

amounts under paragraph (f) of this section.

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§ 1.1502-19 Excess loss accounts.

(a) *In general*—(1) *Purpose*. This section provides rules for a member (P) to include in income its excess loss account in the stock of another member (S). The purpose of the excess loss account is to recapture in consolidated taxable income P's negative adjustments with respect to S's stock (e.g., under § 1.1502-32 from S's deductions, losses, and distributions), to the extent the negative adjustments exceed P's basis in the stock.

(2) *Excess loss accounts*—(i) *In general*. P's basis in S's stock is adjusted under the consolidated return regulations and other rules of law. Negative adjustments may exceed P's basis in S's stock. The resulting negative amount is P's excess loss account in S's stock. For example:

(A) Once P's negative adjustments under § 1.1502-32 exceed its basis in S's stock, the excess is P's excess loss account in the S stock. If P has further adjustments, they first increase or decrease the excess loss account.

(B) If P forms S by transferring property subject to liabilities in excess of basis, § 1.1502-80(d) provides for the nonapplicability of section 357(c) and the resulting negative basis under section 358 is P's excess loss account in the S stock.

(ii) *Treatment as negative basis*. P's excess loss account is treated for all Federal income tax purposes as basis that is a negative amount, and a reference to P's basis in S's stock includes a reference to P's excess loss account.

(3) *Application of other rules of law*. The rules of this section are in addition to other rules of law. See, e.g., §§ 1.1502-32 (investment adjustment rules establishing and adjusting excess loss accounts) and 1.1502-80(d) (nonapplicability of section 357(c)). The provisions of this section and other rules of law must not be applied to recapture the same amount more than once. For purposes of this section, the definitions in § 1.1502-32 apply.

(b) *Excess loss account taken into account as income or gain*—(1) *Operating rules*—(i) *General rule*. Except as provided in paragraph (b)(1)(ii) of this section, if P is treated under this section as disposing of a share of S's stock, P takes into account its excess loss account in the share as income or gain from the disposition.

(ii) *Special limitation on amount taken into account*. Notwithstanding paragraph (b)(1)(i) of this section, if P is treated as disposing of a share of S's stock as a result of the application of paragraph (c)(1)(iii)(B) of this section, the aggregate amount of its excess loss account in the shares of S's stock that P takes into account as income or gain from the disposition shall not exceed the amount of S's indebtedness that is discharged that is neither included in gross income nor treated as tax-exempt income under § 1.1502-32(b)(3)(ii)(C)(I). If more than one share of S's stock has an excess loss account, such excess loss accounts shall be taken into account pursuant to the preceding sentence, to the extent possible, in a manner that equalizes the excess loss accounts in S's shares that have an excess loss account.

(iii) *Treatment of disposition*. Except as provided in paragraph (b)(4) of this section, the disposition is treated as a sale or exchange for purposes of determining the character of the income or gain.

(2) *Nonrecognition or deferral*—(i) *In general*. P's income or gain under paragraph (b)(1) of this section is subject to any nonrecognition or deferral rules applicable to the disposition. For example, if S liquidates and the exchange of P's stock in S is subject to section 332, or P transfers all of its assets (including S's stock) to S in a reorganization to which section 361(a) applies, P's income or gain from the excess loss account is not recognized under these rules.

(ii) *Nonrecognition or deferral inapplicable*. If P's income or gain under paragraph (b)(1) of this section is from a disposition described in paragraph (c)(1) (ii) or (iii) of this section (relating to deconsolidations and worthlessness), the income or gain is taken into account notwithstanding any nonrecognition or deferral rules (even if

the disposition is also described in paragraph (c)(1)(i) of this section). For example, if P transfers S's stock to a nonmember in a transaction to which section 351 applies, P's income or gain from the excess loss account is taken into account.

(3) *Tiering up in chains.* If the stock of more than one subsidiary is disposed of in the same transaction, the income or gain under this section is taken into account in the order of the tiers, from the lowest to the highest.

(4) *Insolvency—(i) In general.* Gain under this section is treated as ordinary income to the extent of the amount by which S is insolvent (within the meaning of section 108(d)(3)) immediately before the disposition. For this purpose S's liabilities include any amount to which preferred stock would be entitled if S were liquidated immediately before the disposition, and any former liabilities that were discharged to the extent the discharge was treated as tax-exempt income under § 1.1502-32(b)(3)(ii)(C) (special rule for discharges).

