[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9583]

RIN 1545-BI92

Guidance under Section 267(f); Deferral of Loss on Transactions between Members of a Controlled Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the deferral of losses on the sale or exchange of property between members of a controlled group and provides guidance as to the time for taking into account those losses. These regulations affect corporations that are members of a controlled group.

DATES: Effective Date: These regulations are effective on **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER].**

FOR FURTHER INFORMATION CONTACT: Amie Colwell Breslow (202) 622-7530 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

Section 267(a)(1) provides that no deduction shall be allowed for any loss on the sale or exchange of property between certain related persons. Section 267(f)(2) contains an exception for a loss on the sale or exchange of property between members of a controlled group. For this purpose, "controlled group" has the meaning given to

such term in section 1563(a) except that "more than 50 percent" is substituted for "at least 80 percent" each place it appears. In the case of a sale or exchange of loss property between members of a controlled group, the loss is deferred rather than disallowed. Under section 267(f)(2)(B), the loss is deferred until the property is transferred outside of the controlled group and there would be recognition of loss under consolidated return principles or until such other time as may be prescribed in regulations.

The regulations under section 267(f) provide that the timing principles for intercompany sales or exchanges between members of a consolidated group (see generally §1.1502-13(c)(2)) apply to sales or exchanges of property at a loss between members of a controlled group. See §1.267(f)-1(a)(2). The attribute redetermination rules applicable to transactions between members of a consolidated group (see §1.1502-13(c)(1)), however, do not apply to sales or exchanges between members of a controlled group.

Although the attribute redetermination rule generally does not apply to sales or exchanges between members of a controlled group, §1.267(f)-1(c)(1)(iv) contains a special rule with respect to losses that would have been redetermined to be a noncapital, nondeductible amount if the consolidated return attribute redetermination rule did apply. Under §1.267(f)-1(c)(1)(iv), if an intercompany loss between members of a consolidated group would have been redetermined to be a noncapital, nondeductible amount as a result of the attribute redetermination rule applicable to consolidated groups, but is not redetermined because the sale or exchange occurred between members of a controlled group (to which the attribute redetermination rule does not

apply), then the loss will be deferred. The loss is taken into account when the selling member (S) and buying member (B) are no longer in a controlled group relationship.

On April 21, 2011, the IRS and Treasury Department published a notice of proposed rulemaking (REG-118761-09) in the **Federal Register** (76 FR 22336). The notice included proposed regulations under section 267(f) providing guidance concerning the Federal income tax treatment of deferred losses on the sale or exchange of property between members of a controlled group, including transactions in which the member acquiring the property subsequently recognizes a corresponding gain with respect to the property. The proposed regulations provided that certain losses on the sale or exchange of property between members of a controlled group, which have been deferred, are taken into account upon the occurrence of either of two events. The deferred loss is taken into account to the extent of any corresponding gain that the member acquiring the property recognizes with respect to the property. Alternatively, the deferred loss is taken into account when the parties to the transaction cease to be in a controlled group relationship. The proposed regulations also provided that for purposes of determining whether the loss is redetermined to be a noncapital, nondeductible amount under the principles of §1.1502-13, stock held by S, stock held by B, and stock held by all members of the consolidated group that includes S, as well as stock held by any member of a controlled group of which S is a member that was acquired from a member of S's consolidated group, must be taken into account. A public hearing was requested and held on August 3, 2011. The IRS received one formal comment in response to the notice of proposed rulemaking. The comment

raised several questions with certain recommendations, which are discussed in the following paragraphs of this preamble.

The commentator suggested that the final regulations incorporate a model that allows a loss to be taken into account based on the arm's length principles contained in section 482 and the regulations thereunder. Specifically, the commentator noted that if the transaction is arm's length in nature and has substance from a business perspective, the loss should be taken into account immediately. The IRS and Treasury Department do not agree with this comment. In a transaction described in these regulations, it is assumed that the parties are acting at arm's length. Section 267(f) serves a different purpose, namely, to determine the timing of when a loss should be taken into account on a sale or exchange of property between members of a controlled group. Accordingly, the final regulations retain the model contained in the proposed regulations.

