

## HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

### INCOME TAX

**Rev. Rul. 96-36, page 6.**

**LIFO; price indexes; department stores.** The May 1996 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, May 31, 1996.

**T.D. 8676, page 4.**

**FI-59-94, page 23.**

Temporary and proposed regulations under section 166 of the Code relate to the allowance of a deduction for a partially worthless debt when the terms of a debt instrument have been modified.

**T.D. 8677, page 7.**

**CO-24-96, page 22.**

Final, temporary, and proposed regulations under section 1502 of the Code relate to the limitations on the use of certain losses and deductions on consolidated returns. A public hearing on the proposed regulations will be held on October 17, 1996.

**IA-26-94, page 24.**

Proposed regulations under section 1202 of the Code relate to the 50-percent exclusion for gain from certain small business stock. A public hearing will be held on October 3, 1996.

### EXEMPT ORGANIZATIONS

**Announcement 96-67, page 26.**

A list is given of organizations now classified as private foundations.

## Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the

quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

## Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

# Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semi-annually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

## **Part I.—1986 Code.**

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

## **Part II.—Treaties and Tax Legislation.**

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

## **Part III.—Administrative, Procedural, and Miscellaneous.**

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

## **Part IV.—Items of General Interest.**

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

## Section 166.—Bad Debts

26 CFR 1.166-3T: Partial or total worthlessness (temporary).

T.D. 8676

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Part 1

### Modifications of Bad Debts and Dealer Assignments of Notional Principal Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

**SUMMARY:** This document contains temporary regulations relating to the allowance of a deduction for a partially worthless debt when the terms of a debt instrument have been modified. The temporary regulations provide guidance to certain taxpayers that modify the terms of a debt instrument after deducting an amount for partial worthlessness. This document also contains temporary regulations relating to certain assignments of notional principal contracts by dealers in those contracts. The temporary regulations provide guidance to taxpayers relating to consequences of these assignments. The text of these temporary regulations also serves as the text of the proposed regulations set forth in FI-59-94 on page 23 in this issue of the Bulletin.

**DATES:** These regulations are effective September 23, 1996.

**FOR FURTHER INFORMATION CONTACT:** Concerning the modifications of bad debts, Craig R. Wojay, Office of Assistant Chief Counsel (Financial Institutions and Products), (202) 622-3920 (not a toll-free number), and concerning dealer assignments of notional principal contracts, Thomas J. Kelly, Office of the Assistant Chief Counsel (Financial Institutions and Products), (202) 622-3940 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

#### *Background*

On December 2, 1992, the IRS published in the **Federal Register** (57 FR

57034 [FI-31-92, 1992-2 C.B. 683]) a notice of proposed rulemaking that set forth proposed income tax regulations (26 CFR part 1) under section 1001 of the Internal Revenue Code (Code). Under § 1.1001-3(a) of the proposed regulations, a significant modification of a debt instrument is deemed to result in an exchange of the original debt instrument for a modified instrument that differs materially either in kind or in extent. This rule is retained in the final regulations under § 1.1001-3, published in TD 8675, 1996-29 I.R.B. 50. Thus, when a debt is significantly modified, a taxpayer (holder) is required to recognize gain or loss based on the difference between the issue price of the significantly modified debt and the taxpayer's adjusted issue price in the original instrument.

Prior to finalizing the § 1.1001-3 regulations, the IRS and Treasury received comments that gain recognized as the result of a significant modification of a debt instrument often is attributable to the fact that the taxpayer previously claimed a deduction for partial worthlessness with respect to the debt. According to the commentators, the modification does not alter the fact that a portion of the debt remains uncollectible. Thus, the commentators suggested that, in this situation, a taxpayer should be permitted to offset the gain with a corresponding bad debt deduction.

The IRS and Treasury also received comments that the assignment by a dealer in notional principal contracts of its position in a contract to another dealer should not result in a deemed exchange under section 1001. Although the dealer will recognize gain or loss on the disposition of its position, treating the transaction as a deemed exchange would force the counterparty to realize the gain or loss on the contract even though the counterparty is maintaining its position. The commentators argued that dealer-to-dealer assignments are a common business practice and that these assignments have relatively little significance to the dealers' counterparties.

#### *Explanation of Provisions*

Section 166(a)(2) and § 1.166-3(a) provide that a deduction for a partially worthless debt is allowed only to the

extent the debt is charged off in the taxable year. The charge-off requirement is also contained in § 1.166-2(d)(1) and (3), which provides for a conclusive presumption of worthlessness under certain circumstances.

In general, the amount of a deduction on account of partial worthlessness is the amount by which the adjusted basis of a debt (as determined under section 1011) exceeds the amount recoverable on the debt. The amount of the deduction, however, may not exceed the amount charged off during the taxable year. The charge-off requirement is satisfied for a debt when a portion of the debt is removed from a taxpayer's books and records. This generally is accomplished by reducing the debt's book basis. Thus, when an amount has been deducted for partial worthlessness, there is generally a reduction of both the book basis and tax basis of a debt.

When a taxpayer is required to recognize gain under section 1001 because of a modification of a debt instrument, the taxpayer's tax basis in the debt is increased by the amount of gain recognized. Commentators on the proposed § 1.1001-3 regulations have indicated, however, that regulatory and general accounting principles generally would not permit a corresponding increase in the book basis of the debt. Because the prior charge-off is not restored (that is, the book basis of the debt is not increased), there is no opportunity for the taxpayer to take a new charge-off for pre-existing worthlessness. Thus, the charge-off requirement of section 166(a)(2) can never be satisfied with respect to the amount by which the debt's tax basis exceeds its book basis as a result of the modification, and the excess would not be allowed as a deduction until the debt becomes totally worthless.

