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DEPARTMENT OF THE TREASURY

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Internal Revenue Service

26 CFR Part 1

REG-167265-03

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Guidance Under Section 1502; Application of Section 108 to Members of a Consolidated Group; Computation of Taxable Income When Section 108 Applies to a Member of a Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 1502 that govern the timing of certain basis adjustments in respect of the realization of discharge of indebtedness income that is excluded from gross income and the reduction of attributes in respect of that excluded income. In addition, the text of the temporary regulations published elsewhere in the Rules and Regulations section of this issue of the **Federal Register** serves as the text of these proposed regulations with respect to the application of section 108 when a member of a consolidated group realizes discharge of indebtedness income. The proposed regulations affect corporations filing consolidated returns.

DATES: Written or electronic comments must be received by June 14, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-167265-03), room 5203, Internal Revenue Service, POB 7604 Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-167265-03), Courier's Desk, Internal Revenue

Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Candace B. Ewell or Marie C. Milnes-Vasquez at (202) 622-7530; concerning submission of comments, Treena Garrett at (202) 622-3401 (not toll-free numbers).

### **Background and Explanation of Provisions**

On September 4, 2003, the IRS and Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG-132760-03, 68 FR 52542) and temporary regulations (TD 9089, 68 FR 52487) under section 1502 of the Internal Revenue Code. The temporary regulations added §1.1502-28T, which provides guidance regarding the determination of the attributes that are available for reduction when a member of a consolidated group realizes discharge of indebtedness income that is excluded from gross income (excluded COD income) and the method for reducing those attributes.

The text of the temporary regulations published in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to section 1502. The temporary regulations address certain issues related to the application of section 1245 and the matching rule of §1.1502-13, and the inclusion of excess loss accounts in cases in which excluded COD is not fully applied to reduce attributes. The text of those regulations also serves as the text of these proposed regulations with respect to those issues. The preamble to the temporary regulations explains those amendments.

These regulations also propose amendments to §§1.1502-28T and 1.1502-11 to address certain issues that have been raised regarding the computation of gain or loss on the disposition of member stock and regarding the computation of the portion of an excess loss account that must be taken into account when excluded COD income is not fully applied to reduce attributes. In particular, if the stock of the subsidiary that realizes excluded COD income is sold, the reduction of other members' attributes will cause an increase in the basis of the stock of the subsidiary, thus reducing the gain (or increasing the loss) on the stock sale that might otherwise have been offset by attributes and possibly making more attributes available for reduction. If the stock of a subsidiary other than one that realizes excluded COD income is sold, the reduction of such subsidiary's attributes in respect of the excluded COD income will cause a decrease in the basis of the sold subsidiary stock, thus increasing the gain (or reducing the loss) on the stock sale, possibly resulting in the absorption of more attributes and making fewer attributes available for reduction.

In addition, the amount of the excess loss account in the stock of a subsidiary that is required to be taken into account can only be determined after the computation of tax for the year of the discharge and the reduction of attributes. Pursuant to §1.1502-28T(b)(6)(ii), however, that excess loss account must be included on the group's tax return for the taxable year that includes the date on which the subsidiary realizes the excluded COD income. If that excess loss account were offset by losses that could be reduced in respect of the excluded COD income, the inclusion of that amount could result in fewer attributes available for reduction. The availability of fewer attributes for reduction might increase the excluded COD income that was not applied to reduce

attributes and, therefore, the amount of the excess loss account in the subsidiary's stock required to be taken into account.

These regulations provide guidance regarding the timing of stock basis adjustments, the calculation of stock gain or loss (including the amount of an excess loss account required to be taken into account), and the reduction of attributes when a member (P) disposes of stock of a subsidiary (S) during a year in which a member realizes excluded COD income. In particular, these regulations propose the steps used to compute the group's consolidated taxable income and to effect the reduction of attributes. In order to avoid circular calculations, these proposed regulations adopt an approach that limits the reduction of attributes in certain cases in which a disposition of subsidiary stock occurs during a year in which one or more members realize excluded COD income.

This methodology applies not only when there is an actual disposition of subsidiary stock, but also when there is a deemed disposition, including a disposition that results by reason of the application of §1.1502-19(c)(1)(iii)(B) when excluded COD income is not fully applied to reduce attributes. However, in order to know whether there has been a disposition of stock by reason of the application of §1.1502-19(c)(1)(iii)(B), the group must have computed its consolidated taxable income (or loss) and applied the rules of sections 108 and 1017 and §1.1502-28T. Therefore, as discussed below, a number of the steps proposed will have a slightly different application when there is such a deemed disposition of subsidiary stock rather than an actual disposition of subsidiary stock. The following paragraphs outline the proposed steps.

First, the extent to which S's deductions and losses for the tax year of the disposition (and its deductions and losses carried over from prior years) may offset

income and gain is computed pursuant to the current rules of §1.1502-11(b)(2) and (3). Those rules require a tentative computation of the group's taxable income, without regard to the stock gain or loss. In the case of a disposition of subsidiary stock that results from the application of ' 1.1502-19(c)(1)(iii)(B) (which will only be apparent after the application of the sixth step described below), the application of §1.1502-11(b)(2) and (3) will not result in the imposition of a limitation on the use of S's deductions and losses.

Second, ' 1.1502-32 and 1.1502-32T are tentatively applied to adjust the basis of the S stock to reflect the amount of S's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) that is made pursuant to §1.1502-11(b)(2). The basis of the S stock is not adjusted to reflect the realization of excluded COD income and the reduction of attributes in respect thereof.

Third, in the case of a disposition of S stock that does not result from excluded COD income not being fully applied to reduce attributes, P's income, gain, or loss from the disposition of S stock is computed using the basis of such stock computed in the preceding step.

