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In this article, Silverman and Gordon discuss the Tax Court and Second Circuit decisions in *Marvel*, explain why the courts erred in rejecting the separate-entity approach, and consider the potential ramifications of the courts' decisions under the consolidated return regulations.

A. Introduction

Marvel[1] was wrongly decided. Our reasoning for this conclusion is discussed below. More troubling than the result in the case was the decision by the IRS to pursue a position that is inconsistent with its historic view and contradicts the conclusions set forth in contemporaneously issued proposed regulations. The IRS took this position even though it would give rise to uncertainty and confusion in applying the consolidated return regulations. These disappointing actions by the IRS were compounded by the Tax Court's failure to appreciate the issue presented in the case and to rely solely on a conclusion in a Supreme Court decision that is different from and not applicable to the relevant issue. In the aggregate, the foregoing results in a very troubling administration of the tax laws.

B. Background

The Marvel comic book universe has its share of dangerous characters — Wolverine, Magneto, and the Incredible Hulk, to name a few. But those characters pale in comparison to those encountered in *Marvel*, in which Marvel Entertainment LLC's tax position was struck down by the IRS, the Tax Court, and most recently, the Second Circuit. The issue presented in *Marvel* involves a relatively basic fact pattern: A corporation that is a member of a consolidated group files for bankruptcy and, as a result, has debt discharged, which creates cancellation of indebtedness (COD) income. That COD income is excluded from gross income under section 108(a) and, under section 108(b), the cost of this exclusion is a reduction to the taxpayer's tax attributes, the first of which is generally the taxpayer's net operating loss in the year of discharge and any available NOL carryover. In *Marvel*, the question was how this reduction to attributes is made when the taxpayer with excluded COD income is a member of a consolidated group. Is a separate-entity approach appropriate, under which the consolidated net operating loss (CNOL) of the group is reduced by the portion of the CNOL attributable to the debtor member? Or must a single-entity approach be used so that the group's entire CNOL is reduced by the amount of the debtor member's excluded COD income, regardless of the member from which the CNOL originated?

The Tax Court — and later, the Second Circuit — decided that a taxpayer is required to use the single-entity approach. As discussed below, the decisions in *Marvel* could have a profound effect on the consolidated return regulations. The outcome in *Marvel* threatens to make the investment basis adjustment system under reg. section 1.1502-32 unworkable because the decisions can be interpreted as supporting the proposition that a CNOL cannot be allocated to an individual consolidated group member to reduce the basis in the member's stock. This article discusses the decisions in *Marvel*, explains why the courts erred in rejecting the separate-entity approach, and considers the potential ramifications of the courts' decisions under the consolidated return regulations.

C. Section 108 in Consolidation

Congress overhauled section 108 in 1980, which included the enactment of the attribute reduction mechanism in section 108(b), and for many years, the IRS struggled with its application in consolidation, electing to forgo the issuance of specific rules and taking positions on both sides of the question in

[1] *Marvel Entertainment LLC v. Commissioner*, 842 F.3d 1291 (2d Cir. 2016), *aff'g* 145 T.C. 69 (2015).

various forms of unpublished guidance.[2] Eventually, in 2003, the IRS issued temporary regulations that adopted a hybrid approach to attribute reduction that looks first to the CNOL attributable to the debtor member before turning to the remainder of the group's CNOL.[3] In support of this approach, the IRS pointed to *United Dominion*,[4] a rare opinion by the Supreme Court on the consolidated return regulations that, on a superficial level, appeared to have some bearing on the application of section 108 in consolidation. Armed with that opinion, the IRS took the position in the 2003 regulations that the tax attributes subject to reduction under section 108(b) when the debtor is a consolidated group member include all attributes that are available to the debtor, including consolidated tax attributes that are attributable to members other than the debtor member.[5] The hybrid approach adopted by the IRS, however, expressly recognized that an individual group member has its own share of the CNOL that constitutes that member's attribute.

Although the 2003 regulations provided guidance on the application of section 108 in consolidation prospectively, the IRS went one step further by seeking to use its strained reading of *United Dominion* to impose the single-entity approach on taxpayers with excluded COD income *before* the effective date of the 2003 regulations.[6] This was the situation in *Marvel*, in which the Tax Court and the Second Circuit sided with the IRS by mandating the single-entity approach. Both courts, it seems, declined to undertake the type of in-depth analysis needed to realize that the separate-entity approach was the correct position before the issuance of the 2003 regulations. Instead, it appears that both courts placed undue reliance on the Supreme Court's decision in *United Dominion* while glossing over the many principled arguments that supported the use of the separate-entity approach.

D. Facts of *Marvel*

The deficiencies at issue in *Marvel* stemmed from several members of a predecessor consolidated group filing for bankruptcy and realizing COD income for the group's short tax year that ended October 1, 1998. Each of those members excluded the COD income from its gross income under section 108(a) and applied the separate-entity approach under section 108(b) to reduce the member's allocable share of the CNOL by its excluded COD income.[7] Some of the members had excluded COD income that exceeded their share of the CNOL, while other members had excluded COD income that was less than their share of the CNOL. The remainder of the CNOL that was not reduced under section 108(b) continued to be available to be carried over to future years. The IRS challenged the use of a portion of that CNOL carryover in 2003 and 2004, asserting that the single-entity approach should have been applied in connection with the COD income realized in 1998 to reduce the CNOL by the amount of each debtor member's excluded COD income regardless of the CNOL attributable to the specific member.[8]

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[2]In 1991 the IRS issued a private letter ruling in which it applied the separate-entity approach. *See* LTR 9121017. In 1999, and without any change to section 108 or the applicable law, the IRS adopted a different position in informal guidance that adopted the single-entity approach. *See* FSA 199912007.

[3]T.D. 9089. The 2003 regulations applied to discharges of indebtedness occurring after August 29, 2003. Today, the rules governing the application of section 108 in consolidation are primarily embodied in reg. section 1.1502-28.

[4]*United Dominion Industries Inc. v. United States*, 532 U.S. 822 (2001).

[5]*See* preamble to T.D. 9089, 68 F.R. at 52488 (''Reducing all of the consolidated attributes available to the debtor member reflects the principle enunciated by the Supreme Court in [*United Dominion*], that, in general, the only net operating loss of a consolidated group or its members for a consolidated return year is the consolidated net operating loss. Consistent with *United Dominion*, the tax attributes subject to reduction under section 108(b) when the debtor is a member of a consolidated group include the group's consolidated attributes in their entirety.'').

