

(3) *Amended returns.* A taxpayer that has had an ownership change before January 1, 1997, may file an amended return for any taxable year to modify the amount of a limitation under section 382 with respect to a controlled group loss only if—

(i) The modification complies with the rules contained in this section for computing a limitation under section 382;

(ii) Any other component member of the controlled group with respect to the controlled group loss who elects to restore value and whose taxable income is affected by the election to restore value also files amended returns that comply with such rules; and

(iii) Corresponding adjustments are made in amended returns for all taxable years ending after December 31, 1986.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In § 602.101, paragraph (c) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *				
(c) * * *				
CFR part or section where identified or described				Current OMB control No.
* * * * *				*
1.382.8T			1545-1434
* * * * *				*

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: May 31, 1996.

Leslie Samuels,
Assistant Secretary of the Treasury.
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26 CFR Parts 1 and 602

[TD 8677]

RIN 1545-AU35

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 and temporary amendments to the consolidated return regulations relating to deductions and losses of members. The temporary amendments concern the method for computing the limitations with respect to separate return limitation year (SRLY) losses. They also concern the rules relating to carryover and carryback of losses to consolidated and separate return years and to the built-in deduction rules. Final amendments are made amending definitions and redesignating sections displaced by temporary regulations. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register.

DATES: These amendments are effective June 27, 1996.

For dates of application and special transition rules, see Effective Dates under **SUPPLEMENTARY INFORMATION.**

FOR FURTHER INFORMATION CONTACT: David B. Friedel at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in the temporary regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the control number 1545-1237. Section 1.1502-21T(b)(3) requires a response from certain consolidated groups. The IRS requires the information to assure that an election to relinquish a carryback period is properly documented. Responses to this collection of information are required to obtain a benefit (relating to the carryover of losses which would otherwise be carried back).

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

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

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 IRS and Treasury published in the Federal Register a notice of proposed rulemaking (CO-078-90, 56 FR 4228) setting forth amendments to the rules regarding the net operating losses, built-in deductions, and capital losses of consolidated groups, including rules regarding the carryover and carryback of losses to consolidated and separate return years. Some of the amendments are clarifying, and some change the existing rules. The principal changes related to losses arising in (or carried to) SRLY years. The preamble to the proposed amendments explains the proposed changes in detail. The IRS and Treasury also published Notice 91-27 (1991-2 C.B. 629) to advise of intended modifications to the proposed amendments.

Generally, section 1503(a) requires that a consolidated group determine its tax in accordance with the regulations under section 1502 prescribed before the last day prescribed by law for the filing of its tax return. Many of the proposed amendments have proposed effective dates of January 29, 1991, and other transitional rules for their application. Because of this effective date, consolidated groups have been uncertain whether the existing rules or the proposed rules (if adopted) will determine their use of losses for consolidated return years ending on or after January 29, 1991.

To address the uncertainty, the IRS and Treasury are issuing this Treasury decision to adopt temporary amendments to the rules regarding a consolidated group's losses, including the carryover and carryback of SRLY losses. The temporary amendments are substantially identical to the rules proposed on January 29, 1991. A more detailed discussion of the effective dates of the temporary amendments, including special transitional rules, is set forth below under *Effective Dates.*

These temporary amendments primarily address the uncertainty created by the proposed effective dates. They do not address the comments on the proposed amendments. Many of these comments are still under consideration.

As companions to this Treasury decision, the IRS and Treasury also issue two other sets of temporary regulations under sections 382 and 383

concerning the use of losses and deductions by consolidated groups and by members of controlled groups. See TD 8678 and TD 8679 published elsewhere in this issue of the Federal Register.

Effective Date

The temporary amendments are generally effective for consolidated return years beginning on or after January 1, 1997. However, two important changes are made to the effective date provisions set forth in the proposed rules.

As proposed, the amendments generally applied to consolidated return years ending on or after January 29, 1991, without regard to the year in which the losses arose and without regard to whether the losses are subject to the SRLY rules. An exception to the general effective date rules was made for the proposed SRLY rules and built-in deduction rules, which generally applied only to losses and deductions of corporations that became members (and acquisitions occurring) on or after January 29, 1991, without regard to when they arose. Thus, the proposed amendments required the losses and deductions of members acquired before January 29, 1991, to remain subject to the existing SRLY limitations.

The temporary amendments revise this treatment. Losses and deductions of a member (including SRLY losses) carried to consolidated return years beginning on or after January 1, 1997, are governed by the temporary amendments, regardless of the year in which the loss or deduction was recognized, and regardless of when the member with the SRLY loss became a member of the group.

The temporary amendments also contain rules relating to consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997. Specifically, a consolidated group may apply the temporary amendments to those consolidated return years provided that three principal conditions are met: (1) all the

temporary amendments must be applied consistently on the group's final return (original or amended return) for each such year for which the statute of limitations does not preclude the filing of an amended return on January 1, 1997; (2) the temporary amendments relating to the treatment of built-in deductions and SRLY losses must be applied with respect to the losses and deductions of those corporations that became members of the group, and to acquisitions occurring, on or after January 29, 1991, and only with respect to such losses and deductions; and (3) appropriate adjustments must be made in the earliest subsequent open year to reflect any inconsistency in a year for which the statute of limitations precludes the filing of an amended return on January 1, 1997. Until consolidated return years beginning on or after January 1, 1997, the rules of the existing regulations relating to the treatment of built-in deductions and SRLY losses continue to apply to corporations that became members before, and to acquisitions occurring before, January 29, 1991. See § 1.1502-21T(g)(3).

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations were sent to the Small Business Administration for

comment on their impact on small business.

