elimination of the SRLY rules would likely present new unforeseen opportunities for trafficking in tax benefits.

Those commentators supporting retention of SRLY argued that the objectives of section 382 and SRLY differ. Section 382, which seeks to prevent loss trafficking, is based on the notion that the rate of loss utilization following a change in ownership should be based on the ex-

pected income generated if all of the assets were converted to tax-exempt debt instruments. Accordingly, section 382 permits a fixed amount of income to be used each year to absorb a loss, regardless of the actual income contribution of the loss corporation. Moreover, under section 382 and in the absence of SRLY, the available loss can be used against any member’s income. SRLY, on the other hand, makes actual income generation by the SRLY member the determinant of loss usage. Thus, SRLY assures that the loss attributes that arose outside of the consolidated group are not generally available to the other group members.

These commentators noted that the consolidated return system combines single and separate entity treatment. The ability to offset the income of one member with the losses of another member reflects single entity treatment of the consolidated group. But, when a corporation becomes a member of a consolidated group, it retains its separate existence and individual status, its own accounting methods, and its own separate attributes, including its losses that are carried from a separate return year to a consolidated return year. These aspects reflect treatment of each member of a consolidated group as a separate entity. The carryover of losses from separate return years reflects separate entity treatment, while the sharing of losses among the members of a consolidated group reflects single entity treatment. Thus, there is a conflict between single entity and separate entity treatment. Single entity treatment in computing consolidated taxable income is inconsistent with permitting a corporation’s losses to straddle consolidated and separate return years when it enters or leaves a consolidated group. These commentators argued that the SRLY rules present a resolution of this conflict and protect the integrity of the consolidated return system by ensuring that attributes arising in a separate return year belong to, and remain with, the SRLY member, and attributes arising in a consolidated return year belong to the group.

Through these rules, according to these commentators, SRLY seeks to provide that the manner and extent to which a corporation’s separate tax attributes are absorbed or utilized should not vary based on whether the corporation is inside or

outside a consolidated group. Unlike in the case of section 382, the policy objectives underlying these rules do not hinge on whether the ownership of the corporation changes upon its entrance into or departure from the group.

Moreover, commentators urging the retention of SRLY pointed out that the rules of section 381 dictate the circumstances under which one corporation can use the tax attributes of another corporation. In certain reorganizations, section 381 allows the tax attributes of one corporation to be used by another corporation after an acquisition, but in those transactions generally stock basis is also lost. By contrast, in a taxable stock purchase where the stock takes a cost basis and the corporation retains its existence, including its underlying attributes, there is no policy reason for those attributes to be freely available to the purchaser. In essence, these commentators argued, the SRLY limitation prevents the benefits provided by section 381 in certain reorganization transactions from being extended to acquisitions and restructurings that do not involve the commingling of assets in one entity that section 381 transactions generally require. A consolidated group’s acquisition of the stock of a corporation should not be treated the same way as an asset acquisition.

#### *Notice 98–38*

Notice 98–38 announced that the Treasury and the IRS were considering an approach that would model the SRLY limitation on the mechanism of section 382. One intended advantage of this approach was to reduce complexity in cases of overlap of the SRLY rules with section 382. In those cases, the SRLY limitation would be the same as the section 382 limitation, and consolidated groups would not need to make two computations to determine how much income could be used to absorb a loss. A second intended advantage was to address concerns that the impact of a SRLY limitation can be minimized by stuffing transactions (e.g., transferring income-producing assets to the loss corporation) which could not be used to affect the section 382 limitation.

Although many commentators favor the elimination of a separate SRLY limita-

tion in the case where section 382 also applies, commentators did not favor adoption of the section 382 mechanism in cases where section 382 does not otherwise apply. Commentators argued that imposing a limitation based on section 382 in a case where section 382 would not otherwise apply would be inordinately burdensome. Because (absent an ownership change) the owners of a loss corporation held outside a consolidated group could engage in a stuffing transaction in order to increase that corporation's loss absorption, commentators argued that a SRLY limitation that could not be increased through stuffing transactions would violate the objective of providing that the extent of a corporation's loss absorption should not vary based on whether it is inside or outside a consolidated group.

In light of these concerns, the Treasury and the IRS decided not to impose a SRLY limitation based on the mechanism of section 382.

#### *The Overlap Rule*

The Treasury and the IRS believe that limitations on the extent to which a consolidated group can use attributes arising in a separate return limitation year remain necessary. However, the Treasury and the IRS remain concerned about complexity in applying the current SRLY rules, particularly with respect to situations where both the SRLY rules and section 382 apply. As described above, the SRLY limitation is based on the member's (or subgroup's) actual contribution to consolidated taxable income. The section 382 limitation is based on the expected income generation of the member (or subgroup) determined with reference to its value on the change date. On balance, the Treasury and the IRS believe that the simultaneous or proximate imposition of a section 382 limitation reasonably approximates a corresponding SRLY limitation. Accordingly, these regulations generally eliminate the SRLY limitation in circumstances in which its application overlaps with that of section 382.

In the majority of cases, the date on which a corporation becomes a member of a consolidated group (and thus subject to the SRLY rules) is also a "change date" as defined in section 382(j), determined

as a result of an ownership change as defined in section 382(g). In this situation, under the temporary regulations, taxpayers must calculate two separate limitations for loss carryovers — the SRLY limitation and the section 382 limitation. The final regulations provide an overlap rule which eliminates the application of the SRLY rules in this situation. As a result, the final regulations remove the burden of determining two limitations, and simplify the loss limitation rules applicable to consolidated groups in most instances in which both the SRLY and the section 382 limitations would otherwise arise.

To address situations in which not all of an acquisition occurs simultaneously, the overlap rule also applies if the acquisition results in a corporation joining the consolidated group on a date other than the "change date", provided the transactions are separated by no more than six months. Additional rules have been included to prevent the inappropriate operation of the overlap rule in certain cases involving the acquisition of multiple corporations.

#### *Net Operating Losses*

Generally, to qualify for the net operating loss overlap rule, a corporation must become a member of a consolidated group (a SRLY event) within six months of the change date of an ownership change that gives rise to a section 382(a) limitation with respect to that carryover (a section 382 event). For net operating losses, an overlap also will generally include situations in which a net operating loss arises in the maximum six month period after the section 382 event but before the SRLY event.

For example, if a section 382 event occurs on April 1 and a SRLY event occurs on September 1, any losses that arise between April 1 and September 1 would not be subject to a section 382 limitation because they would be allocable to the post-change period. However, in the absence of the overlap rule, those losses would be subject to a SRLY limitation. The overlap rule of the final regulations eliminates the application of SRLY to those post-change losses. In cases of an acquisition of a single corporation, the elimination of SRLY has been determined to be an appropriate result and is a trade-off to pro-

mote simplicity in the consolidated return regulations.

The final regulations provide special overlap rules for subgroups. In general, the overlap rule applies to the subgroup and not separately to the members of the subgroup. However, the overlap rule does not apply unless the SRLY subgroup is coextensive with the section 382 loss subgroup. This rule is necessary because a section 382 subgroup limitation that is computed with respect to the expected income generation of a group of corporations does not reasonably approximate a limitation that would be based on the actual contribution to consolidated taxable income by a smaller number of corporations. In the reverse case, where the SRLY subgroup is larger than any corresponding section 382 loss subgroup or single new loss member, and particularly with respect to built-in losses, it is unclear in certain circumstances how the overlap rule could be applied. To address such circumstances in which a SRLY subgroup would otherwise be larger than the corresponding section 382 subgroup or single new loss member, the accompanying final regulations relating to the application of sections 382 and 383 provide for an election effectively to expand a newly-formed section 382 subgroup to conform with a SRLY subgroup.

For example, assume that the S consolidated group (composed entirely of S and T) has a \$200 consolidated net operating loss, of which \$100 is attributable to S and \$100 is attributable to T. If the M group acquires the S group, S and T compose both a SRLY subgroup as well as a section 382 loss subgroup. Because the subgroups are coextensive, the overlap rule applies to eliminate the application of SRLY in the M group for the \$200 consolidated net operating loss.

The overlap rule will not apply, however, if all the corporations included in a section 382 loss subgroup are not also included in a SRLY subgroup. For example, in Year 1, T joins the S group with a net operating loss carryover in a transaction that is not subject to section 382, and T does not subsequently have an ownership change. Under §1.1502-96 (relating to the end of separate tracking), after five years, T's net operating loss becomes an attribute of the S group (also referred to as

a “fold-in”) for section 382 purposes. If the P group later acquires S in a transaction to which section 382 applies, the section 382 loss subgroup with respect to the T loss would include S and T, but for SRLY purposes there would be no subgroup. In this situation, the overlap rule would not apply, and the limitations under both SRLY and section 382 would continue to apply.

To preserve the effect of the elimination of SRLY under the overlap rule as corporations move from group to group, the final regulations also provide a special rule expanding the definition of SRLY subgroups. Under this rule, a SRLY subgroup includes a member carrying over a loss that was subject to the overlap rule in a former group, and all members of that former group who become a member of the current group at the same time as the loss member. The effect of this rule is to increase the number of circumstances in which SRLY subgroups and section 382 subgroups will be coextensive as corporations move from group to group. However, SRLY and section 382 subgroups may not be coextensive with respect to losses that were carried into a former group in a transaction to which the overlap rule does not apply. Subgroups may not be coextensive, as demonstrated above, if for purposes of section 382, such losses “fold-in” to the former group by virtue of an ownership change occurring more than six months after the SRLY event or because the loss member remains a member of the former group for at least five years.

#### *Operating Rules*

If the section 382 event occurs on the same date as the SRLY event or precedes the SRLY event, the overlap rule, and therefore the elimination of SRLY, is applicable to the tax year that includes the SRLY event. If the SRLY event precedes the section 382 event, the elimination of SRLY is delayed until the first tax year that begins after the section 382 event. The delay is necessary to ensure that an adequate limitation is always in effect for a net operating loss carryover.

For example, for a calendar year consolidated group, if the SRLY event occurs December 1, Year 1, but the section 382 event occurs on April 1, Year 2, it is necessary to maintain the application of the

SRLY rules between such dates because otherwise no limitation would be applicable and the separate attributes could be freely absorbed during that period.

#### *Built-in Losses*

The overlap rule for built-in losses is very similar to the overlap rule for net operating losses. Generally, to qualify for the built-in loss overlap rule, a SRLY event must occur within six months of the change date of an ownership change that gives rise to a section 382(a) limitation that would apply to recognized built-in losses (a section 382 event). However, the overlap rule does not apply (even with respect to assets held on the date of the section 382 event) if assets are transferred to a corporation after the section 382 event and before the SRLY event that exceed the de minimis threshold of section 382(h). In that case, both the SRLY rules and the section 382 rules will apply. Even after the application of the overlap rule, the SRLY rules for built-in losses apply to asset acquisitions by an acquired corporation that occur after the latter or the SRLY event or section 382 event.

#### *Special Subgroup Rule for Built-in Losses*

The temporary regulations provide that, for purposes of built-in losses, a SRLY subgroup consists of those members that have been continuously affiliated for the 60-month period ending immediately before they become members of the group in which the loss is recognized. Generally, the final regulations maintain the subgroup rule provided by the temporary regulations. The final regulations, however, modify the subgroup rules to take account of the overlap rule. These modifications, in effect, conform the SRLY subgroup rules to adopt principles contained in §§1.1502–91 through 1.1502–98 (regarding the application of section 382 to consolidated groups) where necessary to preserve the effect of an overlap transaction in a former group and to increase the number of SRLY and section 382 subgroups that are coextensive and eligible for future operation of the overlap rule as corporations move from group to group.

The final regulations provide that after a corporation joins a group in an overlap transaction, it is deemed to have been affiliated with the common parent of the ac-

quiring group for 60 consecutive months. Those corporations that join the group in the same transaction, but that were not part of a subgroup eligible for the overlap rule, begin measuring the period of their affiliation immediately after joining the group, notwithstanding their actual affiliation history. This rule may prevent some corporations from subsequently qualifying as a SRLY subgroup, notwithstanding their actual affiliation history. For example, assume that after four years of affiliation, S and T join the P group without any net operating loss carryovers. S, which has a net unrealized built-in loss, and T, which has a net unrealized built-in gain, would not qualify as a SRLY subgroup with respect to their built-in items because they do not have the requisite affiliation history. Therefore, S and T are tested separately under section 382 and §1.1502–15. The acquisition results in S becoming subject to section 382 (but owing to the overlap rule, not to the limitation contained in §1.1502–15(a)). T is not subject to either. Because S joined the P group in a transaction subject to the overlap rule, it is deemed to have been affiliated with P for 60 consecutive months. T, however, is required to begin measuring its affiliation with P and S from the date it joined the group, notwithstanding its historic affiliation with S.

#### *Other Substantive Changes*

##### Predecessors and Successors Material Difference Requirement

The temporary regulations provide that a reference to a corporation or member also includes, as the context may require, a reference to a successor or predecessor. See, §1.1502–15T(e) and §1.1502–21T(f). The definition of predecessor is provided in §1.1502–1(f)(4). In general, a predecessor is any transferor of assets in a section 381(a) transaction. A predecessor also includes any transferor of assets in a transaction in which the basis of assets to the transferee (successor) is determined by reference to the transferor’s basis, but only if there is a “material difference” between the basis and the value of assets. Thus the application of the predecessor rule to a section 351 transaction is dependent upon the specific assets transferred, and consequently a transferor in a section 351 transaction might not

qualify as a predecessor. Also, in the case of such a section 351 transaction, the temporary regulations provided that there be a maximum of one predecessor to, or successor of, any member.

Commentators objected to the “material difference” requirement and suggested that a section 351 transferee should not be excluded from successor status solely because there was no material difference between the basis and value of the assets transferred. The final regulations eliminate both the material difference and the single predecessor-successor requirements.

#### CNOL Carrybacks

Section 1.1502-21T(b)(2)(B) of the temporary regulations provides an offspring rule which generally permits the common parent of a group to carryback a consolidated net operating loss (CNOL) attributable to a member that did not exist in the year to which the loss is carried, provided that the member has been a member of the group continuously since its organization. In that section, there is also a reference to the application of the predecessor and successor rule of §1.1502-21T(f), which states that a reference to a member also includes references to a predecessor of the member, as the context may require.

Commentators were concerned that the combination of the predecessor and successor rule would deny any carryback in the case of a merger under section 368(a)(1)(A) and (a)(2)(D). For example, assume that P, the common parent of a consolidated group, forms Newco in Year 2 for the sole purpose of acquiring T, in a merger with and into Newco. In Year 3, there is a CNOL all of which is attributable to Newco. Newco appears to be within the scope of the offspring rule, and therefore a carryback to P’s Year 1 consolidated return, a year before Newco’s existence, would be permitted. However, because the merger is a transaction to which section 381(a) applies, Newco is also a successor to T. Under this analysis, Newco would not be considered to have been a member of the P group continuously since its organization, so a carryback to the P group’s consolidated return year would not be permitted. Moreover, Newco would not be permit-

ted to carryback the loss to any year of T. Thus, no carryback of Newco’s loss would be permitted.

The Treasury and the IRS believe that the denial of any carryback in this situation is inappropriate. In general, a newly-formed group member should be permitted to carry back its contribution to the consolidated net operating loss, whether or not it is a successor to a corporation that was acquired by the group. Moreover, the Treasury and the IRS believe that rules providing for a carryback within — rather than outside — the group would be more administrable than rules requiring taxpayers to trace the assets of a newly-formed member to determine whether such corporation’s contribution to the consolidated net operating loss should be carried back to the pre-consolidation years of an acquired corporation or back within the group. The Treasury and the IRS also considered whether to provide that all consolidated net operating losses should be carried back within the group, even if attributable to a corporation that was itself acquired from outside the group. Whether or not such a rule is appropriate, it was determined that such a change should not be adopted in final regulations. Accordingly, the final regulations provide that the offspring rule applies regardless of whether the newly-formed member is a successor to any other corporation.

#### Successor’s Income

Section 1.1502-21T(f)(2) of the temporary regulations provides, “Except as the Commissioner may otherwise determine, any increase in the taxable income of a SRLY subgroup that is attributable to a successor is disregarded unless the successor acquires substantially all of the assets and liabilities of its predecessor and the predecessor ceases to exist.” The rule was intended to prevent the subgroup from inappropriately affecting the determination of its taxable income either by removing assets that would generate losses or by bringing into the subgroup income generated by members outside the subgroup.

