

stock of S. S becomes a member of the P group. In Year 2, P contributes Asset A with a basis of \$50 and a value of \$20 in exchange for 20 shares of the common stock of S in a transfer to which section 351 applies. In Year 3, in a transaction that is not part of the plan that includes the Year 2 contribution, P sells the 20 shares of the common stock of S that it acquired in Year 2 for \$20. Immediately after the Year 3 stock sale, S is a member of the P group. At the time of the Year 3 stock sale, S has \$80 and Asset A. In Year 4, S sells Asset A, the basis and value of which have not changed since its contribution to S. On the sale of Asset A for \$20, S recognizes a \$30 loss. The P group cannot establish that all or a portion of the \$30 loss was not reflected in the calculation of the duplicated loss of S on the date of the Year 3 stock sale. The \$30 loss is used on the P group return to offset income of P. In Year 5, P sells its remaining S common stock for \$80.

(ii) *Application of basis redetermination and loss suspension rules.* Because P's basis in the common stock sold exceeds its value immediately prior to the sale and S is a member of the P group immediately after the sale, P's basis in all of the stock of S is redetermined pursuant to paragraph (b)(1) of this section. Of P's total basis of \$130 in the S common stock, a proportionate amount is allocated to each of the 100 shares of S common stock. Accordingly, \$26 is allocated to the common stock of S that is sold and \$104 is allocated to the common stock of S that is retained. On P's sale of the 20 shares of the common stock of S for \$20, P recognizes a loss of \$6. Because the sale of the 20 shares of common stock of S does not result in the deconsolidation of S, under paragraph (c)(1) of this section, that loss is suspended to the extent of the duplicated loss with respect to the shares sold. The duplicated loss with respect to the shares sold is \$6. Therefore, the entire \$6 loss is suspended.

(iii) *Effect of subsequent asset sale on stock basis.* Of the \$30 loss recognized on the sale of Asset A, \$24 is taken into account in determining the basis adjustments made under § 1.1502-32 to the stock of S owned by P. Accordingly, P's basis in its S stock is reduced by \$24 from \$104 to \$80.

(iv) *Effect of subsequent asset sale on suspended loss.* Because P cannot establish that all or a portion of the loss recognized on the sale of Asset A was not reflected in the calculation of the duplicated loss of S on the date of the Year 3 stock sale and such loss is allocable to the period beginning on the date of the Year 3 disposition of the S stock and ending on the day before the first date on which S is not a member of the P group and is taken into account in determining consolidated taxable income (or loss) of the P group for a taxable year that includes a date on or after the date of the Year 3 disposition and before the first date on which S is not a member of the P group, such asset loss reduces the suspended loss pursuant to paragraph (c)(4) of this section. The amount of such reduction, however, cannot exceed \$6, the excess of the amount of such loss, \$30, over the amount of such loss that is taken into account in determining the basis adjustment made to the stock of S owned by

P, \$24. Therefore, the suspended loss is reduced to zero.

(v) *Effect of subsequent stock sale.* P recognizes \$0 gain/loss on the Year 5 sale of its remaining S common stock. No amount of suspended loss remains to be allowed under paragraph (c)(5) of this section.

Example 4. Nondeconsolidating sale of common stock of lower-tier subsidiary. (i) *Facts.* In Year 1, P forms S1 with a contribution of \$200 in exchange for all of the common stock of S1, which represents all of the outstanding stock of S1. In the same year, S1 forms S2 with a contribution of \$80 in exchange for 80 shares of the common stock of S2, which at that time represents all of the outstanding stock of S2. S1 and S2 become members of the P group. In the same year, S2 purchases Asset A for \$80. In Year 2, S1 contributes Asset B with a basis of \$50 and a value of \$20 in exchange for 20 shares of the common stock of S2 in a transfer to which section 351 applies. In Year 3, S1 sells the 20 shares of the common stock of S2 that it acquired in Year 2 for \$20. Immediately after the Year 3 stock sale, S2 is a member of the P group. At the time of the Year 3 stock sale, the bases and values of Asset A and Asset B are unchanged. In Year 4, S2 sells Asset B for \$45, recognizing a \$5 loss. The P group cannot establish that all or a portion of the \$5 loss was not reflected in the calculation of the duplicated loss of S2 on the date of the Year 3 stock sale. The \$5 loss is used on the P group return to offset income of P. In Year 5, S1 sells its remaining S2 common stock for \$100.