Drafting Information

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

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for Part 1 is amended in part by adding citations in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.1502-0 also issued under 26 U.S.C. 1502. * * *
Section 1.1502-1T also issued under 26 U.S.C. 1502.
Section 1.1502-2 also issued under 26 U.S.C. 1502. * * *
Section 1.1502-15T also issued under 26 U.S.C. 1502. * * *
Section 1.1502-21T also issued under 26 U.S.C. 1502.
Section 1.1502-22T also issued under 26 U.S.C. 1502.
Section 1.1502-23T also issued under 26 U.S.C. 1502. * * *
Section 1.1502-79T also issued under 26 U.S.C. 1502.
Section 1.1502-15A also issued under 26 U.S.C. 1502.
Section 1.1502-21A also issued under 26 U.S.C. 1502.
Section 1.1502-22A also issued under 26 U.S.C. 1502.
Section 1.1502-23A also issued under 26 U.S.C. 1502.
Section 1.1502-41A also issued under 26 U.S.C. 1502.
Section 1.1502-79A 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.

Affected section	Remove	Add
1.469-1(h)(2)	1.1502-21 (consolidated net operating loss), and 1.1502-22 (consolidated net capital gain or loss).	1.1502-21T (Net operating losses (temporary)), and 1.1502-22T (consolidated net capital gain and loss (temporary)).
1.597-2(c)(5), first sentence	§§ 1.1502-15, 1.1502-21, and 1.1502-22	§§ 1.1502-15T, 1.1502-21T, and 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A, and 1.1502-22A, as appropriate).
1.597-2(c)(5), second sentence	§§ 1.1502-15, 1.1502-21 or 1.1502-22	§§ 1.1502-15T, 1.1502-21T or 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A or 1.1502-22A, as appropriate).
1.597-4(g)(3), fifth sentence	§§ 1.1502-15, 1.1502-21 and 1.1502-22	§§ 1.1502-15T, 1.1502-21T and 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A and 1.1502-22A, as appropriate).

Affected section	Remove	Add
1.597-4(g)(3), sixth sentence	§§ 1.1502-15, 1.1502-21, or 1.1502-22	§§ 1.1502-15T, 1.1502-21T, or 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A, or 1.1502-22A, as appropriate).
1.904(f)-3(a)	(or §§ 1.1502-21(b) and 1.1502-79(a))	(or § 1.1502-21T(b) (or §§ 1.1502-21A(b) and 1.1502-79A(a), as appropriate)).
1.904(f)-3(b)	(or §§ 1.1502-22 and 1.1502-79(b))	(or § 1.1502-22T(b) (or §§ 1.1502-22A and 1.1502-79A(b), as appropriate)).
1.1341-1(f)(2)(i)	§ 1.1502-2A	§ 1.1502-2A (as contained in the 26 C.F.R. edition revised as of April 1, 1996).
1.1502-9(a), seventh sentence	§ 1.1502-79	§ 1.1502-21T(b)(2) (or § 1.1502-79A, as appropriate).
1.1502-9(a), eighth sentence	§ 1.1502-79	§ 1.1502-21T(b)(1) (or § 1.1502-79A, as appropriate).
1.1502-9(f) Example 5(ii)	§ 1.1502-21(c)	§ 1.1502-21A(c)
1.1502-11(a)(2)	§ 1.1502-21	§§ 1.1502-21T (or 1.1502-21A, as appropriate).
1.1502-11(a)(3)	§ 1.1502-22	§§ 1.1502-22T (or 1.1502-22A, as appropriate).
1.1502-11(a)(4)	§ 1.1502-23	§§ 1.1502-23T (or 1.1502-23A, as appropriate).
1.1502-11(b)(2)(iii) Example 1(c)	§ 1.1502-79	§ 1.1502-21T (or § 1.1502-79A, as appropriate).
1.1502-11(b)(2)(iii) Example 2(d)	§ 1.1502-79	§§ 1.1502-21T and 1.1502-22T, respectively (or § 1.1502-79A, as appropriate).
1.1502-11(b)(2)(iii) Example 3(e)	§ 1.1502-79	§ 1.1502-21T (or § 1.1502-79A, as appropriate).
1.1502-12(b)	§ 1.1502-15 shall be taken into account as provided in that section.	§§ 1.1502-15A or 1.1502-15T shall be taken into account as provided in those sections.
1.1502-13(c)(7)(ii) Example 10(d)	§ 1.1502-21(c)	§ 1.1502-21T(c).
1.1502-13(g)(5) Example 4(b)	§ 1.1502-15	§ 1.1502-15T (or § 1.1502-15A, as appropriate).
1.1502-13(h)(2), Example 1(a)	§ 1.1502-21(c)	§ 1.1502-21T(c).
1.1502-13(h)(2), Example 1(b)	§ 1.1502-21(c)	§ 1.1502-21T(c).
1.1502-13(h)(2), Example 2(a)	§ 1.1502-15	§ 1.1502-15T.
1.1502-13(h)(2), Example 2(b)	1.1502-22	1.1502-22T.
1.1502-15(a)(1), first sentence	§ 1.1502-21(c)	§ 1.1502-21A(c).
1.1502-15(a)(1), first sentence	§ 1.1502-22(c)	§ 1.1502-22A(c).
1.1502-15(a)(1), second sentence	Under §§ 1.1502-21, 1.1502-22, and 1.1502-79.	Under §§ 1.1502-21A, 1.1502-22A, and 1.1502-79A (or §§ 1.1502-21T and 1.1502-22T, as appropriate).
1.1502-15(a)(1), second sentence	In § 1.1502-21(c) or § 1.1502-22(c) (as the case may be).	In §§ 1.1502-21T(c) or 1.1502-22T(c) (or §§ 1.1502-21A(c) or 1.1502-22A(c), as appropriate), as the case may be.
1.1502-15(a)(3)	§ 1.1502-31A(b)(9)	§ 1.1502-31A(b)(9) (as contained in the 26 C.F.R. edition revised as of April 1, 1996).
1.1502-18(f)(1)(ii), (1)(iii), (2)(i), (2)(ii), and (4) Example (i) and (ii).	§ 1.1502-39A	§ 1.1502-39A (as contained in the 26 C.F.R. edition revised as of April 1, 1996).
1.1502-18(f)(5)	§ 1.1502-31A(b)(1)	§ 1.1502-31A(b)(1) (as contained in the 26 C.F.R. edition revised as of April 1, 1996).
1.1502-20(a)(1)	1.1502-15(b)	1.1502-11(c).
1.1502-20(c)(4), Example 7(iii)	§ 1.1502-21	§§ 1.1502-21A or 1.1502-21T.
1.1502-20(g)(3), Example 1(i)	§ 1.1502-21	§§ 1.1502-21A or 1.1502-21T.
1.1502-20(g)(3), Example 2(i)	§ 1.1502-21	§§ 1.1502-21A or 1.1502-21T.
1.1502-21(b)(1)	Paragraph (a) of § 1.1502-79	§§ 1.1502-79A(a).
1.1502-21(b)(1)	§ 1.1502-15	§ 1.1502-15A (or § 1.1502-11(c), as appropriate).
1.1502-21(b)(2)(i)	Paragraph (a)(4) of § 1.1502-79	This paragraph.
1.1502-21(e)(1)(i)	Paragraph (a)(3) of § 1.1502-79	This paragraph.
1.1502-22(a)(1)(ii)	§ 1.1502-23	§§ 1.1502-23A or 1.1502-23T.
1.1502-22(a)(3)	§ 1.1502-15	§§ 1.1502-15A and 1.1502-11(c).
1.1502-22(b)(1)	Paragraph (b) of § 1.1502-79	§ 1.1502-79A(b) (or § 1.1502-22T(b), as appropriate).
1.1502-23	§§ 1.1502-21(c) and 1.1502-22(c), as provided in § 1.1502-15(a).	§§ 1.1502-21A(c) and 1.1502-22A(c), as provided in § 1.1502-15A(a) (or §§ 1.1502-21T(c) and 1.1502-22T(c), as provided in § 1.1502-15T(a), as appropriate).
1.1502-26(a)(1)(ii) concluding text	Paragraph (f) of § 1.1502-21	§§ 1.1502-21T(e) or 1.1502-21A(f), as appropriate.
1.1502-32(b)(5) Example 2(b)	1.1502-79	1.1502-21T(b).
1.1502-41(a)	Paragraph (a)(1) of § 1.1502-22	§ 1.1502-22A(a).
1.1502-41(a)	§ 1.1502-23	§ 1.1502-23A.
1.1502-41(b)	Paragraph (a)(1) of § 1.1502-22	§ 1.1502-22A(a).
1.1502-41(b)	Paragraph (b) of § 1.1502-22	§ 1.1502-22A(b).

