

sustained a \$50 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$40 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, S2, and S3 had no liabilities. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$10 was attributable to S1, \$20 was attributable to S2, and \$20 was attributable to S3 under the principles of § 1.1502-21T(b)(2)(iv). At the beginning of Year 4, S1's only asset was the stock of S2, with a basis of \$120, and S2's only asset was the stock of S3 with a basis of \$180 and a value of \$10. None of P, S1, or S2 had a separate return limitation year.

(ii) *Analysis—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.

(A) *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. Pursuant to section 108(b)(4)(B), S1's net operating loss for the taxable year of the discharge is 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 S1, to \$40. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 2 is reduced by \$40, the portion of that consolidated net operating loss carryover attributable to S1, to \$10.

(B) *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 \$120, from \$120 to \$0.

(C) *Tiering down of stock basis reduction to S2.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S2 is treated as realizing \$120 of excluded COD income. Pursuant to section 108(b)(2)(A), therefore, the net operating loss and 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. Pursuant to section 108(b)(4)(B), S2's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is further reduced by \$20, the portion of the consolidated net operating loss attributable to S2, to \$20. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 1 is reduced by \$50, the portion of that consolidated net operating loss carryover attributable to S2, to \$100. Then, again pursuant to section 108(b)(4)(B),

the consolidated net operating loss carryover from Year 2 is further reduced by \$10, the portion of that consolidated net operating loss carryover attributable to S2, to \$0. 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 its S3 stock by \$40 to \$140.

(D) *Tiering down of stock basis reduction to S3.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing \$40 of excluded COD income. Pursuant to section 108(b)(2)(A), therefore, the net operating loss and the net operating loss carryovers of S3 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 S3 under the principles of § 1.1502-21T(b)(2)(iv) are reduced. Pursuant to section 108(b)(4)(B), S3's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is further reduced by \$20, the portion of the consolidated net operating loss attributable to S3, to \$0. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 1 is reduced by \$20, the lesser of the portion of that consolidated net operating loss carryover attributable to S3 and the remaining excluded COD income, to \$80.

Example 4. (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 each of S1 and S2. Each of S1 and S2 owns stock of S3 that represents 50 percent of the value of the stock of S3. In Year 1, the P group sustained a \$160 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$10 was attributable to P, \$50 was attributable to S2, and \$100 was attributable to S3. In Year 2, the P group sustained a \$110 consolidated net operating loss. Under the principles of § 1.1502-21T(b)(2)(iv), of that amount, \$40 was attributable to S1 and \$70 was attributable to S2. In Year 3, S1 realized \$200 of excluded COD income from the discharge of non-intercompany indebtedness, and S2 realized \$270 of excluded COD income from the discharge of non-intercompany indebtedness. After the discharge of this indebtedness, S1, S2, and S3 had no liabilities. In that same year, the P group sustained a \$50 consolidated net operating loss, of which \$10 was attributable to S1, \$20 was attributable to S2, and \$20 was attributable to S3 under the principles of § 1.1502-21T(b)(2)(iv). At the beginning of Year 4, S1's basis in its S3 stock was \$60, S2's basis in its S3 stock was \$120, and S3 had one asset with a basis of \$200 and a value of \$10. None of P, S1, S2, or S3 had a separate return limitation year.

(ii) *Analysis—Reduction of tax attributes attributable to debtors.* Pursuant to paragraph (b)(1)(i) of this section, the tax attributes attributable to each of S1 and S2 are reduced pursuant to paragraph (a)(2) of this section, and the tax attributes attributable to S3 are reduced pursuant to paragraph (a)(3) of this section so as to reflect a reduction of S1's and

S2's basis in the stock of S3 prior to the application of paragraph (a)(4) to reduce additional tax attributes. Pursuant to paragraph (a)(2) of this section, the tax attributes attributable to S1 and S2 must be reduced to take into account their excluded COD income.

(A) *Reduction of net operating losses generally.* Pursuant to section 108(b)(2)(A), the net operating losses and the net operating loss carryovers of S1 and S2 are reduced. Pursuant to section 108(b)(4)(B) and paragraph (a) of this section, the net operating losses and the net operating loss carryovers attributable to S1 and S2 under the principles of § 1.1502-21T(b)(2)(iv) are reduced first.

(B) *Reduction of net operating losses attributable to S1.* Pursuant to section 108(b)(4)(B), S1's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is reduced by \$10, the portion of the consolidated net operating loss attributable to S1, to \$40. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 2 is reduced by \$40, the portion of that consolidated net operating loss carryover attributable to S1, to \$70.

(C) *Reduction of net operating losses attributable to S2.* Pursuant to section 108(b)(4)(B), S2's net operating loss for the taxable year of the discharge is reduced. Accordingly, the consolidated net operating loss for Year 3 is further reduced by \$20, the portion of the consolidated net operating loss attributable to S2, to \$20. Then, pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 1 is reduced by \$50, the portion of that consolidated net operating loss carryover attributable to S2, to \$110. Then, again pursuant to section 108(b)(4)(B), the consolidated net operating loss carryover from Year 2 is further reduced by \$70, the portion of that consolidated net operating loss carryover attributable to S2, to \$0.

(D) *Reduction of basis.* Following the reduction of the net operating losses and the net operating loss carryovers attributable to S1 and S2, S1 and S2 must reduce their basis in their assets pursuant to section 1017 and § 1.1017-1. Accordingly, S1 reduces its basis in the stock of S3 by \$60, from \$60 to \$0, and S2 reduces its basis in the stock of S3 by \$120, from \$120 to \$0.

(E) *Tiering down of basis reduction.* Pursuant to paragraph (a)(3) of this section, for purposes of sections 108 and 1017 and this section, S3 is treated as realizing \$180 of excluded COD income. Pursuant to section 108(b)(2)(A), therefore, the net operating loss and the net operating loss carryovers of S3 are reduced, in the order indicated by section 108(b)(4)(B). Pursuant to paragraph (a)(2) of this section the consolidated net operating loss and any consolidated net operating loss carryovers that are attributable to S3 under the principles of § 1.1502-21T(b)(2)(iv) are reduced. Accordingly, the consolidated net operating loss for Year 3 is further reduced by \$20, the portion of the consolidated net operating loss attributable to S3, to \$0. Then, the consolidated net operating loss carryover from Year 1 is reduced by \$100, the portion