[6]This is despite the fact that in issuing the 2003 regulations, the IRS indicated that regulations were needed to adopt a consolidated approach to section 108(b) attribute reduction. The IRS also said that it was still considering the separate-entity approach and did not state that reduction of the group's CNOL was required before the effective date of the 2003 regulations.

[7]As explained in further detail by the Tax Court:

> In MEG [Marvel] Group's short taxable year ending October 1, 1998, four of its consolidated group members realized total COD income of $171,462,463 resulting from bankruptcy filings under chapter 11. Each of the four MEG Group debtor members excluded the COD income from its respective gross incomes under section 108(a)(1)(A). MEG Group also had a $187,154,680 CNOL for its short taxable year ending October 1, 1998. Under section 108(b)(2)(A), MEG Group allocated a portion of the group's CNOL to each of the four MEG Group debtor members and reduced the allocated CNOL shares by each member's previously excluded COD income. As a result, MEG Group reduced its $187,154,680 CNOL by $89,566,469 of the $171,462,463 in excluded COD income.

[8]Even though the years at issue were 2003 and 2004, the Tax Court recognized that under the NOL carryover rules in section 172(e), the resolution of the case was based on the relevant law in effect in 1998 (that is, the time when the COD income was realized and section 108 applied). Accordingly, unless otherwise indicated, the discussion in this article of the relevant law, including the consolidated return regulations, is to the law in effect at that time.

E. Errors of Tax Court Decision

The Tax Court rejected Marvel's use of the separate-entity approach and upheld the determinations resulting from the IRS's application of the single-entity approach. The Tax Court's analysis in reaching this decision is flawed for a number of reasons, the most notable of which are discussed below.

1. The Tax Court's reliance on *United Dominion* was misplaced, and its conclusion that *United Dominion* is dispositive was erroneous. Ignoring the fact that there was no specific statutory or regulatory language that supported the single-entity approach, the Tax Court concluded that the Supreme Court's holding in *United Dominion* was "dispositive" on the issue in the case. The obvious problem with that conclusion is that *United Dominion* did not involve or have anything to do with section 108. Moreover, the Tax Court's conclusion is based on a mischaracterization of the Supreme Court's decision and a fundamental misunderstanding of the holding in that case.

In *United Dominion*, the Supreme Court addressed the proper method for a consolidated group to determine what portion of its CNOL constituted a product liability loss under section 172, which benefited from an extended 10-year carryback period. A product liability loss equaled the amount of a taxpayer's product liability expenses but was limited to the amount of the taxpayer's NOL. The statute and the regulations, however, did not provide any rules for consolidated groups. The Supreme Court found that the determination under section 172 should be made on a consolidated level, which meant that the required comparison between an NOL and product liability expenses is based on the group's CNOL and the aggregate product liability expenses of all group members. The Court rejected the government's argument that a separate computation of a member's NOL could be made for purposes of this application of section 172. The government's position represented an attempt to limit the product liability loss by excluding the product liability expenses of group members that, according to the government, did not themselves generate a separate NOL. The Court observed that a consolidated group computes a single CNOL in determining its taxable income, and, consequently, the only NOL that could be used for section 172 purposes was the CNOL.

The Supreme Court's conclusion in *United Dominion* made perfect sense. Because a consolidated group determines whether it has a CNOL and only the CNOL (or a portion thereof) can be carried to another tax year in accordance with the consolidated return regulations,[9] the group was the "taxpayer" to which section 172 applied, and it was appropriate to adopt a consolidated approach to determine the extent to which the group's CNOL was a product liability loss eligible for a 10-year carryback period. The notion that in the absence of statutory or regulatory guidance, a consolidated group was required to compute a separate NOL for its members to make this determination under section 172 was properly rejected.

In *Marvel*, the Tax Court attempted to extend the holding in *United Dominion* to section 108 through the analysis in the following two paragraphs:

> Petitioner's argument that *United Dominion* addresses an issue distinctly different from tax attribute reduction under section 108 fails to recognize that the Supreme Court's decision concerning the proper computation of a consolidated group's PLL [product liability loss] could only have been reached by first determining whether members of a consolidated group have separate NOLs. We agree with petitioner that *United Dominion* concerned the application of PLL carryback rules in the consolidated group context. However, a central prerequisite to the Supreme Court's decision in *United Dominion* was the legal determination of whether separate NOLs exist for consolidated group members where no specific rule provides authority for NOL computation on a separate-entity basis.
>
> Despite the fact that the matter currently before the Court involves the application of section 108(b)(2)(A) — rather than section 172 — the critical issue is identical to that in *United Dominion*: whether the pre-2003 consolidated return regulations allow for the separate-entity approach. The Supreme Court in *United Dominion* concluded that a consolidated group member cannot have a separate NOL for a consolidated return year unless a specific consolidated return regulation allocates and apportions part of the CNOL to that member. No such regulation existed for petitioner's short taxable year ending October 1, 1998, and therefore the proper NOL subject to reduction under section 108(b)(2)(A) is petitioner's CNOL. In applying the Supreme Court's holding in *United Dominion* to the matter currently before

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[9]*See* reg. section 1.1502-21(b) ("Net operating losses of members arising during a consolidated return year are taken into account in determining the group's CNOL . . . for that year. Losses taken into account in determining the CNOL may be carried to other taxable years (whether consolidated or separate) only under this paragraph (b).").

> us, we conclude that the NOL subject to reduction under section 108(b)(2)(A) for petitioner's short tax year ending October 1, 1998, is the consolidated group's CNOL.

The Tax Court's focus on the conclusion that an individual group member cannot have a separate NOL for a consolidated return year absent a clear regulatory rule completely misses the issue in *Marvel*. The question to be decided was not whether a consolidated group member can have a separate NOL, but what portion of the CNOL is an individual member's attribute for purposes of reducing the member's tax attributes under section 108(b). The Supreme Court's holding in *United Dominion* did not consider how and for what purposes a group's CNOL is attributable to its members. Hence, *United Dominion* provides no guidance on what portion of a CNOL constitutes a member's attribute and the attribute reduction required under section 108(b).

The application of section 108 in *Marvel* is also fundamentally different from the issue in *United Dominion* regarding the operation of section 172. As discussed in more detail below, section 108 applies to individual group members by permitting the exclusion of a member's COD income but requiring the reduction of its tax attributes. In contrast, only a consolidated group has an NOL — the CNOL — to which the carryover rules in section 172 could apply. Thus, the "taxpayer" to whom the section applies is different. In *Marvel*, the taxpayer is the individual group member, while in *United Dominion*, the taxpayer is the consolidated group — meaning that whether a separate entity or consolidated approach is appropriate is dictated by the statute.