The commentator also suggested that the proposed regulations do not clearly state how to establish whether a recognized loss is redetermined to be a noncapital, nondeductible amount under the principles of §1.1502-13. Specifically, the commentator noted that it is unclear whether the proposed regulations, as written, are intended to direct taxpayers to a §1.1502-34 type of analysis in determining whether the loss is redetermined to be a noncapital, nondeductible amount. Under the rule, stock held by S, stock held by B, and stock held by all members of the consolidated group that includes S, as well as stock held by any member of a controlled group of which S is a member that was acquired from a member of S's consolidated group must be taken into account. After considering the comment, the IRS and Treasury Department believe

that the rules in the proposed regulations, as written, are clear in that they expressly list the corporations the stock holdings of which must be take into account. Furthermore, the IRS and Treasury Department believe that the proposed regulation is appropriately broader than the stock aggregation rule of §1.1502-34 to account for, among other considerations, the fact that the controlled group definition is broader than the definition of a consolidated group.

In addition, the commentator questioned whether the proposed regulations were consistent with the holdings in Granite Trust v. United States, 238 F.2d 670 (1st Cir. 1956), and other applicable case law. The IRS and Treasury Department believe that the rules contained in the proposed regulations and these final regulations are consistent with applicable case law. These rules are intended to address the timing for taking into account a loss on a sale of property between members of a controlled group, and do not relate to whether a liquidation otherwise results in the recognition of a loss.

**Explanation of Provisions**

These final regulations retain the rules of the proposed regulations, but make one revision to clarify the interaction of section 267(f) and §1.1502-13 principles. The final regulations also make one modification to ensure that taxpayers cannot circumvent the purposes of the proposed regulation through issuances of target corporation stock to controlled group members.

The proposed regulations provided that a deferred loss is taken into account to the extent of any corresponding gain that the member acquiring the property recognizes with respect to the property. For example, assume S sells 30 percent of T's stock to B

(a member of S's controlled group) at a loss (in a transaction that is treated as a sale or exchange for Federal income tax purposes). If T's stock appreciates after the sale and before a subsequent event that results in B's recognition of gain, the proposed regulations provided that S's deferred loss may be taken into account to the extent that B recognizes a corresponding gain.

Questions have been raised concerning whether this rule is necessary because the relevant consolidated return provisions currently allow the loss to be taken into account to the extent of the corresponding gain. The IRS and Treasury Department agree that an explicit rule is unnecessary because the timing of taking the loss into account in these circumstances is provided for under §1.1502-13. Accordingly, the rule in the proposed regulations has been removed from the final regulations and an example has been added to §1.267(f)-1(j) to illustrate the interaction of these final regulations and the consolidated return regulations.

In addition to this clarification, these final regulations provide that stock issued to a member of the controlled group by a target corporation is taken into account for purposes of determining whether a loss would be treated as noncapital, nondeductible amount if the rules of §1.1502-13 applied. For example, assume FP is a foreign corporation that owns all the stock of FS, a foreign subsidiary, and all the stock of P, a domestic corporation. P owns all the stock of T. In Year 1, FS contributes cash to T in exchange for newly issued stock of T that constitutes 40 percent of T's outstanding stock. In Year 2, when the value of the T stock owned by P is less than its basis in P's hands, P sells all of its T stock to FP. In Year 3, in a transaction unrelated to the

issuance of the T stock in Year 1, T converts under state law to a limited liability company that is treated as a partnership for Federal income tax purposes.

Under these final regulations, the T stock issued by T to FS is taken into account for purposes of determining whether, upon the conversion of T, P's deferred loss would be treated under the principles of §1.1502-13 as a noncapital, nondeductible amount.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations primarily affect controlled groups of corporations which tend to be larger businesses. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. No comments were received.

**Drafting Information**

The principal author of this regulation is Amie Colwell Breslow, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in its 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 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. * * *

Section 1.267(f)-1 is also issued under 26 U.S.C. 267.

. Par. 2. Section 1.267(f)-1 is amended as follows:

1. Paragraph (c)(1)(iv) is revised.
2. Adding Example 9 to paragraph (j).
3. Adding Example 10 to paragraph (j).
4. Paragraph (l)(3) is redesignated as paragraph (l)(4) and a new paragraph (l)(3) is added.

The additions and revision read as follows:

§1.267(f)-1 Controlled groups.

