

2. The Excess Loss Account Rules

Under § 1.1502–19, an excess loss account attributable to subsidiary stock must be included in income when an indebtedness of that subsidiary is discharged and any part of the amount discharged is not included in gross income and is not treated as tax-exempt income under § 1.1502–32. This rule may require inclusion of an excess loss account in income in an amount that is substantially greater than the amount discharged that is not treated as tax-exempt income.

The IRS and Treasury Department believe that requiring the inclusion of the excess loss account in income only to the extent of the amount discharged that is not treated as tax-exempt income is consistent with the policies underlying section 108 and the consolidated return regulations. Accordingly, these temporary regulations modify the rules of § 1.1502–19 to provide that the excess loss account must be included in income only to the extent that any amount discharged that is excluded from gross income is not treated as tax-exempt income.

3. Rules Governing Apportionment of Net Operating Losses

The temporary regulations also include modifications to the rules of § 1.1502–21 relating to the amount of consolidated net operating losses apportioned to a subsidiary when a consolidated net operating loss is absorbed and when a subsidiary departs from the group. These modifications take into account the reduction of the net operating losses attributable to that member that occurs as a result of discharge of indebtedness.

D. Request for Comments

The IRS and Treasury Department are considering adopting rules under section 1502 (and possibly other Code sections) to address the effect of transitory transactions and other transactions designed to avoid the application of the rules concerning attribute reduction. Comments are requested regarding whether such a rule should be adopted and the appropriate scope of such a rule. Even in the absence of such a rule, such transactions may be challenged under existing law. If the IRS and Treasury Department determine such a rule is necessary to protect the policies underlying section 108 and the consolidated return regulations, the IRS and Treasury Department are prepared to promulgate such a rule with retroactive effect to

discharges of indebtedness that occur after August 29, 2003.

Effective Dates

The temporary regulations related to the application of section 108(b) when a member of a consolidated group realizes discharge of indebtedness income that is excluded from gross income apply to discharges of indebtedness that occur after August 29, 2003. The amendments to the investment adjustment rules apply with respect to determinations of stock basis in consolidated return years the original return for which is due (without extensions) after August 29, 2003. The amendments to the excess loss account rules apply to dispositions of subsidiary stock after August 29, 2003. However, taxpayers may apply the amendments to the investment adjustment rules and the excess loss account rules retroactively. Finally, the amendments to the net operating loss rules apply only to taxable years the original return for which the due date (without extensions) is after August 29, 2003.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. These temporary regulations are necessary to provide taxpayers with immediate guidance regarding the application of section 108 when a member of a consolidated group has discharge of indebtedness income that is excluded from gross income. Current circumstances have made the application of section 108 in the consolidated group context an issue that needs to be addressed at this time. In addition, consolidated groups may be taking positions that are inconsistent with the policies underlying section 108 and the principle enunciated by the Supreme Court in *United Dominion Indus., Inc. v. United States*, 532 U.S. 822 (2001). Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b)(B) and with a delayed effective date pursuant to 5 U.S.C. 553(d)(3). For applicability of the Regulatory Flexibility Act, please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

Various personnel from the IRS and Treasury Department participated in the development of the regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by removing the two entries for § 1.1502–32T and adding the following entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–19T also issued under 26 U.S.C. 1502. * * *

Section 1.1502–28T also issued under 26 U.S.C. 1502. * * *

Section 1.1502–32T also issued under 26 U.S.C. 1502. * * *

■ **Par. 2.** Section 1.1502–19 is amended as follows:

■ 1. Paragraph (b)(1) is revised.

■ 2. The headings for paragraphs (h)(2) and (h)(2)(i) are revised.

■ 3. Paragraph (h)(2)(ii) is redesignated as paragraph (h)(2)(iii).

■ 4. New paragraph (h)(2)(ii) is added.

The revisions and addition read as follows:

§ 1.1502–19 Excess loss accounts.

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(b) * * * (1) [Reserved]. For further guidance, see § 1.1502–19T(b)(1).

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(h) * * *

(2) *Dispositions of stock—(i)*
Dispositions of stock before effective date. * * *

(ii) *Application of special limitation.* [Reserved]. For further guidance, see § 1.1502–19T(h)(2)(ii).

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■ **Par. 3.** Section 1.1502–19T is added to read as follows:

§ 1.1502–19T Excess loss accounts (temporary).

(a) [Reserved]. For further guidance, see § 1.1502–19(a).

(b) *Excess loss account taken into account as income or gain—(1) Operating rules—(i) General rule.* Except as provided in paragraph (b)(1)(ii) of this section, if P is treated under § 1.1502–19 as disposing of a share of S's stock, P takes into account its excess loss account in the share as income or gain from the disposition.

(ii) *Special limitation on amount taken into account.* Notwithstanding