Some commentators stated that they did not understand whether the rule was intended to require the subgroup to disregard all income of the successor, or only that income of the successor in excess of

that generated by the transferred assets. In the event that all the successor’s income is disregarded, commentators argued that the rule produced unduly harsh results. A particularly sympathetic case is a divisive section 351 transaction. For example, if T, a member of a SRLY subgroup, formed T1, by contributing to it one of its businesses, and T1 produced net operating losses, those losses would be included in determining the taxable income of the subgroup. On the other hand, if T1 produced taxable income, that income would not be included in the subgroup’s taxable income. If no transfer to T1 had occurred, and the business had remained in T, all of its income or loss, as the case may be, would be included in determining the subgroup’s taxable income.

The Treasury and the IRS have determined that a broad rule disregarding all income contributed by the successor is necessary to avoid an unadministrable requirement that the successor’s income be traced to particular assets, but that the rule should only be applied in more limited circumstances. Thus, the final regulations provide that the net positive income attributable to the successor generally is disregarded, but provide four exceptions to this rule: (A) the successor acquires substantially all of the assets and liabilities of its predecessor, and the predecessor ceases to exist; (B) the successor became a member of the SRLY subgroup at the time the subgroup was formed (e.g., the successor was organized before it and its affiliates joined the current group and thus qualifies in its own right as a subgroup member); (C) 100 percent of the stock of the successor is owned directly by corporations that were members of the SRLY subgroup when the subgroup was formed; or (D) the Commissioner determines otherwise. The IRS might, for example, publish a revenue ruling or other guidance expanding the list of exceptions if it is later determined that other circumstances should be excluded from the general rule. It is also anticipated that through the letter ruling process, the IRS will evaluate individual cases upon request and determine whether income attributable to a successor will be included in determining the subgroup’s taxable income. See also §1.1502-21(c)(2)(iv) of the regulations (an anti-abuse rule deny-

ing SRLY subgroup treatment in certain circumstances.)

#### Built-in Losses Non-Corporate Transferors

Section 1.1502-15T(a) of the temporary regulations provides that solely for the purpose of determining the amount of, and the extent to which, a built-in loss is limited by the SRLY rules for the year in which it is recognized, a built-in loss is treated as a hypothetical net operating loss carryover or net capital loss arising in a SRLY, instead of as a deduction or loss in the year recognized.

Some commentators thought the rule was anomalous as applied to transfers of built-in loss assets by individuals. In their view, because a SRLY is defined only with respect to corporations (see §1.1502-1(f)), it would be inappropriate to view a corporate transferee as a successor to a non-corporate transferor. Other commentators asserted that because the built-in loss concept is a subset of the SRLY limitations, the built-in loss rules should not apply to transfers by an individual or other non-corporate transferor to a member of a consolidated group in a section 351 transaction.

The temporary regulation does not base the determination of whether a corporation has built-in losses on any application of the predecessor and successor rule. If an asset enters the group with a built-in loss, in general, the temporary regulation deems the built-in loss to have arisen in a SRLY without regard to whether the asset was owned by a corporation when the built-in loss arose. Moreover, §1.1502-15T(b)(2)(i) provides that in the case of an asset acquisition by a group, the assets and liabilities acquired directly from the same transferor pursuant to the same plan are treated as the assets and liabilities of a corporation that becomes a member of the group on the date of the acquisition. That corporation would generally be subject to the SRLY built-in loss rules when it becomes a member of the consolidated group. The Treasury and the IRS continue to believe that a separate tax attribute arising outside the consolidated group should not be freely absorbed within the group, regardless of where that separate attribute arose. Accordingly, these final regulations reaffirm that a

built-in loss asset transferred to a group by a non-corporate transferor is subject to the SRLY rules. An example explains that for purposes of applying the SRLY limitation to that built-in loss, all of the items contributed by the acquiring member (and not just items attributable to that asset) to consolidated taxable income are taken into account.

#### Lonely Parent

Under §1.1502-15T of the temporary regulations, the SRLY limitation on recognized built-in losses applies to a loss recognized by the group on an asset the common parent held prior to the formation of a group. In contrast, net operating loss carryovers of a corporation that becomes the common parent of a consolidated group are not subject to a SRLY limitation within the group under the so-called "lonely parent" rule (see §1.1502-1(f)(2)(i)).

The final regulations conform the built-in loss rules to the net operating loss rules as applied in conjunction with the lonely parent rule. Therefore, a loss recognized by any member of the group on an asset that was held by the corporation that becomes the common parent when the group is formed is not subject to the SRLY rules. However, a built-in loss asset acquired by the common parent after the formation of the group remains subject to the SRLY limitation. An anti-abuse rule is also provided to apply the SRLY limitation to built-in loss assets transferred to a corporation prior to and in anticipation of the corporation becoming the common parent of a group.

For example, in Year 1, P, a stand alone corporation holds Asset 1, a built-in loss asset. In Year 3, P forms S but retains Asset 1. In Year 4, P sells Asset 1, recognizing a loss. Section 1.1502-15(f) of the final regulations provides that the loss is not subject to the SRLY limitation. Similarly if P transferred Asset 1 with an unrealized built-in loss to S, the SRLY limitation on built-in losses would not apply if S sold Asset 1 and recognized the loss. However if, after the formation of the P/S group, P acquired an asset with an unrealized built-in loss and sold the asset, recognizing that loss during the recognition period, a SRLY limitation would apply with respect to that loss.

#### Split Election Rule

Section 1.1502-21T(b)(3)(i) of the temporary regulations permits a consolidated group to waive the entire carryback period provided by section 172. This irrevocable election is not available on a member by member basis, but rather requires that the common parent waive the carryback period for all members of the group.

Some commentators suggested that the election be permitted on a member-by-member basis. The commentators expressed concern that requiring the whole group to waive the carryback period makes it difficult for sellers and purchasers to negotiate who gets the benefit of a post-acquisition loss. Because section 172 generally requires a carryback to the earliest year, absent the purchaser's waiver of the carryback, a seller could be required to disclose confidential tax information to the purchaser relating to the ability to use the loss carryback. In situations where such disclosure is a concern, an election to waive the loss carryback, available on a member by member basis, could ensure the separation of a particular purchaser and seller without requiring the group to waive the remaining amount of the consolidated net operating loss carryback.

The final regulations permit taxpayers to waive, with respect to all consolidated net operating losses attributable to a member, the portion of the carryback period for which the corporation was a member of another group. If an election is made for any member, all members acquired from the same group, in the same transaction, are required to make the election. The election must be made on the timely filed original return for the year of the acquisition.

#### Absorption of Losses

Section 1.1502-21T(b)(1) provides general rules concerning the absorption of losses within a consolidated group. Although the rules refer to section 382(1)(2)(B), commentators stated that the absorption rules were ambiguous with respect to establishing the priority of absorption of multiple losses carried from the same taxable year if only a portion of the losses were subject to limitation under

section 382. The final regulations make clear that the rule of section 382(l)(2)(B) applies, and that losses limited by section 382 are absorbed before losses from the same taxable year that are not subject to a section 382 limitation, regardless of whether such losses are attributable to the same member.

A comment was also received requesting guidance on how to determine the amount of a subgroup member's net operating loss carryover that was absorbed so that it can determine how much of the loss it retains when it leaves the group. In response to this comment, the final regulations provide that within a subgroup, losses are absorbed on a pro rata basis. Thus, when a subgroup member leaves the group, its net operating loss carryover is treated as having been absorbed on a pro rata basis, determined by comparing its initial net operating loss carryover and the subgroup's initial net operating loss carryover.

#### *Dates of Applicability*

The final regulations generally are applicable for taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However, there are several special effective dates, including an effective date which addresses transitional issues relating to the adoption of the rule eliminating SRLY in the event of an overlap with section 382. Generally, if a particular attribute would not have been subject to a SRLY limitation as of June 25, 1999 if these final regulations had always been in effect, and the overlap transaction occurred after the effective date of section 382 as amended by the 1986 Tax Reform Act, then the existing SRLY limitation will not apply in taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999 (but will not be eliminated retroactively with respect to earlier taxable years).

If an existing SRLY limitation for which the cumulative register began in a taxable year prior to a taxable year for which the due date (without extensions) of the consolidated return is after June 25, 1999 would not be eliminated by the overlap rule, that SRLY limitation continues to be applied without regard to the changes applicable to the definition of SRLY subgroups (so that a member or

SRLY subgroup is not forced to alter the application of a SRLY limitation in mid-stream). However, when corporations enter a group in a new SRLY event occurring in a taxable year for which the due date (without extensions) of the consolidated return is after June 25, 1999, the regulations apply (with respect to any overlap transactions occurring after the effective date of section 382 as amended by the 1986 Tax Reform Act) as if the final regulations had always been in effect.

Thus, for example, and assuming that all corporations are on a calendar taxable year, if a corporation S joins the P group in an overlap transaction in 1996, and the first year for which this final regulation is effective is 1999, then any losses carried by S into the P group are subject to a SRLY limitation in 1996, 1997 and 1998. However, the losses are no longer subject to a SRLY limitation within the P group starting in 1999.

If, in the above example, the M group had acquired both P and S on January 1, 1998 in a non-overlap transaction, and S carried into the M group its losses arising before it joined the P group, then, in 1998, under the temporary regulations as then in effect, those S losses would have been subject to a SRLY limitation computed with reference only to S's cumulative register. Under the special transition rule, the new regulations would not operate in 1999 or thereafter to cause S and P to constitute a SRLY subgroup in the M group with respect to those S losses, even though P and S would otherwise qualify as a SRLY subgroup with respect to those losses under the new rules. However, if the X group acquires both P and S from M in or after 1999, P and S would constitute a SRLY subgroup with respect to those S loss carryovers.

#### *Need for Immediate Guidance*

Because the temporary regulations are not applicable for taxable years ending after June 26, 1999, it is necessary to implement these final regulations without delay to ensure continuity of treatment of certain attributes and to ensure that there is no period within which the treatment of such attributes is inconsistent with the temporary regulations and these final regulations. See section 7805(e)(2). Accordingly, it is impracticable and contrary to the public interest to issue this Treasury

decision subject to the effective date limitation of section 553(d) of title 5 of the United States Code (if applicable).

#### *Special Analyses*

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. It is hereby certified that these regulations will 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 corporations filing consolidated federal income tax returns that have carryover or carryback of certain losses 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 loss 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 Code, the notice of proposed rulemaking preceding these regulations was sent to the Small Business Administration for comment on its impact on small businesses.

#### *Drafting Information*

The principal author of these regulations is Jeffrey L. Vogel of the Office of Assistant Chief Counsel (Corporate), IRS. Other personnel from the Treasury and the IRS participated in their development.

\* \* \* \* \*

#### *Adoption of Amendments to the Regulations*

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

#### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for sections 1.1502-15T, 1.1502-21T, 1.1502-22T, and 1.1502-23T and adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*  
Section 1.1502-12 also issued under 26 U.S.C. 1502.\* \* \*



Section 1.1502-15 also issued under 26 U.S.C. 1502.\* \* \*

Section 1.1502-22 also issued under 26 U.S.C. 1502.

Section 1.1502-23 also issued under 26 U.S.C. 1502.\* \* \*

Par. 2. In the list below, for each section indicated in the left column, remove

the wording indicated in the middle column, and add the wording indicated in the right column.

<i>Affected Section</i>	<i>Remove</i>	<i>Add</i>
1.469-1(h)(2)	1.1502-21T (net operating losses (temporary)), and 1.1502-22T (consolidated net capital gain and loss (temporary))	1.1502-21 (net operating losses), and 1.1502-22 (consolidated net capital gain and loss)
1.597-2(c)(5), first sentence	1.1502-15T, 1.1502-21T, and 1.1502-22T	1.1502-15, 1.1502-21, and 1.1502-22
1.597-2(c)(5), second sentence	1.1502-15T, 1.1502-21T or 1.1502-22T	1.1502-15, 1.1502-21 or 1.1502-22
1.597-4(g)(3), fifth sentence	1.1502-15T, 1.1502-21T and 1.1502-22T	1.1502-15, 1.1502-21 and 1.1502-22
1.597-4(g)(3), sixth sentence	1.1502-15T, 1.1502-21T, or 1.1502-22T	1.1502-15, 1.1502-21, or 1.1502-22
1.904(f)-3(a), first sentence	(or §1.1502-21T(b))	(or §1.1502-21(b))
1.904(f)-3(b), first sentence	(or §1.1502-22T(b))	(or §1.1502-22(b))
1.1502-2(h)	1.1502-22T(or, for consolidated return years to which §1.1502-22T	1.1502-22)(or, for consolidated return years to which §1.1502-22
1.1502-3T(c)(2)(iii), first sentence	1.1502-21T(c)(2)	1.1502-21(c)(2)
1.1502-3T(c)(2)(iii), second sentence	1.1502-21T(f)	1.1502-21(f)
1.1502-9(a), seventh sentence	§1.1502-21T(b)(2)	1.1502-21(b)(2)
1.1502-9(a), eighth sentence	1.1502-21T(b)(1)	1.1502-21(b)(1)
1.1502-11(a)(2)	§1.1502-21T	1.1502-21
1.1502-11(a)(3)	§1.1502-22T	1.1502-22
1.1502-11(a)(4)	§1.1502-23T	1.1502-23
1.1502-11(b)(2)(iii) <i>Example 1(c)</i> , last sentence	1.1502-21T	1.1502-21
1.1502-11(b)(2)(iii) <i>Example 2(d)</i> , last sentence	1.1502-21T and 1.1502-22T	1.1502-21 and 1.1502-22
1.1502-12(b)	1.1502-15T	1.1502-15
1.1502-13(c)(7)(ii) <i>Example 10(d)</i> , first and second sentences	S's net operating loss carryovers are subject to the separate return limitation year (SRLY) rules. See §1.1502-21T(c)	P's acquisition of S is not subject to the overlap rule of §1.1502-21(g), and S's net operating loss carryovers are subject to the separate return limitation year (SRLY) rules. See §1.1502-21(c)
1.1502-13(g)(5) <i>Example 4(b)</i> , fourth sentence	1.1502-15T (or §1.1502-15A, as appropriate) (limitations on the absorption of built in losses)	1.1502-15 (as appropriate)

1.1502-13(h)(2) <i>Example 1(a)</i> , second sentence	1.1502-21T(c)	1.1502-21(c)
1.1502-13(h)(2) <i>Example 1(b)</i> , first sentence	1.1502-21T(c)	1.1502-21(c)
1.1502-13(h)(2) <i>Example 2(a)</i> , last sentence	1.1502-15T	1.1502-15
1.1502-13(h)(2) <i>Example 2(b)</i> , second sentence	1.1502-22T	1.1502-22
1.1502-20(c)(4) <i>Example 7(iii)</i> , first sentence	1.1502-21T	1.1502-21
1.1502-20(g)(3) <i>Example 1(i)</i> , second sentence	1.1502-21T	1.1502-21
1.1502-20(g)(3) <i>Example 2(i)</i> , third sentence	§1.1502-21A or 1.1502-21T	1.1502-21A or 1.1502-21
1.1502-23A(a), third sentence	1.1502-21T(c) and 1.1502-22T(c), as provided in 1.1502-15T(a)	(1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999 and 1.1502-22T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as provided in 1.1502-15T(a) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999) or (1.1502-21(c) and 1.1502-22(c), as provided in 1.1502-15(a), as applicable))
1.1502-23A(b), first sentence	1.1502-21T(g)	1.1502-21(h) or 1.1502-21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-23A(b), second sentence	1.1502-21T(g) for effective dates of that section	1.1502-21(h) or 1.1502-21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable for effective dates of these sections
1.1502-26(a)(1) concluding text	1.1502-21T(e)	1.1502-21(e)
1.1502-32(b)(5)(ii) <i>Example 2(b)</i> , third sentence	1.1502-21T(b)	1.1502-21(b)
1.1502-41A(c), first sentence	1.1502-21T(g)	1.1502-21(h) or 1.1502-21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-41A(c), second sentence	1.1502-21T(g) for effective dates of that section	1.1502-21(h) or 1.1502-21T(g) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable for effective dates of these sections