The temporary regulations contained in this document set forth limited circumstances under which a taxpayer will be permitted to deduct an amount on account of a partially worthless debt even though no amount has been charged off within the taxable year. The purpose of these temporary regulations is to preserve the portion of a taxpayer's bad debt deduction with respect to a partially worthless debt that corresponds to the amount the taxpayer would have been entitled to deduct for partial worthlessness with respect to the modified

debt if the book basis of the modified debt were increased to the same extent as the tax basis of that debt. Thus, these temporary regulations apply only if all of the following conditions are satisfied. First, a significant modification of a debt instrument (within the meaning of § 1.1001-3) must result in a taxpayer's recognition of gain under § 1.1001-1(a). In addition, the debt must have been previously charged off and deducted by the taxpayer, and the prior charge-off and deduction must have satisfied the requirements of § 1.166-3(a)(1) and (2). If these conditions are satisfied, then a modified debt is deemed to have been charged off in the year in which gain is recognized. The amount of the charge-off, however, is limited to the difference between the tax basis of the debt and the greater of the book basis or the fair market value of the debt.

Both the proposed and the final regulations under § 1.1001-3 deal only with modifications of debt instruments. In response to comments on the proposed regulations, however, the temporary regulations contained in this document provide a limited rule dealing with a dealer's assignment of its position in an interest rate or commodity swap, or other notional principal contract to another dealer. If the assignment is permitted by the terms of the contract, the assignment will not be treated as a deemed exchange by the nonassigning party of the original contract for a new contract that differs materially either in kind or in extent. Thus, an assignment to which the rule applies does not trigger gain or loss to the dealer's counterparty. No inference is intended with respect to whether an assignment of rights by one party to other types of bilateral contracts results in an exchange or other disposition under section 1001 by the nonassigning party.

#### *Effective Dates*

The temporary regulations apply to significant modifications of debt instruments and assignments of interest rate swaps, commodity swaps, and other notional principal contracts occurring on or after September 23, 1996.

#### *Special Analyses*

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined

that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### *Drafting Information*

The principal author of the regulations concerning the modification of bad debts is Craig R. Wojay, Office of the Assistant Chief Counsel (Financial Institutions and Products), IRS. The principal author of the regulations concerning the dealer assignments of certain notional principal contracts is Thomas J. Kelly, Office of the Assistant Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

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

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

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

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

Par. 2. Section 1.166-3T is added to read as follows:

#### *§ 1.166-3T Partial or total worthlessness (temporary).*

(a)(1) and (2) [Reserved]. For guidance, see § 1.166-3(a)(1) and (2).

(3) *Significantly modified debt—(i) Deemed charge-off.* If a significant modification of a debt instrument (within the meaning of § 1.1001-3) during a taxable year results in the recognition of gain by a taxpayer under § 1.1001-1(a), and if the requirements of paragraph (a)(3)(ii) of this section are met, there is a deemed charge-off of the debt during that taxable year in the amount specified in paragraph (a)(3)(iii) of this section.

(ii) *Requirements for deemed charge-off.* A debt is deemed to have been charged off only if—

(A) The taxpayer (or, in the case of a debt that constitutes transferred basis

property within the meaning of section 7701(a)(43), a transferor taxpayer) has claimed a deduction for partial worthlessness of the debt in any prior taxable year; and

(B) Each prior charge-off and deduction for partial worthlessness satisfied the requirements of paragraphs (a)(1) and (2) of this section.

(iii) *Amount of deemed charge-off.* The amount of the deemed charge-off, if any, is the amount by which the tax basis of the debt exceeds the greater of the fair market value of the debt or the amount of the debt recorded on the taxpayer's books and records reduced as appropriate for a specific allowance for loan losses. The amount of the deemed charge-off, however, may not exceed the amount of recognized gain described in paragraph (a)(3)(i) of this section.

(iv) *Effective date.* This paragraph (a)(3) is effective September 23, 1996.

(b) [Reserved]. For further guidance, see § 1.166-3(b).

Par. 3. Section 1.1001-4T is added to read as follows:

#### *§ 1.1001-4T Modifications of certain notional principal contracts.*

(a) *Dealer assignments.* For purposes of § 1.1001-1(a), the substitution of a new party on an interest rate or commodity swap, or other notional principal contract (as defined in § 1.446-3(c)(1)) is not treated as a deemed exchange by the nonassigning party of the original contract for a modified contract that differs materially either in kind or in extent if—

(1) The party assigning its rights and obligations under the contract and the party to which the rights and obligations are assigned are both dealers in notional principal contracts, as defined in § 1.446-3(c)(4)(iii); and

(2) The terms of the contract permit the substitution.

(b) *Effective date.* This section is effective September 23, 1996.

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

Approved May 31, 1996.

Leslie Samuels,  
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on June 24, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 25, 1996, 61 F.R. 32653)

**Section 472.—Last-in, First-out Inventories**

26 CFR 1.472-1: Last-in, first-out inventories.

**LIFO; price indexes; department stores.** The May 1996 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, May 31, 1996.

**Rev. Rul. 96-36**

The following Department Store Inventory Price Indexes for May 1996 were issued by the Bureau of Labor Statistics on June 12, 1996. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods

for tax years ended on, or with reference to, May 31, 1996.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

**BUREAU OF LABOR STATISTICS, DEPARTMENT STORE  
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS  
(January 1941 = 100, unless otherwise noted)**