Affected section	Remove	Add
1.1502-42(f)(4)(i)(A)	§ 1.1502-79(a)(3).	§ 1.1502-21T(b) (or § 1.1502-79A(a)(3), as appropriate).
1.1502-42(j) Example 4(b)	§ 1.1502-79(a)(3).	§ 1.1502-79A(a)(3).
1.1502-42(j) Example 4(c)	§ 1.1502-21(b)(3)	§ 1.1502-21A(b)(3).
1.1502-42(j) Example 4(c)	§ 1.1502-79(a)(3)	§ 1.1502-79A(a)(3).
1.1502-43(b)(2)(iv)	§ 1.1502-21(a)	§§ 1.1502-21T(a) or 1.1502-21A(a), as appropriate.
1.1502-43(b)(2)(v)	§ 1.1502-22(a)	§§ 1.1502-22T(a) or 1.1502-22A(a), as appropriate.
1.1502-43(b)(2)(vi)	§ 1.1502-41(a)	§§ 1.1502-22T(a) or 1.1502-41A, as appropriate.
1.1502-43(b)(2)(vii)	§ 1.1502-41(b)	§§ 1.1502-22T(a) or 1.1502-41A, as appropriate.
1.1502-43(b)(2)(viii)	§ 1.1502-22(b)	§§ 1.1502-22T(b) or 1.1502-22A(b), as appropriate.
1.1502-43(b)(2)(viii)	Section 1.1502-15 (built-in deductions) does	Sections 1.1502-15A (Limitations on built-in deductions not subject to § 1.1502-15T) and 1.1502-15T (SRLY limitation on built-in losses (temporary)) do.
1.1502-44(b)(2)	§ 1.1502-21	§§ 1.1502-21T or 1.1502-21A (as appropriate).
1.1502-44(b)(3)	§ 1.1502-22	§§ 1.1502-22T or 1.1502-22A (as appropriate).
1.1502-47(h)(2)(i)	§ 1.1502-21	§§ 1.1502-21T or 1.1502-21A (as appropriate).
1.1502-47(h)(2)(ii)	§ 1.1502-21(f)	§§ 1.1502-21(A)(f) or 1.1502-21T(e) (as appropriate).
1.1502-47(h)(2)(iii)	§ 1.1502-21	§§ 1.1502-21A or 1.1502-21T (as appropriate).
1.1502-47(h)(2)(iv)	§ 1.1502-21	§§ 1.1502-21A or 1.1502-21T (as appropriate).
1.1502-47(h)(2)(vii) Example	§§ 1.1502-21 and 1.1502-79	§§ 1.1502-21A and 1.1502-79A.
1.1502-47(h)(3)(iii)	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c) (as appropriate).
1.1502-47(h)(3)(iv) and (v)	§ 1.1502-21(d)	§ 1.1502-21A(d).
1.1502-47(h)(4)(i), first sentence	§ 1.1502-22	§§ 1.1502-22T or 1.1502-22A (as appropriate).
1.1502-47(h)(4)(i), second sentence	§ 1.1502-22(a)	§§ 1.1502-22T or 1.1502-22A(a) (as appropriate).
1.1502-47(h)(4)(ii), first sentence	§ 1.1502-22	§§ 1.1502-22A or 1.1502-22T.
1.1502-47(h)(4)(ii), first sentence	§ 1.1502-21	§§ 1.1502-21T or 1.1502-21A (as appropriate).
1.1502-47(h)(4)(ii), second sentence	“§ 1.1502-22(d)”	“§ 1.1502-22A(d)”.
1.1502-47(h)(4)(ii), second sentence	“§ 1.1502-21(d)”	“§ 1.1502-21A(d)”.
1.1502-47(h)(4)(iii)	§ 1.1502-22(b)(1)	§§ 1.1502-22A(b)(1) or 1.1502-22T(b).
1.1502-47(k)(5)	§ 1.1502-22	§§ 1.1502-22T or 1.1502-22A (as appropriate).
1.1502-47(l)(3)(i)	§ 1.1502-21	§§ 1.1502-21T or 1.1502-21A (as appropriate).
1.1502-47(m)(2)(ii)	§ 1.1502-21	§§ 1.1502-21T or 1.1502-21A (as appropriate).
1.1502-47(m)(2)(ii)	§ 1.1502-22	§§ 1.1502-22T or 1.1502-22A (as appropriate).
1.1502-47(m)(3)(i)	§§ 1.1502-21 and 1.1502-22	§§ 1.1502-21T and 1.1502-22T (or §§ 1.1502-21A and 1.1502-22A, as appropriate).
1.1502-47(m)(3)(vi)(A), both instances	§ 1.1502-79(a)(3)	§§ 1.1502-21T(b) or 1.1502-79A(a)(3) (as appropriate).
1.1502-47(m)(3)(vii)	§ 1.1502-21(b)(3)(ii)	§ 1.1502-21A(b)(3)(ii).
1.1502-47(m)(3)(ix)	§ 1.1502-15 (including the exceptions in paragraph (a)(4) thereof).	§§ 1.1502-15T and 1.1502-15A (including applicable exceptions thereto).
1.1502-47(m)(5) Example 4	§ 1.1502-15	§ 1.1502-15A.
1.1502-47(o)(2)(i)	§ 1.1502-41	§§ 1.1502-41A or 1.1502-22T (as appropriate).
1.1502-47(o)(2)(ii)	§ 1.1502-41	§§ 1.1502-41A or 1.1502-22T (as appropriate).
1.1502-47(q)	§ 1.1502-21(b)(3) and § 1.1502-79(a)(3)	§§ 1.1502-21A(b)(3) and 1.1502-79A(a)(3) (or § 1.1502-21T, as appropriate).
1.1502-78(a)	§ 1.1502-79 (a), (b), or (c)	§§ 1.1502-21T(b), 1.1502-22T(b), or 1.1502-79(c) (or §§ 1.1502-79A(a), 1.1502-79A(b), or 1.1502-79(c), as appropriate).
1.1502-79(a)(1)(i)	§ 1.1502-21	§ 1.1502-21A.
1.1502-79(b)(1)	1.1502-22	1.1502-22A.

