

(1) The aggregate adjusted basis of the subsidiary member's assets other than any stock that subsidiary member owns in another subsidiary member; and

(2) Any losses attributable to the subsidiary member and carried to the subsidiary member's first taxable year following the disposition; and

(3) Any deductions of the subsidiary member that have been recognized but are deferred under a provision of the Internal Revenue Code (such as deductions deferred under section 469); over

(B) The sum of—

(1) The value of the subsidiary member's stock; and

(2) Any liabilities of the subsidiary member that have been taken account for tax purposes.

(ii) *Special rules.* (A) The amounts determined under paragraph (d)(4)(i) (other than amounts described in paragraph (d)(4)(i)(B)(1)) of this section with respect to a subsidiary member include its allocable share of corresponding amounts with respect to all lower-tier subsidiary members. If 80 percent or more in value of the stock of a subsidiary member is acquired by purchase in a single transaction (or in a series of related transactions during any 12-month period), the value of the subsidiary member's stock may not exceed the purchase price of the stock divided by the percentage of the stock (by value) so purchased. For this purpose, stock is acquired by purchase if the transferee is not related to the transferor within the meaning of sections 267(b) and 707(b)(1), using the language “10 percent” instead of “50 percent” each place that it appears, and the transferee's basis in the stock is determined wholly by reference to the consideration paid for such stock.

(B) The amounts determined under paragraph (d)(4)(i) of this section are not applied more than once to suspend a loss under this section.

(5) *Predecessor and Successor.* A predecessor is a transferor of assets to a transferee (the successor) in a transaction—

(i) To which section 381(a) applies;

(ii) In which substantially all of the assets of the transferor are transferred to members in a complete liquidation;

(iii) In which the successor's basis in assets is determined (directly or indirectly, in whole or in part) by reference to the transferor's basis in such assets, but the transferee is a successor only with respect to the assets the basis of which is so determined; or

(iv) Which is an intercompany transaction, but only with respect to assets that are being accounted for by

the transferor in a prior intercompany transaction.

(6) *Successor group.* A surviving group is treated as a successor group of a consolidated group (the terminating group) that ceases to exist as a result of—

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

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

(7) *Preferred stock, common stock.* Preferred stock and common stock shall have the meanings set forth in § 1.1502-32(d)(2) and (3), respectively.

(8) *Higher-tier.* A subsidiary member is *higher-tier* with respect to a member if or to the extent investment basis adjustments under § 1.1502-32 with respect to the stock of the latter member would affect investment basis adjustments with respect to the stock of the former member.

(9) *Lower-tier.* A subsidiary member is *lower-tier* with respect to a member if or to the extent investment basis adjustments under § 1.1502-32 with respect to the stock of the former member would affect investment basis adjustments with respect to the stock of the latter member.

(e) *Examples.* For purposes of the examples in this section, all groups file consolidated returns on a calendar-year basis, the facts set forth the only corporate activity, all transactions are between unrelated persons unless otherwise specified, and tax liabilities are disregarded. The principles of paragraphs (a) through (d) of this section are illustrated by the following examples:

*Example 1. Nondeconsolidating sale of preferred stock of lower-tier subsidiary member.* (i) *Facts.* P owns 100 percent of the common stock of each of S1 and S2. S1 and S2 each have only one class of stock outstanding. P's basis in the stock of S1 is \$100 and the value of such stock is \$130. P's basis in the stock of S2 is \$120 and the value of such stock is \$90. P, S1, and S2 are all members of the P group. S1 and S2 form S3. In Year 1, in transfers to which section 351 applies, S1 contributes \$100 to S3 in exchange for all of the common stock of S3 and S2 contributes an asset with a basis of \$50 and a value of \$20 to S3 in exchange for all of the preferred stock of S3. S3 becomes a member of the P group. In Year 3, in a transaction that is not part of the plan that includes the contributions to S3, S2 sells the preferred stock of S3 for \$20. Immediately after the sale, S3 is a member of the P group.

(ii) *Application of basis redetermination rule.* Because S2's basis in the preferred stock of S3 exceeds its value immediately prior to

the sale and S3 is a member of the P group immediately after the sale, all of the P group members' bases in the stock of S3 is redetermined pursuant to paragraph (b)(1) of this section. Of the group members' total basis of \$150 in the S3 stock, \$20 is allocated to the preferred stock, the fair market value of the preferred stock on the date of the sale, and \$130 is allocated to the common stock. S2's sale of the preferred stock results in the recognition of \$0 of gain/loss. Pursuant to paragraph (b)(5) of this section, the redetermination of S1's and S2's bases in the stock of S3 results in adjustments to P's basis in the stock of S1 and S2. In particular, P's basis in the stock of S1 is increased by \$30 to \$130 and its basis in the stock of S2 is decreased by \$30 to \$90.

*Example 2. Deconsolidating sale of common stock.* (i) *Facts.* In Year 1, in a transfer to which section 351 applies, P contributes Asset A with a basis of \$900 and a value of \$200 to S in exchange for one share of S common stock (CS1). In Years 2 and 3, in successive but unrelated transfers to which section 351 applies, P transfers \$200 to S in exchange for one share of S common stock (CS2), Asset B with a basis of \$300 and a value of \$200 in exchange for one share of S common stock (CS3), and Asset C with a basis of \$1000 and a value of \$200 in exchange for one share of S common stock (CS4). In Year 4, S sells Asset A for \$200, recognizing \$700 of loss that is used to offset income of P recognized during Year 4. As a result of the sale of Asset A, the basis of each of P's four shares of S common stock is reduced by \$175. Therefore, the basis of CS1 is \$725. The basis of CS2 is \$25. The basis of CS3 is \$125, and the basis of CS4 is \$825. In Year 5 in a transaction that is not part of a plan that includes the Year 1 contribution, P sells CS4 for \$200. Immediately after the sale of CS4, S is not a member of the P group.

(ii) *Application of basis redetermination rule.* Because P's basis in each of CS1 and CS4 exceeds its value immediately prior to the deconsolidation of S, P's basis in its shares of S common stock is redetermined pursuant to paragraph (b)(2) of this section. Pursuant to paragraph (b)(2)(ii) of this section, the reallocable basis amount is \$350 (the lesser of \$1150, the gross loss inherent in the stock of S owned by P immediately before the sale, and \$350, the aggregate amount of S's items of deduction and loss that were previously taken into account in the computation of the adjustment to the basis of the stock of S that P did not hold at a loss immediately before the deconsolidation). Pursuant to paragraph (b)(2)(i) of this section, first, P's basis in CS1 is reduced from \$725 to \$600 and P's basis in CS4 is reduced from \$825 to \$600. Then, the reallocable basis amount increases P's basis in CS2 from \$25 to \$250 and P's basis in CS3 from \$125 to \$250. P recognizes \$400 of loss on the sale of CS4. The loss suspension rule does not apply because S is no longer a member of the P group. Thus, the loss is allowable at that time.

*Example 3. Nondeconsolidating sale of common stock.* (i) *Facts.* In Year 1, P forms S with a contribution of \$80 in exchange for 80 shares of the common stock of S, which at that time represents all of the outstanding