Fourth, taxable income (or loss) for the year of disposition (and any prior years to which the deductions or losses may be carried) is tentatively computed. For this purpose, in the case of a disposition of S stock that does not result from excluded COD income not being fully applied to reduce attributes, the tentative computations of taxable income (or loss) take into account P's income, gain, or loss from the disposition of S stock computed in the preceding step. Any excess loss account that is taken into account as a result of

excluded COD income not being fully applied to reduce attributes is not included in this tentative computation of taxable income (or loss).

Fifth, the excluded COD income is tentatively applied to reduce attributes pursuant to the rules of sections 108 and 1017 and §1.1502-28T. Only those attributes that remain after the tentative computations of taxable income (or loss) in the fourth step are subject to reduction.

Sixth, ' ' 1.1502-32 and 1.1502-32T are applied to adjust the basis of the S stock to reflect the amount of S's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) made pursuant to the fourth step, and the excluded COD income that is applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the fifth step.

Seventh, the group's actual gain or loss on the disposition of S stock is computed using the basis of such stock computed in the preceding step. At this point, whether and to what extent an excess loss account in the stock of a subsidiary that realizes excluded COD income must be taken into account is computed. In many cases, taking into account the basis consequences of the excluded COD income prior to computing the amount of an excess loss account required to be taken into account may be favorable to taxpayers because those consequences might decrease or even eliminate an excess loss account and, therefore, reduce the amount of excess loss account required to be taken into account. The IRS and Treasury Department are aware that taking into account the basis effects of the excluded COD income of all members of the group may increase the excess loss account in the subsidiary stock. This result may occur in a case in which the excluded

COD income of one subsidiary (the first subsidiary) is not fully applied to reduce attributes and the excluded COD income of another subsidiary (the second subsidiary) is applied to reduce attributes in the first subsidiary's chain. The IRS and Treasury Department nevertheless believe that this result is not inappropriate as the reduction of an attribute in the first subsidiary's chain in respect of excluded COD income of the second subsidiary may avoid taking into account an excess loss account in the second subsidiary's stock.

Eighth, the taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) is computed. These amounts are calculated by applying the limitation on the use of S's deductions and losses to offset income computed pursuant to the first step, and by including the gain or loss recognized on the disposition of S stock computed pursuant to the preceding step. However, attributes that were tentatively used to offset income in the tentative computation of taxable income (or loss) in the fourth step and attributes that were tentatively reduced in the fifth step cannot offset any excess loss account taken into account as a result of excluded COD income not being fully applied to reduce attributes. This limitation gives effect to the requirement that the excess loss account be taken into account and avoids circular calculations. If an excess loss account that is taken into account as a result of excluded income could be offset by attributes that could be reduced in respect of the excluded COD income, the use of attributes to offset the excess loss account could result in fewer attributes available for reduction and a greater amount of excluded COD income that was not applied to reduce attributes, which, in turn, would increase the amount of the excess loss account required to be taken into account. Ultimately, the inclusion of the

excess loss account and the realization of excluded COD income could have no effect on the overall tax liability of the group, thereby rendering meaningless the requirement to take into account the excess loss account.

Ninth, the excluded COD income is actually applied to reduce attributes pursuant to the rules of sections 108 and 1017 and §1.1502-28T. Only those attributes remaining after the actual computations of taxable income (or loss) pursuant to the eighth step are subject to reduction in the ninth step. In certain cases, however, the reduction of attributes will be limited to prevent circular calculations. The proposed regulations include two rules in this regard.

The first rule provides that when S or a subsidiary of S realizes excluded COD income, the aggregate amount of excluded COD income that is applied to reduce attributes attributable to members other than S and any lower-tier corporation of S cannot exceed the aggregate amount of excluded COD income that is applied to reduce attributes attributable to members other than S and any lower-tier corporation of S pursuant to the fifth step (tentative reduction of attributes). Without this limitation, the amount of excluded COD income applied to reduce attributes could exceed the amount of excluded COD income applied to reduce attributes in the fifth step, which would result in a greater positive adjustment (or a lesser negative adjustment) to the basis of the S stock compared to that made in the sixth step, and reduce the gain (or increase the loss) recognized on the disposition of the S stock, which might increase the attributes available for reduction and the amount of excluded COD income applied to reduce attributes.

The second rule provides that when a member other than S or a subsidiary of S realizes excluded COD income, the aggregate amount of excluded COD income that is

applied to reduce attributes (other than credits) attributable to S and any lower-tier corporation of S cannot exceed the aggregate amount of excluded COD income that is applied to reduce attributes (other than credits) attributable to S and any lower-tier corporation of S in the fifth step. Without this limitation, the amount of excluded COD income applied to reduce the attributes (other than credits) attributable to S or a subsidiary of S could exceed the amount of excluded COD income applied to reduce the attributes (other than credits) attributable to S or a subsidiary of S in the fifth step, which would result in a lesser positive adjustment (or a greater negative adjustment) to the basis of the S stock compared to that made in the sixth step, and increase the gain (or decrease the loss) recognized on the disposition of the S stock, which might decrease the attributes of S's shareholder available for reduction, increase the reduction of S's attributes, and result in a lesser positive adjustment (or a greater negative adjustment) to the basis of the S stock.

The IRS and Treasury Department are aware that the foregoing methodology does not prevent circular calculations in all cases, specifically certain cases in which there is a disposition of the stock of more than one subsidiary. The IRS and Treasury Department request comments regarding whether rules preventing circular calculations in these other cases are necessary. If such rules are necessary, the IRS and Treasury Department request comments regarding the approach that those rules should adopt.

Given the difficulty of the problem addressed by these regulations, the IRS and Treasury Department request comments regarding these rules prior to making them effective. Therefore, the rules described above are proposed. Before these rules are

adopted as temporary or final regulations, taxpayers may rely on the rules proposed in these regulations.

### **Special Analysis**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Further, it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Accordingly, 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 (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will 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 these regulations is Marie C. Milnes-Vasquez of the Office of Associate Chief Counsel (Corporate). 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.