1.1502-42(f)(4)(i)(A)	1.1502-21T(b)	1.1502-21(b)
1.1502-43(b)(2)(iv)	1.1502-21T(a)	1.1502-21(a)
1.1502-43(b)(2)(v)	1.1502-22T(a)	1.1502-22(a)
1.1502-43(b)(2)(vi)(A)	1.1502-22T(a)	1.1502-22(a)
1.1502-43(b)(2)(vii)	1.1502-22T(b)	1.1502-22(b)
1.1502-43(b)(2)(viii)	1.1502-15T and 1.1502-15T (SRLY limitation on built-in losses (temporary))	1.1502-15 and 1.1502-15
1.1502-44(b)(2)	§1.1502-21T	1.1502-21
1.1502-44(b)(3)	§1.1502-22T	1.1502-22
1.1502-47(h)(2)(i)	1.1502-21T	1.1502-21
1.1502-47(h)(2)(ii)	1.1502-21T(e)	1.1502-21(e)
1.1502-47(h)(2)(iii), first sentence	1.1502-21T	1.1502-21
1.1502-47(h)(2)(iv), first sentence	1.1502-21T	1.1502-21
1.1502-47(h)(3)(iii)	1.1502-21T(c)	1.1502-21(c)
1.1502-47(h)(4)(i), first sentence	1.1502-22T	1.1502-22
1.1502-47(h)(4)(i), second sentence	1.1502-22T	1.1502-22
1.1502-47(h)(4)(ii), first sentence	1.1502-22T	1.1502-22
1.1502-47(h)(4)(ii), first sentence	1.1502-21T	1.1502-21
1.1502-47(h)(4)(iii)	1.1502-22T(b)	1.1502-22(b)
1.1502-47(k)(5) introductory text	1.1502-22T	1.1502-22
1.1502-47(l)(3)(i), second sentence	1.1502-21T	1.1502-21
1.1502-47(m)(2)(ii), first sentence	1.1502-21T	1.1502-21
1.1502-47(m)(2)(ii), first sentence	1.1502-22T	1.1502-22
1.1502-47(m)(3)(i), first sentence	1.1502-21T and 1.1502-22T	1.1502-21 and 1.1502-22
1.1502-47(m)(3)(vi)(A), second sentence	1.1502-21T(b) or 1.1502-79A(a)(3) (as appropriate)	1.1502-21(b))
1.1502-47(m)(3)(vi)(A), second sentence	§1.1502-21T(b) or 1.1502-79A(a)(3) (as appropriate)	1.1502-21(b)
1.1502-47(m)(3)(vii)(A)	1.1502-21A(b)(3)(ii)	1.1502-21A(b)(3)(ii) or 1.1502-21(b)
1.1502-47(m)(3)(ix), last sentence	1.1502-15T	1.1502-15
1.1502-47(q), last sentence	1.1502-21T	1.1502-21
1.1502-55T(h)(4)(iii)(B)(4), first sentence	1.1502-21T(c)(2)	1.1502-21(c)(2)

1.1502-55T(h)(4)(iii) (B)(4), second sentence	1.1502-21T(f)	1.1502-21(f)
1.1502-78(a), first sentence	1.1502-21T(b), 1.1502-22T(b)	1.1502-21(b), 1.1502-22(b)
1.1502-79(a), second sentence	1.1502-21T(b)	1.1502-21(b)
1.1502-79(b), second sentence	1.1502-22T(b)	1.1502-22(b)
1.1502-79(c)(1)	1.1502-21T(b)	1.1502-21(b)
1.1502-79(d)(1)	1.1502-21T(b)	1.1502-21(b)
1.1502-79(e)(1)	1.1502-21T(b)	1.1502-21(b)
1.1502-91T(a)(2), last sentence	1.1502-21T(a)	1.1502-21(a) or 1.1502-21T(a) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-91T(c)(3) <i>Example</i> (b), first sentence	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-91T(d)(1)(iii)	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-91T(d)(6) <i>Example 1</i> (a), fourth sentence	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-91T(d)(6) <i>Example 2</i> (a), fourth sentence	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-91T(f)(2) <i>Example</i> (a), last sentence	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-92T(b)(2) <i>Example 3</i> (a), fourth sentence	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-93T(e)	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-94T(a)(1)(i)	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable

1.1502-94T(b)(4) <i>Example 1(c)</i> , last sentence	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-95T(b)(1)(i)	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-95T(b)(4) <i>Example 1(a)</i> , sixth sentence	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-95T(c)(7) <i>Example 1(a)</i> , fifth sentence	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-96T(a)(1) introductory text sixth sentence	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-96T(a)(2), first sentence	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-96T(a)(5), first sentence	1.1502-15T and 1.1502-21T	1.1502-15 and 1.1502-21 (or §1.1502-15T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999 and 1.1502-21T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable)
1.1502-96T(b)(2)(ii)(A)	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-96T(b)(2)(ii)(B)	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-99T(c)(2)(i), fourth sentence	1.1502-21T(c)	1.1502-21(c) or 1.1502-21T(c) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-99T(c)(2)(ii)	1.1502-21T(b)	1.1502-21(b) or 1.1502-21T(b) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable
1.1502-100(c)(2)	§§1.1502-21A or 1.1502-21T	§1.1502-21A or 1.1502-21

1.1503-2(d)(2)(i), last sentence	§1.1502-21A(c) or 1.1502-21T(c)	1.1502-21A(c) or 1.1502-21(c)
1.1503-2(d)(2)(ii), last sentence	§1.1502-21A(c) or 1.1502-21T(c)	1.1502-21A(c) or 1.1502-21(c)
1.1503-2(d)(4) <i>Example 1</i> (iv), last sentence	1.1502-22T(c)	1.1502-22(c)
1.1503-2(g)(2)(vii)(B)(1), second sentence	§1.1502-21A(c) or 1.1502-21T(c)	1.1502-21A(c) or 1.1502-21(c)
1.1503-2(g)(2)(vii)(B)(2), first sentence	§1.1502-21A(c) or 1.1502-21T(c)	1.1502-21A(c) or 1.1502-21(c)
1.1503-2(g)(2)(vii)(G) <i>Example 1</i> , ninth sentence	§1.1502-21A(c) or 1.1502-21T(c)	1.1502-21A(c) or 1.1502-21(c)
1.1503-2(g)(2)(vii)(G) <i>Example 2</i> , last sentence	§§1.1502-21A(c) or 1.1502-21T(c)	§1.1502-21A(c) or 1.1502-21(c)
1.1503-2(h)(3), second sentence	§§1.1502-21A(c) or 1.1502-21T(c)	(§1.1502-21A(c) or 1.1502-21(c))
1.1503-2A(f)(1)(i) introductory text	1.1502-21T(b)	1.1502-79A(a)(3)
1.1503-2A(f)(1)(i)(C)	1.1502-22T(b)	1.1502-22
1.1503-2A(f)(2)(i), fourth sentence	1.1502-21T(c)	1.1502-21(c)
1.1503-2A(f)(2)(ii), last sentence	1.1502-21T(c)	1.1502-21(c)
301.6402-7(g)(2)(iii), first sentence	§1.1502-21T(b)	1.1502-21(b)
301.6402-7(g)(3) <i>Example 2</i> , second sentence	1.1502-21T	1.1502-21
301.6402-7(g)(3) <i>Example 2</i> , third sentence	1.1502-21T(c)	1.1502-21(c)
301.6402-7(h)(1)(ii) <i>Example (b)</i> , first sentence	1.1502-21T(b) and 1.1502-22T(b)	1.1502-21(b) and 1.1502-22(b)

Par. 3. Section 1.1502-1 is amended by revising paragraph (f)(4) to read as follows:

*§1.1502-1 Definitions.*

\* \* \* \* \*

(f) \* \* \*

(4) *Predecessor and successors.* The term *predecessor* means a transferor or distributor of assets to a member (the successor) in a transaction-

- (i) To which section 381(a) applies; or
- (ii) That occurs on or after January 1, 1997, in which the successor's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the assets of the transferor or distributor, but in the case of a transaction

that occurs before June 25, 1999, only if the amount by which basis differs from value, in the aggregate, is material. For a transaction that occurs before June 25, 1999, only one member may be considered a predecessor to or a successor of one other member.

\* \* \* \* \*

Par. 4. Section 1.1502-15 is added to read as follows:

*§1.1502-15 SRLY limitation on built-in losses.*

(a) *SRLY limitation.* Except as provided in paragraph (f) of this section (relating to built-in losses of the common parent) and paragraph (g) of this section (relating to

an overlap with section 382), built-in losses are subject to the SRLY limitation under §§1.1502-21(c) and 1.1502-22(c) (including applicable subgroup principles). Built-in losses are treated as deductions or losses in the year recognized, except for the purpose of determining the amount of, and the extent to which the built-in loss is limited by, the SRLY limitation for the year in which it is recognized. Solely for such purpose, a built-in loss is treated as a hypothetical net operating loss carryover or net capital loss carryover arising in a SRLY, instead of as a deduction or loss in the year recognized. To the extent that a built-in loss is allowed as a deduction under this section in the year it is recognized, it offsets any consolidated taxable income for the year before

any loss carryovers or carrybacks are allowed as a deduction. To the extent not so allowed, it is treated as a separate net operating loss or net capital loss carryover or carryback arising in the year of recognition and, under §1.1502-21(c) or 1.1502-22(c), the year of recognition is treated as a SRLY.

(b) *Built-in losses*—(1) *Defined*. If a corporation has a net unrealized built-in loss under section 382(h)(3) (as modified by this section) on the day it becomes a member of the group (whether or not the group is a consolidated group), its deductions and losses are built-in losses under this section to the extent they are treated as recognized built-in losses under section 382(h)(2)(B) (as modified by this section). This paragraph (b) generally applies separately with respect to each member, but see paragraph (c) of this section for circumstances in which it is applied on a subgroup basis.

(2) *Operating rules*. Solely for purposes of applying paragraph (b)(1) of this section, the principles of §1.1502-94(c) apply with appropriate adjustments, including the following:

(i) *Stock acquisition*. A corporation is treated as having an ownership change under section 382(g) on the day the corporation becomes a member of a group, and no other events (e.g., a subsequent ownership change under section 382(g) while it is a member) are treated as causing an ownership change.

(ii) *Asset acquisition*. In the case of an asset acquisition by a group, the assets and liabilities acquired directly from the same transferor (whether corporate or non-corporate, foreign or domestic) pursuant to the same plan are treated as the assets and liabilities of a corporation that becomes a member of the group (and has an ownership change) on the date of the acquisition.

(iii) *Recognized built-in gain or loss*. A loss that is included in the determination of net unrealized built-in gain or loss and that is recognized but disallowed or deferred (e.g., under §1.1502-20 or section 267) is not treated as a built-in loss unless and until the loss would be allowed during the recognition period without regard to the application of this section. Section 382(h)(1)(B)(ii) does not apply to the extent it limits the amount of recognized built-in loss that may be treated as a pre-

change loss to the amount of the net unrealized built-in loss.

(c) *Built-in losses of subgroups*—(1) *In general*. In the case of a subgroup, the principles of paragraph (b) of this section apply to the subgroup, and not separately to its members. Thus, the net unrealized built-in loss and recognized built-in loss for purposes of paragraph (b) of this section are based on the aggregate amounts for each member of the subgroup.

(2) *Members of subgroups*. A subgroup is composed of those members that have been continuously affiliated with each other for the 60 consecutive month period ending immediately before they become members of the group in which the loss is recognized. A member remains a member of the subgroup until it ceases to be affiliated with the loss member. For this purpose, the principles of §1.1502-21(c)(2)-(iv) through (vi) apply with appropriate adjustments.

(3) *Coordination of 60 month affiliation requirement with the overlap rule*. If one or more corporations become members of a group and are included in the determination of a net unrealized built-in loss that is subject to the overlap rule described in paragraph (g)(1) of this section, then for purposes of paragraph (c)(2) of this section, such corporations that become members of the group are treated as having been affiliated for 60 consecutive months with the common parent of the group and are also treated as having been affiliated with any other members who have been affiliated or are treated as having been affiliated with the common parent at such time. The corporations are treated as having been affiliated with such other members for the same period of time that those members have been affiliated or are treated as having been affiliated with the common parent. If two or more corporations become members of the group at the same time, but this paragraph (c)(3) does not apply to every such corporation, then immediately after the corporations become members of the group, and solely for purposes of paragraph (c)(2) of this section, the corporations to which this paragraph (c)(3) applies are treated as having not been previously affiliated with the corporations to which this paragraph (c)(3) does not apply. If the common parent has become the common parent of an existing group

within the previous five year period in a transaction described in §1.1502-75(d)-(2)(ii) or (3), the principles of §§1.1502-91(g)(6) and 1.1502-96(a)(2)(iii) shall apply.

(4) *Built-in amounts*. Solely for purposes of determining whether the subgroup has a net unrealized built-in loss or whether it has a recognized built-in loss, the principles of §1.1502-91(g) and (h) apply with appropriate adjustments.

(d) *Examples*. For purposes of the examples in this section, unless otherwise stated, all groups file consolidated returns, all corporations have calendar taxable years, the facts set forth the only corporate activity, value means fair market value and the adjusted basis of each asset equals its value, all transactions are with unrelated persons, and the application of any limitation or threshold under section 382 is disregarded. The principles of this section are illustrated by the following examples:

*Example 1. Determination of recognized built-in loss.* (i) Individual A owns all of the stock of P and T. T has two depreciable assets. Asset 1 has an unrealized loss of \$55 (basis \$75, value \$20), and asset 2 has an unrealized gain of \$20 (basis \$30, value \$50). P acquires all the stock of T from Individual A during Year 1, and T becomes a member of the P group. P's acquisition of T is not an ownership change as defined by section 382(g). Paragraph (g) of this section does not apply because there is not an overlap of the application of the rules contained in paragraph (a) of this section and section 382.

(ii) Under paragraph (b)(2)(i) of this section, and solely for purposes of applying paragraph (b)(1) of this section, T is treated as having an ownership change under section 382(g) on becoming a member of the P group. Under paragraph (b)(1) of this section, none of T's \$55 of unrealized loss is treated as a built-in loss unless T has a net unrealized built-in loss under section 382(h)(3) on becoming a member of the P group.

(iii) Under section 382(h)(3)(A), T has a \$35 net unrealized built-in loss on becoming a member of the P group ( $($55) + \$20 = ($35)$ ). Assume that this amount exceeds the threshold requirement in section 382(h)(3)(B). Under section 382(h)(2)(B), the entire amount of T's \$55 unrealized loss is treated as a built-in loss to the extent it is recognized during the 5-year recognition period described in section 382(h)(7). Under paragraph (b)(2)(iii) of this section, the restriction under section 382(h)(1)(B)(ii), which limits the amount of recognized built-in loss that is treated as pre-change loss to the amount of the net unrealized built-in loss, is inapplicable for this purpose. Consequently, the entire \$55 of unrealized loss (not just the \$35 net unrealized loss) is treated under paragraph (b)(1) of this section as a built-in loss to the extent it is recognized within 5 years of T's becoming a member of the P group. Under paragraph (a) of this section, a built-in loss is

subject to the SRLY limitation under §1.1502-21(c)(1).

(iv) Under paragraph (b)(2)(ii) of this section, the built-in loss would similarly be subject to a SRLY limitation under §1.1502-21(c)(1) if T transferred all of its assets and liabilities to a subsidiary of the P group in a single transaction described in section 351. To the extent the built-in loss is recognized within 5 years of T's transfer, all of the items contributed by the acquiring subsidiary to consolidated taxable income (and not just the items attributable to the assets and liabilities transferred by T) are included for purposes of determining the SRLY limitation under §1.1502-21(c)(1).

*Example 2. Actual application of section 382 not relevant.* (i) Individual A owns all of the stock of P, and Individual B owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized loss of \$25 (basis \$75, value \$50), and asset 2 has an unrealized gain of \$20 (basis \$30, value \$50). P buys 55 percent of the stock of T in January of Year 1, resulting in an ownership change of T under section 382(g). During March of Year 2, P buys the 45 percent balance of the T stock, and T becomes a member of the P group.

