trict Supervisor, Interstate Commerce Commission, Bureau of Operations and Compliance, 2022 Federal Office Building, Denver, Colo. 80202.

No. MC 128087 (Sub-No. 1 TA), filed August 29, 1966. Applicant: JOHN N. JOHN III, doing business as JOHN N. JOHN TRUCK LINE, 1020 West Second Street, Crowley, La. 70526. Applicant's representative: Aaron and Aaron, Aaron Building, East Court Circle, Post Office Box 422, Crowley, La. 70526. Authority sought to operate as a *common carrier*, by motor vehicle, over irregular routes, transporting: *Urea*, in bags, from Lake Charles, La., to points in Arkansas, Oklahoma, Mississippi, and Texas, with *refused shipments* to be returned to original point or as directed by shipper, for 180 days. Supporting shipper: Agricultural Division, Olin Mathieson Chemical Corp., Post Office Box 991, Little Rock, Ark. Send protests to: W. R. Atkins, District Supervisor, Interstate Commerce Commission, Bureau of Operations and Compliance, T-4009 Federal Office Building, 701 Loyola Avenue, New Orleans, La. 70113.

No. MC 128542 (Sub-No. 1 TA), filed August 29, 1966. Applicant: GARRY BREM, doing business as BREM'S TRUCKING, 11 Fernwood Lane, Gilroy, Calif. 95020. Applicant's representative: Marvin Handler, 405 Montgomery Street, San Francisco, Calif. 94104. Authority sought to operate as a *common carrier*, by motor vehicle, over irregular routes, transporting: *Ore-bearing rock*, from a mine just east of the southeast corner of Yosemite National Park and approximately 10 miles west of the Devils Postpile National Monument (in California) to the smelter of American Smelting & Refining Co. in Hayden, Ariz., for 150 days. Supporting shipper: Mark Mines, Inc., 147 North Church, Gilroy, Calif. Send protests to: William R. Murdoch, District Supervisor, Bureau of Operations and Compliance, Interstate Commerce Commission, 450 Golden Gate Avenue, Box 36004, San Francisco, Calif. 94102.

No. MC 128550 TA, filed August 26, 1966. Applicant: FRANK H. LOCHNER, doing business as LOCHNER'S MOVING & STORAGE, 807 Eighth Avenue SC., Austin, Minn. 55912. Applicant's representative: Gary E. Leonard, 218 First National Bank Building, Austin, Minn. 55912. Authority sought to operate as a *contract carrier*, by motor vehicle, over irregular routes, transporting: *Such commodities as are dealt in by retail department stores and mail order houses*, from between sites of retail store and warehouse of Sears, Roebuck & Co., at Austin, Minn., and points in Chickasaw, Cerro Gordo, Floyd, Hancock, Howard, Mitchell, Winnebago, and Worth Counties, Iowa, under a continuing contractual arrangement with Sears, Roebuck & Co., including *return unsatisfactory merchandise* to store from residence in above-listed counties, for 180 days. Supporting shipper: Sears, Roebuck & Co., Midwestern Territory Executive Offices, 8 East Congress Parkway, Chicago, Ill. Send protests to: C. H. Bergguist, District Supervisor, Bureau of Operations and Compliance, Interstate Commerce Commission, 448 Federal Building and U.S. Courthouse, 110 South Fourth Street, Minneapolis, Minn. 55401.

No. MC 128551 TA, filed August 29, 1966. Applicant: JAMES J. KENNEDY, JR., doing business as KENNEDY VAN & STORAGE, 3359 Army Street, San Francisco, Calif. Applicant's representative: Alan F. Wohlstetter, 1 Farragut Square, Washington, D.C. 20006. Authority sough to operate as a *common carrier*, by motor vehicle, over irregular routes, transporting: *Household goods*, as defined by the Commission, between points in San Francisco, Marin, Contra Costa, Alameda, and San Mateo Counties, Calif., restricted to shipments having prior or subsequent movement between said points in containers, and further restricted to pickup and delivery services incidental to and in connection with packing, crating, and containerization, or unpacking, uncrating, and decontainerization of such shipments, for 180 days. Supporting shipper: Sunpak International, 1621 Queen Ann Avenue North, Seattle, Wash. 98109. Send protests to: District Supervisor, William R. Murdoch, Interstate Commerce Commission, Bureau of Operations and Compliance, 450 Golden Gate Avenue, Box 36004, San Francisco, Calif. 94102.

