

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9469]

RIN 1545-BH54

Section 108 Reduction of Tax Attributes for S Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance on the manner in which an S corporation reduces its tax attributes under section 108(b) for taxable years in which the S corporation has discharge of indebtedness income that is excluded from gross income under section 108(a). In particular, the regulations address situations in which the aggregate amount of the shareholders' disallowed section 1366(d) losses and deductions that are treated as a net operating loss tax attribute of the S corporation exceeds the amount of the S corporation's excluded discharge of indebtedness income. The regulations affect S corporations and their shareholders.

DATES: Effective Date: These regulations are effective on **[INSERT DATE OF**

PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER].

Applicability Date: For dates of applicability, see §1.108-7(f)(2).

FOR FURTHER INFORMATION CONTACT: Jennifer N. Keeney, (202) 622-3060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations were previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2155. The collections of information in this final regulation are in §1.108-7(d)(4). This information must be provided by S corporations that exclude discharge of indebtedness income from gross income under section 108(a) and shareholders of those S corporations. The information provided by shareholders will be used by S corporations to properly reduce their tax attributes under section 108(b). The information provided by S corporations will be used by shareholders of those S corporations to calculate their taxable income in succeeding taxable years.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under section 108 of the Internal Revenue Code (Code).

Section 61(a) provides that gross income means all income from whatever source derived, including (but not limited to) income from discharge of indebtedness, also known as cancellation of debt income (COD income). Section 108(a) provides an exclusion from gross income for COD income if the discharge occurs while the taxpayer is bankrupt or insolvent, or if the indebtedness discharged is qualified farm indebtedness, certain qualified real property business indebtedness, or certain qualified principal residence indebtedness. In the case of a discharge of indebtedness during insolvency, the exclusion from income is limited to the amount by which the taxpayer is insolvent. Section 108(b) provides that the taxpayer must reduce certain specified tax attributes to the extent COD income is excluded from gross income under section 108(a)(1)(A), (B), or (C). Section 108(b) also provides the order in which these tax attributes must be reduced. Unless the taxpayer makes an election under section 108(b)(5) to first reduce the basis of depreciable property, section 108(b)(2)(A) provides that the first tax attribute to be reduced is any net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year.

A notice of proposed rulemaking and a notice of public hearing (REG-102822-08, 2008-38 IRB 744) were published in the **Federal Register** (73 FR 45656) on August 6, 2008, proposing amendments to the regulations regarding the manner in which an S corporation reduces its tax attributes under section 108(b) for taxable years in which the S corporation has discharge of indebtedness income that is excluded from gross income under section 108(a).

A public hearing on the proposed regulations was scheduled for December 8, 2008, but was cancelled because no one requested to speak. However, comments responding to the proposed regulations were received. After consideration of these comments, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations, with the modifications discussed in this preamble.

Summary of Comments and Explanation of Revisions

A. Allocation of Excess Losses and Deductions After Section 108(b) Tax Attribute Reduction

Section 108 provides special rules for an S corporation that has COD income. Section 108(d)(7)(A), as amended by the Job Creation and Worker Assistance Act of 2002, Public Law 107-147, provides, in part, that the rules under section 108(a) for the exclusion of COD income and under section 108(b) for the reduction of tax attributes are applied at the corporate level, including by not taking into account under section 1366(a) any amount excluded under section 108(a). Therefore, if an S corporation excludes COD income from its gross income under section 108(a), the amount excluded is applied to reduce the S corporation's tax attributes under section 108(b)(2). Under section 108(b)(4)(A), the reduction of tax attributes occurs after the S corporation's items of income, loss, deduction and credit for the taxable year of the discharge pass through to its shareholders under section 1366(a). Under section 1366(d)(1), the aggregate amount of losses and deductions a shareholder can take into account under section 1366(a) cannot exceed the shareholder's adjusted basis in the

shareholder's stock in the S corporation and the shareholder's adjusted basis of any indebtedness of the S corporation to the shareholder. For purposes of the tax attribute reduction rule under section 108(b)(2), section 108(d)(7)(B) provides that any loss or deduction that is disallowed for the taxable year of the discharge under section 1366(d)(1) is treated as a net operating loss of the S corporation (deemed NOL).