Groups	May 1995	May 1996	Percent Change from May 1995 to May 1996 <sup>1</sup>
1. Piece Goods . . . . .	507.4	545.1	7.4
2. Domestics and Draperies . . . . .	643.5	649.3	0.9
3. Women's and Children's Shoes . . . . .	635.2	659.7	3.9
4. Men's Shoes . . . . .	920.2	906.5	-1.5
5. Infants' Wear . . . . .	599.2	631.2	5.3
6. Women's Underwear . . . . .	529.4	534.1	0.9
7. Women's Hosiery . . . . .	283.1	286.8	1.3
8. Women's and Girls' Accessories . . . . .	539.4	550.8	2.1
9. Women's Outerwear and Girls' Wear . . . . .	437.0	417.9	-4.4
10. Men's Clothing . . . . .	610.4	626.1	2.6
11. Men's Furnishings . . . . .	575.7	593.3	3.1
12. Boys' Clothing and Furnishings . . . . .	483.8	493.3	2.0
13. Jewelry . . . . .	984.9	1020.1	3.6
14. Notions . . . . .	750.3	773.8	3.1
15. Toilet Articles and Drugs . . . . .	857.9	883.8	3.0
16. Furniture and Bedding . . . . .	655.3	668.0	1.9
17. Floor Coverings . . . . .	569.4	576.1	1.2
18. Housewares . . . . .	775.1	803.9	3.7
19. Major Appliances . . . . .	247.3	245.1	-0.9
20. Radio and Television . . . . .	84.8	79.2	-6.6
21. Recreation and Education <sup>2</sup> . . . . .	114.3	112.8	-1.3
22. Home Improvements <sup>2</sup> . . . . .	122.3	127.2	4.0
23. Auto Accessories <sup>2</sup> . . . . .	107.2	107.4	0.2
Groups 1-15: Soft Goods . . . . .	597.1	603.0	1.0
Groups 16-20: Durable Goods . . . . .	465.4	467.6	0.5
Groups 21-23: Misc. Goods <sup>2</sup> . . . . .	114.2	113.7	-0.4
Store Total <sup>3</sup> . . . . .	552.4	556.3	0.7

<sup>1</sup>Absence of a minus sign before percentage change in this column signifies price increase.

<sup>2</sup>Indexes on a January 1986=100 base.

<sup>3</sup>The store total index covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

**DRAFTING INFORMATION**

The principal author of this revenue ruling is Stan Michaels of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Michaels on (202) 622-4970 (not a toll-free call).

## Section 1502.—Regulations

26 CFR 1.1502–21T: Net operating losses (temporary).

T.D. 8677

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

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final 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 CO–24–96 on page 22 in this issue of the Bulletin.

DATES: These amendments are effective Thursday, 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 this issue of the Bulletin.

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 the Bulletin.

#### *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*

1.469-1(h)(2)

1.597-2(c)(5), first sentence

1.597-2(c)(5), second sentence

1.597-4(g)(3), fifth sentence

1.597-4(g)(3), sixth sentence

1.904(f)-3(a)

#### *Remove*

1.1502-21 (consolidated net operating loss), and 1.1502-22 (consolidated net capital gain or loss)

§§ 1.1502-15, 1.1502-21, and 1.1502-22

§§ 1.1502-15, 1.1502-21 or 1.1502-22

§§ 1.1502-15, 1.1502-21 and 1.1502-22

§§ 1.1502-15, 1.1502-21, or 1.1502-22

(or §§ 1.1502-21(b) and 1.1502-79(a))  
(or § 1.1502-21T(b))

#### *Add*

1.1502-21T (Net operating losses (temporary)), and 1.1502-22T (consolidated net capital gain and loss (temporary))

§§ 1.1502-15T, 1.1502-21T, and 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A, and 1.1502-22A, as appropriate)

§§ 1.1502-15T, 1.1502-21T or 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A or 1.1502-22A, as appropriate)

§§ 1.1502-15T, 1.1502-21T and 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A and 1.1502-22A, as appropriate)

§§ 1.1502-15T, 1.1502-21T, or 1.1502-22T (or §§ 1.1502-15A, 1.1502-21A, or 1.1502-22A, as appropriate)

(or §§ 1.1502-21A(b) and 1.1502-79A(a), as appropriate))

<i>Affected Section</i>	<i>Remove</i>	<i>Add</i>
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

<i>Affected Section</i>	<i>Remove</i>	<i>Add</i>
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)
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)(vi)	§ 1.1502–41(b)	§§ 1.1502–22T(a) or 1.1502–41A, as appropriate
1.1502–43(b)(2)(vii)	§ 1.1502–22(b)	§§ 1.1502–22T(b) or 1.1502–22A(b), as appropriate
1.1502–43(b)(2)(vi ii)	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)

<i>Affected Section</i>	<i>Remove</i>	<i>Add</i>
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

<i>Affected Section</i>	<i>Remove</i>	<i>Add</i>
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)(i) 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, and adding paragraphs (f)(4) and (j), 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));

\* \* \* \* \*

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. \* \* \*

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 con-

solidated 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 (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 carry-back.* 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 car-*

ryovers. (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 sub-

group 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, S'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 Monday, 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 con-

solidated 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.*

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33321)

## Part IV. Items of General Interest

### Notice of Proposed Rulemaking and Notice of Public Hearing

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

CO-24-96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of prior proposed rule, notice of proposed rulemaking by cross-reference to temporary regulations, and notice of public hearing.

SUMMARY: On January 29, 1991, proposed rules under section 1502 were filed with the Office of the **Federal Register** (CO-78-90; see 56 FR 4228; 1991-1 C.B. 757). A public hearing was held on April 8, 1991. The IRS and Treasury published Notice 91-27 (1991-2 C.B. 629) to advise of intended modifications to the proposed regulations. The January, 1991, proposed rules are withdrawn, and these proposed rules are issued in their place.

In TD 8677 on page 7 of this issue of the Bulletin, the IRS is issuing temporary regulations relating to the carryover and carryback of losses to consolidated and separate return years. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by Wednesday, September 25, 1996. Outlines of topics to be discussed at the public hearing scheduled for Thursday, October 17, 1996, at 10 a.m. must be received by Thursday, September 26, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (CO-24-96), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (CO-24-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. The public hearing will be held in the NYU Classroom, Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, David B. Friedel, (202) 622-7550; concerning submissions and the hearing, Evangelista Lee, (202) 622-7190 (not toll-free numbers).