Lastly, *United Dominion* provides no support for the idea that the entire CNOL is an attribute that belongs to an individual group member, which is what the Tax Court had to determine in reaching its ultimate conclusion that the attribute that must be reduced under section 108(b) is the CNOL. The Tax Court did not even discuss this issue. Instead, the Tax Court summarily concluded that because *United Dominion* states that a group member cannot have a separate NOL unless a specific regulation says that it does, the individual member's NOL attribute is the group's CNOL. But it is simply wrong to assert that an entire CNOL belongs to each member of the group, and there is nothing in the code or the consolidated return regulations that supports this position.[10] The Supreme Court's analysis in *United Dominion* does not alter this conclusion.

Because *United Dominion* does not concern section 108 or address the issue in *Marvel*, the Tax Court erred in basing its holding on that decision.[11] More important, in placing such heavy reliance on *United Dominion*, the Tax Court failed to consider properly the many arguments supporting the separate-entity approach and created significant uncertainty regarding the future application of the consolidated return regulations.

2. The Tax Court failed to identify the 'taxpayer' under section 108 as the debtor member and misapplied the statute. Support for the separate-entity approach is rooted in the statutory language of section 108. Section 108(a)(1)(A) allows a taxpayer to exclude from gross income COD income that arises from the discharge of debt in bankruptcy. In exchange, section 108(b) states that amounts excluded from gross income under section 108(a)(1)(A) are "applied to reduce the tax attributes of the taxpayer," generally starting first with the taxpayer's NOL attribute (that is, any current-year NOL or NOL carryovers). Other attributes of the taxpayer are also subject to reduction under section 108(b), including specific credit carryovers, capital loss carryovers, and property basis, but any COD income exceeding those attributes is permanently excluded from gross income.

The operation of section 108 does not change if the taxpayer is a member of a consolidated group. As conceded by the IRS, the "taxpayer" referred to in section 108 is the individual group member with excluded COD income, and that individual member is required to reduce its NOL attribute. Because the member joins in the filing of a consolidated return, any loss generated by that member must go into the computation of the consolidated group's taxable income and can be used to offset income generated by other members of the group. However, if the aggregate results of the group produce a CNOL, the portion of the CNOL attributable to a member that contributed to that loss should remain that member's attribute. There is no authority that indicates that a member's attributes include the portion of the

[10]Because the entire CNOL does not belong to an individual member, the regulations require the CNOL to be apportioned to group members for purposes of carrying the CNOL allocable to a member to a separate return year. *See* reg. section 1.1502-21(b).

[11]The only other court that has directly addressed the impact of *United Dominion* on section 108 in the consolidated group context reached this same conclusion. *See Temple-Inland Inc. v. United States*, 68 Fed. Cl. 561, 569 n.5 (2005) ("*United Dominion* dealt with the carryback period for product liability losses under section 172(b) and has nothing to do with section 108.").

CNOL attributable to other group members. Thus, the member's share of the CNOL is that member's NOL attribute that is reduced in applying section 108(b).

The error in the Tax Court's analysis stems from its apparent refusal to acknowledge that the "taxpayer" in section 108 refers to the individual member rather than a consolidated group, finding instead that "nowhere does the statute specifically define 'the taxpayer' as either a member entity of a consolidated group or the consolidated group as a whole." This statement is so flawed that not even the IRS was willing to make that assertion.[12] It completely ignores the fact that numerous provisions within section 108 can only be read as applicable to an individual corporation rather than a consolidated group. Most obvious is that only an individual corporation can incur debt, file for bankruptcy, have its debt discharged, and realize COD income that can be excluded under section 108(a). Further, some attributes listed in section 108(b), such as the basis of property, could not be identified if the taxpayer were a consolidated group, because only individual corporations own and have basis in property. It is unclear how the Tax Court would reconcile any of these inconsistencies because its opinion does not address them. What is clear is that the "taxpayer" in section 108 cannot vacillate between an individual debtor member and a consolidated group depending on the particular provision. The language must be read in a consistent manner that fits within the operation of the statute.

The Tax Court's flawed analysis of the "taxpayer" in section 108 led it to conclude that "section 108 does not articulate whether the 'tax attributes' subject to reduction are those at the consolidated level or are those allocable to each member entity."[13] However, because the "taxpayer" in section 108 must be the individual group member, the statute expressly requires that only the tax attributes of that member be reduced. The language of the statute thus reflects Congress's intent for section 108 to be applied consistently with the separate-entity approach.

As a result of determining that the application of section 108 was uncertain in consolidation, the Tax Court turned to the legislative history of section 108. The Tax Court pointed to the general purpose of section 108, which it said was to minimize the potential for the permanent exclusion of income, in concluding that a member that excludes COD income must reduce tax attributes that would otherwise be available to offset its income. The Tax Court's analysis is based on two erroneous conclusions.

First, the Tax Court wrongly found that the legislative history of section 108 supports the single-entity approach because it minimizes the potential for the permanent exclusion of COD income. The relevant legislative history does not contain a mandate against the permanent exclusion of COD income. The legislative history refers to a general approach to defer, rather than eliminate, the taxation of COD income, but it explicitly states that COD income in excess of a taxpayer's attributes is permanently excluded from gross income.[14] In its discussion of the legislative history of section 108, the Tax Court selectively omitted any reference to the permanent exclusion of COD income contemplated by Congress.

Second, the Tax Court used the anti-permanent-exclusion mandate that it inferred from the legislative history to support the notion that a member with excluded COD income must reduce the CNOL as a whole because any part of the CNOL could potentially be used to offset the member's income in the future. But there is no statutory or regulatory support for concluding that a group's CNOL is an attribute belonging to an individual member. The CNOL is an aggregate, group-level computation that originates from the losses attributable to the group's individual members. The Tax Court improperly relies on general (and misconstrued) statements of congressional intent to conclude that the entire CNOL is an individual member's attribute. The Tax Court's argument also overlooks the fact that even though a CNOL may continue to be

[12]In *Marvel*, the IRS did not argue that "taxpayer" in section 108 should be interpreted to mean the consolidated group. The IRS had also recognized previously that the taxpayer is the individual group member. *See* CCA 201033031 ("The Service acknowledges that the reference to 'the taxpayer' in section 108(b)(1) refers to the consolidated group *member* with excluded COD income . . . rather than the entire group.").