## **Adoption of 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, in part as follows:

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

Section 1.1502-28 also issued under 26 U.S.C. 1502. \* \* \*

Par. 2. Section 1.1502-11 is amended by:

1. Revising paragraph (b)(1).
2. Redesignating paragraph (c) as paragraph (d).
3. Adding new paragraph (c).

The revision and addition read as follows:

§1.1502-11 Consolidated taxable income.

\* \* \* \* \*

(b) Elimination of circular stock basis adjustments when there is no excluded COD income--(1) In general. If one member (P) disposes of the stock of another member (S), this paragraph (b) limits the use of S's deductions and losses in the year of disposition

and the carryback of items to prior years. The purpose of the limitation is to prevent P's income or gain from the disposition of S's stock from increasing the absorption of S's deductions and losses, because the increased absorption would reduce P's basis (or increase its excess loss account) in S's stock under §1.1502-32 and, in turn, increase P's income or gain. See paragraph (b)(3) of this section for the application of these principles to P's deduction or loss from the disposition of S's stock, and paragraph (b)(4) of this section for the application of these principles to multiple stock dispositions. This paragraph (b) applies only when no member realizes discharge of indebtedness income that is excluded from gross income under section 108(a) (excluded COD income) during the taxable year of the disposition. See paragraph (c) of this section for rules that apply when a member realizes excluded COD income during the taxable year of the disposition. See §1.1502-19(c) for the definition of disposition.

\* \* \* \* \*

(c) Elimination of circular stock basis adjustments when there is excluded COD income--(1) In general. If one member (P) disposes of the stock of another member (S) in a year during which any member realizes excluded COD income, this paragraph (c) limits the use of S's deductions and losses in the year of disposition and the carryback of items to prior years, the amount of the attributes of certain members that can be reduced in respect of excluded COD income of certain other members, and the attributes that can be used to offset an excess loss account taken into account by reason of the application of §1.1502-19(c)(1)(iii)(B). In addition to the purpose set forth in paragraph (b)(1) of this section, the purpose of these limitations is to prevent the reduction of tax attributes in respect of excluded COD income from affecting P's income, gain, or loss on the

disposition of S stock (including a disposition of S stock that results from the application of §1.1502-19(c)(1)(iii)(B)) and, in turn, affecting the attributes available for reduction pursuant to sections 108 and 1017 and §1.1502-28T.

(2) Computation of taxable income, reduction of attributes, and computation of limits on absorption and reduction of attributes. If a member realizes excluded COD income in the taxable year during which P disposes of S stock, the steps used to compute taxable income (or loss), to effect the reduction of attributes, and to compute the limitations on the absorption and reduction of attributes are as follows. These steps also apply to determine whether and to what extent an excess loss account must be taken into account as a result of the application of §§1.1502-19(c)(1)(iii)(B) and 1.1502-19T(b)(1).

(i) Limitation on deductions and losses to offset income or gain. First, the determination of the extent to which S's deductions and losses for the tax year of the disposition (and its deductions and losses carried over from prior years) may offset income and gain is made pursuant to §1.1502-11(b)(2) and (3).

(ii) Tentative adjustment of stock basis. Second, ' ' 1.1502-32 and 1.1502-32T are tentatively applied to adjust the basis of the S stock to reflect the amount of S's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) that is made pursuant to §1.1502-11(b)(2), but not to reflect the realization of excluded COD income and the reduction of attributes in respect thereof.

(iii) Tentative computation of stock gain or loss. Third, in the case of a disposition of S stock that does not result from the application of ' 1.1502-19(c)(1)(iii)(B), P's income, gain, or loss from the disposition of S stock is computed.

For this purpose, the result of the computation pursuant to paragraph (c)(2)(ii) of this section is treated as the basis of such stock.

(iv) Tentative computation of taxable income (or loss). Fourth, taxable income (or loss) for the year of disposition (and any prior years to which the deductions or losses may be carried) is tentatively computed. For this purpose, in the case of a disposition of S stock that does not result from the application of ' 1.1502-19(c)(1)(iii)(B), the tentative computation of taxable income (loss) takes into account P's income, gain, or loss from the disposition of S stock computed pursuant to paragraph (c)(2)(iii) of this section. The tentative computation of taxable income (loss) is made without regard to whether all or a portion of an excess loss account in a share of S is required to be taken into account pursuant to ' 1.1502-19(c)(1)(iii)(B) and 1.1502-19T(b)(1).

(v) Tentative reduction of attributes. Fifth, the rules of sections 108 and 1017 and §1.1502-28T are tentatively applied to reduce the attributes remaining after the tentative computation of taxable income (or loss) pursuant to paragraph (c)(2)(iv) of this section.

(vi) Actual adjustment of stock basis. Sixth, ' 1.1502-32 and 1.1502-32T are applied to reflect the amount of S's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) made pursuant to paragraph (c)(2)(iv) of this section, and the excluded COD income applied to reduce attributes and the attributes tentatively reduced in respect of the excluded COD income pursuant to paragraph (c)(2)(v) of this section.

(vii) Actual computation of stock gain or loss. Seventh, the group's actual gain or loss on the disposition of S stock (including a disposition that results from the application

of ' 1.1502-19(c)(1)(iii)(B)) is computed. The result of the computation pursuant to paragraph (c)(2)(vi) of this section is treated as the basis of such stock.

(viii) Actual computation of taxable income (or loss). Eighth, taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) is computed. The group's actual consolidated taxable income (or loss) for the year of the disposition is computed by applying the limitation computed pursuant to paragraph (c)(2)(i) of this section, and by including the gain or loss recognized on the disposition of S stock computed pursuant to paragraph (c)(2)(vii) of this section.

However, attributes that were tentatively used to offset income pursuant to paragraph (c)(2)(iv) of this section and attributes that were tentatively reduced pursuant to paragraph (c)(2)(v) of this section cannot offset any excess loss account taken into account as a result of the application of ' ' 1.1502-19(c)(1)(iii)(B) and 1.1502-19T(b)(1).