(ii) *Reduction for amount of distributions.* The amount treated as ordinary income under this paragraph (b)(4) is reduced to the extent it exceeds the amount of P's excess loss account redetermined without taking into account S's distributions to P to which § 1.1502-32(b)(2)(iv) applies.

(c) *Disposition of stock.* For purposes of this section:

(1) *In general.* P is treated as disposing of a share of S's stock:

(i) *Transfer, cancellation, etc.* At the time—

(A) P transfers or otherwise ceases to own the share for Federal income tax purposes, even if no gain or loss is taken into account; or

(B) P takes into account gain or loss (in whole or in part) with respect to the share.

(ii) *Deconsolidation.* At the time—

(A) P becomes a nonmember, or a nonmember determines its basis in the share (or any other asset) by reference to P's basis in the share, directly or indirectly, in whole or in part (e.g., under section 362); or

(B) S becomes a nonmember, or P's basis in the share is reflected, directly or indirectly, in whole or in part, in

the basis of any asset other than member stock (e.g., under section 1071).

(iii) *Worthlessness.* At the time—

(A) Substantially all of S's assets are treated as disposed of, abandoned, or destroyed for Federal income tax purposes (e.g., under section 165(a) or § 1.1502-80(c), or, if S's asset is stock of a lower-tier member, the stock is treated as disposed of under this paragraph (c)). An asset of S is not considered to be disposed of or abandoned to the extent the disposition is in complete liquidation of S or is in exchange for consideration (other than relief from indebtedness);

(B) An indebtedness of S is discharged, if any part of the amount discharged is not included in gross income and is not treated as tax-exempt income under § 1.1502-32(b)(3)(ii)(C); or

(C) A member takes into account a deduction or loss for the uncollectibility of an indebtedness of S, and the deduction or loss is not matched in the same tax year by S's taking into account a corresponding amount of income or gain from the indebtedness in determining consolidated taxable income.

(2) *Becoming a nonmember.* A member is treated as becoming a nonmember if it has a separate return year (including another group's consolidated return year). For example, S may become a nonmember if it issues additional stock to nonmembers, but S does not become a nonmember as a result of its complete liquidation. A disposition under paragraph (c)(1)(ii) of this section must be taken into account in the consolidated return of the group. For example, if a group ceases under § 1.1502-75(c) to file a consolidated return as of the close of its consolidated return year, the disposition under paragraph (c)(1)(ii) of this section is treated as occurring immediately before the close of the year. If S becomes a nonmember because P sells S's stock to a nonmember, P's sale is a disposition under both paragraphs (c)(1)(i) and (ii) of this section. If a group terminates under § 1.1502-75(d) because the common parent is the only remaining member, the common parent is not treated as having a deconsolidation event under paragraph (c)(1)(ii) of this section.

(3) *Exception for acquisition of group—*
 (i) *Application.* This paragraph (c)(3) applies only if a consolidated group (the terminating group) ceases to exist as a result of—

(A) The acquisition by a member of another consolidated group of either the assets of the common parent of the terminating group in a reorganization described in section 381(a)(2), or the stock of the common parent of the terminating group; or

(B) The application of the principles of § 1.1502-75(d)(2) or (d)(3).

(ii) *General rule.* Paragraph (c)(1)(ii) of this section does not apply solely by reason of the termination of a group in a transaction to which this paragraph (c)(3) applies, if there is a surviving group that is, immediately thereafter, a consolidated group. Instead, the surviving group is treated as the terminating group for purposes of applying this section to the terminating group. This treatment does not apply, however, to members of the terminating group that are not members of the surviving group immediately after the terminating group ceases to exist (e.g., under section 1504(a)(3) relating to re-consolidation, or section 1504(c) relating to includible insurance companies).