[13]The Tax Court puzzlingly refused to assign any significance to the fact that Congress adopted a specific rule for consolidated groups in section 1017(b)(3)(D), which allows a group member to treat stock in a subsidiary member as depreciable property and to reduce its basis in that stock under section 108(b). The Tax Court concluded that this rule was "not instructive as to what [Congress] intended under section 108(b)(2)(A)," and that it "will refrain from inferring congressional intent." But that analysis fails to apply basic rules of statutory construction. Based on the adoption of section 1017(b)(3)(D), it should be inferred that Congress intended section 108 to be applied on a separate member basis, because if Congress had intended differently, it would have adopted a specific rule for consolidated groups by indicating that section 108 applies to reduce the CNOL of the member's group.

(Footnote continued in next column.)

[14]The legislative history describes the operation of section 108(b) and the required reduction of attributes but concludes by stating that "any further remaining debt discharge amount is disregarded, i.e., does not result in income or have any other tax consequences." S. Rep. No. 96-1035, at 2 (1980).

available to a consolidated group to offset income generated by the debtor member with excluded COD income, it is just as likely that the CNOL could ultimately be used to offset income generated by other group members.[15]

3. The Tax Court wrongly disregarded rules in the consolidated return regulations that supported the separate-entity approach. The Tax Court adopted an overly simplified view of the impact of the consolidated return regulations on the application of section 108. The Tax Court acknowledged that the relevant regulations did not "specifically articulate how a consolidated group should reduce its tax attributes under section 108(b)," but again turned to *United Dominion* in stating that the regulations "prohibit the allocation of separate NOLs for consolidated group members unless it was within the ambit of a specific regulatory provision."

Although the consolidated return regulations, as in effect in 1998, did not specify an approach to attribute reduction under section 108(b), the regulations recognized that only a member's allocable share of the CNOL is that member's attribute. This is reflected in numerous provisions that require a CNOL to be allocated to the particular members to which it is attributable.[16]

The allocation of the CNOL to a particular member is most clearly demonstrated in the investment basis adjustment rules in reg. section 1.1502-32.[17] Generally, under those rules, a member is required to adjust annually its basis in the stock of a subsidiary member based on the net adjustments required under the regulations, with positive adjustments made for taxable income and negative adjustments made for loss items and distributions.[18] The negative adjustment for a subsidiary's loss is made to the extent the loss is absorbed (that is, used to offset income by any member of the consolidated group).[19] If, in any particular year that loss (or any portion of that loss) goes unused and the consolidated group has a CNOL carryover, a negative adjustment is made if and when the CNOL carryover is used by the group, at which time the negative adjustment would be based on the portion of the CNOL attributable to the member.[20] Thus, the rules in reg. section 1.1502-32 require one to determine the member's allocable share of the CNOL to make adjustments to the member's stock basis.

An allocation of the CNOL to a particular member must also be made under the investment basis adjustment rules to take into account the consequences of income exclusion and attribute reduction under section 108. The portion of the CNOL allocable to a member that is reduced under section 108(b) is a noncapital, nondeductible expense that results in a negative basis adjustment.[21] Conversely, to the extent there is a reduction in tax attributes under section 108(b), the excluded COD income is treated as tax-exempt income that results in an offsetting positive adjustment to stock basis.[22] The consolidated return regulations in effect in 1998 contained an example that illustrated the operation of these rules and provided direct evidence that section 108 was to be applied using the separate-entity approach.[23] The example indicated that excluded COD income resulted in a reduction to only

[15]The single-entity approach could lead to results that are contrary to the intended operation of section 108(b). If a CNOL is reduced under section 108(b) without regard to the member to which the CNOL is attributable, a member's excluded COD income may not reduce its allocable share of the CNOL by the full amount of the excluded income. Moreover, in some circumstances it may not result in a reduction to *any* part of the member's share of a group's CNOL. *See* section 108(b)(4)(B) (the NOL reduction under section 108(b)(2)(A) is first made to the NOL for the tax year of the discharge and then to NOL carryovers to that year in the order of the tax years from which each carryover arose). If a member were to then leave the consolidated group, the member would be apportioned an amount of the CNOL that does not reflect the amount of its excluded COD income, meaning that the cost of excluding the COD income would be shouldered by other members of the consolidated group.

[16]In recognition of the fact that a CNOL allocable to a member is its attribute, the IRS adopted a hybrid approach in the 2003 regulations that requires the determination and reduction of the debtor member's share of the CNOL based on reg. section 1.1502-21(b)(2) principles.

[17]Other areas in the applicable consolidated return regulations in which a calculation of the CNOL attributable to a member was needed included (1) to apply the circular basis rules in reg. section 1.1502-11(b), which generally prevent a group from offsetting gain on the disposition of a member's stock with the portion of a CNOL attributable to the member; (2) the loss disallowance rules in former reg. section 1.1502-20(g), which provided that on a sale of member stock, the common parent could reattribute any portion of the CNOL attributable to

(Footnote continued in next column.)

the member; and (3) reg. section 1.1502-21(b), under which the CNOL is apportioned for purposes of carrying the CNOL allocable to a member to a separate return year.

[18]*See* reg. section 1.1502-32(a)(1) and (b)(2). A subsidiary's taxable income or loss is consolidated taxable income (or loss) determined by including only the subsidiary's items of income, gain, deduction, and loss taken into account in determining consolidated taxable income (or loss). *See* reg. section 1.1502-32(b)(3)(i).

[19]*See* reg. section 1.1502-32(b)(3)(i).

[20]*Id.* If the CNOL is carried forward and absorbed in a later year, it is taken into account in that later year. *Id.* If the CNOL is carried back and absorbed in a prior year (whether consolidated or separate), it is taken into account in the year in which it arises. *Id.*

[21]*See* reg. section 1.1502-32(b)(3)(iii) and (b)(5), Example 4(a) and (b).

[22]*See* reg. section 1.1502-32(b)(3)(ii)(C).

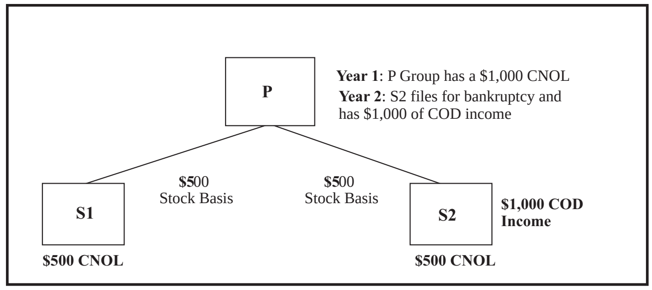
[23]*See* former reg. section 1.1502-32(b)(5), Example 4(c), which was amended in connection with the issuance of the 2003 regulations.

the debtor member's allocable share of the CNOL by suggesting that the CNOL attributable to the debtor member was the only relevant attribute for section 108(b) purposes.[24] The Tax Court apparently assigned no significance to this example or to any aspect of the rules in reg. section 1.1502-32, which were not addressed at all in its opinion.