(ii) Although T has an ownership change for purposes of section 382 in Year 1 and not Year 2, T's joining the P group in Year 2 is treated as an ownership change under section 382(g) solely for purposes of this section. Consequently, for purposes of this section, whether T has a net unrealized built-in loss under section 382(h)(3) is determined as if the day T joined the P group were a change date.

*Example 3. Determination of a recognized built-in loss of a subgroup.* (i) Individual A owns all of the stock of P, S, and M. P and M are each common parents of a consolidated group. During Year 1, P acquires all of the stock of S from Individual A, and S becomes a member of the P group. P's acquisition of S is not an ownership change as defined by section 382(g). At the beginning of Year 7, M acquires all of the stock of P from Individual A, and P and S become members of the M group. M's acquisitions of P and S are also not ownership changes as defined by section 382(g). At the time of M's acquisition of the P stock, P has (disregarding the stock of S) a \$10 net unrealized built-in gain (two depreciable assets, asset 1 with a basis of \$35 and a value of \$55, and asset 2 with a basis of \$55 and a value of \$45), and S has a \$75 net unrealized built-in loss (two depreciable assets, asset 3 with a basis of \$95 and a value of \$10, and asset 4 with a basis of \$10 and a value of \$20).

(ii) Under paragraph (c) of this section, P and S compose a subgroup on becoming members of the M group because P and S were continuously affiliated for the 60 month period ending immediately before they became members of the M group. Consequently, paragraph (b) of this section does not apply to P and S separately. Instead, their separately computed unrealized gains and losses are aggregated for purposes of determining whether, and the extent to which, any unrealized loss is treated as built-in loss under this section and is subject to the SRLY limitation under §1.1502-21(c).

(iii) Under paragraph (c) of this section, the P subgroup has a net unrealized built-in loss on the day P and S become members of the M group, determined by treating the day they become members as a change date. The net unrealized built-in loss is the

aggregate of P's net unrealized built-in gain of \$10 and S's net unrealized built-in loss of \$75, or an aggregate net unrealized built-in loss of \$65. (The stock of S owned by P is disregarded for purposes of determining the net unrealized built-in loss. However, any loss allowed on the sale of the stock within the recognition period is taken into account in determining recognized loss.) Assume that the \$65 net unrealized built-in loss exceeds the threshold requirement under section 382(h)(3)(B).

(iv) Under paragraphs (b)(1), (b)(2)(iii), and (c) of this section, a loss recognized during the 5-year recognition period on an asset of P or S held on the day that P and S became members of the M group is a built-in loss except to the extent the group establishes that such loss exceeds the amount by which the adjusted basis of such asset on the day the member became a member exceeded the fair market value of such asset on that same day. If P sells asset 2 for \$45 in Year 7 and recognizes a \$10 loss, the entire \$10 loss is treated as a built-in loss under paragraphs (b)(2)(iii) and (c) of this section. If S sells asset 3 for \$10 in Year 7 and recognizes an \$85 loss, the entire \$85 loss is treated as a built-in loss under paragraphs (b)(2)(iii) and (c) of this section (not just the \$55 balance of the P subgroup's \$65 net unrealized built-in loss).

(v) The determination of whether P and S constitute a SRLY subgroup for purposes of loss carryovers and carrybacks, and the extent to which built-in losses are not allowed under the SRLY limitation, is made under §1.1502-21(c).

*Example 4. Computation of SRLY limitation.* (i) Individual A owns all of the stock of P, the common parent of a consolidated group. During Year 1, Individual A forms T by contributing \$300 and T sustains a \$100 net operating loss. During Year 2, T's assets decline in value to \$100. At the beginning of Year 3, P acquires all the stock of T from Individual A, and T becomes a member of the P group with a net unrealized built-in loss of \$100. P's acquisition of T is not an ownership change as defined by section 382(g). Assume that \$100 exceeds the threshold requirements of section 382(h)(3)(B). During Year 3, T recognizes its unrealized built-in loss as a \$100 ordinary loss. The members of the P group contribute the following net income to the consolidated taxable income of the P group (disregarding T's recognized built-in loss and any consolidated net operating loss deduction under §1.1502-21) for Years 3 and 4:

	Year 3	Year 4	Total
P group (without T)	\$100	\$100	\$200
T	\$60	\$40	\$100
CT	\$160	\$140	\$300

(ii) Under paragraph (b) of this section, T's \$100 ordinary loss in Year 3 (not taken into account in the consolidated taxable income computations above) is a built-in loss. Under paragraph (a) of this section, the built-in loss is treated as a net operating loss carryover for purposes of determining the SRLY limitation under §1.1502-21(c).

(iii) For Year 3, §1.1502-21(c) limits T's \$100 built-in loss and \$100 net operating loss carryover from Year 1 to the aggregate of the P group's consolidated taxable income through Year 3, determined by reference to only T's items. For this purpose, con-

solidated taxable income is determined without regard to any consolidated net operating loss deductions under §1.1502-21(a).

(iv) The P group's consolidated taxable income through Year 3 is \$60 when determined by reference to only T's items. Under §1.1502-21(c), the SRLY limitation for Year 3 is therefore \$60.

(v) Under paragraph (a) of this section, the \$100 built-in loss is treated as a current deduction for all purposes other than determination of the SRLY limitation under §1.1502-21(c). Consequently, a deduction for the built-in loss is allowed in Year 3 before T's loss carryover from Year 1 is allowed, but only to the extent of the \$60 SRLY limitation. None of T's Year 1 loss carryover is allowed because the built-in loss (\$100) exceeds the SRLY limitation for Year 3.

(vi) The \$40 balance of the built-in loss that is not allowed in Year 3 because of the SRLY limitation is treated as a \$40 net operating loss arising in Year 3 that is carried to other years in accordance with the rules of §1.1502-21(b). The \$40 net operating loss is treated under paragraph (a) of this section and §1.1502-21(c)(1)(ii) as a loss carryover or carryback from Year 3 that arises in a SRLY, and is subject to the rules of §1.1502-21 (including §1.1502-21(c)) rather than this section. See also §1.1502-21(c)(1)(iii) *Example 4*.

(vii) The facts are the same as in paragraphs (i) through (vi) of this *Example 4*, except that T has an additional built-in loss when it joins the P group which is recognized in Year 4. For purposes of determining the SRLY limitation for these additional losses in Year 4 (or any subsequent year), the \$60 of built-in loss allowed as a deduction in Year 3 is treated under paragraph (a) of this section as a deduction in Year 3 that reduces the P group's consolidated taxable income when determined by reference to only T's items.

*Example 5. Built-in loss exceeding consolidated taxable income in the year recognized.* (i) Individual A owns all of the stock of P and T. During Year 1, P acquires all the stock of T from Individual A, and T becomes a member of the P group. P's acquisition of T was not an ownership change as defined by section 382(g). At the time of acquisition, T has a non-capital asset with an unrealized loss of \$45 (basis \$100, value \$55), which exceeds the threshold requirements of section 382(h)(3)(B). During Year 2, T sells its asset for \$55 and recognizes the unrealized built-in loss. The P group has \$10 of consolidated taxable income in Year 2, computed by disregarding T's recognition of the \$45 built-in loss and the consolidated net operating loss deduction, while the consolidated taxable income would be \$25 if determined by reference to only T's items (other than the \$45 loss).

(ii) T's \$45 loss is recognized in Year 2 and, under paragraph (b) of this section, constitutes a built-in loss. Under paragraph (a) of this section and §1.1502-21(c)(1)(ii), the loss is treated as a net operating loss carryover to Year 2 for purposes of applying the SRLY limitation under §1.1502-21(c).

(iii) For Year 2, T's SRLY limitation is the aggregate of the P group's consolidated taxable income through Year 2 determined by reference to only T's items. For this purpose, consolidated taxable income is determined by disregarding any built-in loss that is treated as a net operating loss carryover, and any consolidated net operating loss deductions under



§1.1502–21(a). Consolidated taxable income so determined is \$25.

(iv) Under §1.1502–21(c), \$25 of the \$45 built-in loss could be deducted in Year 2. Because the P group has only \$10 of consolidated taxable income (determined without regard to the \$45), the \$25 loss creates a consolidated net operating loss of \$15. This loss is carried back or forward under the rules of §1.1502–21(b) and absorbed under the rules of §1.1502–21(a). This loss is not treated as arising in a SRLY (see §1.1502–21(c)(1)(ii)) and therefore is not subject to the SRLY limitation under §1.1502–21(c) in any consolidated return year of the group to which it is carried. The remaining \$20 is treated as a loss carryover arising in a SRLY and is subject to the limitation of §1.1502–21(c) in the year to which it is carried.

(e) *Predecessors and successors.* For purposes of this section, any reference to a corporation or member includes, as the context may require, a reference to a successor or predecessor, as defined in §1.1502–1(f)(4).

(f) *Built-in losses recognized by common parent of group—(1) General rule.* Paragraph (a) of this section does not apply to any loss recognized by the group on an asset held by the common parent on the date the group is formed. Following an acquisition described in §1.1502–75(d)(2) or (3), references to the common parent are to the corporation that was the common parent immediately before the acquisition.

(2) *Anti-avoidance rule.* If a corporation that becomes a common parent of a group acquires assets with a net unrealized built-in loss in excess of the threshold requirement of section 382(h)(3)(B) (and thereby increases its net unrealized built-in loss or decreases its net unrealized built-in gain) prior to, and in anticipation of, the formation of the group, paragraph (f)(1) of this section does not apply.

(g) *Overlap with section 382—(1) General rule.* The limitations provided in §§1.1502–21(c) and 1.1502–22(c) do not apply to recognized built-in losses or to loss carryovers or carrybacks attributable to recognized built-in losses when the application of paragraph (a) of this section results in an overlap with the application of section 382.

(2) *Definitions—(i) Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in section 382, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap—(A)* An overlap of the application of paragraph (a) of this section and the application of section 382 with respect to built-in losses occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382(a) limitation that would apply with respect to the corporation's recognized built-in losses (the section 382 event). Except as provided in paragraph (g)(3) of this section, application of the overlap rule does not require that the size and composition of the corporation's net unrealized built-in loss is the same on the date of the section 382 event and the SRLY event.

(B) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(2) with respect to built-in losses, see paragraph (g)(4) of this section.

(3) *Operating rules—(i) Section 382 event before SRLY event.* If a SRLY event occurs on the same date as a section 382 event or within the six month period beginning on the date of the section 382 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event. Paragraph (g)(1) of this section does not apply, however, if a corporation that would otherwise be subject to the overlap rule acquires assets from a person other than a member of the group with a net unrealized built-in loss in excess of the threshold requirement of section 382(h)(3)(B) (and thereby increases its net unrealized built-in loss) after the section 382 event, and before the SRLY event.

(ii) *SRLY event before section 382 event.* If a section 382 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 382 event. However, paragraph (g)(1) of this section does not apply at any time if a corporation that otherwise would be subject to paragraph (g)(1) of this section transfers assets with an unrealized built-in loss to another member of the group after the SRLY event, but before the section 382 event, unless the corporation recognizes the built-in loss upon the transfer.

(4) *Subgroup rules.* In general, in the case of built-in losses for which there is a SRLY subgroup and the corporations joining the group at the time of the SRLY event also constitute a loss subgroup (as defined in §1.1502–91(d)(2)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies with respect to built-in losses only if—

(i) all members of the SRLY subgroup with respect to those built-in losses are also included in a loss subgroup; and

(ii) all members of a loss subgroup are also members of a SRLY subgroup with respect to those built-in losses.

(5) *Asset acquisitions.* Notwithstanding the application of this paragraph (g), paragraph (a) of this section applies to asset acquisitions by the corporation that occurs after the latter of the SRLY event and the section 382 event. See, paragraph (b)(2)(ii) of this section.

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

*Example 1. Determination of subgroup.* (i) Individual A owns all of the stock of P, P1, and S. In Year 1, P acquires all of the stock of P1, and they file a consolidated return. In Year 3, P acquires all of the stock of S, and S joins the P group. Individual B, unrelated to Individual A, owns all of the stock of M and K, each the common parent of a consolidated group. Individual C, unrelated to either Individual A or Individual B, owns all of the stock of T.

(ii) At the beginning of Year 7, M acquires all of the stock of P from Individual A, and, as a result, P, P1, and S become members of the M group. At the time of M's acquisition of the P stock, P has a \$15 net unrealized built-in loss (disregarding the stock of P1), P1 has a net unrealized built-in gain of \$10, and S has a net unrealized built-in gain of \$5.

(iii) During Year 8, M acquires all of the stock of T, and T joins the M group. At the time of M's acquisition of the T stock, T had an unrealized built-in loss of \$15. At the beginning of Year 9, K acquires all of the stock of M from Individual B, and the members of the M consolidated group including P, P1, S, and T become members of the K group. At the time of K's acquisition of the M stock, M has (disregarding the stock of P and T) a \$15 net unrealized built-in loss, P has a \$20 net unrealized built-in loss (disregarding the stock of P1), P1 has a net unrealized built-in gain of \$5, S has a net unrealized built-in loss of \$35, and T has a \$15 net unrealized built-in loss.

(iv) M's acquisition of P in Year 7 results in P, P1, and S becoming members of the M group (the SRLY event). Under paragraph (c) of this section, P and P1 compose a SRLY built-in loss subgroup because they have been affiliated for the 60 consecutive

month period immediately preceding joining the M group. S is not a member of the subgroup because on becoming a member of the M group it had not been continuously affiliated with P and P1 for the 60 month period ending immediately before it became a member of the M group. Consequently, §1.1502-15 applies to S separately from the P and P1 subgroup.

(v) Assuming that the \$5 net unrealized built-in loss of the P/P1 subgroup exceeds the threshold requirement under section 382(h)(3)(B), M's acquisition of P resulted in an ownership change of P and P1 within the meaning of section 382(g) that subjects P and P1 to a limitation under section 382(a) (the section 382 event). Because, with respect to P and P1, the SRLY event and the change date of the section 382 event occur on the same date and because the loss subgroup and SRLY subgroup are coextensive, there is an overlap of the application of the SRLY rules and the application of the section 382.

(vi) S was not a loss corporation because it did not have a net operating loss carryover, or a net unrealized built-in loss, and therefore, M's acquisition of P did not result in an ownership change of S within the meaning of section 382(g). S, therefore is not subject to the overlap rule of paragraph (g) of this section.

(vii) M's acquisition of T resulted in T becoming a member of the M group (the SRLY event). Assuming that T's \$15 net unrealized built-in loss exceeds the threshold requirement under section 382(h)(3)(B), M's acquisition of T also resulted in an ownership change of T within the meaning of section 382(g) that subjects T to a limitation under section 382(a) (the section 382 event). Because, with respect to T, the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section.

(viii) K's acquisition of M results in the members of the M consolidated group, including T, P, P1, and S, becoming members of the K group (the SRLY event). Because T, P, and P1 were each included in the determination of a net unrealized built-in loss that was subject to the overlap rule described in paragraph (g)(1) of this section when they each became members of the M group, they are deemed under paragraph (c)(3) of this section to have been continuously affiliated with M for the 60 month period ending immediately before becoming a member of the M group, notwithstanding their actual affiliation history. As a result, M, T, P, and P1 compose a SRLY built-in loss subgroup under paragraph (c)(2) of this section. K's acquisition of M is not subject to paragraph (g) of this section because it does not result in a section 382 event.

(ix) S, however, is not a member of the subgroup under paragraph (c)(2) of this section. Because S was not included in the determination of a net unrealized built-in loss that was subject to the overlap rule described in paragraph (g)(1) of this section when it joined the M group, S is treated as becoming an affiliate of M on the date it joined the M group. Furthermore, under paragraph (c)(3) of this section, S is deemed to have begun its affiliation with P and P1 on the date it joined the M group. Consequently, §1.1502-15 applies to S separately to the extent its built-in loss is recognized with the recognition period.

*Example 2. Post-overlap acquisition of assets.* (i) Individual A owns all of the stock of P, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized built-in loss of \$25 (basis \$75, value \$50), and asset 2 has an unrealized built-in gain of \$20 (basis \$30, value \$50). During Year 3, P buys all of the stock of T from Individual B. On January 1, Year 4, P contributes \$80 cash and Individual A contributes asset 3, a depreciable asset, with a net unrealized built-in loss of \$45 (basis \$65, value \$20), in exchange for T stock in a transaction that is described in section 351.