Several commentators recommended that net operating losses of an S corporation carried forward from one or more C corporation taxable years (C Year NOLs) should be considered S corporation tax attributes for purposes of section 108(b)(2). The proposed regulations are silent on whether attributes such as net operating losses, capital losses, and business credits arising in a C corporation taxable year should be considered tax attributes of the S corporation for purposes of section 108(b)(2). Section 1371(b)(1) states that no carryforward, and no carryback, arising for a taxable year for which a corporation is a C corporation may be carried to a taxable year for which such corporation is an S corporation. This prohibition applies to tax attribute carryovers described in section 108(b)(2). For example, section 108(b)(2)(A) describes a net operating loss tax attribute as "any net operating loss for the taxable year of discharge and any net operating loss carryover to such taxable year." Accordingly, section 1371(b)(1) prohibits an S corporation from using a C Year NOL as an S corporation tax attribute for purposes of section 108(b)(2). The same analysis applies to capital losses and business credits that arose in a C corporation taxable year. Therefore, the final regulations do not adopt this recommendation.

One commentator suggested that the final regulations clarify how the allocation rules in §1.108-7(d)(2) of the proposed regulations apply when an S corporation, with the consent of all affected shareholders, makes an election under section 1377(a)(2) (a terminating election). Regardless of whether a terminating election is made, all disallowed losses and deductions of a shareholder under section 1366(d)(1), including disallowed losses and deductions of a terminating shareholder, are treated as an S corporation's deemed NOL. The impact of a terminating election on the allocation of the COD income, however, may result in a different allocation of the S corporation's excess deemed NOL among the shareholders. Therefore, the final regulations add an example to clarify how the allocation rules apply when a terminating election is made.

Commentators asked whether a deemed NOL described in section 108(d)(7)(B) includes any losses that are suspended under section 465 or section 469. Section 108(d)(7)(B) provides that a deemed NOL is any loss or deduction which is disallowed for the taxable year of the discharge under section 1366(d)(1). Section 1366(d)(1) specifically provides for the disallowance of losses due only to lack of basis. Therefore, a deemed NOL does not include losses suspended under section 465 or section 469.

One commentator requested that the final regulations clarify whether disallowed losses and deductions under section 1366(d)(1) of a shareholder that is an employee stock ownership plan (ESOP) are included in the S corporation's deemed NOL. Section 108(d)(7)(B) provides that any loss or deduction that is

disallowed for the taxable year of the discharge under section 1366(d)(1) is treated as a deemed NOL of the S corporation. Accordingly, section 108(d)(7)(B) applies to any shareholder, including an ESOP shareholder, that has disallowed losses and deductions for the taxable year of the discharge under section 1366(d)(1).

One commentator asked whether nondeductible, noncapital expenses that reduce basis under section 1367(a)(2)(D) are treated as disallowed losses and deductions under section 1366(d)(1) for purposes of section 108(d)(7)(B). These expenses, including any that are carried over as a result of the elective ordering rule in §1.1367-1(g) of the Income Tax Regulations, are not losses and deductions that can be taken into account by a shareholder under section 1366(a) and therefore are not included as disallowed losses and deductions under section 1366(d)(1) for purposes of section 108(d)(7)(B).

One commentator noted that in some situations, an S corporation shareholder may have a different taxable year than the S corporation. The commentator asked whether, in these situations, a shareholder determines its disallowed losses and deductions under section 1366(d)(1) for purposes of section 108(d)(7) as of the close of the S corporation's taxable year. The basis adjustments under section 1367 are determined as of the close of the S corporation's taxable year. See §1.1367-1(d)(1) and §1.1367-2(d)(1). Therefore, a shareholder's disallowed losses and deductions under section 1366(d)(1) are determined for purposes of section 108(d)(7) as of the close of the S corporation's taxable year.

Finally, one commentator recommended that the final regulations provide that all shareholders share tax attribute reductions in proportion to their ownership interests in the S corporation in all situations. The preamble to the proposed regulations noted that shareholders may be disproportionately impacted where the shareholders' respective disallowed losses or deductions are disproportionate to their respective interests. However, the disproportionate impact that occurs in certain situations is a result of the statutory provisions of section 108. Therefore, the final regulations do not adopt this recommendation. In certain situations, an S corporation may eliminate or mitigate inequitable results by making an election under section 108(b)(5) to reduce the basis of its depreciable property before reducing its net operating loss.