Affected section	Remove	Add
1.1502-79(c)(1)	Paragraph (a)(1) and (2) of this section	§ 1.1502-21T(b) (or §§ 1.1502-79A(a)(1) and (2), as appropriate).
1.1502-79(d)(1)	Paragraph (a)(1) and (2) of this section	§ 1.1502-21T(b) (or §§ 1.1502-79A(a)(1) and (2), as appropriate).
1.1502-79(e)(1)	Paragraph (a)(1) and (2) of this section	§ 1.1502-21T(b) (or §§ 1.1502-79A(a)(1) and (2), as appropriate).
1.1502-80(c)	§ 1.1502-15(b)	§ 1.1502-11(c).
1.1502-100(c)(2)	§ 1.1502-21	§§ 1.1502-21A or 1.1502-21T (as appropriate).
1.1503-2(d)(2)(i)	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c), as appropriate.
1.1503-2(d)(2)(ii)	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c), as appropriate.
1.1503-2(d)(4) Example 1(iv)	1.1502-22	1.1502-22T(c).
1.1503-2(d)(4) Example 2(iv)	§ 1.1502-21(c)	§ 1.1502-21A(c).
1.1503-2(g)(2)(vii)(B)(1)	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c) (as appropriate).
1.1503-2(g)(2)(vii)(B)(2)	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c) (as appropriate).
1.1503-2(g)(2)(vii)(E)	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c) (as appropriate).
1.1503-2(g)(2)(vii)(G) Example 1	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c), as appropriate.
1.1503-2(g)(2)(vii)(G) Example 2	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c), as appropriate.
1.1503-2(h)(3)	§ 1.1502-21(c)	§§ 1.1502-21A(c) or 1.1502-21T(c) (as appropriate).
1.1503-2A(f)(1)(i) intro text	§ 1.1502-79(a)(3)	§ 1.1502-21T(b).
1.1503-2A(f)(1)(i)(C)	§ 1.1502-79	§ 1.1502-22T(b).
1.1503-2A(f)(2)(i)	§ 1.1502-21(c)(2)	§§ 1.1502-21A(c)(2) or 1.1502-21T(c) (as appropriate).
1.1503-2A(f)(2)(ii)	§ 1.1502-21(c)(2)	§§ 1.1502-21A(c)(2) or 1.1502-21T(c) (as appropriate).
1.1503-2A(f)(4) Example 2(iv), first sentence	§ 1.1502-21(c)(2)	§ 1.1502-21A(c)(2).
1.1503-2A(f)(4) Example 2(iv), second sentence	§ 1.1502-21(c)	§ 1.1502-21A(c).
1.1552-1(a)(3)(i)	§ 1.1502-30A	§ 1.1502-30A (as contained in the 26 C.F.R. edition revised as of April 1, 1996).
1.1552-1(b)(1)	§ 1.1502-30A	§ 1.1502-30A (as contained in the 26 C.F.R. edition revised as of April 1, 1996).
301.6402-7(g)(2)(iii)	§ 1.1502-21(b)	§§ 1.1502-21T(b) or 1.1502-21A(b) (as appropriate).
301.6402-7(g)(3) Example 2, second sentence	§ 1.1502-21	§ 1.1502-21T.
301.6402-7(g)(3) Example 2, third sentence	§ 1.1502-21(c)	§ 1.1502-21T(c).
301.6402-7(h)(1)(ii) Example (B)	1.1502-21(b)	1.1502-21T(b).
301.6402-7(h)(1)(ii) Example (B)	1.1502-22(b)	1.1502-22T(b).