(ix) Actual reduction of attributes. Ninth, the rules of sections 108 and 1017 and §1.1502-28T are actually applied to reduce the attributes remaining after the actual computation of taxable income (or loss) pursuant to paragraph (c)(2)(viii) of this section.

(A) S or a lower-tier corporation realizes excluded COD income. If S or a lower-tier corporation of S realizes excluded COD income, the aggregate amount of excluded COD income that is applied to reduce attributes attributable to members other than S and any lower-tier corporation of S pursuant to this paragraph (c)(2)(ix) shall not exceed the aggregate amount of excluded COD income that was tentatively applied to reduce attributes attributable to members other than S and any lower-tier corporation of S pursuant to paragraph (c)(2)(v) of this section. The amount of the actual reduction of attributes attributable to S and any lower-tier corporation of S that may be reduced in

respect of the excluded COD income of S or a lower-tier corporation of S shall not be so limited.

(B) A member other than S or a lower-tier corporation realizes excluded COD income. If a member other than S or a lower-tier corporation of S realizes excluded COD income, the aggregate amount of excluded COD income that is applied to reduce attributes (other than credits) attributable to S and any lower-tier corporation of S pursuant to this paragraph (c)(2)(ix) shall not exceed the aggregate amount of excluded COD income that was tentatively applied to reduce attributes (other than credits) attributable to S and any lower-tier corporation of S pursuant to paragraph (c)(2)(v) of this section. The amount of the actual reduction of attributes attributable to any member other than S and any lower-tier corporation of S that may be reduced in respect of the excluded COD income of S or a lower-tier corporation of S shall not be so limited.

(3) Special rules. (i) If the reduction of attributes attributable to a member is prevented as a result of a limitation described in paragraph (c)(2)(ix)(B) of this section, the excluded COD income that would have otherwise been applied to reduce such attributes is applied to reduce the remaining attributes of the same type that are available for reduction under §1.1502-28T(a)(4), on a pro rata basis, prior to reducing attributes of a different type. The reduction of such remaining attributes, however, is subject to any applicable limitation described in paragraph (c)(2)(ix)(B) of this section.

(ii) To the extent S's deductions and losses in the year of disposition (or those of a lower-tier corporation of S) cannot offset income or gain because of the limitation under paragraph (b) of this section or this paragraph (c) and are not reduced pursuant to sections 108 and 1017 and §1.1502-28T, such items are carried to other years under the applicable

provisions of the Internal Revenue Code and regulations as if they were the only items incurred by S (or a lower-tier corporation of S) in the year of disposition. For example, to the extent S incurs an operating loss in the year of disposition that is limited and is not reduced pursuant to section 108 and §1.1502-28T, the loss is treated as a separate net operating loss attributable to S arising in that year.

(4) Definition of lower-tier corporation. A corporation is a lower-tier corporation of S if all of its items of income, gain, deduction, and loss (including the absorption of deduction or loss and the reduction of attributes other than credits) would be fully reflected in P's basis in S's stock under §1.1502-32.

(5) Examples. For purposes of the examples in this paragraph (c), unless otherwise stated, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, all transactions are between unrelated persons, tax liabilities are disregarded, and no election under section 108(b)(5) is made. The principles of this paragraph (c) are illustrated by the following examples:

Example 1. Departing member realizes excluded COD income. (i) Facts. P owns all of S's stock with a \$90 basis. For Year 1, P has ordinary income of \$30, and S has an \$80 ordinary loss and \$100 of excluded COD income from the discharge of non-intercompany indebtedness. P sells the S stock for \$20 at the close of Year 1. As of the beginning of Year 2, S has Asset A with a basis of \$0 and a fair market value of \$20.

(ii) Analysis. The steps used to compute the group's consolidated taxable income, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deductions and losses to offset income or gain. To determine the amount of the limitation under paragraph (c)(2)(i) of this section on S's loss and the effect of the absorption of S's loss on P's basis in S's stock under §1.1502-32(b), P's gain or loss from the disposition of S's stock is not taken into account. The group is tentatively treated as having a consolidated net operating loss of \$50 (P's \$30 of

income minus S's \$80 loss). Under the principles of §1.1502-21T(b)(2)(iv), all of such loss is attributable to S.

(B) Tentative adjustment of stock basis. Then, pursuant to paragraph (c)(2)(ii) of this section, ' ' 1.1502-32 and 1.1502-32T are tentatively applied to adjust the basis of S stock. For this purpose, however, adjustments attributable to the excluded COD income and the reduction of attributes in respect thereof are not taken into account. Under §1.1502-32(b), the absorption of \$30 of S's loss decreases P's basis in S's stock by \$30 to \$60.

(C) Tentative computation of stock gain or loss. Then, P's income, gain, or loss from the sale of S stock is computed pursuant to paragraph (c)(2)(iii) of this section using the basis computed in the previous step. Thus, P is treated as recognizing a \$40 loss from the sale of S stock.

(D) Tentative computation of taxable income (or loss). Pursuant to paragraph (c)(2)(iv) of this section, taxable income (or loss) for the year of disposition (and any prior years to which the deductions or losses may be carried) is then tentatively computed, taking into account P's \$40 loss on the sale of the S stock computed pursuant to paragraph (c)(2)(iii) of this section. The group has a \$50 consolidated net operating loss for Year 1 that, under the principles of §1.1502-21T(b)(2)(iv), is wholly attributable to S and a consolidated capital loss of \$40 that, under the principles of §1.1502-21T(b)(2)(iv), is wholly attributable to P.

(E) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and §1.1502-28T are tentatively applied to reduce attributes remaining after the tentative computation of taxable income (or loss). Pursuant to §1.1502-28T(a)(2), the tax attributes attributable to S would first be reduced to take into account its \$100 of excluded COD income. Accordingly, the consolidated net operating loss for Year 1 would be reduced by \$50 to \$0. Then, pursuant to §1.1502-28T(a)(4), S's remaining \$50 of excluded COD income would reduce the consolidated capital loss attributable to P of \$40 by \$40 to \$0. The remaining \$10 of excluded COD income would have no effect.