B. Character of Excess Deemed NOL Allocated to a Shareholder

The proposed regulations provide an ordering approach for determining the character of the amount of the S corporation's excess deemed NOL that is allocated to a shareholder. The approach in the proposed regulations is generally consistent with the ordering rules of section 108(b)(2) in that ordinary losses are reduced before capital losses. One commentator recommended that the final regulations adopt an approach that is consistent with the method for determining the character of a shareholder's losses and deductions under section 1366(d). Under this approach, the S corporation's excess deemed NOL that is allocated to a shareholder consists of a proportionate amount of each item of the shareholder's loss or deduction that is disallowed for the taxable year of

the discharge under section 1366(d)(1). After considering this comment, the IRS and Treasury have decided to adopt this approach in the final regulations.

C. Information Sharing Requirements

The proposed regulations require a shareholder of an S corporation that excludes COD income from its gross income in a taxable year to report to the S corporation the amount of the shareholder's losses and deductions that are disallowed for the taxable year of the discharge under section 1366(d)(1) (shareholder-information reporting requirement). The proposed regulations also require the S corporation to report to its shareholders the amount of any excess deemed NOL that is allocated to a shareholder (S corporation-information reporting requirement). Commentators recommended changes to the shareholder-information reporting requirement to minimize dependence on information furnished by shareholders who provide (intentionally or unintentionally) incorrect information or on shareholders who fail to furnish this information. One commentator explained that as a practical matter, an S corporation often maintains records for its shareholders and may possess all the requisite information to determine the amount of a shareholder's suspended loss under section 1366(d). Another commentator requested that the final regulations provide consequences for shareholders who do not comply with the shareholder-information reporting requirement or who provide incorrect information.

After considering these comments, the final regulations modify the shareholder-information reporting requirement to alleviate the dependence on shareholders who fail to furnish information or who provide incorrect information.

The final regulations provide that in certain situations, the S corporation may rely on its own books and records as well as other information available to the S corporation to determine a shareholder's disallowed losses or deductions under section 1366(d)(1), provided that the S corporation knows that the amount reported by the shareholder is inaccurate, or the information, as provided, appears to be incomplete or incorrect. The final regulations do not adopt any special rules to provide for consequences to shareholders who either fail to report this information to the S corporation or report incorrect information to the S corporation. However, the IRS and Treasury note that section 6037(c) requires that a shareholder of an S corporation, on the shareholder's return, treat a "subchapter S item" in a manner consistent with the S corporation return. The IRS and Treasury believe that the S corporation's excess deemed NOL that is allocated to a shareholder is a "subchapter S item" for purposes of section 6037(c) and that the consequences of failure to comply with section 6037(c) are sufficient to encourage shareholders to cooperate with the S corporation in order to avoid inconsistencies between the S corporation's return and the shareholder's return.

Effective/Applicability Date

The final regulations apply to discharges of indebtedness occurring on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection burden imposed on S corporations and their shareholders is minimal in that it requires S corporations and their shareholder(s) to share information that shareholders already maintain to determine their respective tax liabilities. Moreover, it should take an S corporation or a shareholder no more than one hour to satisfy the information sharing requirements in these regulations. Finally, the collection burden imposed applies only to S corporations that are required to reduce their tax attributes under section 108(b) of the Code – a group estimated to be less than 1 percent of all existing S corporations. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Jennifer N. Keeney, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

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

PART 1--INCOME TAXES

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

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

Par. 2. Section 1.108-7 is amended by:

1. Redesignating paragraphs (d) and (e) as paragraphs (e) and (f), respectively.
2. Adding new paragraph (d).
3. Adding paragraph (e) Example 5, Example 6, and Example 7 to newly-redesignated paragraph (e).
4. Revising newly-redesignated paragraph (f).

The additions and revision read as follows:

§1.108-7 Reduction of attributes.