(ii) P's acquisition of T results in T becoming a member of the P group (the SRLY event) and also results in an ownership change of T, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event).

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382. Consequently, under paragraph (g) of this section, the limitation under paragraph (a) of this section does not apply to T's net unrealized built-in loss when it joined the P group.

(iv) Individual A's Year 4 contribution of a depreciable asset occurred after T was a member of the P group. Assuming that the amount of the net unrealized built-in loss exceeds the threshold requirement of section 382(h)(3)(B), the sale of asset 3 within the recognition period is subject to the SRLY limitation of paragraphs (a) and (b)(2)(ii) of this section.

*Example 3. Overlap rule.* (i) Individual A owns all of the stock of P, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of T. T has two depreciable assets. Asset 1 has an unrealized loss of \$55 (basis \$75, value \$20), and asset 2 has an unrealized gain of \$30 (basis \$30, value \$60). On February 28 of Year 2, P purchases 55% of T from Individual B. On June 30, of Year 2, P purchases an additional 35% of T from Individual B.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T that gives rise to a section 382(a) limitation. The June 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382, and paragraph (a) of this section does not apply. Therefore, the SRLY limitation does not apply to any of the \$55 loss in asset 1 recognized by T after T joined the P group. See §1.1502-94 for rules relating to the application of section 382 with respect to T's \$25 unrealized built-in loss.

*Example 4. Overlap rule-Fluctuation in value.* (i) The facts are the same as in *Example 3*, except that by June 30, of Year 2, asset 1 had declined in value by a further \$10. Thus asset 1 had an unrealized loss of \$65 (basis \$75, value \$10), and asset 2 had an unrealized gain of \$30 (basis \$30, value \$60).

(ii) Because paragraph (a) of this section does not apply, the further decrease in asset 1's value is disregarded. Consequently, the results are the same as in *Example 3*.

(h) *Effective date*—(1) *In general.* This section generally applies to built-in losses recognized in taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraphs (f)(1) and (g)(1) of this section do not apply to a particular built-in loss in the current group, then solely for purposes of applying paragraph (a) of this section to determine a limitation with respect to that built-in loss and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's (or subgroup's) items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), paragraph (c)(3) of this section shall not apply; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 382(a) as amended by the Tax Reform Act of 1986 applies shall constitute a section 382 event.

(2) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502-15T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

#### §1.1502-15T [Removed]

Par. 5. Section 1.1502-15T is removed.

Par. 6. Section 1.1502-21 is added to read as follows:

#### §1.1502-21 Net operating losses.

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

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

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

(b) *Net operating loss carryovers and carrybacks to consolidated return and separate return years.* Net operating losses of members arising during a consolidated return year are taken into account in determining the group's CNOL

under paragraph (e) of this section for that year. Losses taken into account in determining the CNOL may be carried to other taxable years (whether consolidated or separate) only under this paragraph (b).

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

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

(ii) *Special rules—(A) Year of departure from group.* If a corporation ceases to be a member during a consolidated return year, net operating loss carryovers attributable to the corporation are first carried to the consolidated return year, and only the amount so attributable that is not absorbed by the group in that year is carried to the corporation's first separate return year. For rules concerning a member de-

parting a subgroup, see paragraph (c)(2)-(vii) of this section.

(B) *Offspring rule.* In the case of a member that has been a member continuously since its organization (determined without regard to whether the member is a successor to any other corporation), the CNOL attributable to the member is included in the carrybacks to consolidated return years before the member's existence. If the group did not file a consolidated return for a carryback year, the loss may be carried back to a separate return year of the common parent under paragraph (b)(2)(i) of this section, but only if the common parent was not a member of a different consolidated group or of an affiliated group filing separate returns for the year to which the loss is carried or any subsequent year in the carryback period. Following an acquisition described in §1.1502-75(d)(2) or (3), references to the common parent are to the corporation that was the common parent immediately before the acquisition.

(iii) *Equivalent years.* Taxable years are equivalent if they bear the same numerical relationship to the consolidated return year in which a CNOL arises, counting forward or backward from the year of the loss. For example, in the case of a member's third taxable year (which was a separate return year) that preceded the consolidated return year in which the loss arose, the equivalent year is the third consolidated return year preceding the consolidated return year in which the loss arose. See paragraph (b)(3)(iii) of this section for certain short taxable years that are disregarded in making this determination.

(iv) *Amount of CNOL attributable to a member.* The amount of a CNOL that is attributable to a member is determined by a fraction the numerator of which is the separate net operating loss of the member for the year of the loss and the denominator of which is the sum of the separate net operating losses for that year of all members having such losses. 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, including the member's losses and deductions actually absorbed by the group in the taxable year (whether or not absorbed by the member).

(v) *Examples.* For purposes of the examples in this section, unless otherwise stated, all groups file consolidated returns, all corporations have calendar taxable years, the facts set forth the only corporate activity, value means fair market value and the adjusted basis of each asset equals its value, all transactions are with unrelated persons, and the application of any limitation or threshold under section 382 is disregarded. The principles of this paragraph (b)(2) are illustrated by the following examples:

*Example 1. Offspring rule.* (i) During Year 1, Individual A forms P and T, and they each file a separate return. P forms S on March 15 of Year 2, and P and S file a consolidated return. P acquires all the stock of T from Individual A at the beginning of Year 3, and T becomes a member of the P group. P's acquisition of T is not an ownership change within the meaning of section 382. P, S, and T sustain a \$1,100 CNOL in Year 3 and, under paragraph (b)(2)(iv) of this section, the loss is attributable \$200 to P, \$300 to S, and \$600 to T.

(ii) Of the \$1,100 CNOL in Year 3, the \$500 amount of the CNOL that is attributable to P and S (\$200 + \$300) may be carried to P's separate return in Year 1. Even though S was not in existence in Year 1, the \$300 amount of the CNOL attributable to S may be carried back to P's separate return in Year 1 because S (unlike T) has been a member of the P group since its organization and P is a qualified parent under paragraph (b)(2)(ii)(B) of this section. To the extent not absorbed in that year, the loss may then be carried to the P group's return in Year 2. The \$600 amount of the CNOL attributable to T is a net operating loss carryback to T's separate return in Year 1, and if not absorbed in Year 1, then to Year 2.

*Example 2. Departing members.* (i) The facts are the same as in *Example 1*. In addition, on June 15 of Year 4, P sells all the stock of T. The P group's consolidated return for Year 4 includes the income of T through June 15. T files a separate return for the period from June 16 through December 31.

(ii) \$600 of the Year 3 CNOL attributable to T is apportioned to T and is carried back to its separate return in Year 1. To the extent the \$600 is not absorbed in T's separate return in Year 1 or Year 2, it is carried to the consolidated return in Year 4 before being carried to T's separate return in Year 4. Any portion of the loss not absorbed in T's Year 1 or Year 2 or in the P group's Year 4 is then carried to T's separate return in Year 4.

*Example 3. Offspring rule following acquisition.* (i) Individual A owns all of the stock of P, the common parent of a consolidated group. In Year 1, B, an individual unrelated to Individual A, forms T. P acquires all of the stock of T at the beginning of Year 3, and T becomes a member of the P group. The P group has \$200 of consolidated taxable income in Year 2, and \$300 of consolidated taxable income in Year 3 (computed without regard to the CNOL deduction). At the beginning of Year 4, T forms a subsidiary, Y, in a transaction described in section 351. The P group has a \$300 consolidated net operating

loss in Year 4, and under paragraph (b)(2)(iv) of this section, the loss is attributable entirely to Y.

(ii) Even though Y was not in existence in Year 2, \$300, the amount of the consolidated net operating loss attributable to Y, may be carried back to the P group's Year 2 consolidated return under paragraph (b)(2)(ii)(B) of this section because Y has been a member of the P group since its organization. To the extent not absorbed in that year, the loss may then be carried to the P group's consolidated return in Year 3

(3) *Special rules*—(i) *Election to relinquish carryback.* A group may make an irrevocable election under section 172(b)(3) to relinquish the entire carryback period with respect to a CNOL for any consolidated return year. Except as provided in paragraph (b)(3)(ii)(B) of this section, the election may not be made separately for any member (whether or not it remains a member), and must be made in a separate statement entitled “THIS IS AN ELECTION UNDER SECTION 1.1502–21(b)(3)(i) TO WAIVE THE ENTIRE CARRYBACK PERIOD PURSUANT TO SECTION 172(b)(3) FOR THE [insert consolidated return year] CNOLs OF THE CONSOLIDATED GROUP OF WHICH [insert name and employer identification number of common parent] IS THE COMMON PARENT.” The statement must be signed by the common parent and filed with the group's income tax return for the consolidated return year in which the loss arises.

(ii) *Special elections*—(A) *Groups that include insolvent financial institutions.* For rules applicable to relinquishing the entire carryback period with respect to losses attributable to insolvent financial institutions, see §301.6402–7 of this chapter.

(B) *Acquisition of member from another consolidated group.* If one or more members of a consolidated group becomes a member of another consolidated group, the acquiring group may make an irrevocable election to relinquish, with respect to all consolidated net operating losses attributable to the member, the portion of the carryback period for which the corporation was a member of another group, provided that any other corporation joining the acquiring group that was affiliated with the member immediately before it joined the acquiring group is also included in the waiver. This election is not a yearly election and applies to all losses that would otherwise be subject to a carryback to a former group under section 172. The election must be made in a

separate statement entitled “THIS IS AN ELECTION UNDER SECTION 1.1502–21(b)(3)(ii)(B) TO WAIVE THE PRE-[insert first taxable year for which the member (or members) was not a member of another group] CARRYBACK PERIOD FOR THE CNOLs attributable to [insert names and employer identification number of members].” The statement must be filed with the acquiring consolidated group's original income tax return for the year the corporation (or corporations) became a member, and it must be signed by the common parent and each of the members to which it applies.

(iii) *Short years in connection with transactions to which section 381(a) applies.* If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transaction does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a net operating loss may be carried.

(iv) *Special status losses.* [Reserved]

(c) *Limitations on net operating loss carryovers and carrybacks from separate return limitation years*—(1) *SRLY limitation*—(i) *General rule.* Except as provided in paragraph (g) of this section (relating to an overlap with section 382), the aggregate of the net operating loss carryovers and carrybacks of a member arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group under paragraph (a) of this section may not exceed the aggregate consolidated taxable income for all consolidated return years of the group determined by reference to only the member's items of income, gain, deduction, and loss. For this purpose—

(A) Consolidated taxable income is computed without regard to CNOL deductions;

(B) Consolidated taxable income takes into account the member's losses and deductions (including capital losses) actually absorbed by the group in consolidated return years (whether or not absorbed by the member);

(C) In computing consolidated taxable income, the consolidated return years of

the group include only those years, including the year to which the loss is carried, that the member has been continuously included in the group's consolidated return, but exclude—

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

(2) For carrybacks, any years ending after the year in which the loss arose; and

(D) The treatment under §1.1502–15 of a built-in loss as a hypothetical net operating loss carryover in the year recognized is solely for purposes of determining the limitation under this paragraph (c) with respect to the loss in that year and not for any other purpose. Thus, for purposes of determining consolidated taxable income for any other losses, a built-in loss allowed under this section in the year it arises is taken into account.

(ii) *Losses treated as arising in SRLYs.* If a net operating loss carryover or carryback did not arise in a SRLY but is attributable to a built-in loss (as defined under §1.1502–15), the carryover or carryback is treated for purposes of this paragraph (c) as arising in a SRLY if the built-in loss was not allowed, after application of the SRLY limitation, in the year it arose. For an illustration, see §1.1502–15(d), *Example 5*. But see §1.1502–15(g)(1).

(iii) *Examples.* The principles of this paragraph (c)(1) are illustrated by the following examples:

*Example 1. Determination of SRLY limitation.* (i) Individual A owns P. In Year 1, Individual A forms T, and T sustains a \$100 net operating loss that is carried forward. P acquires all the stock of T at the beginning of Year 2, and T becomes a member of the P group. The P group has \$300 of consolidated taxable income in Year 2 (computed without regard to the CNOL deduction). Such consolidated taxable income would be \$70 if determined by reference to only T's items.

(ii) T's \$100 net operating loss carryover from Year 1 arose in a SRLY. See §1.1502–1(f)(2)(iii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, the \$100 net operating loss carryover is subject to the SRLY limitation in paragraph (c)(1) of this section. The SRLY limitation for Year 2 is consolidated taxable income determined by reference to only T's items, or \$70. Thus, \$70 of the loss is included under paragraph (a) of this section in the P group's CNOL deduction for Year 2.

(iii) The facts are the same as in paragraph (i) of this *Example 1*, except that such consolidated taxable income (computed without regard to the CNOL deduction and by reference to only T's items) for Year 2 is a loss (a CNOL) of \$370. Because the SRLY limitation may not exceed the consolidated

taxable income determined by reference to only T's items, and such items aggregate to a CNOL, T's \$100 net operating loss carryover from Year 1 is not allowed under the SRLY limitation in Year 2. Moreover, if consolidated taxable income (computed without regard to the CNOL deduction and by reference to only T's items) did not exceed \$370 in Year 3, the carryover would still be restricted under paragraph (c) of this section in Year 3, because the aggregate consolidated taxable income for all consolidated return years of the group computed by reference to only T's items would not be a positive amount.

*Example 2. Net operating loss carryovers.* (i) In Year 1, Individual A forms P, and P sustains a \$40 net operating loss that is carried forward. P has no income in Year 2. Individual A also owns T which sustains a net operating loss of \$50 in Year 2 that is carried forward. P acquires the stock of T from Individual A during Year 3, but T is not a member of the P group for each day of the year. P and T file separate returns and sustain net operating losses of \$120 and \$60, respectively, for Year 3. The P group files consolidated returns beginning in Year 4. During Year 4, the P group has \$160 of consolidated taxable income (computed without regard to the CNOL deduction). Such consolidated taxable income would be \$70 if determined by reference to only T's items. These results are summarized as follows:

	Separate Year 1	Separate Year 2	Separate/Affiliated Year 3	Consolidated Year 4
P	\$(40)	\$0	\$(120)	\$90
T	0	(50)	(60)	70
CTI				160

(ii) P's Year 1, Year 2, and Year 3 are not SRLYs with respect to the P group. See §1.1502-1(f)(2)(i). Thus, P's \$40 net operating loss arising in Year 1 and \$120 net operating loss arising in Year 3 are not subject to the SRLY limitation under paragraph (c) of this section. Under the principles of section 172, paragraph (b) of this section requires that the loss arising in Year 1 be the first loss absorbed by the P group in Year 4. Absorption of this loss leaves \$120 of the group's consolidated taxable income available for offset by other loss carryovers.

(iii) T's Year 2 and Year 3 are SRLYs with respect to the P group. See §1.1502-1(f)(2)(ii). P's acquisition of T was not an ownership change as defined by section 382(g). Thus, T's \$50 net operating loss arising in Year 2 and \$60 net operating loss arising in Year 3 are subject to the SRLY limitation. Under paragraph (c)(1) of this section, the SRLY limitation for Year 4 is \$70, and under paragraph (b) of this section, T's \$50 loss from Year 2 must be included under paragraph (a) of this section in the P group's CNOL deduction for Year 4. The absorption of this loss leaves \$70 of the group's consolidated taxable income available for offset by other loss carryovers.

(iv) P and T each carry over net operating losses to Year 4 from a taxable year ending on the same date (Year 3). The losses carried over from Year 3 total \$180. Under paragraph (b) of this section, the losses carried over from Year 3 are absorbed on a pro rata basis, even though one arises in a SRLY and the other does not. However, the group cannot absorb more than \$20 of T's \$60 net operating loss arising in Year 3 because its \$70 SRLY limitation for

Year 4 is reduced by T's \$50 Year 2 SRLY loss already included in the CNOL deduction for Year 4. Thus, the absorption of Year 3 losses is as follows:

Amount of P's Year 3 losses absorbed = \$120/(\$120 + \$20) × \$70 = \$60.