(F) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, ' ' 1.1502-32 and 1.1502-32T are applied to reflect the amount of S's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Under §1.1502-32(b), the absorption of \$30 of S's loss, the application of \$90 of S's excluded COD income to reduce attributes of P and S, and the reduction of the \$50 loss attributable to S in respect of the excluded COD income results in a positive adjustment of \$10 to P's basis in the S stock. P's basis in the S stock, therefore, is \$100.

(G) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, P's actual gain or loss on the sale of the S stock is computed using the basis computed in the previous step. Accordingly, P recognizes an \$80 loss on the disposition of the S stock.

(H) Actual computation of taxable income (or loss). Pursuant to paragraph (c)(2)(viii) of this section, taxable income (or loss) is computed by taking into account P's \$80 loss from the sale of S stock. Before the application of §1.1502-28T, the group, therefore, has a consolidated net operating loss of \$50 that is wholly attributable to S under the principles of §1.1502-21T(b)(2)(iv), and a consolidated capital loss of \$80 that is wholly attributable to P under the principles of §1.1502-21T(b)(2)(iv).

(I) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and ' 1.1502-28T are then actually applied to reduce attributes remaining after the actual computation of taxable income (or loss). Pursuant to section 108(b)(4)(B) and §1.1502-28T(a), the consolidated net operating loss attributable to S under the principles of §1.1502-21T(b)(2)(iv) is reduced first. Accordingly, the operating loss for Year 1 that S would otherwise carry forward is reduced by \$50 to \$0. Then, pursuant to §1.1502-28T(a)(4), S's remaining \$50 of excluded COD income reduces consolidated tax attributes. In particular, without regard to the limitation imposed by paragraph (c)(2)(ix)(A) of this section, the \$80 consolidated capital loss, which under the principles of §1.1502-21T(b)(2)(iv) is attributable to P, would be reduced by \$50 from \$80 to \$30. However, the limitation imposed by paragraph (c)(2)(ix)(A) of this section prevents the reduction of the consolidated capital loss attributable to P by more than \$40. Therefore, the consolidated capital loss attributable to P is reduced by only \$40 in respect of S's excluded COD income. The remaining \$10 of excluded COD income has no effect.

Example 2. Member other than departing member realizes excluded COD income. (i) Facts. P owns all of S1's and S2's stock. P's basis in S2's stock is \$600. For Year 1, P has ordinary income of \$30, S1 has a \$100 ordinary loss and \$100 of excluded COD income from the discharge of non-intercompany indebtedness, and S2 has \$200 of ordinary loss. P sells the S2 stock for \$600 at the close of Year 1. As of the beginning of Year 2, S1 has Asset A with a basis of \$0 and a fair market value of \$10.

(ii) Analysis. The steps used to compute the group's consolidated taxable income, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deductions and losses to offset income or gain. To determine the amount of the limitation under paragraph (c)(2)(i) of this section on S2's loss and the effect of the absorption of S2's loss on P's basis in S2's stock under §1.1502-32(b), P's gain or loss from the sale of S2 stock is not taken into account. The group is tentatively treated as having a consolidated net operating loss of \$270 (P's \$30 of income minus S1's \$100 loss and S2's \$200 loss). Consequently, \$20 of S2's loss

from Year 1 is unlimited and \$180 of S2's loss from Year 1 is limited under paragraph (c)(2)(i) of this section.

(B) Tentative adjustment of stock basis. Then, pursuant to paragraph (c)(2)(ii) of this section, ' ' 1.1502-32 and 1.1502-32T are tentatively applied to adjust the basis of S2 stock. For this purpose, however, adjustments to the basis of S2 stock attributable to the reduction of attributes in respect of S1's excluded COD income are not taken into account. Under §1.1502-32(b), the absorption of \$20 of S2's loss decreases P's basis in S2's stock by \$20 to \$580.

(C) Tentative computation of stock gain or loss. Then, P's income, gain, or loss from the disposition of S2 stock is computed pursuant to paragraph (c)(2)(iii) of this section using the basis computed in the previous step. Thus, P is treated as recognizing a \$20 gain from the sale of the S2 stock.

(D) Tentative computation of taxable income (or loss). Pursuant to paragraph (c)(2)(iv) of this section, taxable income (or loss) for the year of disposition (and any prior years to which the deductions or losses may be carried) is then tentatively computed, taking into account P's \$20 gain from the sale of S2 stock. P's \$20 gain from the sale of S2's stock is offset by \$20 of S1's loss. Therefore, the group is tentatively treated as having a consolidated net operating loss of \$250, \$70 of which is attributable to S1 and \$180 of which is attributable to S2 under the principles of §1.1502-21T(b)(2)(iv).

(E) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and §1.1502-28T are tentatively applied to reduce attributes remaining after the tentative computation of taxable income (or loss). Pursuant to §1.1502-28T(a)(2), the tax attributes attributable to S1 would first be reduced to take into account its \$100 of excluded COD income. Accordingly, the consolidated net operating loss for Year 1 would be reduced by \$70, the portion of the consolidated net operating loss attributable to S1 under the principles of §1.1502-21T(b)(2)(iv), to \$0. Then, pursuant to §1.1502-28T(a)(4), S1's remaining \$30 of excluded COD income would reduce the consolidated net operating loss attributable to S2 of \$180 by \$30 to \$150.

(F) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, ' ' 1.1502-32 and 1.1502-32T are applied to reflect the amount of S2's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Under §1.1502-32(b), the absorption of \$20 of S2's loss and the application of \$30 of S1's excluded COD income to reduce attributes attributable to S2 results in a negative adjustment of \$50 to P's basis in the S2 stock. P's basis in the S2 stock, therefore, is \$550.