### SUPPLEMENTARY INFORMATION:

#### *Paperwork Reduction Act*

The collection of information contained in this notice of proposed rulemaking 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 1.1502-21(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.

Comments concerning the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC, 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, T:FP. Washington, DC, 20224. Comments on the collection of information should be received by Monday, August 26, 1996.

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.

The collection of information is in Proposed § 1.1502-21(b)(3). That section permits an election to relinquish a carryback period with respect to a consolidated net operating loss. The common parent of the group files the statement evidencing the election with the income tax return of the group. This information is required by the IRS to assure that an election to relinquish a carryback period is properly documented. The likely respondents and/or recordkeepers are certain consolidated groups of corporations. Responses to this collection of information are required to obtain a benefit (relating to the carryover of losses which would otherwise be carried back).

Books or records relating to this 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.

Estimated total annual reporting burden: 1,000 hours. The estimated annual burden per respondent varies from five to thirty minutes, depending on individual circumstances, with an estimated average of ten minutes. Estimated number of respondents: 6,000. Estimated annual frequency of responses: 1.

#### *Background*

Temporary regulations in TD 8677 of this issue of the Bulletin amend the Income Tax Regulations (26 CFR par 1) 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 deductions rules. The final regulations that are proposed to be based on these proposed regulations would be added to part 1 of title 26 of the Code of Federal Regulations. Those final regulations would provide rules 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 deductions rules.

For the text of these new temporary regulations, see TD 8677. The preamble to the temporary regulations explains the regulations.

#### *Proposed Effective Date*

For dates of application and special transition rules, see the discussion of Effective Dates under SUPPLEMENTARY INFORMATION relating to the temporary regulations, published elsewhere in this issue of the Bulletin.

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking 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, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### *Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Monday, September 16, 1996, at 10 a.m. in the NYU Classroom, Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by Wednesday, September 25, 1996, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by Thursday, September 26, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### *Drafting Information*

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

#### *Withdrawal of Notice of Proposed Rulemaking*

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed

rulemaking that was published on January 29, 1991 (56 FR 4228) is withdrawn.

\* \* \* \* \*

#### *Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be 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 1.1502-15 also issued under 26 U.S.C. 1502.

\* \* \*

Section 1.1502-21 also issued under 26 U.S.C. 1502.

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

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

Section 1.1502-79 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. Section 1.1502-15 is added to read as follows:

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

[The text of this proposed section is the same as the text of § 1.1502-15T published elsewhere in this issue of the Bulletin.]

Par. 3. Section 1.1502-21 is added to read as follows:

*§ 1.1502-21 Net operating losses.*

[The text of this proposed section is the same as the text of § 1.1502-21T published elsewhere in this issue of the Bulletin.]

Par. 4. Section 1.1502-22 is added to read as follows:

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

[The text of this proposed section is the same as the text of § 1.1502-22T published elsewhere in this issue of the Bulletin.]

Par. 5. Section 1.1502-23 is added to read as follows:

*§ 1.1502-23 Consolidated net section 1231 gain or loss.*

[The text of this proposed section is the same as the text of § 1.1502-23T published elsewhere in this issue of the Bulletin.]

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on June 26, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 27, 1996, 61 F.R. 33393)

#### **Notice of Proposed Rulemaking**

#### **Modifications of Bad Debts and Dealer Assignments of Notional Principal Contracts**

#### **FI-59-94**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In TD 8676 on page 4 of this issue of the Bulletin, the IRS is issuing temporary regulations relating to the allowance of a deduction for a partially worthless debt when the terms of a debt instrument have been modified. The temporary regulations provide relief to certain taxpayers that are required to recognize gain as the result of modifying a debt instrument, when a portion of the gain is in part caused by a reduction of the debt's basis attributable to a bad debt deduction claimed in a prior taxable year. The temporary regulations provide guidance to taxpayers that modify the terms of a debt instrument after deducting an amount for partial worthlessness.

In TD 8676 the IRS is also issuing temporary regulations relating to certain assignments of notional principal contracts by dealers in those contracts. The temporary regulations provide guidance to taxpayers relating to consequences of these assignments.

The text of those temporary regulations also serves as the text of these proposed regulations.

**DATES:** Written comments and requests for a public hearing must be received by September 23, 1996.

**ADDRESSES:** Send submissions to: CC:DOM:CORP:R (FI-59-94), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (FI-59-94), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, D.C. 20224

**FOR FURTHER INFORMATION CONTACT:** Craig R. Wojay, Office of Assistant Chief Counsel, Financial Institutions and Products, (202) 622-3920 (not a toll-free number) concerning the modifications of bad debts, and Thomas J. Kelly, Office of Assistant Chief Counsel, Financial Institutions and Products, (202) 622-3940 (not a toll-free number) concerning dealer assignments of notional principal contracts.

**SUPPLEMENTARY INFORMATION:**

*Background*

Temporary regulations in TD 8676 amend the Income Tax Regulations (26 CFR part 1) relating to section 166. The temporary regulations contain rules relating to the requirement that a debt be charged off before a deduction on account of partial worthlessness is allowed. The rules apply to certain taxpayers who are required to recognize gain as the result of a significant modification of a debt instrument.

Temporary regulations in TD 8676 amend the Income Tax Regulations (26 CFR part 1) relating to section 1001. The temporary regulations contain rules relating to certain assignments of notional principal contracts by dealers in those contracts.

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

*Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO

12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

*Comments and Requests for a Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

*Drafting Information*

The principal author of the regulations concerning the modifications of bad debts is Craig R. Wojay, Office of Assistant Chief Counsel (Financial Institutions and Products), IRS. The principal author of the regulations concerning dealer assignments of notional principal contracts is Thomas J. Kelly, Office of Assistant Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

*List of Subjects in 26 CFR Part 1*

Income taxes, Reporting and recordkeeping requirements.

*Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

**PART 1—INCOME TAXES**

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

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

Par. 2. Section 1.166-3 is amended by adding paragraph (a)(3) to read as follows:

*§ 1.166-3 Partial or total worthlessness.*

[The text of proposed paragraph (a)(3) is the same as the text of § 1.166-3T(a)(3) published elsewhere in this issue of the Bulletin].

Par. 3. Section 1.1001-4 is added to read as follows:

*§ 1.1001-4 Modifications of notional principal contracts.*

[The text of proposed section 1.1001-4 is the same as the text of § 1.1001-4T published elsewhere in this issue of the Bulletin].

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on June 24, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 25, 1996, 61 F.R. 32728)

**Notice of Proposed Rulemaking and Notice of Public Hearing**

**Qualified Small Business Stock**

**IA-26-94**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed regulations relating to the 50-percent exclusion for gain from certain small business stock. The proposed regulations reflect changes to the law made by the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) and provide guidance to the issuers and owners of the stock of certain small businesses. This document also provides a notice of public hearing on these proposed regulations.

**DATES:** Written comments and outlines of oral comments to be presented at the public hearing scheduled for October 3, 1996 must be received by September 4, 1996.

**ADDRESSES:** Send submissions to: CC:DOM:CORP:R (IA-26-94), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between

the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (IA-26-94), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Catherine A. Prohofsky at (202) 622-4930; concerning submissions and the public hearing, Christina Vasquez at (202) 622-7180; (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) relating to section 1202 of the Internal Revenue Code. Section 1202 was added by section 13113 of OBRA '93. Section 1202 allows a taxpayer (other than a corporation) to exclude 50 percent of certain gain from the sale of qualified small business stock held for more than 5 years.

Section 1202(c)(1) provides that only stock acquired after August 10, 1993, at its original issuance in exchange for money, property other than stock, or as compensation for services to the corporation (other than as an underwriter) qualifies for the exclusion (the original issue requirement). Section 1202(c)(3) provides two rules to prevent evasion of the original issue requirement. Under the first rule, the exclusion does not apply to stock acquired by the taxpayer if, at any time during the 4-year period beginning 2 years before the issuance of such stock, the corporation purchased (directly or indirectly) any of its stock from the taxpayer or a related person. Section 1202(c)(3)(A). Under the second rule, the exclusion does not apply to stock issued by a corporation if, during the 2-year period beginning 1 year before the issuance of such stock, the corporation made one or more purchases of its stock with an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of its stock as of the beginning of the 2-year period. Section 1202(c)(3)(B).

The IRS and Treasury are concerned that, in many cases, redemptions that have neither the purpose nor the effect of evading the original issue require-

ment may result in disqualification under these rules. Section 1202(k) authorizes Treasury to prescribe such regulations as may be appropriate to carry out the purposes of section 1202.

##### *Explanation of provisions*

The proposed regulations permit a corporation to redeem de minimis amounts of stock without violating the anti-evasion rules. The proposed regulations also provide that certain redemptions that are incident to events affecting a shareholder and are unlikely to result in evasion of the original issue requirement are disregarded in determining whether redemptions exceed the de minimis amounts. In particular, redemptions upon termination of a shareholder's employment or the death, disability, or mental incompetency of a shareholder are disregarded. Finally, the regulations clarify that transfers of stock by a shareholder to an employee in connection with the performance of services are not treated as redemptions for purposes of the anti-evasion rules.

The regulations will apply to stock issued after the date they are published as final regulations. The regulations will also apply to stock issued on or before that date, but only with respect to the effect of redemptions occurring after that date.

##### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these proposed regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

##### *Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and 8 copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

The IRS and Treasury invite comments on matters addressed in the proposed regulations and suggestions for any additional exceptions and clarifications that may be appropriate in the context of the purpose of section 1202(c)(3) and the regulatory authority granted in section 1202(k). The IRS and Treasury specifically invite comments from the small business community.

The IRS and Treasury are particularly interested in comments regarding the scope of the exception for redemptions incident to termination of employment. The IRS and Treasury are committed to extending the exception to independent contractors, but seek comments regarding how to determine when a termination of the independent contractor's services has occurred.

A public hearing has been scheduled for October 3, 1996, at 10 a.m. in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments and an outline of topics to be discussed and the time to be devoted to each topic (signed original and 8 copies) by September 4, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

##### *Drafting Information*

The principal author of these regulations is Catherine A. Prohofsky, Office of Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

##### *Proposed Amendments to the Regulations*

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 \* \* \*  
Section 1.1202-2 is also issued under 26  
U.S.C. 1202(k).  
\* \* \*

Par. 2. Sections 1.1202-0 and  
1.1202-2 are added to read as follows:

§ 1.1202-0 *Table of contents.*

This section lists the major captions  
that appear in the regulations under  
§ 1.1202-2.

§ 1.1202-2 *Qualified small business  
stock; effect of redemptions.*

(a) Redemptions from taxpayer or re-  
lated person.

- (1) In general.
- (2) De minimis amount.
- (b) Significant redemptions.
  - (1) De minimis amount.
  - (2) Special rule.

(c) Transfers by shareholders in con-  
nection with the performance of services  
not treated as purchases.

(d) Exceptions for termination of ser-  
vices, death, or disability or mental  
incompetency.

- (1) Termination of services.
- (2) Death.
- (3) Disability or mental incompe-  
tency.
- (e) Effective date.