4. The Tax Court failed to consider the many defects of the single-entity approach and its unworkability in practice. One of the most disappointing aspects of the Tax Court's opinion was its refusal to consider any arguments concerning the many issues that would arise if the single-entity approach applied. Noticeably absent from the Tax Court's opinion is any discussion of how one would actually reconcile the many inconsistencies and unanswered questions raised by the single-entity approach. The Tax Court seemed to be operating under a mistaken assumption that the single-entity approach and the separate-entity approach were on equal footing and that taxpayers faced a simple choice in choosing between the two alternatives.

The unanswered issues under the single-entity approach are illustrated in the context of the investment basis adjustment rules and their application to an individual debtor member with excluded COD income that requires the reduction of attributes under section 108(b). The investment basis adjustment rules are applied on a member-by-member basis that requires the identification of member-specific items so that the basis in member stock can be properly adjusted. However, the attribution of a CNOL to a specific debtor member to apply reg. section 1.1502-32 and make stock basis adjustments is in direct conflict with the Tax Court's decision. The single-entity approach is inconsistent with the investment basis adjustment rules because it applies the attribute reduction under section 108(b) to the CNOL as a consolidated attribute that cannot be attributed to an individual group member. Consequently, the Tax Court's adoption of the single-entity approach can be interpreted to mean that no basis adjustments are made to member stock.

Even if it is assumed that the investment basis adjustment rules can operate in conflict with the single-entity approach adopted in *Marvel*, the applicable consolidated return regulations provided no guidance on how any such adjustments would be made. In the absence of guidance, it is unclear how the single-entity approach could be reconciled with the investment basis adjustment rules. This is demonstrated through the following example:



Facts: P owns S1 and S2, all of which are members of a consolidated group. In year 1, the P group has a $1,000 CNOL, $500 of which is attributable to each of S1 and S2. In year 2, S2 files for bankruptcy, which results in S2 realizing $1,000 of COD income that S2 excludes from gross income under section 108(a). Apart from the year 1 CNOL, there are no other tax attributes to reduce under section 108(b).

Basis adjustments:

- Under the separate-entity approach, the exclusion of the COD income causes S2's $500 allocable portion of the year 1 CNOL to be reduced to zero. P's S2 stock basis is reduced by $500 because the reduction of the CNOL attributable to S2 is a noncapital, nondeductible expense. There is a $500 positive adjustment to P's S2 stock basis for the COD income that is treated as tax-exempt income (resulting in no net change to basis). The remaining $500 of COD income for which no attribute reduction occurs is not treated as tax-exempt income and does not affect P's basis in its S2 stock.
- Under the single-entity approach, the exclusion of the COD income should cause the entire year 1 CNOL to be reduced to zero. Thus, both the CNOL attributable to S1 and S2 should be reduced by $500, which should be a noncapital, nondeductible expense that reduces P's basis in its S1 and S2 stock by $500 to zero. P's S2 stock basis should be increased by at least $500 because the reduction to S2's attributable share of the CNOL causes $500 of the COD income to be treated as tax-exempt income. However, there was no authority that addressed whether the remaining $500 of S2's COD income is treated as tax-exempt income to S2 because it reduced the attributes of S1,

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[24]In the example, P forms S in year 1, and S borrows $200. According to the example, "the P group has a $100 [CNOL] when determined by including only S's items of income, gain, deduction and loss taken into account." It is assumed that $70 of S's NOL in year 1 is used to offset P's income for that year, and S realizes $100 of COD income in year 2 that is excluded under section 108(a). The example concludes that: "Under section 108(b), the remaining $30 of S's net operating loss carryover from Year 1 is reduced to zero at the close of Year 2. *No other attributes are reduced*" (emphasis added). A similar example under the rules dealing with excess loss accounts in reg. section 1.1502-19 refers to the "consolidated net operating loss carryover attributable to" the debtor member as the item reduced under section 108(b). *See* reg. section 1.1502-19(g), Example 5(c).

which would allow P to increase its basis in its S2 stock by an additional $500. If this basis shift from the S1 stock to the S2 stock were permitted, the end result would be that P's basis in its S2 stock is increased to $1,000.

Alternative facts: Assume S2 had only $500 of COD income in year 2 (that is, the amount of the excluded COD income is less than the CNOL).

- Under the separate-entity approach, the result is the same as above, except that there is no $500 of excess COD income for which no attribute reduction occurs.
- Under the single-entity approach, the $1,000 year 1 CNOL is reduced to $500, and, because this reduction under section 108(b) is made without any determination of the CNOL attributable to the debtor member (S2), this should result in a proportionate reduction to the CNOL attributable to S1 and S2 (that is, each of S1 and S2's $500 portion of the CNOL is reduced to $250). Therefore, for investment basis adjustment purposes, the single-entity approach requires P's stock basis in each subsidiary to be reduced by $250 to account for the attribute reduction under section 108(b). This results in a $250 basis in P's S1 stock, and P's S2 stock basis either remains at $500 (because S2's COD income offsets the $250 attribute reduction) or is increased to $750 (to account for the reduction of S1's attributes, if a basis shift is permitted). This leads to an illogical result, because P ends up reducing its basis in S1, a member with zero COD income, while its basis in the debtor member remains the same or is even increased. This result is patently inappropriate when the debtor member that generated the COD income still has available attributes.

Because the single-entity approach was administratively unworkable, a taxpayer could not have applied the single-entity approach without detailed rules explaining the effect on both the debtor member and other members of the consolidated group.[25] This would have required the IRS to issue published guidance and revise numerous rules in the consolidated return regulations. Neither the IRS nor the Tax Court offered any insight into how a taxpayer could apply the single-entity approach or presented any explanation of how the single-entity approach can be considered the correct application of the law despite its defects. Because of the significant uncertainty presented by the single-entity approach, the separate-entity approach represented a far more appropriate interpretation of the existing law.[26]

5. The Tax Court should have permitted the separate-entity approach as a reasonable application of the law. Given the IRS's failure to provide guidance on the application of section 108(b) in consolidation, Marvel had a strong argument that its position should be upheld because, at a minimum, the separate-entity approach represented a reasonable interpretation of the relevant law. This position was supported by the Tax Court's decision in *Gottesman*, which held that a taxpayer's reasonable application of the law must be upheld in the absence of consolidated return regulations that prescribe a particular approach.[27] Under this argument, the Tax Court did not need to decide whether the separate-entity approach or the single-entity approach was the correct application of section 108, but only needed to recognize that use of the separate-entity approach was reasonable.