* * * * *

(d) Special rules for S corporations--(1) In general. If an S corporation excludes COD income from gross income under section 108(a)(1)(A), (B), or (C), the amount excluded shall be applied to reduce the S corporation's tax attributes under paragraph (a)(1) of this section. For purposes of paragraph (a)(1)(i) of this section, the aggregate amount of the shareholders' losses or deductions that are disallowed for the taxable year of the discharge under section 1366(d)(1), including disallowed losses or deductions of a shareholder that transfers all of the shareholder's stock in the S corporation during the taxable year of the discharge, is treated as the net operating loss tax attribute (deemed NOL) of the S corporation for the taxable year of the discharge.

(2) Allocation of excess losses or deductions--(i) In general. If the amount of an S corporation's deemed NOL exceeds the amount of the S corporation's COD income that is excluded from gross income under section 108(a)(1)(A), (B), or (C), the excess deemed NOL shall be allocated to the shareholder or shareholders of the S corporation as a loss or deduction that is disallowed under section 1366(d) for the taxable year of the discharge.

(ii) Multiple shareholders--(A) In general. If an S corporation has multiple shareholders, to determine the amount of the S corporation's excess deemed NOL to be allocated to each shareholder under paragraph (d)(2)(i) of this section, calculate with respect to each shareholder the shareholder's excess amount. The shareholder's excess amount is the amount (if any) by which the shareholder's losses or deductions disallowed under section 1366(d)(1) (before

any reduction under paragraph (a)(1) of this section) exceed the amount of COD income that would have been taken into account by that shareholder under section 1366(a) had the COD income not been excluded under section 108(a).

(B) Shareholders with a shareholder's excess amount. Each shareholder that has a shareholder's excess amount, as determined under paragraph (d)(2)(ii)(A) of this section, is allocated an amount equal to the S corporation's excess deemed NOL multiplied by a fraction, the numerator of which is the shareholder's excess amount and the denominator of which is the sum of all shareholders' excess amounts.

(C) Shareholders with no shareholder's excess amount. If a shareholder does not have a shareholder's excess amount as determined in paragraph (d)(2)(ii)(A) of this section, none of the S corporation's excess deemed NOL shall be allocated to that shareholder.

(iii) Terminating shareholder. Any amount of the S corporation's excess deemed NOL allocated under paragraph (d)(2) of this section to a shareholder that had transferred all of the shareholder's stock in the corporation during the taxable year of the discharge is permanently disallowed under §1.1366-2(a)(5), unless the transfer of stock is described in section 1041(a). If the transfer of stock is described in section 1041(a), the amount of the S corporation's excess deemed NOL allocated to the transferor under paragraph (d)(2) of this section shall be treated as a loss or deduction incurred by the corporation in the succeeding taxable year with respect to the transferee. See section 1366(d)(2)(B).

(3) Character of excess losses or deductions allocated to a shareholder.

The character of an S corporation's excess deemed NOL that is allocated to a shareholder under paragraph (d)(2) of this section consists of a proportionate amount of each item of the shareholder's loss or deduction that is disallowed for the taxable year of the discharge under section 1366(d)(1).

(4) Information requirements. If an S corporation excludes COD income from gross income under section 108(a) for a taxable year, each shareholder of the S corporation during the taxable year of the discharge must report to the S corporation the amount of the shareholder's losses and deductions that are disallowed for the taxable year of the discharge under section 1366(d)(1), even if that amount is zero. If a shareholder fails to report the amount of the shareholder's losses and deductions that are disallowed for the taxable year of the discharge under section 1366(d)(1) to the S corporation, or if the S corporation knows that the amount reported by the shareholder is inaccurate, or if the information, as reported, appears to be incomplete or incorrect, the S corporation may rely on its own books and records, as well as other information available to the S corporation, to determine the amount of the shareholder's losses and deductions that are disallowed for the taxable year of the discharge under section 1366(d)(1), provided that the S corporation knows or reasonably believes that its information presents an accurate reflection of the shareholder's disallowed losses and deductions under section 1366(d)(1). The S corporation must report to each shareholder the amount of the S corporation's excess deemed NOL that is allocated to that shareholder under paragraph (d)(2) of this

section, even if that amount is zero, in accordance with applicable forms and instructions.