§ 1.1202-2 *Qualified small business  
stock; effect of redemptions.*

(a) *Redemptions from taxpayer or re-  
lated person*—(1) *In general.* Stock ac-  
quired by a taxpayer is not qualified  
small business stock if, in one or more  
purchases during the 4-year period be-  
ginning on the date 2 years before the  
issuance of the stock, the issuing corpo-  
ration purchases (directly or indirectly)  
more than a de minimis amount of its  
stock from the taxpayer or from a  
person related (within the meaning of  
section 267(b) or 707(b)) to the tax-  
payer.

(2) *De minimis amount.* For purposes  
of this paragraph (a), stock exceeds a de  
minimis amount only if the aggregate  
amount paid for the stock exceeds  
\$10,000 and more than 2 percent of the  
stock held by the taxpayer and related  
persons is acquired. The following rules  
apply for purposes of determining  
whether the 2-percent limit is exceeded.  
The percentage of stock acquired in any  
single purchase is determined by divid-  
ing the stock's value (as of the time of  
purchase) by the value (as of the time of  
purchase) of all stock held (directly or

indirectly) by the taxpayer and related  
persons immediately before the pur-  
chase. The percentage of stock acquired  
in multiple purchases is the sum of the  
percentages determined for each sepa-  
rate purchase.

(b) *Significant redemptions*—(1) *In  
general.* Stock is not qualified small  
business stock if, in one or more pur-  
chases during the 2-year period begin-  
ning on the date 1 year before the  
issuance of the stock, the issuing corpo-  
ration purchases more than a de minimis  
amount of its stock and the purchased  
stock has an aggregate value (as of the  
time of the respective purchases) ex-  
ceeding 5 percent of the aggregate value  
of all of the issuing corporation's stock  
as of the beginning of such 2-year  
period.

(2) *De minimis amount.* For purposes  
of this paragraph (b), stock exceeds a de  
minimis amount only if the aggregate  
amount paid for the stock exceeds  
\$10,000 and more than 2 percent of all  
outstanding stock is purchased. The fol-  
lowing rules apply for purposes of de-  
termining whether the 2-percent limit is  
exceeded. The percentage of the stock  
acquired in any single purchase is deter-  
mined by dividing the stock's value (as  
of the time of purchase) by the value (as  
of the time of purchase) of all stock  
outstanding immediately before the pur-  
chase. The percentage of stock acquired  
in multiple purchases is the sum of the  
percentages determined for each sepa-  
rate purchase.

(c) *Transfers by shareholders in con-  
nection with the performance of services  
not treated as purchases.* A transfer of  
stock by a shareholder to an employee  
or independent contractor (or to a ben-  
eficiary of an employee or independent  
contractor) is not treated as a purchase  
of the stock by the issuing corporation  
for purposes of this section even if the  
stock is treated as having first been  
transferred to the corporation under  
§ 1.83- 6(d)(1) (relating to transfers by  
shareholders to employees or independ-  
ent contractors).

(d) *Exceptions for termination of ser-  
vices, death, or disability or mental  
incompetency.* A stock purchase is disre-  
garded for purposes of this section if—

(1) *Termination of services*—(i) *Em-  
ployees and directors.* The stock was  
acquired by the seller in connection with  
the performance of services as an em-  
ployee or director and the stock is  
purchased from the seller incident to the  
seller's retirement or other bona fide  
termination of such services;

(ii) *Independent contractors.* [Re-  
served];

(2) *Death.* The stock is purchased  
from the deceased shareholder's estate,  
beneficiary, heir, surviving joint tenant,  
or from a surviving spouse or a trust  
established by a decedent, the stock is  
purchased within 3 years and 9 months  
from the date of death, and the stock (or  
an option to acquire the stock) was  
acquired by the seller before or on  
account of the death of the decedent; or

(3) *Disability or mental incompe-  
tency.* The stock is purchased incident to  
the disability or mental incompetency of  
the selling shareholder.

(e) *Effective date.* This section ap-  
plies to stock issued after the date these  
regulations are published as final regula-  
tions in the **Federal Register**. This  
section also applies to stock issued on  
or before the date these regulations are  
published as final regulations in the  
**Federal Register**, but only with respect  
to the effect of purchases by the issuing  
corporation that occur after that date.

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on  
June 3, 1996, 11:29 a.m., and published in the  
issue of the Federal Register for June 6, 1996, 61  
F.R. 28821)

## Foundations Status of Certain Organizations

### Announcement 96-67

The following organizations have  
failed to establish or have been unable  
to maintain their status as public chari-  
ties or as operating foundations. Accord-  
ingly, grantors and contributors may not,  
after this date, rely on previous rulings  
or designations in the Cumulative List  
of Organizations (Publication 78), or on  
the presumption arising from the filing  
of notices under section 508(b) of the  
Code. This listing does *not* indicate that  
the organizations have lost their status  
as organizations described in section  
501(c)(3), eligible to receive deductible  
contributions.

*Former Public Charities.* The follow-  
ing organizations (which have been  
treated as organizations that are not  
private foundations described in section  
509(a) of the Code) are now classified  
as private foundations:

Abode Incorporation, New Orleans, LA  
Addiction Recovery Resources, Inc.,  
Jonesboro, GA