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[25]The reduction of the portion of a CNOL attributable to a non-debtor member under the single-entity approach could lead to an unworkable circular basis problem if subsidiary stock were sold in the year of the COD income. *See* Lawrence M. Axelrod, ''*Marvel* and *United Dominion*'s Dangerous Dictum,'' *Tax Notes*, Oct. 10, 2016, p. 283. Other examples of unanswerable questions raised by the single-entity approach include (1) the treatment of a non-debtor member that leaves the consolidated group during the tax year in which the COD income is realized and attributes are reduced; (2) whether a debtor member is considered worthless and an excess loss account is triggered if attributes of another member are reduced (see reg. section 1.1502-19(c)(1)(iii)); and (3) whether the basis of assets held by non-debtor members is reduced by the debtor member's excluded COD income. In contrast, the separate-entity approach did not present the same type of issues because only the attributes of the debtor member are reduced and the other members of the group are not affected.

[26]The Tax Court's willingness to disregard the deficiencies of the single-entity approach is particularly troubling because the IRS discussed those deficiencies when it rejected that approach in issuing the 2003 regulations. The many defects in the single-entity approach led the IRS to adopt a hybrid approach, which required complicated rules under numerous provisions in the consolidated return regulations and amendments to the regulations on three separate occasions.

[27]*Gottesman & Co. v. Commissioner*, 77 T.C. 1149 (1981). In *Gottesman*, the issue was whether accumulated taxable income for section 531 purposes was to be calculated on a separate company or consolidated basis. The regulations did not address the issue, and the IRS's attempts to issue guidance only managed to confuse taxpayers. Before 1966, affiliated corporations filing consolidated returns had to compute their accumulated taxable income on a combined basis. Regulations issued in 1966, however, were silent on the issue. The IRS issued proposed regulations requiring computation on a combined basis in 1968, but it withdrew those regulations in 1971 and did not issue new proposed regulations until 1979. The Tax Court found that the taxpayer's use of a separate company method during its 1973-1975 tax years was reasonable because of the ambiguity that existed (and was caused by the IRS). The court stated, ''We cannot fault [the taxpayer] for not knowing what the law was in this area when the Commissioner, charged by Congress to announce the law (section 1502), never decided what it was himself.''

The Tax Court, however, rejected Marvel's argument and found that the use of the separate-entity approach did not meet this lower threshold, mainly because the court did not actually apply a reasonableness standard. Instead, the Tax Court repeated its conclusion that the single-entity approach was without question the correct approach based on *United Dominion* and that *Gottesman* was therefore inapplicable.

The Tax Court's analysis incorrectly equates *United Dominion* with *Marvel* by stating that the issue in both was ''identifying the appropriate NOL in the consolidated return context.'' The Tax Court wrongly finds that the separate-entity approach not only ''conflicts'' with *United Dominion*, but was ''specifically rejected by the Supreme Court in that case'' because ''a separate NOL does not exist in the consolidated return regulations.'' The two cases presented completely different issues under the code. *United Dominion* did not say a word about section 108 or how a CNOL is attributed to individual group members. There is no support for concluding that *United Dominion* specifically rejected the separate-entity approach or that it definitively answers the question at issue in *Marvel*.

The Tax Court also seems to misunderstand the notion of a ''reasonable'' position in light of the uncertainty created by the IRS under the consolidated return regulations. Even if it is assumed that *United Dominion* conclusively resolves the issue in *Marvel* by requiring the single-entity approach, *United Dominion* does not make the use of the separate-entity approach in *Marvel* unreasonable. *United Dominion* was not decided until 2001 and cannot be relevant to assessing reasonableness under the law in 1998 in accordance with *Gottesman*.[28] The Tax Court itself specifically acknowledged that Marvel's ''application of the separate-entity approach in filing its 1998 consolidated tax return was plausible at the time,'' which suggests that the court agreed that, before *United Dominion*, the separate-entity approach was a reasonable application of the law.[29] Accordingly, Marvel's use of the separate-entity approach prior to the Supreme Court's decision must be reasonable since the Court's decision cannot retroactively make all earlier applications of the separate-entity approach unreasonable. The relevant question is whether Marvel's application of the law was reasonable when applied, and that application cannot become unreasonable because of the subsequent decision in *United Dominion*.

The Tax Court should have held in favor of Marvel based solely on *Gottesman* because of the reasonableness of the separate-entity approach. It is regrettable that the Tax Court did not properly apply the *Gottesman* standard, which would have allowed it to reach a resolution in *Marvel* without having to turn to *United Dominion*.

F. Second Circuit Appeal

On September 7, 2016, one week after oral argument by the parties, the Second Circuit issued a per curiam opinion affirming the decision of the Tax Court.[30] The Second Circuit stated that it agreed with the Tax Court's opinion but offered no insight on its view of the issues. The manner in which the Second Circuit framed the issue in the case, however, suggests that it, too, had difficulty identifying the ''taxpayer'' under section 108:

> Whether [Marvel's] consolidated group must reduce its [CNOL] under [section] 108(b)(2)(A) by the total amount of the *group's* previously excluded cancellation of indebtedness income under a ''single entity'' approach as opposed to determining the amount of CNOL apportionable to each member and applying [section] 108(b)(2)(A) on a member-by-member basis. [Emphasis added.]

The Second Circuit's reference to the group's excluded COD income, as opposed to the individual members who actually filed for bankruptcy and realized and excluded COD income, suggests that the court failed to appreciate the significance of the determination of the ''taxpayer'' in applying section 108 (or, even worse, that it was under the mistaken belief that the ''taxpayer'' in section 108 is the consolidated group itself). Ultimately, the per curiam opinion issued by the Second Circuit indicates that similar to the Tax Court, the court of appeals took the easy way out by leaning on *United*

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[28]Even if a Supreme Court decision is given full retroactive effect, the standard applied under *Gottesman* is one of reasonableness, a standard that is afforded to taxpayers because of the IRS's failure to issue sufficient guidance under the consolidated return regulations.

[29]There was no defensible argument that the separate-entity approach was unreasonable, given the glaring gap in guidance on the application of section 108(b) in consolidation and the inconsistent positions applied by the IRS. The separate-entity approach was accepted as a valid interpretation of the law by numerous well-respected commentators on the consolidated return regulations, many of whom stated that the separate-entity approach was the correct approach. *See, e.g.*, Kevin M. Hennessey et al., *The Consolidated Tax Return*, para. 11.05, at n.84

(Footnote continued in next column.)