(ii) *Application of basis redetermination and loss suspension rules.* Because S1's basis in the S2 common stock sold exceeds its value immediately prior to the sale and S2 is a member of the P group immediately after the sale, S1's basis in all of the stock of S2 is redetermined pursuant to paragraph (b)(1) of this section. Of S1's total basis of \$130 in the S2 common stock, a proportionate amount is allocated to each of the 100 shares of S2 common stock. Accordingly, a total of \$26 is allocated to the common stock of S2 that is sold and \$104 is allocated to the common stock of S2 that is retained. On S1's sale of the 20 shares of the common stock of S2 for \$20, S1 recognizes a loss of \$6. Because the sale of the 20 shares of common stock of S2 does not result in the deconsolidation of S2, under paragraph (c)(1) of this section, that loss is suspended to the extent of the duplicated loss with respect to the shares sold. The duplicated loss with respect to the shares sold is \$6. Therefore, the entire \$6 loss is suspended. Pursuant to paragraph (c)(3) of this section and § 1.1502-32T(b)(3)(iii)(C), the suspended loss is treated as a noncapital, nondeductible expense incurred by S1 during the tax year that includes the date of the disposition of stock to which paragraph (c)(1) of this section applies. Accordingly, P's basis in its S1 stock is reduced from \$200 to \$194.

(iii) *Effect of subsequent asset sale on stock basis.* Of the \$5 loss recognized on the sale of Asset B, \$4 is taken into account in determining the basis adjustments made under § 1.1502-32 to the stock of S2 owned by S1. Accordingly, S1's basis in its S2 stock is reduced by \$4 from \$104 to \$100 and P's

basis in its S1 stock is reduced by \$4 from \$194 to \$190.

(iv) *Effect of subsequent asset sale on suspended loss.* Because P cannot establish that all or a portion of the loss recognized on the sale of Asset B was not reflected in the calculation of the duplicated loss of S2 on the date of the Year 3 stock sale and such loss is allocable to the period beginning on the date of the Year 3 disposition of the S2 stock and ending on the day before the first date on which S2 is not a member of the P group and is taken into account in determining consolidated taxable income (or loss) of the P group for a taxable year that includes a date on or after the date of the Year 3 disposition and before the first date on which S2 is not a member of the P group, such asset loss reduces the suspended loss pursuant to paragraph (c)(4) of this section. The amount of such reduction, however, cannot exceed \$1, the excess of the amount of such loss, \$5, over the amount of such loss that is taken into account in determining the basis adjustment made to the stock of S2 owned by members of the P group, \$4. Therefore, the suspended loss is reduced to \$5.

(v) *Effect of subsequent stock sale.* In Year 5, when S1 sells its remaining S2 stock for \$100, it recognizes \$0 gain/loss. Pursuant to paragraph (c)(5) of this section, the remaining \$5 of the suspended loss is allowed on the P group's return for Year 5 when S1 sells its remaining S2 stock.

Example 5. Deconsolidating sale of subsidiary member owning stock of another subsidiary member that remains in group. (i) *Facts.* In Year 1, P forms S1 with a contribution of Asset A with a basis of \$50 and a value of \$20 in exchange for 100 shares of common stock of S1 in a transfer to which section 351 applies. Also in Year 1, P and S1 form S2. P contributes \$80 to S2 in exchange for 80 shares of common stock of S2. S1 contributes Asset A to S2 in exchange for 20 shares of common stock of S2 in a transfer to which section 351 applies. In Year 3, in a transaction that is not part of a plan that includes the Year 1 contributions, P sells its 100 shares of S1 common stock for \$20. Immediately after the Year 3 stock sale, S2 is a member of the P group. At the time of the Year 3 stock sale, S1 owns 20 shares of common stock of S2, and S2 has \$80 and Asset A. In Year 4, S2 sells Asset A, the basis and value of which have not changed since its contribution to S2. On the sale of Asset A for \$20, S2 recognizes a \$30 loss. That \$30 loss is used on the P group return to offset income of P. In Year 5, P sells its S2 common stock for \$80.

(ii) *Application of basis redetermination and loss suspension rules.* Pursuant to paragraph (b)(4) of this section, because immediately before P's transfer of S1 stock S1 owns stock of S2 (another subsidiary member of the same group) that has a basis that exceeds its value, paragraph (b) of this section applies as if S1 had transferred its stock of S2. Because S2 is a member of the group immediately after the transfer of the S1 stock, the group member's basis in the S2 stock is redetermined pursuant to paragraph (b)(1) of this section immediately prior to the sale of the S1 stock. Of the group members' total basis of \$130 in the S2 stock, \$26 is