No. MC 128552 TA, filed August 29, 1966. Applicant: SPACE, INC., South Industry Road Cidco Park, Box 982, Cocoa, Fla. Authority sought to operate as a *contract carrier*, by motor vehicle, over irregular routes, transporting: *Telephone equipment, material, and supplies* from Cocoa, Fla., to points in Brevard County, Fla., for 180 days. Supporting shipper: Western Electric Co., Inc., 3300 Lexington Road, Winston-Salem, N.C. Send protests to: George H. Fauss, Jr., District Supervisor, Bureau of Operations and Compliance, Interstate Commerce Commission, 428 Post Office Building, Post Office Box 4969, Jacksonville, Fla. 32201.

MOTOR CARRIERS OF PASSENGERS

No. MC 105154 (Sub-No. 7 TA), filed August 29, 1966. Applicant: ROBERT G. WRIGHT, doing business as STAR VALLEY-JACKSON STAGES, 1945 Eagle Drive, Idaho Falls, Idaho 83401. Applicant's representative: Donald M. Olsen, 485 E Street, Idaho Falls, Idaho 83401. Authority sought to operate as a *common carrier*, by motor vehicle, over regular routes, transporting: *Passengers and their baggage and express and newspapers* in the same vehicle with passengers, between Alpine, Wyo., and Teton Village, Wyo., from Alpine over U.S. Highway 89 to Jackson, Wyo., thence over Wyoming Highway 22 to the junction of Wyoming secondary Highway 2001, thence over Wyoming secondary Highway 2001 to junction unnumbered highway, thence over unnumbered highway for approximately three tenths of a mile to Teton Village, and return over the same route, serving all intermediate points. (Applicant presently holds authority to operate between Idaho Falls, Idaho, and Afton, Wyo., with no seasonal restrictions, and between Alpine and Jackson, Wyo., in seasonal operations extending from May 15 to September 15 of each year. Applicant proposes to tack requested authority with his present authority, and also proposes to conduct operations with no seasonal restrictions.) Supporting shippers: Jackson Hole Ski Corp., Teton Village, Jackson Hole, Wyo., Livingston Motor Co., Jackson, Wyo., Town of Jackson, Jackson, Wyo., Chamber of Commerce of the City of Idaho Falls, Idaho Falls, Idaho, Simpson's, Inc., Post Office Box 340, Idaho Falls, Idaho, Mendenhall's, 360 E Street, Idaho Falls, Idaho, Ideal Hardwear, 760 Broadway, Idaho Falls, Idaho. Send protests to: Clyde W. Campbell, District Supervisor, Bureau of Operations and Compliance, Interstate Commerce Commission, 203 Eastman Building, Boise, Idaho 83702.

No. MC 128553 TA, filed August 30, 1966. Applicant: TRANSPORTES FRONTERIZOS DEL NORTE, S.A., Emilio Carranza, 727 Sur, Despacho 205 Monterey, N.L., Mexico. Applicant's representative: Jose Gonzalez R. (same address as above). Authority sought to operate as a *common carrier*, by motor vehicle, over regular routes, transporting: *Passengers, their baggage, express and newspapers*, from the port of entry on the international boundary line between the United States and Mexico at Rio Grande City, Tex., to Rio Grande City, Tex., and return, over U.S. Highway 83 and city streets serving all intermediate points, for 180 days. Supporting shipper: First State Bank & Trust Co., Rio Grande City, Tex.; Galindo Implement Co., Rio Grande City, Tex., Starr Grocery Co., Rio Grande City, Tex., Hotel Ringgold, Rio Grande City, Tex., C. R. Anthony Co., Rio Grande City, Tex., Laredo Furniture Distributors, Rio Grande City, Tex., City Auto Parts, Rio Grande City, Tex., Botica Nueva, C. Miguel Aleman, Tamps., Mex., Madereria Camargo, Cd. Camargo, Tamps., Mex., Madereria Chapa, Cuidad Camargo, Tamps., Mex. Send protests to: James H. Berry, District Supervisor, Bureau of Operations and Compliance, Interstate Commerce Commission, 206 Manion Building, 301 Broadway, San Antonio, Tex. 78205.

