

of a consolidated group on the disposition of stock of a subsidiary member of the same group was allowed and the extent to which the basis of subsidiary member stock was required to be reduced prior to its deconsolidation. Section 1.1502-20 provides that a loss recognized by a group member on the disposition of subsidiary member stock is allowable only to the extent it exceeds the sum of "extraordinary gain dispositions," "positive investment adjustments," and "duplicated loss." In addition, it provides that the basis of subsidiary member stock that is deconsolidated is reduced to its value to the extent of the sum of the same amounts immediately prior to its deconsolidation. The duplicated loss amount equals the sum of the aggregated adjusted basis of the assets of the subsidiary (other than any stock and securities that the subsidiary owns in another member), the losses attributable to the subsidiary that are carried forward to the subsidiary's first taxable year following the disposition or deconsolidation, and any deferred deductions of the subsidiary, over the sum of the value of the subsidiary's stock and its liabilities.

Section 1.1502-32(b)(4) provides that, if a subsidiary has a loss carryover from a separate return limitation year when it becomes a member of a consolidated group, the group may make an election to treat all or any portion of the loss carryover as expiring immediately before the subsidiary becomes a member of the consolidated group. This election allows an acquiring group to prevent the loss of stock basis that otherwise would result if the subsidiary's loss carryovers were to expire before the group could absorb them. See § 1.1502-32(b)(2)(iii). Section 1.1502-32(b)(4) further provides that, if the subsidiary was a member of another group immediately before it became a member of the consolidated group, the losses are treated as expiring immediately after the subsidiary ceases to be a member of the prior group. The election described in § 1.1502-32(b)(4) may be made by identifying either the amount of each loss carryover deemed to expire or the amount of each loss carryover deemed not to expire.

If stock of a subsidiary with loss carryovers is sold by one consolidated group to another and the acquiring group waives all or a portion of the subsidiary's loss carryovers pursuant to § 1.1502-32(b)(4), the selling group can exclude the waived loss carryovers from its computation of duplicated loss. In certain cases, the waiver could have the effect of increasing the amount of stock loss allowed on the disposition of subsidiary stock or reducing the basis

reduction required on the deconsolidation of subsidiary stock. The IRS and Treasury understand that certain waivers of loss carryovers that were made pursuant to § 1.1502-32(b)(4) were made so as to increase the amount of allowed loss on a disposition of subsidiary stock.

In *Rite Aid Corp. v. United States*, 255 F.3d 1357 (Fed. Cir. 2001), the United States Court of Appeals for the Federal Circuit held that the duplicated loss component of § 1.1502-20 was an invalid exercise of regulatory authority. In response to the *Rite Aid* decision, on March 7, 2002, the IRS and Treasury Department filed with the **Federal Register** temporary regulations under sections 337(d) and 1502 governing the determination of a consolidated group's allowable stock loss and basis reduction required on a disposition or deconsolidation of subsidiary member stock. Under the temporary regulations, consolidated groups can compute the allowable loss or the basis reduction required on dispositions and deconsolidations of subsidiary stock before March 7, 2002, and certain dispositions and deconsolidations of subsidiary stock on or after March 7, 2002, by applying § 1.1502-20 in its entirety, by applying the provisions of § 1.1502-20 without regard to the duplicated loss factor of the loss disallowance formula, or by applying the provisions of § 1.337(d)-2T. See § 1.1502-20T(i)(2).

The IRS and Treasury Department believe that in certain cases in which a selling group elects to compute the allowable loss or the basis reduction required on a disposition or deconsolidation of subsidiary member stock by applying § 1.1502-20 without regard to the duplicated loss factor of the loss disallowance formula, or by applying the provisions of § 1.337(d)-2T, it is appropriate to permit an acquiring group to amend certain prior waivers of loss carryovers. The following paragraphs describe these cases and the amendments that this document makes to §§ 1.1502-20T and 1.1502-32T to allow certain amendments to prior waivers of loss carryovers.

Prior Waivers of Loss Carryovers Made To Increase Allowable Loss or Reduce Basis Reduction Required

If a selling group elects to compute the allowable loss or the basis reduction required on a disposition or deconsolidation of subsidiary stock by applying the provisions of § 1.1502-20 without regard to the duplicated loss factor of the loss disallowance formula, or by applying the provisions of

§ 1.337(d)-2T, the acquiring group's prior waiver of loss carryovers of the subsidiary or lower-tier corporation of such subsidiary will have no effect on the selling group's allowable loss or the basis reduction required with respect to the disposed of or deconsolidated subsidiary stock. To the extent, therefore, that an acquiring group made an election to waive loss carryovers to increase the allowable loss or to reduce the basis reduction required with respect to the disposed of or deconsolidated subsidiary stock, the IRS and Treasury Department believe that the acquiring group should be permitted to amend such waivers to decrease, to a limited extent, the amounts of loss carryovers deemed to expire.

Accordingly, the regulations contained in this document provide that, if the acquiring group made an election pursuant to § 1.1502-32(b)(4) to waive a subsidiary's loss carryovers, that election increased the amount of the allowable loss or reduced the basis reduction required with respect to the disposed of or deconsolidated subsidiary stock, and the selling group elects to compute the allowable loss or the basis reduction required with respect to the disposed of or deconsolidated subsidiary stock by applying the provisions of § 1.1502-20 without regard to the duplicated loss factor of the loss disallowance formula, or by applying the provisions of § 1.337(d)-2T, then the acquiring group may reduce the amount of any loss carryover deemed to expire (or increase the amount of any loss carryover deemed not to expire) as a result of the election made pursuant to § 1.1502-32(b)(4). The aggregate amount of loss carryovers that may be treated as not expiring as a result of such an amendment of a waiver of a loss carryover of the subsidiary the stock of which is disposed of or deconsolidated and any lower-tier corporation of such subsidiary, however, may not exceed the duplicated loss with respect to the disposed of or deconsolidated subsidiary stock. This limitation is intended to ensure that all of the loss carryovers that do not expire as a result of the amendment did, in fact, increase the amount of the allowable loss or reduce the basis reduction required with respect to the disposed of or deconsolidated subsidiary stock. In addition, to enable the acquiring group's use of loss carryovers that are not deemed to expire as a result of such an amendment, these regulations permit a selling group to reapportion separate, subgroup, and consolidated section 382 limitations.