(e) * * *

Example 5. (i) Facts. During the entire calendar year 2009, A, B, and C each own equal shares of stock in X, a calendar year S corporation. As of December 31, 2009, A, B, and C each have a zero stock basis and X does not have any indebtedness to A, B, or C. For the 2009 taxable year, X excludes from gross income \$45,000 of COD income under section 108(a)(1)(A). The COD income (had it not been excluded) would have been allocated \$15,000 to A, \$15,000 to B, and \$15,000 to C under section 1366(a). For the 2009 taxable year, X has \$30,000 of losses and deductions that X passes through pro rata to A, B, and C in the amount of \$10,000 each. The losses and deductions that pass through to A, B, and C are disallowed under section 1366(d)(1). In addition, B has \$10,000 of section 1366(d) losses from prior years and C has \$20,000 of section 1366(d) losses from prior years. A's (\$10,000), B's (\$20,000) and C's (\$30,000) combined \$60,000 of disallowed losses and deductions for the taxable year of the discharge are treated as a current year net operating loss tax attribute of X under section 108(d)(7)(B) (deemed NOL) for purposes of the section 108(b) reduction of tax attributes.

(ii) Allocation. Under section 108(b)(2)(A), X's \$45,000 of excluded COD income reduces the \$60,000 deemed NOL to \$15,000. Therefore, X has a \$15,000 excess net operating loss (excess deemed NOL) to allocate to its shareholders. Under paragraph (d)(2)(ii)(C) of this section, none of the \$15,000 excess deemed NOL is allocated to A because A's section 1366(d) losses and deductions immediately prior to the section 108(b)(2)(A) reduction (\$10,000) do not exceed A's share of the excluded COD income for 2008 (\$15,000). Thus, A has no shareholder's excess amount. Each of B's and C's respective section 1366(d) losses and deductions immediately prior to the section 108(b)(2)(A) reduction exceed each of B's and C's respective shares of the excluded COD income for 2008. B's excess amount is \$5,000 (\$20,000 - \$15,000) and C's excess amount is \$15,000 (\$30,000 - \$15,000). Therefore, the total of all shareholders' excess amounts is \$20,000. Under paragraph (d)(2) of this section, X will allocate \$3,750 of the \$15,000 excess deemed NOL to B ($\$15,000 \times \$5,000 / \$20,000$) and \$11,250 of the \$15,000 excess deemed NOL to C ($\$15,000 \times \$15,000 / \$20,000$). These amounts are treated as losses and deductions disallowed under section 1366(d)(1) for the taxable year of the discharge. Accordingly, at the beginning of 2010, A has no section 1366(d)(2) carryovers, B has \$3,750 of carryovers, and C has \$11,250 of carryovers.

(iii) Character. Immediately prior to the section 108(b)(2)(A) reduction, B's \$20,000 of section 1366(d) losses and deductions consisted of \$8,000 of long-term capital losses, \$7,000 of section 1231 losses, and \$5,000 of ordinary

losses. After the section 108(b)(2)(A) tax attribute reduction, X will allocate \$3,750 of the excess deemed NOL to B. Under paragraph (d)(3) of this section, the \$3,750 excess deemed NOL allocated to B consists of \$1,500 of long-term capital losses ($(\$8,000 / \$20,000) \times \$3,750$), \$1,312.50 of section 1231 losses ($(\$7,000 / \$20,000) \times \$3,750$), and \$937.50 of ordinary losses ($(\$5,000 / \$20,000) \times \$3,750$). As a result, at the beginning of 2010, B's \$3,750 of section 1366(d)(2) carryovers consist of \$1,500 of long-term capital losses, \$1,312.50 of section 1231 losses, and \$937.50 of ordinary losses.