§ 1.1501-1 [Removed]

Par. 3. Section 1.1501-1 is removed.

Par. 4. The undesignated centerheading immediately following § 1.1504-4 is revised from "Regulations Applicable to Taxable Years Prior to January 1, 1966" to "Regulations Applicable to Taxable Years Before January 1, 1997".

§§ 1.1502-0A through 1.1502-3A, 1.1502-10A through 1.1502-19A and 1.1502-30A through 1.1502-51A [Removed]

Par. 5. Sections 1.1502-0A through 1.1502-3A, 1.1502-10A through 1.1502-19A, and 1.1502-30A through 1.1502-51A are removed.

Par. 6. Section 1.1502-0 is revised to read as follows:

§ 1.1502-0 Effective dates.

(a) The regulations under section 1502 are applicable to taxable years beginning

after December 31, 1965, except as otherwise provided therein.

(b) The provisions of §§ 1.1502-0A through 1.1502-3A, 1.1502-10A through 1.1502-19A, and 1.1502-30A through 1.1502-51A (as contained in the 26 CFR part 1 edition revised April 1, 1996) are applicable to taxable years beginning before January 1, 1966.

Par. 7. Section 1.1502-1 is amended by revising paragraphs (b), (f)(1), and (f)(2) introductory text, adding paragraphs (f)(4) and (j), and adding and reserving paragraph (i) to read as follows:

§ 1.1502-1 Definitions.

* * * * *

(b) *Member*. The term *member* means a corporation (including the common parent) that is included in the group, or as the context may require, a

corporation that is included in a subgroup.

* * * * *

(f) *Separate return limitation year*—(1) *In general*. Except as provided in paragraphs (f)(2) and (3) of this section, the term *separate return limitation year* (or *SRLY*) means any separate return year of a member or of a predecessor of a member.

(2) *Exceptions*. The term *separate return limitation year* (or *SRLY*) does not include:

* * * * *

(4) *Predecessors 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 only if the amount by which basis differs from value, in the aggregate, is material. In the case of such a transaction, only one member may be considered a predecessor to or a successor of one other member.

* * * * *

(i) [Reserved]

(j) *Affiliated*. Corporations are affiliated if they are members of a group with each other.

Par. 8. In § 1.1502-2, paragraph (h) is revised to read as follows:

§ 1.1502-2 Computation of tax liability.

* * * * *

(h) The tax imposed by section 1201, instead of the taxes computed under paragraphs (a) and (g) of this section, computed by reference to the net capital gain of the group (see § 1.1502-22T) (or, for consolidated return years to which § 1.1502-22T does not apply, computed by reference to the excess of the consolidated net long-term capital gain over the consolidated net short-term capital loss (see § 1.1502-41A for the determination of the consolidated net long-term capital gain and the consolidated net short-term capital loss));

* * * * *

§ 1.1502-15 [Amended]

Par. 9. In § 1.1502-15, paragraph (b) is redesignated as paragraph (c) of § 1.1502-11, and the heading of newly designated § 1.1502-11, paragraph (c) is revised to read as follows:

§ 1.1502-11 Consolidated taxable income.

* * * * *

(c) *Disallowance of loss attributable to pre-1966 distributions.* * * *

§ 1.1502-15 [Redesignated as § 1.1502-15A]

Par. 10. Section 1.1502-15 is redesignated as § 1.1502-15A; the section heading of the newly designated § 1.1502-15A is revised; and paragraph (b) is added to read as follows:

§ 1.1502-15A Limitations on the allowance of built-in deductions for consolidated return years beginning before January 1, 1997.

* * * * *

(b) *Effective date*. This section applies to any consolidated return years to which § 1.1502-21T does not apply. See § 1.1502-21T(g) for effective dates of that section.

Par. 11. Section 1.1502-15T is added to read as follows:

§ 1.1502-15T SRLY limitation on built-in losses (temporary).

(a) *SRLY limitation*. Built-in losses are subject to the SRLY limitation under §§ 1.1502-21T(c) and 1.1502-22T(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 § 1.1502-21T(c) or § 1.1502-22T(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 § 1.1502-94T(c) apply with appropriate adjustments, including the following:

(i) *Ownership change*. 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. 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 (and has an ownership change) on the date of the acquisition.

(ii) *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 § 1.1502-21T(c)(2) (iv) through (vi) apply with appropriate adjustments.

(3) *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 §§ 1.1502-91T (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. (a) P buys all the stock of T during Year 1 for \$100, and T becomes a member of the P group. T has three depreciable assets. Asset 1 has an unrealized loss of \$20 (basis \$45, value \$25), asset 2 has an unrealized loss of \$25 (basis \$50, value \$25), and asset 3 has an unrealized gain of \$25 (basis \$25, value \$50).

(b) Under paragraph (b)(2)(i) of this section, T is treated as having an ownership change under section 382(g) on becoming a member of the P group. This treatment does not depend on whether P's acquisition of the T stock actually constitutes an ownership change under section 382(g), or whether T is subject to any limitation under section 382. Under paragraph (b)(1) of this section, none of T's \$45 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.

(c) Under section 382(h)(3)(A), T has a \$20 net unrealized built-in loss on becoming a member of the P group $((\$20) + (\$25) + \$25 = (\$20))$. 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 \$45 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)(ii) 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 \$45 of unrealized loss (not just the \$20 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 § 1.1502-21T(c)(1).

(d) Under paragraph (b)(2)(i) of this section, the results would be the same if T transferred all of its assets and liabilities to a subsidiary of the P group in a single transaction described in section 351.

Example 2. Actual application of section 382 not relevant. (a) The facts are the same as in *Example 1*, except that P buys 55 percent of the stock of T during Year 1, resulting in an ownership change of T under section 382(g). During Year 2, P buys the 45 percent balance of the T stock, and T becomes a member of the P group.