Amount of T's Year 3 losses absorbed = \$20/(\$120 + \$20) × \$70 = \$10.

(v) The absorption of \$10 of T's Year 3 loss further reduces T's SRLY limitation to \$10 (\$70 of initial SRLY limitation, reduced by the \$60 net operating loss already included in the CNOL deductions for Year 4 under paragraph (a) of this section).

(vi) P carries its remaining \$60 Year 3 net operating loss and T carries its remaining \$50 Year 3 net operating loss over to Year 5. Assume that, in Year 5, the P group has \$90 of consolidated taxable income (computed without regard to the CNOL deduction). The group's CTI determined by reference to only T's items is a CNOL of \$4. For Year 5, the CNOL deduction is \$66, which includes \$60 of P's Year 3 loss and \$6 of T's Year 3 loss (the aggregate consolidated taxable income for Years 4 and 5 determined by reference to T's items, or \$66, reduced by T's SRLY losses actually absorbed by the group in Year 4, or \$60).

*Example 3. Net operating loss carrybacks.* (i) P owns all of the stock of S and T. The members of the P group contribute the following to the consolidated taxable income of the P group for Years 1, 2, and 3:

	Year 1	Year 2	Year 3	Total
P	\$100	\$60	\$80	\$240
S	20	20	30	70
T	30	10	(50)	(10)
CTI	150	90	60	300

(ii) P sells all of the stock of T to Individual A at the beginning of Year 4. For its Year 4 separate return year, T has a net operating loss of \$30.

(iii) T's Year 4 is a SRLY with respect to the P group. See §1.1502-1(f)(1). T's \$30 net operating loss carryback to the P group from Year 4 is not allowed under paragraph (c) of this section to be included in the CNOL deduction under paragraph (a) of this section for Year 1, 2, or 3, because the P group's consolidated taxable income would not be a positive amount if determined by reference to only T's items for all consolidated return years through Year 4 (without regard to the \$30 net operating loss). The \$30 loss is carried forward to T's Year 5 and succeeding taxable years as provided under the Internal Revenue Code.

*Example 4. Computation of SRLY limitation for built-in losses treated as net operating loss carryovers.* (i) Individual A owns P. In Year 1, Individual A forms T by contributing \$300 and T sustains a \$100 net operating loss. During Year 2, T's assets decline in value by \$100. At the beginning of Year 3, P acquires all the stock of T from Individual A, and T becomes a member of the P group in a transaction that does not result in an ownership change under section 382(g). At the time of the acquisition, T has a \$100 net unrealized built-in loss, which exceeds the threshold requirements of section 382(h)(3)(B). During Year 3, T recognizes its unrealized loss as a \$100 ordinary loss. The members of the P group contribute the following to the consolidated taxable income of the P group for Years 3 and 4 (computed without regard to T's recognition of its unrealized loss and any CNOL deduction under this section):

P group (without T)	Year 3	Year 4	Total
T	60	40	100
CTI	160	140	300

(ii) Under §1.1502-15(a), T's \$100 of ordinary loss in Year 3 constitutes a built-in loss that is subject to the SRLY limitation under paragraph (c) of this section. The amount of the limitation is determined by treating the deduction as a net operating loss carryover from a SRLY. The built-in loss is therefore subject to a \$60 SRLY limitation for Year 3. The built-in loss is treated as a net operating loss carryover solely for purposes of determining the extent to which the loss is not allowed by reason of the SRLY limitation, and for all other purposes the loss remains a loss arising in Year 3. Consequently, under paragraph (b) of this section, the \$60 allowed under the SRLY limitation is absorbed by the P group before T's \$100 net operating loss carryover from Year 1 is allowed.

(iii) Under §1.1502-15(a), the \$40 balance of the built-in loss that is not allowed in Year 3 because of the SRLY limitation is treated as a \$40 net operating loss arising in Year 3 that is subject to the SRLY limitation because, under paragraph (c)(1)(ii) of this section, Year 3 is treated as a SRLY, and is carried to other years in accordance with the rules of paragraph (b) of this section. The SRLY limitation for Year 4 is the P group's consolidated taxable income for Year 3 and Year 4 determined by reference to only T's items and without regard to the group's CNOL deductions (\$60 + \$40), reduced by T's loss actually absorbed by the group in Year 3 (\$60). The SRLY limitation for Year 4 is \$40.

(iv) Under paragraph (c) of this section and the principles of section 172(b), \$40 of T's \$100 net operating loss carryover from Year 1 is included in the CNOL deduction under paragraph (a) of this section in Year 4.

*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 in a transaction that does not result in an ownership change under section 382(g). Both of T's carryovers from Year 1 are subject to SRLY limits under this paragraph (c) and §1.1502-22(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 this section or net capital loss carryover under §1.1502-22):

	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. The group determines its ability to use its capital loss carryover before it determines its ability

to use its ordinary loss carryover. Under section 1212, 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 net operating loss 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 T's 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 §1.1502-22(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 net operating loss 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.

(2) *SRLY subgroup limitation.* In the case of a net operating loss carryover or carryback for which there is a SRLY subgroup, the principles of paragraph (c)(1) of this section apply to the SRLY subgroup, and not separately to its members. Thus, the contribution to consolidated taxable income and the net operating loss carryovers and carrybacks arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group under paragraph (a) of this section are based on the aggregate amounts of income, gain, deduction, and loss of the members of the SRLY subgroup for the

relevant consolidated return years (as provided in paragraph (c)(1)(i)(C) of this section). For an illustration of aggregate amounts during the relevant consolidated return years following the year in which a member of a SRLY subgroup ceases to be a member of the group, see paragraph (c)(2)(viii) *Example 4* of this section. A SRLY subgroup may exist only for a carryover or carryback arising in a year that is not a SRLY (and is not treated as a SRLY under paragraph (c)(1)(ii) of this section) with respect to another group (the former group), or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502-15(g) with respect to another group (the former group). A separate SRLY subgroup is determined for each such carryover or carryback. A consolidated group may include more than one SRLY subgroup and a member may be a member of more than one SRLY subgroup. Solely for purposes of determining the members of a SRLY subgroup with respect to a loss:

(i) *Carryovers.* In the case of a carryover, the SRLY subgroup is composed of the member carrying over the loss (the loss member) and each other member that was a member of the former group that becomes a member of the group at the same time as the loss member. A member remains a member of the SRLY subgroup until it ceases to be affiliated with the loss member. The aggregate determination described in paragraph (c)(1) of this section and this paragraph (c)(2) includes the amounts of income, gain, deduction, and loss of each member of the SRLY subgroup for the consolidated return years during which it remains a member of the SRLY subgroup. For an illustration of the aggregate determination of a SRLY subgroup, see paragraph (c)(2)(viii) *Example 2* of this section.

(ii) *Carrybacks.* In the case of a carryback, the SRLY subgroup is composed of the member carrying back the loss (the loss member) and each other member of the group from which the loss is carried back that has been continuously affiliated with the loss member from the year to which the loss is carried through the year in which the loss arises.

(iii) *Built-in losses.* In the case of a built-in loss, the SRLY subgroup is composed of the member recognizing the loss (the loss member) and each other member

that was part of the subgroup with respect to the loss determined under §1.1502-15(c)(2) immediately before the members became members of the group. The principles of paragraphs (c)(2)(i) and (ii) of this section apply to determine the SRLY subgroup for the built-in loss that is, under paragraph (c)(1)(ii) of this section, treated as arising in a SRLY with respect to the group in which the loss is recognized. For this purpose and as the context requires, a reference in paragraphs (c)(2)(i) and (ii) of this section to a group or former group is a reference to the subgroup determined under §1.1502-15(c)(2).

(iv) *Principal purpose of avoiding or increasing a SRLY limitation.* The members composing a SRLY subgroup are not treated as a SRLY subgroup if any of them is formed, acquired, or availed of with a principal purpose of avoiding the application of, or increasing any limitation under, this paragraph (c). Any member excluded from a SRLY subgroup, if excluded with a principal purpose of so avoiding or increasing any SRLY limitation, is treated as included in the SRLY subgroup.

(v) *Coordination with other limitations.* This paragraph (c)(2) does not allow a net operating loss to offset income to the extent inconsistent with other limitations or restrictions on the use of losses, such as a limitation based on the nature or activities of members. For example, any dual consolidated loss may not reduce the taxable income to an extent greater than that allowed under section 1503(d) and §1.1503-2. See also §1.1502-47(q) (relating to preemption of rules for life-non-life groups).

(vi) *Anti-duplication.* If the same item of income or deduction could be taken into account more than once in determining a limitation under this paragraph (c), or in a manner inconsistent with any other provision of the Internal Revenue Code or regulations incorporating this paragraph (c), the item of income or deduction is taken into account only once and in such manner that losses are absorbed in accordance with the ordering rules in paragraph (b) of this section and the underlying purposes of this section.

(vii) *Corporations that leave a SRLY subgroup.* If a loss member ceases to be affiliated with a SRLY subgroup, the

amount of the member's remaining SRLY loss from a specific year is determined by multiplying the aggregate of the unabsorbed net operating loss carryovers of the SRLY subgroup from that year by a fraction, the numerator of which is the net operating loss carryover for that year that the member leaving the subgroup had when it became a member of the group, and the denominator of which is the aggregate of the net operating loss carryovers of the members of the SRLY subgroup for that year when they joined the group. The unabsorbed net operating loss carryovers of the SRLY subgroup are those carryovers that have not been absorbed by the group as of the end of the taxable year in which the loss member leaves the group.

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

*Example 1. Members of SRLY subgroups.* (i) Individual A owns all of the stock of P, S, T and M. P and M are each common parents of a consolidated group. During Year 1, P sustains a \$50 net operating loss. At the beginning of Year 2, P acquires all the stock of S at a time when the aggregate basis of S's assets exceeds their aggregate value by \$70 and S becomes a member of the P group. At the beginning of Year 3, P acquires all the stock of T, T has a \$60 net operating loss carryover at the time of the acquisition, and T becomes a member of the P group. During Year 4, S forms S1 and T forms T1, each by contributing assets with built-in gains which are, in the aggregate, material. S1 and T1 become members of the P group. During Year 7, M acquires all of the stock of P, and the members of the P group become members of the M group for the balance of Year 7. The \$50 and \$60 loss carryovers of P and T are carried to Year 7 of the M group, and the value and basis of S's assets did not change after it became a member of the former P group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) Under paragraph (c)(2) of this section, a separate SRLY subgroup is determined for each loss carryover and built-in loss. In the P group, P's \$50 loss carryover is not treated as arising in a SRLY. See §1.1502-1(f). Consequently, the carryover is not subject to limitation under paragraph (c) of this section in the P group.

(iii) In the M group, P's \$50 loss carryover is treated as arising in a SRLY and is subject to the limitation under paragraph (c) of this section. A SRLY subgroup with respect to that loss is composed of members which were members of the P group, the group as to which the loss was not a SRLY. The SRLY subgroup is composed of P, the member carrying over the loss, and each other member of the P group that became a member of the M group at the same time as P. A member of the SRLY subgroup remains a member until it ceases to be affiliated with P. For Year 7, the SRLY subgroup is composed of P, S, T, S1, and T1.

(iv) In the P group, S's \$70 unrealized loss, if recognized within the 5-year recognition period after S becomes a member of the P group, is subject to limitation under paragraph (c) of this section. See §1.1502-15 and paragraph (c)(1)(ii) of this section. Because S was not continuously affiliated with P, T, or T1 for 60 consecutive months prior to joining the P group, these corporations cannot be included in a SRLY subgroup with respect to S's unrealized loss in the P group. See paragraph (c)(2)(iii) of this section. As a successor to S, S1 is included in a subgroup with S in the P group, and because 100 percent of S1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the P group, its net positive income is not excluded from the consolidated taxable income of the P group that may be offset by the built-in loss. See paragraph (f) of this section.

(v) In the M group, S's \$70 unrealized loss, if recognized within the 5-year recognition period after S becomes a member of the M group, is subject to limitation under paragraph (c) of this section. Prior to becoming a member of the M group, S had been continuously affiliated with P (but not T or T1) for 60 consecutive months and S1 is a successor that has remained continuously affiliated with S. Those members had a net unrealized built-in loss immediately before they became members of the group under §1.1502-15(c). Consequently, in Year 7, S, S1, and P compose a subgroup in the M group with respect to S's unrealized loss. Because S1 was a member of the SRLY subgroup when it became a member of the M group and also because 100 percent of S1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the M group its net positive income is not excluded from the consolidated taxable income of the M group that may be offset by the recognized built-in loss. See paragraph (f) of this section.

(vi) In the P group, T's \$60 loss carryover arose in a SRLY and is subject to limitation under paragraph (c) of this section. P, S, and S1 were not members of the group in which T's loss arose and T's loss carryover was not subject to the overlap rule described in paragraph (g) of this section with respect to the P group (the former group). Thus, P, S, and S1 are not members of a SRLY subgroup with respect to the T carryover in the P group. See paragraph (c)(2)(i) of this section. As a successor to T, T1 is included in a SRLY subgroup with T in the P group; and, because 100 percent of T1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the P group, its net positive income is not excluded from the consolidated taxable income of the P group that may be offset by the carryover. See paragraph (f) of this section.

(vii) In the M group, T's \$60 loss carryover arose in a SRLY and is subject to limitation under paragraph (c) of this section. T and T1 remain the only members of a SRLY subgroup with respect to the carryover. Because T1 was a member of the SRLY subgroup when it became a member of the M group and also because 100 percent of T1's stock is owned directly by corporations that were members of the SRLY subgroup when the members of the SRLY subgroup became members of the M group, its net positive income is not excluded from the consolidated

taxable income of the M group that may be offset by the carryover. See paragraph (f) of this section.

*Example 2. Computation of SRLY subgroup limitation.* (i) Individual A owns all of the stock of S, T, P and M. P and M are each common parents of a consolidated group. In Year 2, P acquires all the stock of S and T from Individual A, and S and T become members of the P group. For Year 3, the P group has a \$45 CNOL, which is attributable to P, and which P carries forward. M is the common parent of another group. At the beginning of Year 4, M acquires all of the stock of P and the former members of the P group become members of the M group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) P's year to which the loss is attributable, Year 3, is a SRLY with respect to the M group. See §1.1502-1(f)(1). However, P, S, and T compose a SRLY subgroup with respect to the Year 3 loss under paragraph (c)(2)(i) of this section because Year 3 is not a SRLY (and is not treated as a SRLY) with respect to the P group. P's loss is carried over to the M group's Year 4 and is therefore subject to the SRLY subgroup limitation in paragraph (c)(2) of this section.

(iii) In Year 4, the M group has \$10 of consolidated taxable income (computed without regard to the CNOL deduction for Year 4). Such consolidated taxable income would be \$45 if determined by reference to only the items of P, S, and T, the members included in the SRLY subgroup with respect to P's loss carryover. Therefore, the SRLY subgroup limitation under paragraph (c)(2) of this section for P's net operating loss carryover from Year 3 is \$45. Because the M group has only \$10 of consolidated taxable income in Year 4, however, only \$10 of P's net operating loss carryover is included in the CNOL deduction under paragraph (a) of this section in Year 4.

(iv) In Year 5, the M group has \$100 of consolidated taxable income (computed without regard to the CNOL deduction for Year 5). Neither P, S, nor T has any items of income, gain, deduction, or loss in Year 5. Although the members of the SRLY subgroup do not contribute to the \$100 of consolidated taxable income in Year 5, the SRLY subgroup limitation for Year 5 is \$35 (the sum of SRLY subgroup consolidated taxable income of \$45 in Year 4 and \$0 in Year 5, less the \$10 net operating loss carryover actually absorbed by the M group in Year 4). Therefore, \$35 of P's net operating loss carryover is included in the CNOL deduction under paragraph (a) of this section in Year 5.

*Example 3. Inclusion in more than one SRLY subgroup.* (i) Individual A owns all of the stock of S, T, P and M. S, P and M are each common parents of a consolidated group. At the beginning of Year 1, S acquires all the stock of T from Individual A, and T becomes a member of the S group. For Year 1, the S group has a CNOL of \$10, all of which is attributable to S and is carried over to Year 2. At the beginning of Year 2, P acquires all the stock of S, and S and T become members of the P group. For Year 2, the P group has a CNOL of \$35, all of which is attributable to P and is carried over to Year 3. At the beginning of Year 3, M acquires all of the stock of P and the former members of the P group become members of the M group. None of the transactions described above resulted in an ownership change under section 382(g).