(d) *Special allocation of basis adjustments or determinations.* If a member has an excess loss account in shares of a class of S's stock at the time of a basis adjustment or determination under the Internal Revenue Code with respect to other shares of the same class of S's stock owned by the member, the adjustment or determination is allocated first to equalize and eliminate that member's excess loss account. For example, if P owns 50 shares of S's only class of stock with a \$100 basis and 50 shares with a \$100 excess loss account, and P contributes \$200 to S without receiving additional shares, the contribution first eliminates P's excess loss account, then increases P's basis in each share by \$1. (If P transfers the \$200 in exchange for an additional 100 shares of S's stock in a transaction to which section 351 applies, P's excess loss account is first eliminated, and P's basis in the additional shares is \$100.) See § 1.1502-32(c) for similar allocations of investment adjustments to prevent or eliminate excess loss accounts.

(e) *Anti-avoidance rule.* If any person acts with a principal purpose contrary to the purposes of this section, to avoid the effect of the rules of this section or apply the rules of this section to avoid the effect of any other provision of the consolidated return regulations, adjustments must be made as necessary to carry out the purposes of this section.

(f) *Predecessors and successors.* For purposes of this section, any reference to a corporation (or to a share of the corporation's stock) includes a reference to a successor or predecessor (or to a share of stock of a predecessor or successor), as the context may require.

(g) *Examples.* For purposes of the examples in this section, unless otherwise stated, P owns all 100 shares of the only class of S's stock and S owns all 100 shares of the only class of T's stock, the stock is owned for the entire year, T owns no stock of lower-tier members, 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, and tax liabilities are disregarded. The principles of this section are illustrated by the following examples.

Example 1. Taxable disposition of stock. (a) *Facts.* P has a \$150 basis in S's stock, and S has a \$100 basis in T's stock. For Year 1, P has \$500 of ordinary income, S has no income or loss, and T has a \$200 ordinary loss. S sells T's stock to a nonmember for \$60 at the close of Year 1.

(b) *Analysis.* Under paragraph (c) of this section, the sale is a disposition of T's stock at the close of Year 1 (the day of the sale). Under § 1.1502-32(b), T's loss results in S having a \$100 excess loss account in T's stock immediately before the sale. Under paragraph (b)(1) of this section, S takes into account the \$100 excess loss account as an additional \$100 of gain from the sale. Consequently, S takes into account a \$160 gain from the sale in determining the group's consolidated taxable income. Under § 1.1502-32(b), T's \$200 loss and S's \$160 gain result in a net \$40 decrease in P's basis in S's stock as of the close of Year 1, from \$150 to \$110.

(c) *Intercompany sale followed by sale to nonmember.* The facts are the same as in paragraph (a) of this *Example 1*, except that S sells T's stock to P for \$60 at the close of Year 1, and P sells T's stock to a nonmember at a gain at the beginning of Year 5. Under paragraph (c) of this section, S's sale is

treated as a disposition of T's stock at the close of Year 1 (the day of the sale). Under § 1.1502-13 and paragraph (b)(2) of this section, S's \$160 gain from the sale is deferred and taken into account in Year 5 as a result of P's sale of the T stock. Under § 1.1502-32(b), the absorption of T's \$200 loss in Year 1 results in P having a \$50 excess loss account in S's stock at the close of Year 1. In Year 5, S's \$160 gain taken into account eliminates P's excess loss account in S's stock and increases P's basis in the stock to \$110.

(d) *Intercompany distribution followed by sale to a nonmember.* The facts are the same as in paragraph (a) of this *Example 1*, except that the value of the T stock is \$60 and S declares and distributes a dividend of all of the T stock to P at the close of Year 1, and P sells the T stock to a nonmember at a gain at the beginning of Year 5. Under paragraph (c) of this section, S's distribution is treated as a disposition of T's stock at the close of Year 1 (the day of the distribution). S's \$100 excess loss account in T's stock is treated as additional gain under section 311(b) from the distribution. Under section 301(d), P's basis in the T stock is \$60. Under § 1.1502-13, and paragraph (b)(2) of this section, S's \$160 gain from the distribution is deferred and taken into account in Year 5 as a result of P's sale of the T stock. Under § 1.1502-32(b), T's \$200 loss and S's \$60 distribution result in P having a \$110 excess loss account in S's stock at the close of Year 1. In Year 5, S's \$160 gain taken into account eliminates P's excess loss account in S's stock and increases P's basis in the stock to \$50.

