

allocated to S1's 20 shares of S2 common stock and \$104 is allocated to P's 80 shares of S2 common stock. Pursuant to paragraph (b)(5) of this section, the redetermination of S1's basis in the stock of S2 results in an adjustment to P's basis in the stock of S1. In particular, P's basis in the stock of S1 is decreased by \$24 to \$26. On P's sale of its 100 shares of S1 common stock for \$20, P recognizes a loss of \$6. Because S1 is not a member of the P group immediately after P's sale of the S1 stock, paragraph (c)(1) of this section does not apply to suspend such loss. However, because P recognizes a loss with respect to the disposition of the S1 stock and S1 owns stock of S2 (which is a member of the P group immediately after the disposition), paragraph (c)(2) of this section does apply to suspend up to \$6 of that loss, an amount equal to the amount by which the duplicated loss with respect to the stock of S1 sold is attributable to S2's adjusted basis in its assets, loss carryforwards, and deferred deductions.

(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 S2 owned by P. Accordingly, P's basis in its S2 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 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 deemed 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 deemed 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 \$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 S2 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 S2 common stock. No amount of suspended loss remains to be allowed under paragraph (c)(5) of this section.

Example 6. Loss recognized on asset with basis determined by reference to stock basis of subsidiary member. (i) *Facts.* In Year 1, P forms S with a contribution of \$80 in exchange for 80 shares of common stock of S which at that time represents all of the outstanding 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 common stock of S 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 and Year 2 contributions, P contributes the 20 shares of

S common stock it acquired in Year 2 to PS, a partnership, in exchange for a 20 percent capital and profits interest in a transaction described in section 721. Immediately after the contribution to PS, S is a member of the P group. In Year 4, P sells its interest in PS for \$20, recognizing a \$30 loss.

(ii) *Application of basis redetermination rule upon nonrecognition transfer.* Because P's basis in the S common stock contributed to PS exceeds its value immediately prior to the transfer and S is a member of the P group immediately after the transfer, P's basis in all of the S stock is redetermined pursuant to paragraph (b)(1) of this section. Of P's total basis of \$130 in the common stock of S, a proportionate amount is allocated to each share of S common stock. Accordingly, \$26 is allocated to the S common stock that is contributed to PS and, under section 722, P's basis in its interest in PS is \$26.

(iii) *Application of loss suspension rule on disposition of asset with basis determined by reference to stock basis of subsidiary member.* P recognizes a \$6 loss on its disposition of its interest in PS. Because P's basis in its interest in PS was determined by reference to the basis of S stock and at the time of the determination of P's basis in its interest in PS such S stock had a duplicated loss of \$6, and, immediately after the disposition, S is a member of the P group, such loss is suspended to the extent of such duplicated loss. Principles similar to those of paragraphs (c)(3), (c)(4), and (c)(5) of this section shall apply to such suspended loss.

(f) *Worthlessness and certain dispositions not followed by separate return years—(1) General rule.* Notwithstanding any other provision in the regulations under section 1502, if stock of a subsidiary member is treated as worthless under section 165 (taking into account the provisions of § 1.1502-80(c)), or if a member of a group disposes of subsidiary member stock and on the following day the subsidiary is not a member of the group and does not have a separate return year, then all losses treated as attributable to the subsidiary member under the principles of § 1.1502-21(b)(2)(iv), after computing the taxable income of the group, the subsidiary member, or a group of which the subsidiary member was previously a member for the taxable year that includes the determination of worthlessness or the disposition and any prior taxable year, shall be treated as expired, but not as absorbed by the group, as of the beginning of the group's taxable year that follows the taxable year that includes the determination of worthlessness or the disposition.

(2) *Election in the case of determinations of worthlessness and dispositions not followed by a separate return that occurred prior to March 14, 2003.* If stock of a subsidiary member is treated as worthless under section 165 (taking into account the provisions of § 1.1502-80(c)) on or after March 7,

2002, and prior to March 14, 2003, or if a member of a group disposes of subsidiary member stock on or after March 7, 2002, and prior to March 14, 2003 and on the following day the subsidiary is not a member of the group and does not have a separate return year, then, notwithstanding paragraph (f)(1) of this section, the common parent may make an irrevocable election to reattribute to itself all or any portion of the losses treated as attributable to such subsidiary member under the principles of § 1.1502-21(b)(2)(iv). The election shall be in the form of a statement filed with or as part of the group's return for the taxable year in which the worthlessness is established or the disposition occurs. The statement shall be entitled "Election under Section 1.1502-35T(f)(2)" and must state that the common parent is making an irrevocable election under this paragraph (f)(2) to reattribute to itself the losses of the subsidiary member the stock of which is worthless or disposed of. In addition, it must identify the subsidiary to which the election relates and the portion of losses subject to the election. If the election provided in this paragraph is made, the common parent shall be treated as succeeding to the reattributed losses as if the losses were succeeded to in a transaction described in section 381(a). For purposes of applying the provisions of § 1.1502-32, the reattributed losses shall be treated as absorbed by the group immediately prior to the allowance of any loss or inclusion of any income or gain with respect to the determination of worthlessness or the disposition. In the case of an election to reattribute less than all of the losses otherwise treated as attributable to such subsidiary member under the principles of § 1.1502-21(b)(2)(iv), paragraph (f)(1) of this section shall apply to that portion of the losses for which an election under this paragraph (f)(2) is not made.

(g) *Anti-avoidance rules—(1) Transfer of share without a loss in avoidance.* If a share of subsidiary member stock has a basis that does not exceed its value and the share is transferred with a view to avoiding application of the rules of paragraph (b) of this section prior to the transfer of a share of subsidiary member stock that has a basis that does exceed its value or a deconsolidation of a subsidiary member, the rules of paragraph (b) of this section shall apply immediately prior to the transfer of stock that has a basis that does not exceed its value.

(2) *Transfers of loss property in avoidance.* If a member of a consolidated group contributes an asset with a basis that exceeds its value to a