(ii) P's and S's net operating losses arising in SRLYs with respect to the M group are subject to limitation under paragraph (c) of this section. P, S, and T compose a SRLY subgroup for purposes of determining the limitation for P's \$35 net operating loss carryover arising in Year 2 because, under paragraph (c)(2)(i) of this section, Year 2 is not a SRLY with respect to the P group. Similarly, S and T compose a SRLY subgroup for purposes of determining the limitation for S's \$10 net operating loss carryover arising in Year 1 because Year 1 is not a SRLY with respect to the S group.

(iii) S and T are members of both the SRLY subgroup with respect to P's losses and the SRLY subgroup with respect to S's losses. Under paragraph (c)(2) of this section, S's and T's items cannot be included in the determination of the SRLY subgroup limitation for both SRLY subgroups for the same consolidated return year; paragraph (c)(2)(vi) of this section requires the M group to consider the items of S and T only once so that the losses are absorbed in the order of the taxable years in which they were sustained. Because S's loss was incurred in Year 1, while P's loss was incurred in Year 2, the items will be added in the determination of the consolidated taxable income of the S and T SRLY subgroup to enable S's loss to be absorbed first. The taxable income of the P, S, and T SRLY subgroup is then computed by including the consolidated taxable income for the S and T SRLY subgroup less the amount of any net operating loss carryover of S that is absorbed after applying this section to the S subgroup for the year.

*Example 4. Corporation ceases to be affiliated with a SRLY subgroup.* (i) Individual A owns all of the stock of P and M. P and S are members of the P group and the P group has a CNOL of \$30 in Year 1, all of which is attributable to P and carried over to Year 2. At the beginning of Year 2, M acquires all of the stock of P, and P and S become members of the M group. P and S compose a SRLY subgroup with respect to P's net operating loss carryover. For Year 2, consolidated taxable income of the M group determined by reference to only the items of P (and without regard to the CNOL deduction for Year 2) is \$40. However, such consolidated taxable income of the M group determined by reference to the items of both P and S is a loss of \$20. Thus, the SRLY subgroup limitation under paragraph (c)(2) of this section prevents the M group from including any of P's net operating loss carryover in the CNOL deduction under paragraph (a) of this section in Year 2, and P carries the Year 1 loss to Year 3.

(ii) At the end of Year 2, P sells all of the S stock and S ceases to be a member of the M group and the P subgroup. For Year 3, consolidated taxable income of the M group is \$50 (determined without regard to the CNOL deduction for Year 3), and such consolidated taxable income would be \$10 if determined by reference to only items of P. However, the limitation under paragraph (c) of this section for Year 3 for P's net operating loss carryover still prevents the M group from including any of P's loss in the CNOL deduction under paragraph (a) of this section. The limitation results from the inclusion of S's items for Year 2 in the determination of the SRLY subgroup limitation for Year 3 even though S ceased to be a member of the M group (and the P subgroup) at the end of Year 2. Thus, the M group's consolidated taxable income determined by reference to only the

SRLY subgroup members' items for all consolidated return years of the group through Year 3 (determined without regard to the CNOL deduction) is not a positive amount.

(ix) *Application to other than loss carryovers.* Paragraph (g) of this section and the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502-15(g) with respect to another group (the former group)" in paragraph (c)(2) of this section apply only to net operating loss carryovers and net capital loss carryovers, and not with respect to other tax attributes, such as credits. Accordingly, as the context may require, if another regulation references this section and such other regulation does not concern net operating loss carryovers or net capital loss carryovers, then such reference does not include a reference to such paragraph or phrase.

(d) *Coordination with consolidated return change of ownership limitation and transactions subject to old section 382—*

(1) *Consolidated return changes of ownership.* If a consolidated return change of ownership occurred before January 1, 1997, the principles of §1.1502-21A(d) apply to determine the amount of the aggregate of the net operating losses attributable to old members of the group that may be included in the consolidated net operating loss deduction under paragraph (a) of this section. For this purpose, §1.1502-1(g) is applied by treating that date as the end of the year of change.

(2) *Old section 382.* The principles of §1.1502-21A(e) apply to disallow or reduce the amount of a net operating loss carryover of a member as a result of a transaction subject to old section 382.

(e) *Consolidated net operating loss.* Any excess of deductions over gross income, as determined under §1.1502-11(a) (without regard to any consolidated net operating loss deduction), is also referred to as the consolidated net operating loss (or CNOL).

(f) *Predecessors and successors—*(1) *In general.* For purposes of this section, any reference to a corporation, member, common parent, or subsidiary, includes, as the context may require, a reference to a successor or predecessor, as defined in §1.1502-1(f)(4).

(2) *Limitation on SRLY subgroups—*(i) *General rule.* Except as provided in para-

graph (f)(2)(ii) of this section, if a successor's items of income and gain exceed the successor's items of deduction and loss (net positive income), then the net positive income attributable to the successor is excluded from the computation of the consolidated taxable income of a SRLY subgroup.

(ii) *Exceptions.* A successor's net positive income is not excluded from the consolidated taxable income of a SRLY subgroup if—

(A) The successor acquires substantially all the assets and liabilities of its predecessor and the predecessor ceases to exist;

(B) The successor was a member of the SRLY subgroup when the SRLY subgroup members became members of the group;

(C) 100 percent of the stock of the successor is owned directly by corporations that were members of the SRLY subgroup when the SRLY subgroup members became members of the group; or

(D) The Commissioner so determines.

(g) *Overlap with section 382—*(1) *General rule.* The limitation provided in paragraph (c) of this section does not apply to net operating loss carryovers (other than a hypothetical carryover described in paragraph (c)(1)(i)(D) of this section and a carryover described in paragraph (c)(1)(ii) of this section) when the application of paragraph (c) of this section results in an overlap with the application of section 382. For a similar rule applying in the case of net operating loss carryovers described in paragraphs (c)(1)(i)(D) and (c)(1)(ii) of this section, see §1.1502-15(g).

(2) *Definitions—*(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in section 382, the regulations thereunder, and §§1.1502-90 through 1.1502-99 apply.

(ii) *Overlap—*(A) An overlap of the application of paragraph (c) of this section and the application of section 382 with respect to a net operating loss carryover occurs if a corporation becomes a member of a consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382(a) limitation with respect to that carryover (the section 382 event).

(B) If an overlap described in paragraph (g)(2)(ii)(A) of this section occurs



with respect to net operating loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 382 event, then an overlap is treated as also occurring with respect to that corporation's net operating loss carryover that arises within the period beginning with the section 382 event and ending with the SRLY event.

(C) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502-91(d)(1) with respect to a carryover, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 382 event before SRLY event.* If a SRLY event occurs on the same date as a section 382 event or within the six month period beginning on the date of the section 382 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event.

(ii) *SRLY event before section 382 event.* If a section 382 event occurs within the period beginning the day after the SRLY event and ending six months after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 382 event.

(4) *Subgroup rules.* In general, in the case of a net operating loss carryover for which there is a SRLY subgroup and a loss subgroup (as defined in §1.1502-91(d)(1)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies—

(i) With respect to a carryover described in paragraph (g)(2)(ii)(A) of this section only if—

(A) All members of the SRLY subgroup with respect to that carryover are also included in a loss subgroup with respect to that carryover; and

(B) All members of a loss subgroup with respect to that carryover are also members of a SRLY subgroup with respect to that carryover; and

(ii) With respect to a carryover described in paragraph (g)(2)(ii)(B) of this section only if all members of the SRLY subgroup for that carryover are also members of a SRLY subgroup that has net operating loss carryovers described in paragraph (g)(2)(ii)(A) of this section that are subject to the overlap rule of paragraph (g)(1) of this section.

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

*Example 1. Overlap—Simultaneous Acquisition.*

(i) Individual A owns all of the stock of P, which in turn owns all of the stock of S. P and S file a consolidated return. In Year 2, B, an individual unrelated to Individual A, forms T which incurs a \$100 net operating loss for that year. At the beginning of Year 3, S acquires T.

(ii) S's acquisition of T results in T becoming a member of the P group (the SRLY event) and also results in an ownership change of T, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event) with respect to the T carryover.

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382.

(iv) Consequently, under this paragraph (g), in Year 3 the SRLY limitation does not apply to the Year 2 \$100 net operating loss.

*Example 2. Overlap—Section 382 event before SRLY event.*

(i) Individual A owns all of the stock of P, which in turn owns all of the stock of S. P and S file a consolidated return. In Year 1, B, an individual unrelated to Individual A, forms T which incurs a \$100 net operating loss for that year. On February 28 of Year 2, S purchases 55% of T from Individual B. On June 30, of Year 2, S purchases an additional 35% of T from Individual B.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover. The June 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382.

(iv) Consequently, under paragraph (g) of this section, in Year 2 the SRLY limitation does not apply to the Year 1 \$100 net operating loss.

*Example 3. No overlap—Section 382 event before SRLY event.* (i) The facts are the same as in *Example 2* except that Individual B does not sell the additional 35% of T to S until September 30, Year 2.

(ii) The February 28 purchase of 55% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover. The September 30 purchase of 35% of T results in T becoming a member of the P group and is therefore a SRLY event.

(iii) Because the SRLY event did not occur within six months of the change date of the section 382 event, there is no overlap of the application of the SRLY rules and the application of section 382. Consequently, the Year 1 net operating loss is subject to a SRLY limitation and a section 382 limitation.

*Example 4. Overlap—SRLY event before section 382 event.*

(i) P and S file a consolidated return. S has owned 40% of T for 6 years. For Year 6, T has a net operating loss of \$500 that is carried forward. On March 31, Year 7, S acquires an additional 40%

of T, and on August 31, Year 7, S acquires the remaining 20% of T.

(ii) The March 31 purchase of 40% of T results in T becoming a member of the P group and is therefore a SRLY event. The August 31 purchase of 20% of T is a section 382 event because it results in an ownership change of T, under section 382(g), that gives rise to a section 382(a) limitation with respect to the T carryover.

(iii) Because the SRLY event occurred within six months of the change date of the section 382 event, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of this paragraph (g).

(iv) Under this paragraph (g), the SRLY rules of paragraph (c) of this section will apply to the Year 7 tax year. Beginning in Year 8 (the year after the section 382 event), any unabsorbed portion of the Year 6 net operating loss will not be subject to a SRLY limitation.

*Example 5. Overlap—Coextensive subgroups.*

(i) Individual A owns all of the stock of S, which in turn owns all of the stock of T. S and T file a consolidated return beginning in Year 1. B, an individual unrelated to A, owns all of the stock of P, the common parent of a consolidated group. In Year 2, the S group has a \$200 consolidated net operating loss which is carried forward, of which \$100 is attributable to S, and \$100 is attributable to T. At the beginning of Year 3, the P group acquires all of the stock of S from Individual A.

(ii) P's acquisition of S results in S and T becoming members of the P group (the SRLY event). With respect to the Year 2 net operating loss carryover, S and T compose a SRLY subgroup under paragraph (c)(2) of this section.

(iii) S and T also compose a loss subgroup under §1.1502-91(d)(1) with respect to the Year 2 net operating loss carryover. P's acquisition also results in an ownership change of S, the subgroup parent, within the meaning of section 382(g), that gives rise to a limitation under section 382(a) (the section 382 event) with respect to the Year 2 carryover.

(iv) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section. Because the SRLY subgroup and the loss subgroup are coextensive, under paragraph (g) of this section, the SRLY limitation does not apply to the Year 2 \$200 net operating loss.

*Example 6. No Overlap—Different subgroups.*

(i) Individual B owns all of the stock of P, the common parent of a consolidated group. P owns all of the stock of S and all of the stock of T. Individual A owns all of the stock of X, the common parent of another consolidated group. In Year 1, the P group has a \$200 consolidated net operating loss, of which \$100 is attributable to S and \$100 is attributable to T. At the beginning of Year 3, the X group acquires all of the stock of S and T from P and does not make an election under §1.1502-91(d)(4) (concerning an election to treat the loss subgroup parent requirement as having been satisfied).

(ii) X's acquisition of S and T results in S and T becoming members of the X group (the SRLY event). With respect to the Year 1 net operating loss,

S and T compose a SRLY subgroup under paragraph (c)(2) of this section.

(iii) S and T do not bear (and are not treated as bearing) a section 1504(a)(1) relationship. Therefore S and T do not qualify as a loss subgroup under §1.1502-91(d)(1). X's acquisition of S and T results in separate ownership changes of S and T, that give rise to separate limitations under section 382(a) (the section 382 events) with respect to each of S and T's Year 1 net operating loss carryovers. See §1.1502-94.

(iv) The SRLY event and the change dates of the section 382 events occur on the same date. However, paragraph (g)(1) of this section does not apply because the SRLY subgroup (composed of S and T) is not coextensive with a loss subgroup with respect to the Year 1 carryovers. Consequently, the Year 1 net operating loss is subject to both a SRLY subgroup limitation and also separate section 382 limitations for each of S and T.

*Example 7. No Overlap—Different subgroups.* (i) Individual A owns all of the stock of T and all of the stock of S, the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of P, the common parent of another consolidated group. In Year 1, T has a net operating loss of \$100 that is carried forward. At the end of Year 2, S acquires all of the stock of T from Individual A. In Year 3, the S group sustains a \$200 consolidated net operating loss that is carried forward. In Year 8, the P group acquires all of the stock of S from Individual A.

(ii) S's acquisition of T in Year 1 results in T becoming a member of the S group. The acquisition, however, did not result in an ownership change under section 382(g). As a result, T's Year 1 net operating loss is subject to SRLY within the S group. At the end of Year 7, §1.1502-96(a) treats T's Year 1 net operating loss as not having arisen in a SRLY with respect to the S group. Section 1.1502-96(a), however, applies only for purposes of §§1.1502-91 through 1.1502-96 and §1.1502-98 but not for purposes of this section. See §1.1502-96(a)(5).

(iii) P's acquisition of S in Year 8 results in S and T becoming members of the P group (the SRLY event). With respect to the Year 1 net operating loss, S and T do not compose a SRLY subgroup under paragraph (c)(2) of this section.

(iv) S and T compose a loss subgroup under §1.1502-91(d)(1) with respect to the Year 1 net operating loss carryover. P's acquisition of S results in an ownership change of the loss subgroup, within the meaning of section 382(g), that gives rise to a subgroup limitation under section 382(a) (the section 382 event) with respect to that carryover.

(v) The SRLY event and the change date of the section 382 event occur on the same date. However, under paragraph (g)(4) of this section, because the SRLY subgroup and the loss subgroup are not coextensive, T's Year 1 net operating loss carryover is subject to a SRLY limitation.

(vi) With respect to the Year 3 net operating loss carryover, S and T compose both a SRLY subgroup and a loss subgroup under §1.1502-91(d)(1). Thus, paragraph (g)(1) of this section applies and the S group's Year 3 net operating loss carryover is not subject to a SRLY limitation.

*Example 8. SRLY after overlap.* (i) Individual A owns all of the stock of R and M, each the common parent of a consolidated group. B, an individual unrelated to Individual A, owns all of the stock of D.

In Year 1, D incurs a \$100 net operating loss that is carried forward. At the beginning of Year 3, R acquires all of the stock of D. In Year 5, M acquires all of the stock of R in a transaction that did not result in an ownership change of R.

(ii) R's Year 3 acquisition of D results in D becoming a member of the R group (the SRLY event) and also results in an ownership change of D, that gives rise to a limitation under section 382(a) (the section 382 event) with respect to D's net operating loss carryover.

(iii) Because the SRLY event and the change date of the section 382 event occur on the same date, there is an overlap of the application of paragraph (c) of this section and section 382 with respect to D's net operating loss. Consequently, under this paragraph (g), D's Year 1 \$100 net operating loss is not subject to a SRLY limitation in the R group.

(iv) M's Year 5 acquisition of R results in R and D becoming members of the M group (the SRLY event), but does not result in an ownership change of R or D that gives rise to a limitation under section 382(a). Because there is no section 382 event, the application of the SRLY rules and section 382 do not overlap. Consequently, D's Year 1 \$100 net operating loss is subject to a SRLY limitation in the M group.