Example 2. Basis determinations under the Internal Revenue Code in intercompany reorganizations. (a) *Facts.* P owns all of the stock of S and T. P has a \$150 basis in S's stock and a \$100 excess loss account in T's stock. P transfers T's stock to S without receiving additional S stock, in a transaction to which section 351 applies.

(b) *Analysis.* Under paragraph (c) of this section, P's transfer is treated as a disposition of T's stock. Under section 351 and paragraph (b)(2) of this section, P does not recognize gain from the disposition. Under section 358 and paragraph (a)(2)(ii) of this section, P's \$100 excess loss account in T's stock decreases P's \$150 basis in S's stock to \$50. In addition, S takes a \$100 excess loss account in T's stock under section 362. (If P had received additional S stock, paragraph (d) of this section would not apply to shift basis from P's original S stock because the basis of the original stock is not adjusted or determined as a result of the contribution; but paragraph (d) would apply to shift basis if P had transferred S's stock to T in exchange for additional T stock, because the basis of the additional T stock would be determined when P has an excess loss account in its original T stock.)

(c) *Intercompany merger.* The facts are the same as in paragraph (a) of this *Example 2*, except that T merges into S in a reorganization described in section 368(a)(1)(A) (and in section 368(a)(1)(D)), and P receives no additional S stock in the reorganization. Under section 354 and paragraph (b)(2) of this section, P does not recognize gain. Under section 358 and paragraph (a)(2)(ii) of this section, P's \$100 excess loss account in T's stock decreases P's \$150 basis in the S stock to \$50. (Similarly, if S merges into T and P does not receive additional T stock, P's \$150 basis in S's stock eliminates P's excess loss account in T's stock, and increases P's basis in T's stock to \$50.)

(d) *Liquidation of only subsidiary.* Assume instead that P and S are the only members of the P group, P has a \$100 excess loss account in S's stock, and S liquidates in a transaction to which section 332 applies. Under paragraph (c)(2) of this section, the liquidation is not a deconsolidation event under paragraph (c)(1)(ii) of this section merely because P is the only remaining member. Under section 332 and paragraph (b)(2) of this section, P does not recognize gain. Under section 334(b), P succeeds to S's basis in the assets it receives from S in the liquidation. (P would also not recognize gain if P transferred all of its assets (including S's stock) to S in a reorganization to which section 361(a) applied, because S would be a successor to P under paragraph (f) of this section.)

Example 3. Section 355 distribution of stock with an excess loss account. (a) *Facts.* P has a \$30 excess loss account in S's stock, and S has a \$90 excess loss account in T's stock. S distributes the T stock to P in a transaction to which section 355 applies, and neither P nor S recognizes any gain or loss. At the time of the distribution, the T stock represents 33% of the value of the S stock. Following the distribution, P's basis in the S stock is allocated under § 1.358-2 in proportion to the fair market values of the S stock and the T stock.

(b) *Analysis.* Under paragraph (c) of this section, S's distribution of the T stock is treated as a disposition. Under section 355(c) and paragraph (b)(2) of this section, S does not recognize any gain from the distribution. Under section 358, S's excess loss account in the T stock is eliminated, and P's \$30 excess loss account in the S stock is treated as basis allocated between the S stock and the T stock based on their relative values. Consequently, P has a \$20 excess loss account in the S stock and a \$10 excess loss account in the T stock. (If P had a \$30 basis rather than a \$30 excess loss account in the S stock, S would not recognize gain, its excess loss account in the T stock would be eliminated, and P's basis in the stock of S and T would be \$20 and \$10, respectively.)

(c) *Section 355 distribution to nonmember.* The facts are the same as in paragraph (a) of this *Example 3*, except that P also distributes the T stock to its shareholders in a transaction to which section 355 applies. Under paragraph (c) of this section, P's distribution is treated as a disposition of T's stock. Under paragraph (b)(2) of this section, because P's disposition is described in paragraph (c)(1)(ii) of this section, P's \$10 excess loss account in the T stock must be taken into account at the time of the distribution, notwithstanding the nonrecognition rules of section 355(c).