(b) 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) 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. Thus, the results are the same as in *Example 1*.

Example 3. Determination of a recognized built-in loss of a subgroup. (a) During Year 1, P buys all of the stock of S for \$100, and S becomes a member of the P group. M is the common parent of another group. At the beginning of Year 7, M acquires all of the stock of P, and P and S become members of the M group. 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).

(b) 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 § 1.1502-21T(c).

(c) 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 built-in loss.) Assume that the \$65 net unrealized built-in loss exceeds the threshold requirement under section 382(h)(3)(B).

(d) Under paragraphs (b)(1), (b)(2)(ii), 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)(ii) 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)(ii) and (c) of this section (not just the \$55 balance of the P subgroup's \$65 net unrealized built-in loss).

(e) 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 § 1.1502-21T(c).

Example 4. Computation of SRLY limitation. (a) 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 buys all the stock of T for \$100, and T becomes a member of the P group with a net unrealized built-in loss of \$100. 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 § 1.1502-21T) for Years 3 and 4:

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

(b) 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 § 1.1502-21T(c).

(c) For Year 3, § 1.1502-21T(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, consolidated taxable income is determined without regard to any consolidated net operating loss deductions under § 1.1502-21T(a).

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

(e) 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 § 1.1502-21T(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.

(f) 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 § 1.1502-21T(b). The \$40 net operating loss is treated under paragraph (a) of this section and § 1.1502-21T(c)(1)(ii) as a loss carryover or carryback from Year 3 that arises in a SRLY, and is subject to the rules of § 1.1502-21T (including § 1.1502-21T(c)) rather than this section.

(g) The facts are the same as in paragraphs (a) through (f) of this *Example 4*, except that T also recognizes additional built-in losses 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. (a) P buys all the stock of T during Year 1, and T becomes a member of the P group. At the time of acquisition, T has

a depreciable 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).

(b) 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 § 1.1502-21T(c)(1)(ii), the loss is treated as a net operating loss carryover to Year 2 for purposes of applying the SRLY limitation under § 1.1502-21T(c).

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

(d) Under § 1.1502-21T(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 over under the rules of § 1.1502-21T(b) and absorbed under the rules of § 1.1502-21T(a). This loss is not treated as arising in a SRLY (see § 1.1502-21T(c)(1)(ii)) and therefore is not subject to the SRLY limitation under § 1.1502-21T(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 § 1.1502-21T(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) *Effective date—(1) In general.* This section applies to built-in losses recognized in consolidated return years beginning on or after January 1, 1997.

(2) *Application to prior periods.* See § 1.1502-21T(g)(3) for rules generally permitting a group to apply the rules of this section to consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997. A group must treat all corporations that were affiliated on January 1, 1987, and continuously thereafter as having met the 60 consecutive month requirement of paragraph (c)(2) of this section on any day before January 1, 1992, on which the determination of net unrealized built-in gain or loss of a subgroup is made.

Par. 12. Section 1.1502-21 is redesignated as § 1.1502-21A; the heading of the newly designated § 1.1502-21A is revised; and paragraphs (d)(4), (e)(3) and (h) are added to read as follows:

§ 1.1502-21A Consolidated net operating loss deduction generally applicable for consolidated return years beginning before January 1, 1997.

* * * * *

(d) * * *

(4) *Cross-reference.* See § 1.1502-21T(d)(1) for the rule that applies the principles of this paragraph (d) in consolidated return years beginning on or after January 1, 1997, with respect to a consolidated return change of ownership occurring before January 1, 1997.

(e) * * *

(3) *Effective date.* This paragraph (e) disallows or reduces the net operating loss carryovers of a member as a result of a transaction to which old section 382 (as defined in § 1.382-2T(f)(21)) applies. See § 1.1502-21T(d)(2) for the rule that applies the principles of this paragraph (e) in consolidated return years beginning on or after January 1, 1997, with respect to such a transaction.

* * * * *

(h) *Effective date.* Except as provided in § 1.1502-21T (d)(1), (d)(2), and (g)(3), this section applies to consolidated return years beginning before January 1, 1997.

Par. 13. Section 1.1502-21T is added to read as follows:

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

(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. 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. Additional rules provided under the Code or regulations also apply. See, e.g., section 382(l)(2)(B).

(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.

(B) *Offspring rule.* In the case of a member that has been a member continuously since its organization, the CNOL attributable to the member is included in the carrybacks to consolidated return years before the member's existence. See paragraph (f) of this section for applications to predecessors and successors. 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. (a) P is formed at the beginning of Year 1 and files a separate return. P forms S on March 15 of Year 2, and P and S file a consolidated return. P purchases all the stock of T at the beginning of Year 3, and T becomes a member of the P group. T was formed in Year 2 and filed a separate return for that year. 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.

(b) 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 2.

Example 2. Departing members. (a) 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.

(b) \$600 of the Year 3 CNOL attributable to T is apportioned to T and is carried back to its separate return in Year 2. To the extent the \$600 is not absorbed in T's separate return in 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 2 or in the P group's Year 4 is then carried to T's separate return in Year 4.

(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. 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 1.1502-21T(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 election for 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.

(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.* 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 § 1.1502-15T 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 § 1.1502-15T), 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 § 1.1502-15T(d), *Example 5*.

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

Example 1. Determination of SRLY limitation. (a) In Year 1, individual A forms T and T sustains a \$100 net operating loss that is carried forward. P buys 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.

(b) T's \$100 net operating loss carryover from Year 1 arose in a SRLY. See § 1.1502-1(f)(2)(iii). 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.

(c) The facts are the same as in paragraph (a) 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) 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 § 1.1502-21T(c) 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.

(a) 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. Unrelated corporation T sustains a net operating loss of \$50 in Year 2 that is carried forward. P buys the stock of T 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

(b) 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.

(c) T's Year 2 and Year 3 are SRLYs with respect to the P group. See § 1.1502-1(f)(2)(ii). 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.