(G) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, P's actual gain or loss on the sale of the S2 stock is computed using the basis computed in the previous step. Therefore, P recognizes a \$50 gain on the disposition of the S2 stock.

(H) Actual computation of taxable income (or loss). Pursuant to paragraph (c)(2)(viii) of this section, taxable income (or loss) is computed by taking into account P's \$50 gain from the disposition of the S2 stock. Before the application of §1.1502-28T, therefore, the group has a consolidated net operating loss of \$220, \$40 of which is attributable to S1 and \$180 of which is attributable to S2 under the principles of §1.1502-21T(b)(2)(iv).

(I) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and ' 1.1502-28T are then actually applied to reduce attributes remaining after the actual computation of taxable income (or loss). Pursuant to §1.1502-28T(a)(2), the tax attributes attributable to S1 must first be reduced to take into account its \$100 of excluded COD income. Accordingly, pursuant to section 108(b)(4)(B) and §1.1502-28T(a), the net operating loss attributable to S1 under the principles of §1.1502-21T(b)(2)(iv) is reduced first. The consolidated net operating loss for Year 1 is reduced by \$40, the portion of the consolidated net operating loss attributable to S1 under the principles of §1.1502-21T(b)(2)(iv), to \$0. Then, pursuant to §1.1502-28T(a)(4), without regard to the limitation imposed by paragraph (c)(2)(ix)(B) of this section, S1's remaining \$60 of excluded COD income would reduce S2's net operating loss of \$180 to \$120. However, the limitation imposed by paragraph (c)(2)(ix)(B) of this section prevents the reduction of S2's loss by more than \$30. Therefore, S2's loss of \$180 is reduced by \$30 to \$150 in respect of S1's excluded COD income. The remaining \$30 of excluded COD income has no effect.

Example 3. Lower-tier corporation of departing member realizes excluded COD income. (i) Facts. P owns all of S1's stock, S2's stock, and S3's stock. S1 owns all of S4's stock. P's basis in S1's stock is \$50 and S1's basis in S4 stock is \$50. For Year 1, P has \$50 of ordinary loss, S1 has \$100 of ordinary loss, S2 has \$150 of ordinary loss, S3 has \$50 of ordinary loss, and S4 has \$50 of ordinary loss and \$80 of excluded COD income from the discharge of non-intercompany indebtedness. P sells the S1 stock for \$100 at the close of Year 1. As of the beginning of Year 2, S4 has Asset A with a basis of \$0 and a fair market value of \$10.

(ii) Analysis. The steps used to compute the group's consolidated taxable income, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deductions and losses to offset income or gain. To determine the amount of the limitation under paragraph (c)(2)(i) of this section on S1's and S4's losses and the effect of the absorption of S1's and S4's losses on P's basis in S1's stock under §1.1502-32(b), P's gain or loss from the disposition of S1's stock is not taken into account. The group is tentatively treated as having a consolidated net

operating loss of \$400. Consequently, \$100 of S1's loss and \$50 of S4's loss is limited under paragraph (c)(2)(i) of this section.

(B) Tentative adjustment of stock basis. Then, pursuant to paragraph (c)(2)(ii) of this section, ' ' 1.1502-32 and 1.1502-32T are tentatively applied to adjust the basis of S stock. For this purpose, adjustments to the basis of S1 stock attributable to S4's realization of excluded COD income and the reduction of attributes in respect of such excluded COD income are not taken into account. There is no adjustment under ' 1.1502-32 to the basis of the S1 stock. Therefore, P's basis in the S1 stock for this purpose is \$50.

(C) Tentative computation of stock gain or loss. Then, P's income, gain, or loss from the sale of S1 stock is computed pursuant to paragraph (c)(2)(iii) of this section using the basis computed in the previous step. Thus, P is treated as recognizing a \$50 gain from the sale of the S1 stock.

(D) Tentative computation of taxable income (or loss). Pursuant to paragraph (c)(2)(iv) of this section, taxable income (or loss) for the year of disposition (and any prior years to which the deductions or losses may be carried) is tentatively computed, taking into account P's \$50 gain from the sale of the S1 stock computed pursuant to the previous step. P's \$50 gain from the sale of the S1 stock is offset by \$10 of P's loss, \$30 of S2's loss, and \$10 of S3's loss. Therefore, the group is tentatively treated as having a consolidated net operating loss of \$350, \$40 of which is attributable to P, \$100 of which is attributable to S1, \$120 of which is attributable to S2, \$40 of which is attributable to S3, and \$50 of which is attributable to S4 under the principles of §1.1502-21T(b)(2)(iv).

(E) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and §1.1502-28T are tentatively applied to reduce attributes remaining after the tentative computation of taxable income (or loss). Pursuant to §1.1502-28T(a)(2), the tax attributes attributable to S4 would first be reduced to take into account its excluded COD income in the amount of \$80. Accordingly, the consolidated net operating loss attributable to S4 would be reduced by \$50 to \$0. Then, pursuant to §1.1502-28T(a)(4), S4's remaining \$30 of excluded COD income would reduce the consolidated net operating loss for Year 1 that is attributable to other members. Therefore, the consolidated net operating loss for Year 1 would be reduced by \$30. Of that amount, \$4 is attributable to P, \$10 is attributable to S1, \$12 is attributable to S2, and \$4 is attributable to S3.

(F) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, ' ' 1.1502-32 and 1.1502-32T are applied to reflect the amount of S1's and S4's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Under §1.1502-32(b), the application of \$80 of S4's excluded COD income to reduce attributes, and the reduction of S4's loss in the amount

of \$50 and S1's loss in the amount of \$10 in respect of the excluded COD income results in a positive adjustment of \$20 to P's basis in the S1 stock. Accordingly, P's basis in S1 stock is \$70.

(G) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, P's actual gain or loss on the sale of the S1 stock is computed using the basis computed in the previous step. Accordingly, P recognizes a \$30 gain on the disposition of the S1 stock.