Example 4. Deconsolidation of a member. (a) *Facts.* P has a \$50 excess loss account in S's stock, and S has a \$100 excess loss account in T's stock. T issues additional stock to a nonmember and, as a consequence, T becomes a nonmember.

(b) *Analysis.* Under paragraph (c)(2) of this section, S is treated as disposing of each of its shares of T's stock immediately before T becomes a nonmember. Under paragraph (b)(1) of this section, S takes into account its \$100 excess loss account as gain from the sale or exchange of T's stock. Under § 1.1502-32(b) of this section, S's \$100 gain eliminates P's excess loss account in S's stock and increases P's basis in S's stock to \$50.

(c) *Deconsolidation of a higher-tier member.* The facts are the same as in paragraph (a) of this *Example 4*, except that S (rather than T) issues the stock and, as a consequence, both S and T become nonmembers. Under paragraph (c)(2) of this section, P is treated as disposing of S's stock and S is treated as disposing of T's stock immediately before S and T become nonmembers. Under § 1.1502-32(b) and paragraph (b)(3) of this section, because S and T become nonmembers in the same transaction and T is the lower-tier member, S is first treated under paragraph (b)(1) of this section as taking into account its \$100 excess loss account as gain from the sale or exchange of T's stock. Under § 1.1502-32(b), S's \$100 gain eliminates P's excess loss account in S's stock and increases P's basis in S's stock to \$50 immediately before S becomes a nonmember. Thus, only S's \$100 gain is taken into account in the determination of the group's consolidated taxable income.

(d) *Intercompany gain and deconsolidation.* The facts are the same as in paragraph (c) of this *Example 4*, except that T has \$30 of gain that is deferred under § 1.1502-13 and taken into account in determining consolidated taxable income immediately before T becomes a nonmember. Under § 1.1502-32(b), T's \$30 gain decreases S's excess loss account in T's stock from \$100 to \$70 immediately before S is treated as disposing of T's stock. Under paragraph (b)(1) of this section, S is treated as taking into account its \$70 excess loss account as gain from the disposition of T's stock. Under § 1.1502-32(b), S's \$70 gain from the excess loss account and T's \$30 deferred

gain that is taken into account eliminate P's \$50 excess loss account in S's stock and increase P's basis in S's stock to \$50 immediately before S becomes a nonmember.

Example 5. Worthlessness. (a) *Facts.* P forms S with a \$150 contribution, and S borrows \$150. For Year 1, S has a \$50 ordinary loss that is carried over as part of the group's consolidated net operating loss. For Year 2, P has \$160 of ordinary income, and S has a \$160 ordinary loss. Under § 1.1502-32(b), S's loss results in P having a \$10 excess loss account in S's stock. During Year 3, the value of S's assets (without taking S's liabilities into account) continues to decline and S's stock becomes worthless within the meaning of section 165(g) (without taking into account § 1.1502-80(c)). For Year 4, S has \$10 of ordinary income.

(b) *Analysis.* Under paragraph (c)(1)(iii)(A) of this section, P is not treated as disposing of S's stock in Year 3 solely because S's stock becomes worthless within the meaning of section 165(g) (taking S's liabilities into account). In addition, because S's stock is not treated as worthless, section 382(g)(4)(D) does not prevent the Year 1 consolidated net operating loss carryover from offsetting S's \$10 of income in Year 4.

(c) *Discharge of indebtedness.* The facts are the same as in paragraph (a) of this *Example 5*, except that, instead of S's stock becoming worthless within the meaning of section 165(g), S's creditor discharges \$40 of S's indebtedness during Year 3, S is insolvent by more than \$40 before the discharge, the discharge is excluded from the P group's gross income under section 108(a), and \$40 of the \$50 consolidated net operating loss carryover attributable to S is eliminated under section 108(b). Under § 1.1502-32(b)(3)(ii)(C), S's \$40 of discharge income is treated as tax-exempt income because there is a corresponding decrease under § 1.1502-32(b)(3)(iii) for elimination of the loss carryover. Under paragraph (c)(1)(iii)(B) of this section, P is treated as disposing of S's stock if the amount discharged is not included in gross income and is not treated as tax-exempt income under § 1.1502-32(b)(3)(ii)(C). Because the discharge is treated as tax-exempt income, P is not treated as disposing of S's stock by reason of the discharge.