(6th ed. 2012) (''The temporary regulations are prospective in nature, and discharges prior to August 30, 2003 should be treated under whatever rules were in place at that time. The authors continue to believe that separate company attribute reduction under Section 108(b) is proper for discharges prior to the effective date of the temporary regulations.'').

[30]On November 28, 2016, the Second Circuit denied a petition filed by Marvel for panel rehearing or rehearing *en banc*.

Dominion and declining to go into the more detailed, but correct, analysis supporting the separate-entity approach. Like the Tax Court, the Second Circuit likely placed excessive weight on *United Dominion* because it was a Supreme Court decision and the appellate panel was hesitant to take a position that could be construed as inconsistent with that precedent.

G. Impact of *Marvel*

1. Investment basis adjustment rules. Although the effect of *Marvel* is ostensibly limited because of the 2003 regulations and the existing rules governing section 108 attribute reduction in consolidation, the reasoning adopted by the Tax Court (and affirmed by the Second Circuit) has implications beyond the application of section 108(b) to years before the 2003 regulations.[31] The Tax Court's narrow focus on the existence of specific and direct rules rather than the broader principles that guide the operation of the consolidated return regulations could raise concerns in applying those regulations. In particular, the Tax Court's holding could have a significant impact on the operation of the investment basis adjustment rules under current law.

As described above, under reg. section 1.1502-32, a subsidiary's loss results in a negative basis adjustment only to the extent the loss is absorbed, meaning that if the group has a CNOL for a particular year, a negative adjustment is not made unless that CNOL is used to offset income in another tax year. When that occurs, the negative basis adjustment for a subsidiary's loss must be determined by reference to the portion of the CNOL used that is attributable to the member, because reg. section 1.1502-32 states that an individual member's loss includes the part of the CNOL that stems from the member's items of income, gain, deduction, and loss.[32] Reg. section 1.1502-32, however, does not contain rules regarding the allocation and apportionment of a CNOL to a particular member. Consequently, if a portion of a CNOL carryover is used in a consolidated return year, there is no prescribed method in reg. section 1.1502-32 for allocating the CNOL to different members to make a negative basis adjustment to each member's stock.[33] In the absence of that guidance, taxpayers in practice rely on the CNOL allocation and absorption rules in reg. section 1.1502-21(b) to make the necessary calculation.[34] Not only do those rules appear intended to be of general application, but it is well recognized under consolidated return principles that a member has an attributable share of the CNOL and the method prescribed in reg. section 1.1502-21(b) is a sensible and relatively simple method to compute this amount.

The reasoning of the Tax Court's decision in *Marvel* is premised on the position that a separate member NOL does not exist in consolidation and that a CNOL cannot be attributed to an individual group member unless a specific consolidated return regulation allocates and apportions the CNOL to that member for a particular purpose. The Tax Court found that no such regulation existed for the application of section 108 in consolidation for the year at issue. The Tax Court rejected the use of reg. section 1.1502-21(b) principles for purposes of applying section 108, citing *United Dominion* for the notion that the regulation applies only narrowly to determine the amount of a CNOL that may be carried to a separate return year in which a member is not part of the consolidated group.

The Tax Court's analysis in embracing the single-entity approach introduces significant uncertainty about the operation of the rules in reg. section 1.1502-32. *Marvel* logically compels that it is inappropriate to apply reg. section 1.1502-21(b) in making investment basis adjustments because of the absence of an explicit regulatory directive in reg. section 1.1502-32. A taxpayer could therefore decide

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[31]*Marvel* most directly affects taxpayers similarly situated to Marvel — that is, consolidated taxpayers that had excluded COD income before the effective date of the 2003 regulations and that applied the separate-entity approach. Those taxpayers could have used a CNOL carryover in a subsequent year, or even still have a CNOL carryover that remains available for use, that would have been reduced under section 108(b) if the single-entity approach applied. Under *Marvel*, taxpayers in those circumstances would be precluded from using any amount of the CNOL that should have been reduced under the single-entity approach. Despite *Marvel*, a taxpayer could still assert that the separate-entity approach is correct if it is inclined to challenge the IRS's position in a jurisdiction outside the Second Circuit.

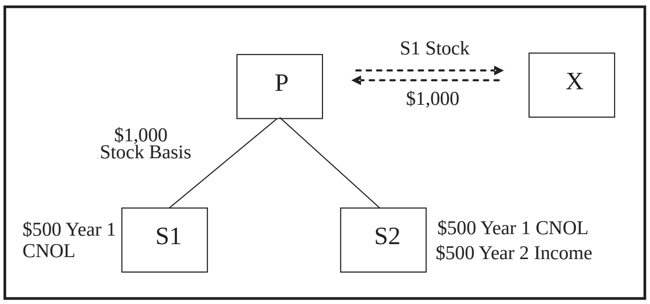
[32]*See* reg. section 1.1502-32(b)(3)(i) (''S's taxable income or loss is consolidated taxable income (or loss) determined by including only S's items of income, gain, deduction, and loss taken into account in determining consolidated taxable income (or loss), treating S's deductions and losses as taken into account to the extent they are absorbed by S or any other member.'').

[33]An allocation would be unnecessary if the subsidiary was the sole source of the CNOL carryover or if the full amount of the CNOL carryover was used in another year.

[34]The 2003 regulations, in addressing the application of section 108 in consolidation, modified the rules of reg. section 1.1502-21 with regard to the CNOL apportioned to a subsidiary when a CNOL is absorbed and when a subsidiary departs from the group. Those modifications also took into account the reduction of the losses attributable to that member that occurs as a result of the exclusion of COD income. *See* reg. section 1.1502-21(b)(1) (''The amount of any CNOL absorbed by the group in any year is apportioned among members based on the percentage of the CNOL attributable to each member as of the beginning of the year. The percentage of the CNOL attributable to a member is determined pursuant to paragraph (b)(2)(iv)(B) of this section.'').

to deviate from commonly accepted consolidated return principles and instead allocate a CNOL in any manner it chooses in making investment basis adjustments (for example, by allocating the absorbed CNOL to a particular member rather than pro rata to all members that contributed to the CNOL).

More significant, one may conclude that reg. section 1.1502-32 does not meet the strict standard applied by the Tax Court as a specific consolidated return regulation that permits the allocation and apportionment of a CNOL to a group member. The reasoning adopted in *Marvel* should therefore be interpreted as precluding any downward adjustments of subsidiary stock basis for a CNOL that is used in consolidation. This interpretation of *Marvel* would have severe consequences under the investment basis adjustment rules, as illustrated in the following example:



Facts: P wholly owns S1 and S2, all of which are members of a consolidated group. In year 1, the P group has a CNOL of $1,000, $500 of which is attributable to each of S1 and S2. In year 2, the $1,000 CNOL from year 1 is used to offset $500 in income generated by S2. At the end of year 2, P's basis in its S1 stock is $1,000. At the beginning of year 3, P sells its S1 stock to an unrelated party for $1,000.