African American Cultural and Economic Alliance Inc., Washington, DC  
 Agape House Inc., Hoyleton, IL  
 Agricutural Educational Foundation Inc., 1497 N 1050 E Road, Monticello, IL  
 Alle-Kiski Literacy Council Inc., New Kensington, PA  
 Archway Programs Delaware Inc., Atco, NJ  
 Armin Mattli Foundation, Inc., Orlando, FL  
 Athenaeum Theatre Company, Chicago, IL  
 Audio Optics Inc., West Orange, NJ  
 Aware Incorporated, Clayton, MO  
 Calvert Chamber Foundation Inc., Prince Frederick, MD  
 Canaan House, Lynchburg, VA  
 Center for Families in Change Inc., Meadville, PA  
 Center for Law in the Public Interest Foundation, Woodland Hills, CA  
 Central Minnesota Youth Symphony Inc., St. Cloud, MN  
 Centro Comunal Unidad Community Center Inc., Washington, DC  
 Cherry Tree Music CO-OP, Philadelphia, PA  
 Citizens Advisory to Probation and Parole, Festus, MO  
 Civil Justice for Civil Liberty, Omaha, NE  
 Coalition to Avert Prison Recidivism, Galesburg, IL  
 Collingwood Foundation Inc., Gibsonia, PA  
 Committee for a Greener Glencoe, Glencoe, IL  
 Community Connections Publications Inc., Asheville, NC  
 Community Education Institute, Cleveland, TN  
 Community Human Development Center Inc., Philadelphia, PA  
 Compass Theatre Inc., Princeton, NJ  
 Consensus Foundation, Dallas, TX  
 Coping Kids Inc., East Petersburg, PA  
 Crawford County Literacy Council Inc., Meadville, PA  
 Creekside Community Center, Muscatine, IA  
 Dauphin County Counseling Center, Harrisburg, PA  
 Delaware Valley Housing Corporation, Philadelphia, PA  
 District of Columbia Cancer Consortium, Washington, DC  
 Dodge County Friends of the Arts Inc., Eastman, GA  
 Dorothy B Ferebee Foundation Incorporated, Washington, DC  
 Douglas County High School Academic Booster Club Inc., Douglasville, GA  
 Durham Ecumenical Youth Choir, Durham, NC  
 East Asia Research Institute, Washington, DC  
 Evensong Chorale Inc., Virginia Beach, VA  
 Employment Development Services, Baton Rouge, LA  
 Emporia Community Development Inc., Emporia, VA  
 End-Time Deliverance Center Inc., Clinton, MS  
 Equipping the Saints Ministries Inc., Deerfield Beach, FL  
 Fenwick Transportation Corporation, Woodstown, NJ  
 First Ozark Housing Development Corp., Mountain Home, AR  
 Fish and Wildlife Alliance, Anoka, MN  
 Food Phone of The Lehigh Valley, Bethlehem, PA  
 Foundation for the Advancement & Support of Educ of Namibia Inc., Washington, DC  
 Fourth Street Consortium Inc., Reading, PA  
 Freedom Faith Ministries Inc., Kenosha, WI  
 Friends of Justice, Kansas City, MO  
 Friends of the Decorative Arts, Inc., Lake Charles, LA  
 Friends of Transportation, Inc., Asheville, NC  
 Flying Pig Theatre, Pittsburgh, PA  
 G.A.N.A.S., Denver, CO  
 Gentle Hands Ministries, Gastonia, NC  
 Georgetown Preparatory School Alumni Association Inc., Rockville, MD  
 Grand Ma's Hands, Charlotte, NC  
 Granville Academy National Inc., Lawrenceville, NJ  
 Grassroot Arts, Kankakee, IL  
 Green Lake County Humane Society Inc., Green Lake, WI  
 Gymnastic Expressions, Montoursville, PA  
 Haddock Foundation, Morrisville, NC  
 Harmonia Music Club, Lebanon, PA  
 Heritage Foundation at Whiteman Air Force Base, Whiteman AFB, MO  
 His Higher Hopes Inc., Independence, MO  
 Historic Wills Preservation Project Inc., Reading, PA  
 Holiday House of Federation Housing Inc., Philadelphia, PA  
 Interamerican Music Festival of Florida, Inc., Miami, FL  
 International Assoc. of Black Professionals, Landover, MD  
 International Missions Outreach, Harrisonville, MO  
 Iowa Historic Preservation Alliance, West Branch, IA  
 Irish American Unity Foundation, Boynton Beach, FL  
 Joyfull Ministries Inc., Pensacola, FL  
 Kansas City Area Teachers of Mathematics Inc., Kansas City, MO  
 Kirke Harris Ensemble, Landover, MD  
 Krisle Christian Ministries, Whitehouse, TX  
 L B G I Educational Services, Chicago, IL  
 L C 38 Charity Fund Inc., Philadelphia, PA  
 Learning Center for Christ, Washington, DC  
 Lincolnnton Chorus Booster, Inc., Lincolnnton, NC  
 Living Composers Inc., Atlanta, GA  
 Mineral Area Choir Connection, Desloge, MO  
 Minnesota Asian Youth Support Group Inc., Minneapolis, MN  
 Miracle on Caney Creek, Inc., Lexington, KY  
 MLAC Inc., Pittsburgh, PA  
 Mooresville Foundation For Excellence in Education, Mooresville, NC  
 Muhammad Ali Education and Humanitarian Foundation, Chicago, IL  
 National Academic Association, Columbus, OH  
 National Coalition for Human Rights, Minneapolis, MN  
 National Housing Preservation Corp., Nashville, TN  
 Native American Television Inc., St. Cloud, MN  
 Nebraska Vegetarian Society, Lincoln, NE  
 New Horizons Charity, Mackinaw, IL  
 New Outlook Inc., Jacksonville, FL  
 North Carolina Foundation for International Commerce, Research Triangle Park, NC  
 Northwest Suburban Bar Association Foundation, Arlington Heights, IL  
 Nurses for Human Development Education Inc., Jonesboro, AR  
 Off the Streets, Hoffman Estates, IL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