(d) 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 = $\$120/(\$120 + \$20) \times \$70 = \$60$.

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

(e) 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).

(f) 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 includes \$60 of P's Year 3 loss but only \$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.

(a)(1) 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

(2) 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.

(b) 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 § 1.1502-21T(c)

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). However, the \$30 loss is carried forward to

T's Year 5 and succeeding taxable years as provided under the Code.

Example 4. Computation of SRLY limitation for built-in losses treated as net operating loss carryovers.

(a) 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 buys all the stock of T for \$100, and T becomes a member of the P group. 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 § 1.1502-21T):

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

(b) Under § 1.1502-15T(a), T's \$100 of ordinary loss in Year 3 constitutes a built-in loss that is subject to the SRLY limitation under § 1.1502-21T(c). 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.

(c) Under § 1.1502-15T(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 § 1.1502-21T(c)(1)(ii), 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.

(d) 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.

(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)(vii) *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), whether or not the group is a consolidated 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)(vii) *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 § 1.1502-15T(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 those paragraphs to a group or former group is a reference to the subgroup determined under § 1.1502-15T(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-nonlife 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 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) *Examples.* The principles of this paragraph (c)(2) are illustrated by the following examples:

Example 1. Members of SRLY subgroups.

(a) During Year 1, P sustains a \$50 net operating loss. At the beginning of Year 2, P buys all the stock of S at a time when the aggregate basis of S's assets exceeds their aggregate value by \$70 (as determined under § 1.1502-15T). At the beginning of Year 3, P buys 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. M is the common parent of another 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.

(b) 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.

(c) 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.

(d) 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 § 1.1502-15T 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. Because S did not cease to exist, however, S1's contribution to consolidated taxable income may not be used to increase the consolidated taxable income of the P group that may be offset by the built-in loss. See paragraph (f) of this section.

(e) 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 § 1.1502-15T(c). Consequently, in Year 7, S, S1, and P compose a subgroup in the M group with respect to S's unrealized loss. S1's contribution to consolidated taxable income may not be used to increase the consolidated taxable income of the M group that may be offset by the recognized built-in loss. See paragraph (f) of this section.

(f) 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 cannot be members of a

SRLY subgroup with respect to the 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; however, because T did not cease to exist, T1's contribution to consolidated taxable income may not be used to increase the consolidated taxable income of the P group that may be offset by the carryover. See paragraph (f) of this section.

(g) 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, but T1's contribution to consolidated taxable income may not be used to increase 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. (a) Individual A forms S. Individual B forms T. In Year 2, P buys all the stock of S and T from A and B, 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.

(b) 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.

(c) In Year 4, the M group has \$10 of consolidated taxable income (computed without regard to the CNOL deduction for Year 4). However, 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.

(d) 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. (a) At the beginning of Year 1, S buys all the stock of T, 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 buys 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.

(b) 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.

(c) 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. (a) 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 loss to Year 3.

(b) 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, in turn, ceases to be affiliated with 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.

(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.* Except as the Commissioner may otherwise determine, any increase in the consolidated taxable income of a SRLY subgroup that is attributable to a successor is disregarded unless the successor acquires substantially all the

assets and liabilities of its predecessor and the predecessor ceases to exist.

(g) *Effective date.*—(1) *In general.* This section generally applies to consolidated return years beginning on or after January 1, 1997.

(2) *SRLY limitation.* Except in the case of those members (including members of a SRLY subgroup) described in paragraph (g)(3)(iii) 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 § 1.1502-15T and § 1.1502-22T(c)) for the members (or SRLY subgroups).

(3) *Application to prior periods.* A consolidated group may apply the rules of this section to all consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997, provided that—

(i) The group's tax liability as shown on an original or an amended return is consistent with the application of the rules of this section (other than this paragraph (g)) and §§ 1.1502-15T, 1.1502-22T, 1.1502-23T, 1.1502-91T through 1.1502-96T, and 1.1502-98T for each such year for which the statute of limitations does not preclude the filing of an amended return on January 1, 1997;

(ii) Each section described in paragraph (g)(3)(i) of this section and § 1.1502-1(f)(4)(ii) is applied by substituting "taxable years ending on or after January 29, 1991" for "taxable years beginning on or after January 1, 1997" (and "before January 29, 1991" for "before January 1, 1997" in the case of consolidated return changes of ownership) as the context requires.

(iii) The rules of paragraph (c) of this section and §§ 1.1502-15T and 1.1502-22T(c) are applied only with respect to the losses and deductions of those corporations that became members of the group (including members of a subgroup), and to acquisitions occurring, on or after January 29, 1991, (and only with respect to such losses and deductions);

(iv) The rules of §§ 1.1502-15A, 1.1502-21A(c) and 1.1502-22A(c) are applied with respect to the losses and deductions of those corporations that became members of the group, and to acquisitions occurring, before January 29, 1991; and

(v) Appropriate adjustments are made in the earliest subsequent open year to reflect any inconsistency in a year for which the statute of limitations precludes the filing of an amended return on January 1, 1997.

(4) *Waiver of carrybacks.* Paragraph (b)(3)(i) of this section (relating to the waiver of carrybacks) applies to net operating losses arising in a consolidated return year for which the due date of the income tax return (without regard to extensions) is on or after August 26, 1996.

Par. 14. Section 1.1502-22 is redesignated as § 1.1502-22A; the heading of the newly designated § 1.1502-22A is revised; and paragraphs (d)(3) and (e) are added to read as follows:

§ 1.1502-22A Consolidated net capital gain or loss generally applicable for consolidated return years beginning before January 1, 1997.

* * * * *

(d) * * *

(3) *Cross-reference.* See § 1.1502-22T(d) for the rule that applies the principles of this paragraph (d) in consolidated return years beginning on or after January 1, 1997, with respect to a consolidated return change of ownership occurring before January 1, 1997.

(e) *Effective date.* This section applies to any consolidated return years to which § 1.1502-21T(g) does not apply. See § 1.1502-21T(g) for effective dates of that section.