Example 6. Avoiding worthlessness. (a) *Facts.* P forms S with a \$100 contribution and S borrows \$150. For Years 1 through 5, S has a \$210 ordinary loss that is absorbed by the group. Under § 1.1502-32(b), S's loss results in P having a \$110 excess loss account in S's stock. S defaults on the indebtedness, but the creditor does not discharge the debt (or initiate collection procedures). At the beginning of Year 6, S ceases any substantial operations with respect to the assets, but maintains their ownership with a principal purpose to avoid P's taking into account its excess loss account in S's stock.

(b) *Analysis.* Under paragraph (c)(1)(iii)(A) of this section, P's excess loss account on each of its shares of S's stock ordinarily is taken into account at the time substantially all of S's assets are treated as disposed of, abandoned, or destroyed for Federal income tax purposes. Under paragraph (e) of this section, however, S's assets are not taken into account at the beginning of Year 6 for purposes of applying paragraph (c)(1)(iii)(A) of this section. Consequently, S is treated as worthless at the beginning of Year 6, and P's §110 excess loss account is taken into account.

(h) *Effective date—(1) Application.* This section applies with respect to determinations of the basis of (including an excess loss account in) the stock of a member in consolidated return years beginning on or after January 1, 1995. If this section applies, basis (and excess loss accounts) must be determined or redetermined as if this section were in effect for all years (including, for example, the consolidated return years of another consolidated group to the extent adjustments during those consolidated return years are still reflected). Any such determination or redetermination does not, however, affect any prior period.

(2) *Dispositions of stock—(i) Dispositions of stock before effective date.* If P was treated as disposing of stock of S in a tax year beginning before January 1, 1995 (including, for example, a deemed disposition because S was worthless) under the rules of this section then in effect, the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount, are not redetermined under paragraph (h)(1) of this section. See paragraph (h)(3) of this section for the applicable rules.

(ii) *Application of special limitation.* If P was treated as disposing of stock of S because S was treated as worthless as a result of the application of paragraph (c)(1)(iii)(B) of this section after August 29, 2003, the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount, are determined or redetermined with regard to paragraph (b)(1)(ii) of this section. If P was treated as disposing of stock of S because S was treated as worthless as a result of the application of paragraph (c)(1)(iii)(B) of this section on or before August 29, 2003, the group may deter-

mine or redetermine the amount of P's income, gain, deduction, or loss, and the stock basis reflected in that amount with regard to paragraph (b)(1)(ii) of this section.

(iii) *Intercompany amounts.* For purposes of this paragraph (h)(2), a disposition does not include a transaction to which §1.1502-13, §1.1502-13T, §1.1502-14, or §1.1502-14T applies. Instead, the transaction is deemed to occur as the income, gain, deduction, or loss (if any) is taken into account.

(3) *Prior law.* For prior determinations, see prior regulations under section 1502 as in effect with respect to the determination. See, e.g., §1.1502-19 as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

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§ 1.1502-20 Disposition or deconsolidation of subsidiary stock.

(a) *Loss disallowance—(1) General rule.* No deduction is allowed for any loss recognized by a member with respect to the disposition of stock of a subsidiary. See also §§1.1502-11(c) (stock losses attributable to certain pre-1966 distributions) and 1.1502-80(c) (deferring the treatment of stock of members as worthless under section 165(g)).

(2) *Disposition.* *Disposition* means any event in which gain or loss is recognized, in whole or in part.

(3) *Coordination with loss deferral and other disallowance rules—(i) In general.* Loss with respect to the stock of a subsidiary may be deferred or disallowed under other applicable provisions of the Code and regulations, including section 267(f). Paragraph (a)(1) of this section does not apply to loss that is disallowed under any other provision. If loss is deferred under any other provision, paragraph (a)(1) of this section applies when the loss is taken into account. However, if an overriding event described in paragraph (a)(3)(ii) of this section occurs before the deferred loss is taken into account, paragraph (a)(1) of this section applies to the loss immediately before the event occurs even though the loss may not be taken into account until a later time. Any loss not disallowed under paragraph (a)(1)