

section, each such member's remaining COD amount shall be applied on a pro rata basis (based on the relative remaining COD amounts), pursuant to paragraph (a)(4) of this section, to reduce such remaining available tax attributes.

(2) *Election under section 108(b)(5).* Any member that realizes excluded COD income may make the election described in section 108(b)(5). The election is made separately for each member. Therefore, an election may be made for one member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section) while another election, or no election, may be made for another member that realizes excluded COD income (either actually or pursuant to paragraph (a)(3) of this section). See § 1.108-4 for rules relating to the procedure for making an election under section 108(b)(5).

(3) *Limitation of section 1017(b)(2).* The limitation of section 1017(b)(2) on the reduction in basis of property shall be applied by reference to the aggregate of the basis of the property held by the member that realizes excluded COD income, not the aggregate of the basis of the property held by all of the members of the group, and the liabilities of such member, not the aggregate liabilities of all of the members of the group.

(c) *Examples.* The principles of paragraphs (a) and (b) of this section are illustrated by the following examples. Unless otherwise indicated, no election under section 108(b)(5) has been made. The examples are as follows:

*Example 1. (i) Facts.* P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 80 percent of the stock of S1 and 100 percent of the stock of S2. In Year 1, the P group sustained a \$250 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$125 was attributable to P and \$125 was attributable to S1. On Day 1 of Year 2, S2 joined the P group. As of the beginning of Year 2, S2 had a \$50 net operating loss carryover from Year 1, a separate return limitation year. In Year 2, the P group sustained a \$200 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$90 was attributable to P, \$70 was attributable to S1, and \$40 was attributable to S2. In Year 3, S2 realized \$200 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S2 had no liabilities. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$40 was attributable to S1 and \$10 was attributable to S2 under the principles of § 1.1502-21T(b)(2)(iv). As of the beginning of Year 4, S2 had Asset A with a basis of \$40 and a fair market value of \$10.

(ii) *Analysis—(A) Reduction of tax attributes attributable to debtor.* Pursuant to

paragraph (a)(2) of this section, the tax attributes attributable to S2 must first be reduced to take into account its excluded COD income in the amount of \$200.

(1) *Reduction of net operating losses.* Pursuant to section 108(b)(2)(A), the net operating loss and the net operating loss carryovers of S2 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S2 under the principles of § 1.1502-21T(b)(2)(iv) are reduced first. Accordingly, the consolidated net operating loss for Year 3 is reduced by \$10, the portion of the consolidated net operating loss attributable to S2, to \$40. Then, again pursuant to section 108(b)(4)(B), S2's net operating loss carryover of \$50 from its separate return limitation year is reduced to \$0. Finally, the consolidated net operating loss carryover from Year 2 is reduced by \$40, the portion of that consolidated net operating loss carryover attributable to S2, to \$160.

(2) *Reduction of basis.* Following the reduction of the net operating loss and the net operating loss carryovers attributable to S2, S2 reduces its basis in its assets pursuant to section 1017 and § 1.1017-1. Accordingly, S2 reduces its basis in Asset A by \$40, from \$40 to \$0.

(B) *Reduction of remaining consolidated tax attributes.* The remaining \$60 of excluded COD income then reduces consolidated tax attributes pursuant to paragraph (a)(4) of this section. In particular, the remaining \$40 consolidated net operating loss for Year 3 is reduced to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$20 from \$250 to \$230. Pursuant to paragraph (a)(4) of this section, a pro rata amount of the consolidated net operating loss carryover from Year 1 that is attributable to each of P and S1 is treated as reduced. Therefore, \$10 of the consolidated net operating loss carryover from Year 1 that is attributable to each of P and S1 is treated as reduced.

*Example 2. (i) Facts.* P is the common parent of a consolidated group that includes subsidiaries S1 and S2. P owns 100 percent of the stock of S1 and S1 owns 100 percent of the stock of S2. None of P, S1, or S2 has a separate return limitation year. In Year 1, the P group sustained a \$50 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$10 was attributable to P, \$20 was attributable to S1, and \$20 was attributable to S2. In Year 2, the P group sustained a \$70 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$30 was attributable to P, \$30 was attributable to S1, and \$10 was attributable to S2. In Year 3, S1 realized \$170 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S1 and S2 had no liabilities. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$10 was attributable to S1 and \$40 was attributable to S2 under the principles of § 1.1502-21T(b)(2)(iv). As of the beginning of Year 4, S1's sole asset was the stock of S2, and S1 had a \$80 basis in the S2 stock. In addition, at the beginning of Year 4, S2 had an asset with a \$0 basis and a \$10 value.

(ii) *Analysis—(A) Reduction of tax attributes attributable to debtor.* Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 must first be reduced to take into account its excluded COD income in the amount of \$170.

(1) *Reduction of net operating losses.* Pursuant to section 108(b)(2)(A), the net operating loss and the net operating loss carryovers of S1 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating loss and the net operating loss carryovers attributable to S1 under the principles of § 1.1502-21T(b)(2)(iv) are reduced first. Accordingly, the consolidated net operating loss for Year 3 is reduced by \$10, the portion of the consolidated net operating loss for Year 3 attributable to S1, to \$40. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$20, the portion of that consolidated net operating loss carryover attributable to S1, to \$30, and the consolidated net operating loss carryover from Year 2 is reduced by \$30, the portion of that consolidated net operating loss carryover attributable to S1, to \$40.

(2) *Reduction of basis.* Following the reduction of the net operating loss and the net operating loss carryovers attributable to S1, S1 reduces its basis in its assets pursuant to section 1017 and § 1.1017-1. Accordingly, S1 reduces its basis in the stock of S2 by \$80, from \$80 to \$0.

(3) *Tiering down of stock basis reduction.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing \$80 of excluded COD income. Accordingly, the consolidated net operating loss for Year 3 is reduced by an additional \$40, the portion of the consolidated net operating loss for Year 3 attributable to S2, to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$20, the portion of that consolidated net operating loss carryover attributable to S2, to \$10. Then, the consolidated net operating loss carryover from Year 2 is reduced by \$10, the portion of that consolidated net operating loss carryover attributable to S2, to \$0. S2's remaining \$10 of excluded COD income does not reduce consolidated tax attributes attributable to P or S1 under paragraph (a)(4) of this section.

(B) *Reduction of remaining consolidated tax attributes.* Finally, pursuant to paragraph (a)(4) of this section, S1's remaining \$30 of excluded COD income reduces the remaining consolidated tax attributes. In particular, the remaining \$10 consolidated net operating loss carryover from Year 1 is reduced by \$10 to \$0, and the remaining \$30 consolidated net operating loss carryover from Year 2 is reduced by \$20 to \$10.

*Example 3. (i) Facts.* P is the common parent of a consolidated group that includes subsidiaries S1, S2, and S3. P owns 100 percent of the stock of S1, S1 owns 100 percent of the stock of S2, and S2 owns 100 percent of the stock of S3. In Year 1, the P group sustained a \$150 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$50 was attributable to S2, and \$100 was attributable to S3. In Year 2, the P group