Par. 15. Section 1.1502-22T is added to read as follows:

§ 1.1502-22T Consolidated capital gain and loss (temporary).

(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 § 1.1502-23T); 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 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 § 1.1502-21T(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 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 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 § 1.1502-21T(c) (including the SRLY subgroup principles under § 1.1502-21T(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 § 1.1502-21T(f) apply with appropriate adjustments.

(g) *Effective date—(1) In general.* This section applies to consolidated return years beginning on or after January 1, 1997.

(2) *Application to prior periods.* See § 1.1502-21T(g)(3) for rules generally permitting a group to apply the rules of this section to consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997.

Par. 16. Section 1.1502-23 is redesignated § 1.1502-23A; the section heading of the newly designated § 1.1502-23A is revised; the current text of the section is designated as paragraph (a), and paragraph (b) is added to read as follows:

§ 1.1502-23A Consolidated net section 1231 gain or loss generally applicable for consolidated return years beginning before January 1, 1997.

* * * * *

(b) *Effective date.* This section applies to any consolidated return years to which § 1.1502-21T(g) does not apply. See § 1.1502-21T(g) for effective dates of that section.

Par. 17. Section 1.1502-23T is added to read as follows:

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

(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) *Recapture of ordinary loss.*

[Reserved]

(c) *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 beginning on or after January 1, 1997.

(2) *Application to prior periods.* See § 1.1502-21T(g)(3) for rules generally permitting a group to apply the rules of this section to consolidated return years ending on or after January 29, 1991, and beginning before January 1, 1997.

Par. 18. Section 1.1502-41 is redesignated as § 1.1502-41A; the section heading of the newly designated § 1.1502-41A is revised; and paragraph (c) is added to read as follows:

§ 1.1502-41A Determination of consolidated net long-term capital gain and consolidated net short-term capital loss generally applicable for consolidated return years beginning before January 1, 1997.

* * * * *

(c) *Effective date.* This section applies to any consolidated return years to which § 1.1502-21T(g) does not apply. See § 1.1502-21T(g) for effective dates of that section.

Par. 19. Section 1.1502-79A is added to read as follows:

§ 1.1502-79A Separate return years generally applicable for consolidated return years beginning before January 1, 1997.

(a) through (e) [Reserved]

(f) *Effective date.* Paragraphs (a) and (b) of this section apply to losses arising in consolidated return years to which § 1.1502-21T(g) does not apply. For this purpose net operating loss deductions, carryovers, and carrybacks arise in the year from which they are carried. See § 1.1502-21T(g) for effective dates of that section.

Par. 20. In § 1.1502-79, paragraphs (a) and (b) are redesignated as § 1.1502-79A, paragraphs (a) and (b).

Par. 21. Section 1.1502-79 is amended by adding new paragraphs (a) and (b) to read as follows:

§ 1.1502-79 Separate return years.

(a) *Carryover and carryback of consolidated net operating losses to separate return years.* For losses arising

in consolidated return years beginning before January 1, 1997, see § 1.1502-79A(a). For later years, see § 1.1502-21T(b).

(b) *Carryover and carryback of consolidated net capital loss to separate return years.* For losses arising in consolidated return years beginning before January 1, 1997, see § 1.1502-79A(b). For later years, see § 1.1502-22T(b).

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 22. The authority citation for part 602 continues to read in part as follows:

Authority: 26 U.S.C. 7805.

Par. 23. In § 602.101, paragraph (c) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

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

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved: May 31, 1996.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 96-15823 Filed 6-26-96; 8:45 am]

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26 CFR Parts 1 and 602

[TD 8678]

RIN 1545-AU36

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: Temporary regulations.

SUMMARY: This document contains temporary 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. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register.

DATES: These regulations are effective June 27, 1996.

For dates of application and special transition rules, see Effective Dates under **SUPPLEMENTARY INFORMATION.**

FOR FURTHER INFORMATION CONTACT: David B. Friedel at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in the temporary regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under the control number 1545-1218. The collection requires a response from certain consolidated groups. The IRS requires the information described in § 1.1502-95T(e) to assure that a section 382 limitation is properly determined in cases of corporations that cease to be members of a group. Responses to this collection of information are required to obtain a benefit (relating to the section 382 limitation applicable to the departing member(s)).

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

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

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 IRS and Treasury issued three notices of proposed rulemaking, CO-132-87 (56 FR 4194), CO-077-90 (56 FR 4183), and CO-078-90 (56 FR 4228), setting forth rules regarding the application of sections 382 and 383 by consolidated groups and by controlled groups, and regarding the use of built-in deductions and net operating losses and capital losses, including the carryover and carryback of separate return limitation year (SRLY) losses of members of consolidated groups. The preambles to the three proposed regulations explain their rules in detail. The IRS and Treasury also published Notice 91-27 (1991-2 C.B. 629) to advise of intended modifications to the proposed regulations.

For reasons explained in the preamble to TD 8677 (published elsewhere in this issue of the Federal Register), the IRS and Treasury are issuing temporary amendments concerning the use of built-in deductions and net operating losses and capital losses of members of consolidated groups. Some of the rules in those temporary amendments are closely related to rules regarding the application of section 382 to members of consolidated groups (for example, rules relating to built-in deductions and subgroups). Because of the close relationship, and in order to give consolidated groups immediate guidance on the application of sections 382 and 383, the IRS and Treasury are issuing these temporary amendments. The temporary amendments are substantially identical to the rules proposed on January 29, 1991.

These temporary amendments do not address the comments on the proposed amendments. Many of these comments are still under consideration.

As a companion to this Treasury decision, the IRS and Treasury are also issuing temporary regulations relating to the application of sections 382 and 383 by members of controlled groups. See TD 8679 published elsewhere in this issue of the Federal Register.

Effective Dates

The temporary regulations are generally effective for testing dates that occur on or after January 1, 1997. Transition rules contained in the proposed amendments are retained and made applicable to testing dates before January 1, 1997.