Example 6. (i) A and B each own 50 percent of the shares of stock in X, a calendar year S corporation. On March 1, 2009, X realizes \$12,000 of COD income and excludes this amount from gross income under section 108(a)(1)(A) for X's 2009 taxable year. On June 30, 2009, A sells all of her shares of stock in X to C in a transfer not described in section 1041(a). X does not make a terminating election under section 1377(a)(2). The COD income (had it not been excluded) would have been allocated \$3,000 to A, \$6,000 to B, and \$3,000 to C under section 1366(a). Prior to the section 108(b)(2)(A) reduction, for the taxable year of the discharge the shareholders have disallowed losses and deductions under section 1366(d) (including disallowed losses carried over to the current year under section 1366(d)(2)) in the following amounts: A - \$5,000, B - \$13,000, and C - \$2,000. The combined \$20,000 of disallowed losses and deductions for the taxable year of the discharge are treated as a current year net operating loss tax attribute of X under section 108(d)(7)(B) (deemed NOL).

(ii) Under section 108(b)(2)(A), X's \$12,000 of excluded COD income reduces the \$20,000 deemed NOL to \$8,000. Therefore, X has an \$8,000 excess net operating loss (excess deemed NOL) to allocate to its shareholders. Under paragraph (d)(2)(ii)(C) of this section, none of the \$8,000 excess deemed NOL is allocated to C because C's section 1366(d) losses and deductions immediately prior to the section 108(b)(2)(A) reduction (\$2,000) do not exceed C's share of the excluded COD income for 2008 (\$3,000). However, each of A's and B's respective section 1366(d) losses and deductions immediately prior to the section 108(b)(2)(A) reduction exceed each of A's and B's respective shares of the excluded COD income for 2009. A's excess amount is \$2,000 ($\$5,000 - \$3,000$) and B's excess amount is \$7,000 ($\$13,000 - \$6,000$). Therefore, the total of all shareholders' excess amounts is \$9,000. Under paragraph (d)(2) of this section, X will allocate \$1,777.78 of the \$8,000 excess deemed NOL to A ($\$8,000 \times \$2,000 / \$9,000$) and \$6,222.22 of the \$8,000 excess deemed NOL to B ($\$8,000 \times \$7,000 / \$9,000$). However, because A transferred all of her shares of stock in X in a transaction not described in section 1041(a), A's \$1,777.78 of section 1366(d) losses and deductions are permanently disallowed under paragraph (d)(2)(iii) of this section. Accordingly, at the beginning of 2010, B has \$6,222.22 of section 1366(d)(2) carryovers and C has no section 1366(d)(2) carryovers.

Example 7. The facts are the same as in Example 6, except that X, with the consent of A and C, makes a terminating election under section 1377(a)(2) upon A's sale of her stock in X to C. Therefore, the COD income (had it not been excluded) would have been allocated \$6,000 to A, \$6,000 to B, and \$0 to C. Under paragraph (d)(2)(ii)(C) of this section, none of the \$8,000 excess deemed NOL is allocated to A because A's section 1366(d) losses and deductions immediately prior to the section 108(b)(2)(A) reduction (\$5,000) do not exceed A's share of the excluded COD income for 2009 (\$6,000). However, each of B's and C's respective section 1366(d) losses and deductions immediately prior to the section 108(b)(2)(A) reduction exceed each of B's and C's respective shares of the excluded COD income for 2009. B's excess amount is \$7,000 (\$13,000 - \$6,000), C's excess amount is \$2,000 (\$2,000 - \$0). Therefore, the total of all shareholders' excess amounts is \$9,000. Under paragraph (d)(2) of this section, X will allocate \$6,222.22 of the \$8,000 excess deemed NOL to B ($\$8,000 \times \$7,000 / \$9,000$) and \$1,777.78 of the \$8,000 excess deemed NOL to C. Accordingly, at the beginning of 2010, B has \$6,222.22 of section 1366(d)(2) carryovers and C has \$1,777.78 of section 1366(d)(2) carryovers.

(f) Effective/applicability date--(1) Paragraphs (a), (b), (c), and Examples 1, 2, 3, and 4 of paragraph (e) of this section apply to discharges of indebtedness occurring on or after May 10, 2004.

(2) Paragraph (d) and Examples 5, 6, and 7 of paragraph (e) of this section apply to discharges of indebtedness occurring on or after **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK
REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
1.108-7	1545-2155

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/s/ Linda E. Stiff

Deputy Commissioner for Services and Enforcement

Approved: October 21, 2009

/s/ Michael Mundaca

Acting Assistant Secretary of the Treasury (Tax Policy)

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