(H) Actual computation of taxable income (or loss). Pursuant to paragraph (c)(2)(viii) of this section, the group's taxable income or loss is then computed by taking into account P's \$30 gain from the sale of S1 stock. Before the application of §1.1502-28T, therefore, the group has a consolidated net operating loss of \$370, \$44 of which is attributable to P, \$100 of which is attributable to S1, \$132 of which is attributable to S2, \$44 of which is attributable to S3, and \$50 of which is attributable to S4.

(I) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and ' 1.1502-28T are then actually applied to reduce attributes remaining after the actual computation of taxable income (or loss). Pursuant to §1.1502-28T(a)(2), the tax attributes attributable to S4 must first be reduced to take into account its \$80 of excluded COD income. Accordingly, the consolidated net operating loss attributable to S4 is reduced by \$50 to \$0. Then, pursuant to §1.1502-28T(a)(4), S4's remaining \$30 of excluded COD income reduces the consolidated net operating loss for Year 1. Therefore, without regard to the limitation imposed by paragraph (c)(2)(ix)(B) of this section, the consolidated net operating loss for Year 1 would be reduced by \$30 (\$4.12 of the consolidated net operating loss attributable to P, \$9.38 of the consolidated net operating loss attributable to S1, \$12.38 of the consolidated net operating loss attributable to S2, and \$4.12 of the consolidated net operating loss attributable to S3) to \$290. However, the limitation imposed by paragraph (c)(2)(ix)(B) of this section prevents the reduction of the consolidated net operating loss attributable to P, S2, and S3 by more than \$4, \$12, and \$4 respectively. The \$.62 of excluded COD income that would have otherwise reduced the consolidated net operating loss attributable to P, S2, and S3 is applied to reduce the consolidated net operating loss attributable to S1. Therefore, S1 carries forward \$90 of loss.

Example 4. Excess loss account taken into account. (i) Facts. P is the common parent of a consolidated group. On Day 1 of Year 2, P acquired all of the stock of S1. As of the beginning of Year 2, S1 had a \$30 net operating loss carryover from Year 1, a separate return limitation year. A limitation under ' 1.1502-21(c) applies to the use of that loss by the P group. For Years 1 and 2, the P group had no consolidated taxable income or loss. On Day 1 of Year 3, S1 acquired all of the stock of S2 for \$10. In Year 3, P had ordinary income of \$10, S1 had ordinary income of \$25, and S2 had an ordinary loss of \$50. In addition, in Year 3, S2 realized \$20 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S2 had no liabilities. As of the beginning of Year 4, S2 had Asset A with a basis of \$0 and a fair market value of \$10. S2 had no taxable income (or loss) for Year 1 and Year 2.

(ii) Analysis. The steps used to compute the group's consolidated taxable income, to effect the reduction of attributes, and to compute the limitations on the use and reduction of attributes are as follows:

(A) Computation of limitation on deduction and losses to offset income or gain, tentative basis adjustments, tentative computation of stock gain or loss. Because it is not initially apparent that there has been a disposition of stock, paragraph (c)(2)(i) of this section does not limit the use of deductions to offset income or gain, no adjustments to the basis are required pursuant to paragraph (c)(2)(ii) of this section, and no stock gain or loss is computed pursuant to paragraph (c)(2)(iii) of this section or taken into account in the tentative computation of taxable income pursuant to paragraph (c)(2)(iv) of this section.

(B) Tentative computation of taxable income (or loss). Pursuant to paragraph (c)(2)(iv) of this section, the group's taxable income (or loss) for Year 3 (and any prior years to which the deductions or losses may be carried) is tentatively computed. For Year 3, the P group has a consolidated taxable loss of \$15, all of which is attributable to S2 under the principles of §1.1502-21T(b)(2)(iv).

(C) Tentative reduction of attributes. Next, pursuant to paragraph (c)(2)(v) of this section, the rules of sections 108 and 1017 and ' 1.1502-28T are tentatively applied to reduce attributes remaining after the tentative computation of consolidated taxable loss. Pursuant to ' 1.1502-28T(a)(2), the tax attributes attributable to S2 would first be reduced to take into account its excluded COD income of \$20. Accordingly, the net operating loss attributable to S2 under the principles of §1.1502-21T(b)(2)(iv) is reduced first. Therefore, the consolidated net operating loss for Year 3 is reduced by \$15, the portion of the consolidated net operating loss attributable to S2, to \$0. The remaining \$5 of excluded COD income is not applied to reduce attributes as there are no remaining attributes that are subject to reduction.

(D) Actual adjustment of stock basis. Pursuant to paragraph (c)(2)(vi) of this section, ' ' 1.1502-32 and 1.1502-32T are applied to reflect the amount of S2's unlimited deductions and losses that are absorbed in the tentative computation of taxable income (or loss) for the year of the disposition (and any prior years to which the deductions or losses may be carried) and the excluded COD income tentatively applied to reduce attributes and the attributes reduced in respect of the excluded COD income pursuant to the previous step. Pursuant to §§1.1502-32 and 1.1502-32T, the absorption of \$35 of S2's loss, the application of \$15 in respect of S2's excluded COD income to reduce attributes, and the reduction of \$15 in respect of the loss attributable to S2 reduced in respect of the excluded COD income results in a negative adjustment of \$35 to the basis of the S2 stock. Therefore, S1 has an excess loss account of \$25 in the S2 stock.

(E) Actual computation of stock gain or loss. Pursuant to paragraph (c)(2)(vii) of this section, S1's actual gain or loss, if any, on the S2 stock is computed. Because S2 realized \$5 of excluded COD income that was not applied to reduce attributes, pursuant

to ' ' 1.1502-19(c)(1)(iii)(B) and 1.1502-19T(b)(1), S1 is required to take into account \$5 of its excess loss account in the S2 stock.