## Announcement of the Disbarment, Suspension, and Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue

Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public

accountant, enrolled agent or enrolled actuary and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Bruender, Lawrence	Lesueur, MN	Attorney	Indefinite from April 18, 1996
Pallman, James J.	New Haven, CT	CPA	April 19, 1996 to October 18, 1996
Pribble Jr., William C.	Minneapolis, MN	Attorney	Indefinite from May 1, 1996
Pyburn, Richard E.	Downers Grove, IL	CPA	May 1, 1996 to October 31, 1997
Scalise, James J.	New Britain, CT	Attorney	May 1, 1996 to July 31, 1996
Kieldaisch, Dale W.	Manteno, IL	CPA	May 1, 1996 to October 31, 1996
Ogorek, Charolotte F.	Park Ridge, IL	CPA	May 3, 1996 to July 2, 1996
Korman, Steven B.	Mulford, CT	CPA	May 3, 1996 to February 2, 1997
Myers, Donald L.	Olney, MD	CPA	May 7, 1996 to May 6, 1998
Sharrett, William R.	Paradise, CA	Enrolled Agent	May 8, 1996 to November 7, 1996
Cornwell, Douglas S.	Norwalk, CT	CPA	May 10, 1996 to November 9, 1996
Chang, Sun Kun	McLean, VA	Enrolled Agent	May 13, 1996 to July 12, 1996
Cariveau, Stewart	Minneapolis, MN	CPA	May 30, 1996 to August 29, 1996
Carter, Gary E.	Ashdown, AR	CPA	June 1, 1996 to August 31, 1996
Underwood, Wendell L.	Sedalia, MO	CPA	June 1, 1996 to July 31, 1996
Candiloro, James A.	Glastonbury, CT	CPA	June 1, 1996 to November 30, 1996
Schwartz, Leonard J.	Danbury, CT	Enrolled Agent	June 1, 1996 to February 28, 1997
Forrester, Donald F.	Fairfield, OH	CPA	Indefinite from June 4, 1996
Shade, Stephen E.	Clearwater, FL	Enrolled Agent	June 8, 1996 to May 7, 1997
Woods, James G.	Huntington, CT	CPA	July 1, 1996 to June 30, 1997
Grove, Michael J.	Alliance, Oh	CPA	July 1, 1996 to June 30, 1997
Jenkins, Frank	Montgomery, AL	CPA	July 1, 1996 to December 31, 1996
Brewton III, George W.	Greenville, MS	CPA	July 1, 1996 to September 30, 1996
Fischer, Randall E.	Lombard, IL	CPA	July 1, 1996 to September 30, 1996
Rhoney, Brian	Wheaton, IL	CPA	July 1, 1996 to Decemer 31, 1996
Devereux, Michael J.	Florissant, MO	CPA	July 1, 1996 to March 31, 1997
Cranston, Robert S.	Saugerties, NY	CPA	July 1, 1996 to December 31, 1996
Miller, Dwight W.	Overland Pk, KS	CPA	July 1, 1996 to June 30, 1997
Beck, Clyde E.	Salina, KS	CPA	July 1, 1996 to October 31, 1996
Seal, Ernest E.	Cleveland, MS	CPA	August 1, 1996 to July 31, 1998
Dicker, Joseph W.	Minneapolis, MN	Attorney	August 1, 1996 to October 31, 1996

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public

accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

After due notice and opportunity for hearing before an administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Bushta, Patrick C.	Sacramento, CA	CPA	April 18, 1996
Hart, Joel S.	Beaumont, TX	CPA	April 19, 1996
Riggs, Patricia A.	Stockton, CA	Enrolled Agent	April 19, 1996
Hammontree, Richard F.	Ogunquit, ME	CPA	April 27, 1996
Otto, Judith M.	Tucson, AZ	Enrolled Agent	May 18, 1996

## Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling

is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does

more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

## Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

A—Individual.

Acq.—Acquiescence.

B—Individual.

BE—Beneficiary.

BK—Bank.

B.T.A.—Board of Tax Appeals.

C.—Individual.

C.B.—Cumulative Bulletin.

CFR—Code of Federal Regulations.

CI—City.

COOP—Cooperative.

Ct.D.—Court Decision.

CY—County.

D—Decedent.

DC—Dummy Corporation.

DE—Donee.

Del. Order—Delegation Order.

DISC—Domestic International Sales Corporation.

DR—Donor.

E—Estate.

EE—Employee.

E.O.—Executive Order.

ER—Employer.

ERISA—Employee Retirement Income Security Act.

EX—Executor.

F—Fiduciary.

FC—Foreign Country.

FICA—Federal Insurance Contribution Act.

FISC—Foreign International Sales Company.

FPH—Foreign Personal Holding Company.

F.R.—Federal Register.

FUTA—Federal Unemployment Tax Act.

FX—Foreign Corporation.

G.C.M.—Chief Counsel's Memorandum.

GE—Grantee.

GP—General Partner.

GR—Grantor.

IC—Insurance Company.

I.R.B.—Internal Revenue Bulletin.

LE—Lessee.

LP—Limited Partner.

LR—Lessor.

M—Minor.

Nonacq.—Nonacquiescence.

O—Organization.

P—Parent Corporation.

PHC—Personal Holding Company.

PO—Possession of the U.S.

PR—Partner.

PRS—Partnership.

PTE—Prohibited Transaction Exemption.

Pub. L.—Public Law.

REIT—Real Estate Investment Trust.

Rev. Proc.—Revenue Procedure.

Rev. Rul.—Revenue Ruling.

S—Subsidiary.

S.P.R.—Statements of Procedural Rules.

Stat.—Statutes at Large.

T—Target Corporation.

T.C.—Tax Court.

T.D.—Treasury Decision.

TFE—Transferee.

TFR—Transferor.

T.I.R.—Technical Information Release.

TP—Taxpayer.

TR—Trust.

TT—Trustee.

U.S.C.—United States Code.

X—Corporation.

Y—Corporation.

Z—Corporation.

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<sup>1</sup>A cumulative list of all Revenue Rulings, Revenue Procedures, Treasury Decisions, etc., published in Internal Revenue Bulletins 1996–1 through 1996–26 will be found in Internal Revenue Bulletin 1996–27, dated July 1, 1996.

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<sup>1</sup>A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1996-1 through 1996-26 will be found in Internal Revenue Bulletin 1996-27, dated July 1, 1996.