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(c) * * *

(1) * * *

(iv) B's item is excluded from gross income or noncapital and nondeductible. To the extent S's loss would be redetermined to be a noncapital, nondeductible amount under the principles of §1.1502-13, but is not redetermined under paragraph (c)(2) of this section (which generally renders the attribute redetermination rule inapplicable to sales between members of a controlled group), S's loss continues to be deferred. For purposes of this paragraph, stock held by S, stock held by B, stock held by all members of S's consolidated group, stock held by any member of a controlled group of which S is a member that was acquired from a member of S's consolidated group, and stock issued by T to a member of the controlled group must be taken into account in determining whether a loss would be redetermined to be a noncapital, nondeductible amount under the principles of §1.1502-13. If the loss remains deferred, it is taken into account when S and B (including their successors) are no longer in a controlled group relationship. (If, however, the property is transferred to certain related persons, paragraph (c)(1)(iii) of this section will cause the loss to be permanently disallowed.) For example, if S sells all of the T stock to B at a loss (in a transaction that is treated as a sale or exchange for Federal income tax purposes), and T subsequently liquidates in an unrelated transaction that qualifies under section 332, S's loss is deferred until S and B are no longer in a controlled group relationship. Similarly, if S owns all of the T stock and sells 30 percent of T's stock to B at a loss (in a transaction that is treated as a sale or exchange for Federal income tax purposes), and T subsequently liquidates, S's loss on the sale is deferred until S and B (including their successors) are no longer in a controlled group relationship.

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(j) * * *

Example 9. Sale of stock by consolidated group member to controlled group member. (a) Facts. P1, a domestic corporation, owns 75% of the outstanding stock of P, the common parent of a consolidated group. P owns all of the outstanding stock of subsidiaries M and S, which are members of P's consolidated group. M and S each own 50% of the only class of stock of L, a nonmember life insurance company. On January 1 of Year 1, S sells 25% of L's stock to P1 for $50 cash. At the time of the sale, S's aggregate basis in the L shares transferred to P1 was $80, and S recognizes a $30 loss. On February 18 of Year 3, at a time when the L shares held by P1 are worth $60, L liquidates. As a result of the liquidation, P1 recognizes a $10 gain.

(b) Timing. Under paragraph (a)(2) of this section, S's loss on the sale of the L stock to P1 is deferred. Under paragraph (c)(1)(iv) of this section, upon the liquidation of L, to the extent S's loss would be redetermined to be a noncapital, nondeductible amount under the principles of §1.1502-13, S's loss continues to be deferred. Under the principles of §1.1502-13, S's loss is not redetermined to be a noncapital, nondeductible amount to the extent of P1's $10 of gain recognized. Accordingly, S takes into account $10 of loss as a result of the liquidation. In determining whether the remainder of S's $20 loss would be redetermined to be a noncapital, nondeductible amount, under paragraph (c)(1)(iv) of this section, stock held by P1, stock held by M, and stock held by S is taken into account. Accordingly, under the principles of §1.1502-13, the liquidation of L would be treated as a liquidation qualifying under section 332, and the remainder of S's loss would be redetermined to be a noncapital, nondeductible amount. Thus, under paragraph (c)(1)(iv), S's remaining $20 loss continues to be deferred until S and P1 are no longer in a controlled group relationship.

Example 10. Issuance of stock to controlled group member. (a) Facts. FP is a foreign corporation that owns all the stock of FS, a foreign corporation, and all the stock of P, a domestic corporation. P owns all of the single class of outstanding common stock of T. In Year 1, FS contributes cash to T in exchange for newly issued stock of T that constitutes 40 percent of T's outstanding stock. In Year 2, when the value of the T stock owned by P is less than its basis in P's hands, P sells all of its T stock to FP. In Year 3, in a transaction unrelated to the issuance of the T stock in Year 1, T converts under state law to a limited liability company that is treated as a partnership for Federal income tax purposes.

(b) Timing. Under paragraph (a)(2) of this section, P's loss on the sale of its T stock is deferred. Under paragraph (c)(1)(iv) of this section, upon the conversion of T, to the extent P's loss would be redetermined to be a noncapital, nondeductible amount under the principles of §1.1502-13, P's loss continues to be deferred. In determining whether the loss would be redetermined to be a noncapital, nondeductible amount, stock held by FS (which was acquired from T) and stock held by FP (the buyer of the T stock from P and a member of P's controlled group) is taken into account. Accordingly, under the principles of §1.1502-13 the deemed liquidation of T resulting from the conversion of T would be treated as a liquidation qualifying under section 332, and P's

loss would be redetermined to be a noncapital, nondeductible amount. Thus, under paragraph (c)(1)(iv), P's loss continues to be deferred until P and FP are no longer in a controlled group relationship.

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(l) * * *

(3) Effective/applicability date. Paragraph (c)(1)(iv) of this section applies to a loss that continues to be deferred pursuant to that paragraph if the event that would cause the loss to be redetermined as a noncapital nondeductible amount under the principles of §1.1502-13 occurs on or after **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

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Steven T. Miller

Deputy Commissioner for Services and Enforcement.

Approved: April 9, 2012

Emily S. McMahon
Acting Assistant Secretary of the Treasury (Tax Policy).

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