(v) Because D's Year 1 net operating loss carryover was subject to the overlap rule of paragraph (g) of this section when it joined the R group, under §1.1502-21(c)(2) the SRLY subgroup with respect to that carryover includes all of the members of the R group that joined the M group at the same time as D.

*Example 9. Overlap—Interim losses.* (i) Individual A owns all of the stock of P and S, each the common parent of a consolidated group. S owns all of the stock of T, its only subsidiary. B, an individual unrelated to Individual A, owns all of the stock of M, the common parent of a consolidated group. In Year 1, the S group has a \$100 consolidated net operating loss. On January 1 of Year 2, P acquires all of the stock of S from Individual A. On January 1 of Year 3, M acquires 51% of the stock of P from Individual A. On May 31 of Year 3, M acquires the remaining 49% of the stock of P from Individual A. The P group, for the Year 3 period prior to June 1 had a \$50 consolidated net operating loss, and under paragraph (b)(2)(iv) of this section, the loss is attributable entirely to S. Other than the losses described above, the P group does not have any other consolidated net operating losses.

(ii) In the P group, S's \$100 loss carryover is treated as arising in a SRLY and is subject to the limitation under paragraph (c) of this section. A SRLY subgroup with respect to that loss is composed of S and T, the members which were members of the S group as to which the loss was not a SRLY.

(iii) M's January 1 purchase of 51% of P is a section 382 event because it results in an ownership change of S and T that gives rise to a section 382(a) limitation (the section 382 event) with respect to the Year 1 net operating loss carryover. The purchase, however, does not result in an ownership change of P because it is not a loss corporation under section 382(k)(1). M's May 31 purchase of 49% of P results in P, S, and T becoming members of the M group and is therefore a SRLY event.

(iv) With respect to the Year 1 net operating loss, S and T compose a SRLY subgroup under paragraph (c)(2) of this section and a loss subgroup under

§1.1502-91(d)(1). The loss subgroup does not include P because the only loss at the time of the section 382 event was subject to SRLY with respect to the P group. See §1.1502-91(d)(1).

(v) Because the SRLY event and the change date of the section 382 event occur on the same date and the SRLY subgroup and loss subgroup are coextensive with respect to the Year 1 net operating loss carryover, there is an overlap of the application of the SRLY rules and the application of section 382 within the meaning of paragraph (g) of this section. Thus, the SRLY limitation does not apply to that carryover.

(vi) The Year 3 net operating loss, which arose between the section 382 event and the SRLY event, is a net operating loss described in paragraph (g)(2)(ii)(B) of this section because it is the net operating loss of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 382 event.

(vii) With respect to the Year 3 net operating loss, P, S, and T compose a SRLY subgroup under paragraph (c)(2) of this section. Because P, a member of the SRLY subgroup for the Year 3 carryover, is not also a member of a SRLY subgroup that has net operating loss carryovers described in paragraph (g)(2)(ii)(A) of this section (the Year 1 net operating loss), the Year 3 carryover is subject to a SRLY limitation in the M group. See paragraph (g)(4)(ii) of this section.

(h) *Effective date—(1) In general.* This section generally applies to taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraph (g)(1) of this section does not apply to a particular net operating loss carryover in the current group, then solely for purposes of applying paragraph (c) of this section to determine a limitation with respect to that carryover and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's or subgroup's items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), paragraph (c)(2) of this section shall be applied without regard to the phrase "or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502-15(g) with respect to another group (the former group)"; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to which section 382(a), as amended by the Tax Reform Act of 1986, applies shall constitute a section 382 event.

(2) *SRLY limitation.* Except in the case of those members (including members of a SRLY subgroup) described in paragraph (h)(3) of this section, a group does not

take into account a consolidated taxable year beginning before January 1, 1997, in determining the aggregate of the consolidated taxable income under paragraph (c)(1) of this section (including for purposes of §1.1502-15 and §1.1502-22(c)) for the members (or SRLY subgroups).

(3) *Prior retroactive election.* A consolidated group that applied the rules of §1.1502-21T(g)(3) in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, to all consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997, does not take into account a consolidated taxable year beginning before January 29, 1991, in determining the aggregate of the consolidated taxable income under paragraph (c)(1) of this section (including for purposes of §1.1502-15 and §1.1502-22(c)) for the members (or SRLY subgroups).

(4) *Offspring rule.* Paragraph (b)(2)(ii)(B) of this section applies to net operating losses arising in taxable years ending on or after June 25, 1999.

(5) *Waiver of carrybacks.* Paragraph (b)(3)(ii)(B) of this section (relating to the waiver of carrybacks for acquired members) applies to acquisitions occurring after August 24, 1999.

(6) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502-21T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

### §1.1502-21T [Removed]

Par. 7. Section 1.1502-21T is removed.

Par. 8. Section 1.1502-22 is added to read as follows:

#### §1.1502-22 Consolidated capital gain and loss.

(a) *Capital gain.* The determinations under section 1222, including capital gain net income, net long-term capital gain, and net capital gain, with respect to members during consolidated return years are not made separately. Instead, consolidated amounts are determined for the group as a whole. The consolidated capital gain net income for any consolidated return year is determined by reference to—

(1) The aggregate gains and losses of members from sales or exchanges of capital assets for the year (other than gains and losses to which section 1231 applies);

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

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

(b) *Net capital loss carryovers and carrybacks—*(1) *In general.* The determinations under section 1222, including net capital loss and net short-term capital loss, with respect to members during consolidated return years are not made separately. Instead, consolidated amounts are determined for the group as a whole. Losses included in the consolidated net capital loss may be carried to consolidated return years, and, after apportionment, may be carried to separate return years. The net capital loss carryovers and carrybacks consist of—

(i) Any consolidated net capital losses of the group; and

(ii) Any net capital losses of the members arising in separate return years.

(2) *Carryovers and carrybacks generally.* The net capital loss carryovers and carrybacks to a taxable year are determined under the principles of section 1212 and this section. Thus, losses permitted to be absorbed in a consolidated return year generally are absorbed in the order of the taxable years in which they were sustained, and losses carried from taxable years ending on the same date, and which are available to offset consolidated capital gain net income, generally are absorbed on a pro rata basis. Additional rules provided under the Internal Revenue Code or regulations also apply, as well as the SRLY limitation under paragraph (c) of this section. See, e.g., section 382(l)(2)(B).

(3) *Carryovers and carrybacks of consolidated net capital losses to separate return years.* If any consolidated net capital loss that is attributable to a member may be carried to a separate return year under the principles of §1.1502-21(b)(2), the amount of the consolidated net capital loss that is attributable to the member is apportioned and carried to the separate return year (apportioned loss).

(4) *Special rules—*(i) *Short years in connection with transactions to which section 381(a) applies.* If a member distributes or transfers assets to a corporation that is a member immediately after the distribution or transfer in a transaction to which section 381(a) applies, the transac-

tion does not cause the distributor or transferor to have a short year within the consolidated return year of the group in which the transaction occurred that is counted as a separate year for purposes of determining the years to which a net capital loss may be carried.

(ii) *Special status losses.* [Reserved]

(c) *Limitations on net capital loss carryovers and carrybacks from separate return limitation years.* The aggregate of the net capital losses of a member arising (or treated as arising) in SRLYs that are included in the determination of consolidated capital gain net income for all consolidated return years of the group under paragraph (a) of this section may not exceed the aggregate of the consolidated capital gain net income for all consolidated return years of the group determined by reference to only the member's items of gain and loss from capital assets as defined in section 1221 and trade or business assets defined in section 1231(b), including the member's losses actually absorbed by the group in the taxable year (whether or not absorbed by the member). The principles of §1.1502-21(c) (including the SRLY subgroup principles under §1.1502-21(c)(2)) apply with appropriate adjustments for purposes of applying this paragraph (c).

(d) *Coordination with respect to consolidated return change of ownership limitation occurring in consolidated return years beginning before January 1, 1997.* If a consolidated return change of ownership occurred before January 1, 1997, the principles of §1.1502-22A(d) apply to determine the amount of the aggregate of the net capital loss attributable to old members of the group (as those terms are defined in §1.1502-1(g)), that may be included in the net capital loss carryover under paragraph (b) of this section. For this purpose, §1.1502-1(g) is applied by treating that date as the end of the year of change.

(e) *Consolidated net capital loss.* Any excess of losses over gains, as determined under paragraph (a) of this section (without regard to any carryovers or carrybacks), is also referred to as the consolidated net capital loss.

(f) *Predecessors and successors.* For purposes of this section, the principles of §1.1502-21(f) apply with appropriate adjustments.

(g) *Overlap with section 383*—(1) *General rule.* The limitation provided in paragraph (c) of this section does not apply to net capital loss carryovers (other than a hypothetical carryover like those described in §1.1502–21(c)(1)(i)(D) and a carryover like those described in §1.1502–21(c)(1)(ii)) when the application of paragraph (c) of this section results in an overlap with the application of section 383. For a similar rule applying in the case of net capital loss carryovers like those described in §§1.1502–21(c)(1)(i)(D) and (c)(1)(ii), see §1.1502–15(g).

(2) *Definitions*—(i) *Generally.* For purposes of this paragraph (g), the definitions and nomenclature contained in sections 382 and 383, the regulations thereunder, and §§1.1502–90 through 1.1502–99 apply.

(ii) *Overlap.* (A) An overlap of the application of paragraph (c) of this section and the application of section 383 with respect to a net capital loss carryover occurs if a corporation becomes a member of the consolidated group (the SRLY event) within six months of the change date of an ownership change giving rise to a section 382 limitation with respect to that carryover (the section 383 event).

(B) If an overlap described in paragraph (g)(2)(ii)(A) of this section occurs with respect to net capital loss carryovers of a corporation whose SRLY event occurs within the six month period beginning on the date of a section 383 event, then an overlap is treated as also occurring with respect to that corporation's net capital loss carryover that arises within the period beginning with the section 383 event and ending with the SRLY event.

(C) For special rules in the event that there is a SRLY subgroup and/or a loss subgroup as defined in §1.1502–91(d)(1) with respect to a carryover, see paragraph (g)(4) of this section.

(3) *Operating rules*—(i) *Section 383 event before SRLY event.* If a SRLY event occurs on the same date as a section 383 event or within the six month period beginning on the date of the section 383 event, paragraph (g)(1) of this section applies beginning with the tax year that includes the SRLY event.

(ii) *SRLY event before section 383 event.* If a section 383 event occurs within the period beginning the day after the SRLY event and ending six months

after the SRLY event, paragraph (g)(1) of this section applies starting with the first tax year that begins after the section 383 event.

(4) *Subgroup rules.* In general, in the case of a net capital loss carryover for which there is a SRLY subgroup and a loss subgroup (as defined in §1.1502–91(d)(1)), the principles of this paragraph (g) apply to the SRLY subgroup, and not separately to its members. However, paragraph (g)(1) of this section applies—

(i) With respect to a carryover described in paragraph (g)(2)(ii)(A) of this section only if—

(A) All members of the SRLY subgroup with respect to that carryover are also included in a loss subgroup with respect to that carryover; and

(B) All members of a loss subgroup with respect to that carryover are also members of a SRLY subgroup with respect to that carryover; and

(ii) With respect to a carryover described in paragraph (g)(2)(ii)(B) of this section only if all members of the SRLY subgroup for that carryover are also members of a SRLY subgroup that has net capital loss carryovers described in paragraph (g)(2)(ii)(A) of this section that are subject to the overlap rule of paragraph (g)(1) of this section.

(h) *Effective date*—(1) *In general.* This section generally applies to taxable years for which the due date (without extensions) of the consolidated return is after June 25, 1999. However—

(i) In the event that paragraph (g)(1) of this section does not apply to a particular net capital loss carryover in the current group, then solely for purposes of applying paragraph (c) of this section to determine a limitation with respect to that carryover and with respect to which the SRLY register (consolidated taxable income determined by reference to only the member's or subgroup's items of income, gain, deduction or loss) began in a taxable year for which the due date of the return was on or before June 25, 1999), the principles of §1.1502–21(c)(2) shall be applied without regard to the phrase “or for a carryover that was subject to the overlap rule described in paragraph (g) of this section or §1.1502–15(g) with respect to another group (the former group)”; and

(ii) For purposes of paragraph (g) of this section, only an ownership change to

which section 383, as amended by the Tax Reform Act of 1986, applies and which results in a section 382 limitation shall constitute a section 383 event.

(2) *Prior periods.* For certain taxable years ending on or before June 25, 1999, see §1.1502–22T in effect prior to June 25, 1999, as contained in 26 CFR part 1 revised April 1, 1999, as applicable.

### §1.1502–22T [Removed]

Par. 9. Section 1.1502–22T is removed.

Par. 10. Section 1.1502–23 is added to read as follows:

#### §1.1502–23 Consolidated net section 1231 gain or loss.

(a) *In general.* Net section 1231 gains and losses of members arising during consolidated return years are not determined separately. Instead, the consolidated net section 1231 gain or loss is determined under this section for the group as a whole.

(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 §1.1502–22(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 §1.1502–22):

	P	T
	Year 1 (SRLY)	
Ordinary Capital		(20)
	Year 2	
Ordinary Capital	10 70	20 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 §1.1502–22(c). Under §1.1502–22(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.

(c) *Recapture of ordinary loss.* [Reserved]

(d) *Effective date*—(1) *In general*. This section applies to gains and losses arising in the determination of consolidated net section 1231 gain or loss for taxable years for which the due date (without extensions) of the consolidated return is taxable years is after June 25, 1999.

(2) *Application to prior periods*. See §1.1502-21(h)(3) for rules applicable to groups that applied the rules of this section to consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997.

**§1.1502-23T [Removed]**

Par. 11. Section 1.1502-23T is removed.

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

Par. 12. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 13. In §602.101, paragraph (b) is amended by removing the entry for §1.1502-21T from the table and adding an entry in numerical order to the table to read as follows:

*§602.101 OMB Control numbers.*

\* \* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502-21	1545-1237
* * * * *	

John M. Dalrymple,  
*Acting Deputy Commissioner of Internal Revenue.*

Approved June 18, 1999.

Donald C. Lubick,  
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on June 25, 1999, 1:27 p.m., and published in the issue of the Federal Register for July 2, 1999, 64 F.R. 36091)

*26 CFR 1.1502-91A: Application of Section 382 with respect to a consolidated group generally applicable for testing dates before June 25, 1999.*

**T.D. 8824**

**DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Parts 1 and 602**

**Regulations Under Section 1502 of the Internal Revenue Code of 1986; Limitations on Net Operating Loss Carryforwards and Certain Built-in Losses and Credits Following an Ownership Change of a Consolidated Group**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding the operation of sections 382 and 383 of the Internal Revenue Code of 1986 (relating to limitations on net operating loss carryforwards and certain built-in losses and credits following an ownership change) with respect to consolidated groups. The regulations include rules for determining whether a loss group or a loss subgroup has an ownership change, for computing a consolidated section 382 limitation or subgroup section 382 limitation, and for applying sections 382 and 383 to corporations that join or leave a group. The rules are necessary to provide guidance to such groups on the use of certain of their tax attributes.

DATES: *Effective Dates:* These regulations are effective June 25, 1999.

*Applicability Dates:* For dates of application and special effective date rules, see Effective Dates under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Lee A. Kelley at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

*Paperwork Reduction Act*

The collection of information in these final regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of

Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545-1218.

The collections of information in this regulation are in §§1.1502-20(g)(4), 1.1502-95(e)(8), 1.1502-95(f), and 1.1502-96(e). This information is required to assure that a section 382 limitation is properly determined and applied in cases of corporations that become or cease to be members of a consolidated group. The collection of information in §1.1502-98(e)(8) is mandatory. The other collections of information are required to obtain a benefit. The likely respondents are business or other for-profit institutions.

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by August 31, 1999. Comments are specifically requested concerning:

Whether the collection[s] of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the collection[s] of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

Estimated total annual reporting burden: 662 hours.

The estimated annual burden per respondent varies from 15 to 25 minutes, depending on individual circumstances, with an estimated average of 20 minutes.

Estimated number of respondents: 12,054

Estimated annual frequency of responses: On occasion