

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

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to: Associate Area Counsel (Philadelphia, Group 1)  
(Large Business & International)

from: Chief, Branch 4  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

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subject: Ten-Year Carryback of Worthless Stock Loss

This memorandum responds to your advice request dated April 7, 2014 on the above-captioned matter.

Legend

Taxpayer =  
Sub1 =  
Parent =  
Business1 =  
ProductD =  
Year1 =  
Year2 =  
Year3 =

ISSUE

Is the Year3 deduction Taxpayer claimed for the worthlessness of its stock in its wholly-owned subsidiary, Sub1, attributable to product liability under § 172(f)(1)(A)(i) of the Internal Revenue Code?

CONCLUSION

Taxpayer's worthless stock loss is not attributable to product liability within the meaning of § 172(f)(1)(A)(i) and therefore, Taxpayer's worthless stock loss is not eligible for a special ten-year carryback period under § 172(b)(1)(C).

## FACTS

Taxpayer, Sub1, and Sub1's subsidiaries were members of an affiliated group of corporations of which Parent was the common parent. They joined Parent in the filing of a consolidated federal income tax return. Sub1 and its subsidiaries were engaged in Business1, and manufactured and sold ProductD. By Year1, Sub1 had been named as a defendant in lawsuits related to ProductD. Sub1 filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code during Year1. Sub1 filed its plan of reorganization (Plan) with the bankruptcy court during Year2. The Plan was approved and became effective during Year3.

Pursuant to the Plan, the existing stock of Sub1 held by Taxpayer was cancelled and new common stock of reorganized Sub1 was issued, but Taxpayer did not receive any shares of the new common stock. Further, Sub1 established a qualified settlement fund (QSF) within the meaning of § 1.468B-1 of the Income Tax Regulations, and transferred to the QSF cash and property, including its new common stock, promissory notes, rights under certain insurance policies, and other assets. In exchange, Sub1 was relieved of all present and future claims related to ProductD and the QSF assumed responsibility for such claims.

On its Year3 consolidated tax return, the consolidated group claimed a deduction under §§ 162 and 468B for Sub1's contribution of its new common stock to the QSF. The group also claimed a deduction under § 165(g) for Taxpayer's worthlessness of its Sub1 stock. The group further claimed that its entire Year3 consolidated net operating loss (CNOL), including Taxpayer's worthless stock loss, was attributable to product liability under § 172(f).

## LAW

Section 172(a) provides for a deduction equal to the amount of the net operating loss (NOL) carryovers and carrybacks to the taxable year.

Section 172(b)(1)(A) generally provides an NOL carryback period consisting of each of the two taxable years preceding the taxable year of the loss and an NOL carryover period equal to each of the twenty taxable years following the taxable year of the loss. However, § 172(b)(1)(C) provides a ten-year NOL carryback period for a specified liability loss.

Section 172(f)(1)(A) defines "specified liability loss," in part, as the sum of the following amounts to the extent taken into account in computing the NOL for the taxable year: any amount allowable as a deduction under § 162 or § 165 which is attributable to (i)

product liability, or (ii) expenses incurred in the investigation or settlement of, or opposition to, claims *against the taxpayer* on account of product liability. (Emphasis added).

Section 172(f)(4) defines “product liability” as *liability of the taxpayer* for damages on account of physical injury or emotional harm to individuals, or damage to or loss of the use of property, on account of any defect in any product which is manufactured, leased, or sold by the taxpayer, but only if such injury, harm, or damage arises after the taxpayer has completed or terminated operations with respect to, and has relinquished possession of, such product. (Emphasis added).

Section 1.172-13(b)(1) defines “product liability loss” as the lesser of (i) the net operating loss for the current taxable year or (ii) the total of the amounts allowable as deductions under §§ 162 and 165 *directly attributable* to (A) product liability and (B) expenses (including settlement payments) incurred in connection with the investigation or settlement of or opposition to claims *against the taxpayer* on account of alleged product liability. (Emphasis added). Indirect corporate expense, or overhead, is not to be allocated to product liability claims so as to become a product liability loss. *Id.*

## ANALYSIS

Taxpayer’s worthless stock loss does not qualify as product liability deductions eligible for the ten-year carryback under § 172(b)(1)(C). Taxpayer’s loss due to the worthlessness of Sub1 stock is not a “specified liability loss” as defined in § 172(f)(1) or a “product liability loss” as defined in § 1.172-13(b)(1). Taxpayer’s loss due to worthlessness of Sub1’s stock was not directly attributable to a liability for damages for physical injury or emotional harm to individuals, or damage to or loss of use property on account of any product that Taxpayer manufactured, leased, or sold. Nor was it an expense directly attributable to expenses incurred in connection with a product liability claim asserted against Taxpayer. Rather, Taxpayer sustained a worthlessness loss on Sub1’s stock because it was cancelled in the Sub1’s bankruptcy reorganization. Taxpayer’s worthless stock loss is at best only indirectly related to Sub1’s liability for damages caused by ProductD. Thus, such loss is not to be allocated to product liability claims, similar to indirect corporate expense or overhead under § 1.172-13(b)(1). Nothing in the statute or regulations thereunder establishes that Taxpayer may carry its worthless stock loss back for ten years as a product liability loss.

Based on the preceding authorities and analysis, we conclude that Taxpayer’s worthless stock in Sub1 does not constitute a product liability loss, and thus, the ten-year carryback for NOLs for product liability deductions does not apply to Taxpayer’s worthless stock loss deductions.

If you have any questions, please contact me at (202) 317-4718.