Analysis:

- Ignoring the holding in *Marvel*, the use of $500 of the year 1 CNOL in year 2 should result in a pro rata reduction to the CNOL attributable to S1 and S2 under reg. section 1.1502-21(b), which causes a $250 reduction to P's stock basis in S1 and S2. When P sells its S1 stock to X for $1,000, P recognizes $250 in gain. Under reg. section 1.1502-21(b), $250 of the remaining $500 of the year 1 CNOL is allocated to S1 on its departure from the P consolidated group.
- Under the rationale of *Marvel*, the use of $500 of the year 1 CNOL in year 2 does not result in a negative basis adjustment to P's S1 stock. Because no specific consolidated return regulation allocates and apportions part of the CNOL to S1 for this purpose, no portion of the CNOL absorbed by the group can be allocated to S1. When P sells its S1 stock to X for $1,000, no gain is recognized by P. As above, under reg. section 1.1502-21(b), $250 of the remaining $500 of the year 1 CNOL is allocated to S1 on its departure from the P consolidated group.

The result in this example is the logical extension of the Tax Court's holding in *Marvel* when it is applied to the investment basis adjustment rules. Taxpayers could reasonably take the position that no downward basis adjustment occurs as a result of the use of the CNOL and cite *Marvel* as support. Because the Tax Court and the Second Circuit failed to even consider the investment basis adjustment rules and how they might be affected (despite Marvel's effort to emphasize these issues), taxpayers are left to assess the effect of *Marvel* and determine how those rules are to be applied.

2. Proposed regulations on loss absorption. In a development with no apparent connection to *Marvel*, the IRS issued proposed regulations in June 2015 (just before the Tax Court's decision in *Marvel*) that address the absorption of members' losses in a consolidated return year.[35] The proposed regulations provide that the absorption of member losses to offset income of other members in the same consolidated return year would be made on a pro rata basis in the same manner as the absorption rules that apply to carryovers in reg. section 1.1502-21(b).[36] The proposed absorption rule appears in reg. section 1.1502-11, which details the calculation of consolidated taxable income.

The discussion in the preamble to the proposed regulations suggests that the IRS may not fully appreciate the potential scope of *Marvel* by indirectly calling into question the logic underlying that decision. In the preamble, the IRS described the existing rules concerning the allocation and absorption of member losses as follows:

> Although the current consolidated return regulations provide rules for apportioning a CNOL among members when a member's loss may be carried to a separate return year, the

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[35]REG-101652-10. The proposed regulations were issued in conjunction with rules on the circular basis problem that arises when the use of a subsidiary member's losses occurs in the same year that a member disposes of stock of that subsidiary.

[36]*See* prop. reg. section 1.1502-11(e)(1) ("If the group has a CNOL for a consolidated return year, the amount of each member's separate net operating loss, as defined in section 1.1502-21(b)(2)(iv)(B)(1), for the year that offsets the income or gain of other members is determined on a pro rata basis under the principles of section 1.1502-21(b)(2)(iv)."). Similar rules are provided for capital losses, and the proposed regulations also address anomalies that may arise under reg. section 1.1502-21(b)(2)(iv) as a result of the presence of capital gains.

> regulations *do not expressly adopt* the fraction-based methodology of [reg. section] 1.1502-21(b)(2)(iv) for computing the amount of each member's absorbed loss that is used to offset the income of members with positive separate taxable income or net capital gain for the consolidated return year in which the loss is recognized. [Emphasis added.]

The IRS describes the issuance of the absorption rule in the proposed regulations as a means "to clarify" that the absorption of members' losses to offset income is made on a pro rata basis just as it is under reg. section 1.1502-21(b).

This discussion in the preamble to the proposed regulations is in direct conflict with the IRS's position in *Marvel* and stands in contrast to the Tax Court's decision. The IRS recognizes the need to determine the absorption of the member's loss and, even though there is no specific rule in the consolidated return regulations, suggests that reg. section 1.1502-21(b)(2)(iv) serves as the general method for this purpose. The proposed regulations that would specifically adopt the rule in reg. section 1.1502-21(b)(2)(iv) are described as a mere clarification of that point.

Accordingly, the discussion in the preamble contradicts the notion that a CNOL cannot be apportioned unless a specific regulation applies because reg. section 1.1502-21(b)(2)(iv) principles can be used when such a calculation is needed. This is wholly inconsistent with the Tax Court's conclusion that, under *United Dominion*, a CNOL cannot be allocated to a member in accordance with reg. section 1.1502-21(b)(2)(iv) (as in effect in 1998) to reduce that member's share of the CNOL in applying section 108 because that regulation only applies in determining the amount of the CNOL that may be carried to a member's separate return year.

H. Conclusion

The Tax Court and the Second Circuit got it wrong in *Marvel* in choosing the single-entity approach. The separate-entity approach was clearly supported by the statutory language and was consistent with the operation of the consolidated return regulations. It is disappointing that the courts gave dispositive weight to a tangentially related Supreme Court case while neglecting to consider the full ramifications of the competing approaches. Despite the detailed rules on consolidated attribute reduction introduced in the 2003 regulations, the reasoning applied in *Marvel* will be relevant outside the context of section 108 and will have a lasting and unanticipated impact on the application of the other rules in the consolidated return regulations.

It is difficult to conclude that the decision by the IRS to challenge the use of the separate-entity approach in *Marvel* was anything but an attempt to maximize collections and prevent COD income from escaping tax. As in *United Dominion*, the IRS sought to apply a strained interpretation of the consolidated return regulations that was decidedly unfavorable to the taxpayer. The position of the IRS was not borne out of a well-established principle emanating from the consolidated return regulations. Rather, the IRS presented an unrelated decision in *United Dominion* as the answer to the application of section 108 in consolidation while ignoring its own long-standing failure to provide a clear set of rules on which taxpayers could rely. Even now, it is uncertain whether the IRS has fully thought through the consequences of the single-entity approach applied in *Marvel* and, as demonstrated in the issuance of proposed regulations on loss absorption in 2015, whether that decision actually comports with the IRS's views regarding the operation of the consolidated return regulations. The IRS would have been better served by letting the 2003 regulations take effect prospectively and leaving well enough alone for excluded COD income in earlier years to avoid injecting unnecessary confusion regarding single-entity and group-level concepts under the consolidated return regulations. ■