(F) Actual computation of taxable income (or loss). Pursuant to paragraph (c)(2)(viii) of this section, the group's taxable income or loss is computed taking into account the \$5 of the excess loss account in the S2 stock required to be taken into account. See ' 1.1502-28T(b)(6) (requiring an excess loss account that is required to be taken into account as a result of the application of ' 1.1502-19(c)(1)(iii)(B) to be included in the group's consolidated taxable income for the year that includes the date of the debt discharge). However, pursuant to paragraph (c)(2)(viii) of this section, such amount may not be offset by any of the consolidated net operating loss attributable to S2. It may, however, subject to applicable limitations, be offset by the separate net operating loss of S1 from Year 1.

(G) Actual reduction of attributes. Pursuant to paragraph (c)(2)(ix) of this section, sections 108 and 1017 and ' 1.1502-28T are then actually applied to reduce attributes remaining after the actual computation of taxable income (or loss). Attributes will be actually reduced in the same way that they were tentatively reduced.

(6) Additional rules for multiple dispositions. [Reserved]

(7) Effective date. This paragraph (c) applies to dispositions of subsidiary stock that occur after the date these regulations are published as temporary or final regulations in the **Federal Register**. Taxpayers may apply this paragraph (c), as contained in these proposed regulations, in whole, but not in part, to any disposition of subsidiary stock that occurs before the date these regulations are published as temporary or final regulations in the **Federal Register**.

Par. 3. Section 1.1502-13 is revised to read as follows:

§1.1502-13 Intercompany transactions.

[The text of this proposed section is the same as the text of §1.1502-13T(g)(3)(ii)(B) published elsewhere in this issue of the **Federal Register**].

Par. 4. Section 1.1502-28 is amended to read as follows:

1. Adding paragraphs (b)(4), (b)(5), (b)(6) and (b)(7).
2. Revising paragraph (d).

3. The additions and revision read as follows:

' 1.1502-28 Consolidated section 108.

\* \* \* \* \*

(b)(4) and (5) [The text of paragraphs (b)(4) and (5) is the same as the text of §1.1502-28T(b)(4) and (5) published elsewhere in this issue of the **Federal Register**].

(6) Taking into account of excess loss account--(i) Determination of inclusion.

The determination of whether any portion of an excess loss account in a share of stock of a subsidiary that realizes excluded COD income is required to be taken into account as a result of the application of ' 1.1502-19(c)(1)(iii)(B) is made after the determination of taxable income (or loss) for the year during which the member realizes excluded COD income (without regard to whether any portion of an excess loss account in a share of the subsidiary is required to be taken into account) and any prior years to which the deductions or losses of the subsidiary may be carried, after the reduction of tax attributes pursuant to sections 108 and 1017, and this section, and after the adjustment of the basis of the share of stock of the subsidiary pursuant to ' 1.1502-32 to reflect the amount of the subsidiary's deductions and losses that are absorbed in the computation of taxable income (or loss) for the year of the disposition and any prior years to which the deductions or losses may be carried, and the excluded COD income applied to reduce attributes and the attributes reduced in respect thereof. See ' 1.1502-11(c) for special rules related to the computation of taxable income (or loss) that apply when an excess loss account is required to be taken into account.

(ii) [The text of paragraph (b)(6)(ii) is the same as the text of §1.1502-28T(b)(6)(ii) published elsewhere in this issue of the **Federal Register**].

\* \* \* \* \*

(7) Dispositions of stock. See §1.1502-11(c) for limitations on the reduction of tax attributes when a member disposes of stock of another member (including dispositions that result from the application of §1.1502-19(c)(1)(iii)(B)) during a taxable year in which any member realizes excluded COD income.

\* \* \* \* \*

(d) Effective dates. (1) This section, other than paragraphs (a)(4), (b)(4), (b)(5), (b)(6), and (b)(7) of this section, applies to discharges of indebtedness that occur after August 29, 2003.

(2) Paragraph (a)(4) of this section applies to discharges of indebtedness that occur after August 29, 2003, but only if the discharge occurs during a taxable year the original return for which is due (without regard to extensions) after December 11, 2003. However, groups may apply paragraph (a)(4) of this section to discharges of indebtedness that occur after August 29, 2003, and during a taxable year the original return for which is due (without regard to extensions) on or before December 11, 2003. For discharges of indebtedness that occur after August 29, 2003, and during a taxable year the original return for which is due (without regard to extensions) on or before December 11, 2003, paragraph (a)(4) of this section shall apply as in effect on August 29, 2003.

(3) Paragraphs (b)(4), (b)(5), and (b)(6)(ii) of this section apply to discharges of indebtedness that occur after August 29, 2003, but only if the discharge occurs during a taxable year the original return for which is due (without regard to extensions) after March 12, 2004. However, groups may apply paragraphs (b)(4), (b)(5), and (b)(6)(ii) of this section to discharges of indebtedness that occur after August 29, 2003, and during a

taxable year the original return for which is due (without regard to extensions) on or before March 12, 2004.

(4) Paragraphs (b)(6)(i) and (b)(7) of this section apply to discharges of indebtedness that occur after August 29, 2003, but only if the discharge occurs during a taxable year the original return for which is due (without regard to extensions) after the date these regulations are published as temporary or final regulations in the **Federal Register**. However, groups may apply paragraphs (b)(6)(i) and (b)(7) of this section to discharges of indebtedness that occur after August 29, 2003, and during a taxable year the original return for which is due (without regard to extensions) on or before the date these regulations are published as temporary or final regulations in the **Federal Register**.

\* \* \* \* \*

Par. 5. The last sentence of paragraph (c) of §1.1502-80 is revised to read as follows:

§1.1502-80 Applicability of other provisions of law.

\* \* \* \* \*

(c) \* \* \* See §§1.1502-11(d) and 1.1502-35T for additional rules relating to stock loss.

\* \* \* \* \*

Mark E. Matthews  
Deputy Commissioner for Services and Enforcement.