By the Commission.

[SEAL] H. NEIL GARSON, *Secretary.*

[F.R. Doc. 66-9852; Filed, Sept. 7, 1966; 8:52 a.m.]

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[Notice 1408]

## MOTOR CARRIER TRANSFER PROCEEDINGS

SEPTEMBER 2, 1966.

Synopses of orders entered pursuant to section 212(b) of the Interstate Comcial rules of practice any interestd perscribed thereunder (49 CFR Part 179), appear below:

As provided in the Commission's special rules of practive any interested person may file a petition seeking reconsideration of the following numbered proceedings within 20 days from the date of publication of this notice. Pursuant to section 17(8) of the Interstate Com-

merce Act, the filing of such a petition will postpone the effective date of the order in that proceeding pending its disposition. The matters relied upon by petitioners must be specified in their petitions with particularity.

No. MC–FC–68727. By order of August 31, 1966, the Transfer Board, on reconsideration, approved the transfer to Laurel Transport Corp., Rio Grande, N.J., of certificate No. MC–15102 (Sub-No. 1), issued March 2, 1942, to Eldredge Storage, a corporation, Atlantic City, N.J., authorizing the transportation of: General commodities, with usual exceptions, over irregular routes, between Atlantic City, Linwood, Somers Point, Sea Isle City, Strathmere, Ventnor, Margate and Longport, N.J. Morris J. Winokur, 1920 Two Penn Center Plaza, Philadelphia, Pa. 19120, attorney for applicants.

No. MC–FC–68918. By order of August 31, 1966, the Transfer Board approved the transfer to Kato Express, Inc., Elizabethtown, Ky., of the certificates in Nos. MC–108329 and MC–108329 (Sub-No. 8), issued November 25, 1964, and June 8, 1965, respectively, to Kato, Inc., Elizabethtown, Ky., authorizing the transportation of: Motion picture films, projector equipment and supplies, and advertising matter, between Indianapolis, Ind., on the one hand, and, on the other, points as specified in Kentucky; magazines and periodicals, from Indianapolis, Ind., and Cincinnati, Ohio, to Bowling Green, Lexington, and Paducah, Ky.; and general commodities, excluding household goods, commodities in bulk, and other specified commodities, between Louisville, Ky., on the one hand, and, on the other, points in Hardin, Larue, and Hart Counties, Ky., as restricted. Rudy Yessin, Post Office Box 457, Frankfort, Ky., attorney for applicants.

No. MC–FC–68936. By order of August 31, 1966, the Transfer Board approved the transfer to Wyeth A. Bond, doing business as Advance Transportation Co., Clinton, Mo., of the certificate of registration in No. MC–121305 (Sub-No. 1), issued April 22, 1965, to Paul M. Eaton, doing business as Advance Transportation Co., Clinton, Mo., and corresponding in scope to the grant of authority in certificate of public convenience and necessity No. T–20,891, dated January 24, 1962, as amended July 31, 1962, issued by the Missouri Public Service Commission. Thomas P. Rose, Jefferson Building, Jefferson City, Mo. 65101, attorney for applicants.

No. MC–FC–68967. By order of August 31, 1966, the Transfer Board approved the transfer to Leonard L. Madsen, Council Bluffs, Iowa, of certificate No. MC–42194, issued March 29, 1955, to Edmund V. Liske and Bessie Liske, a partnership, doing business as Kroeger Transfer, Minden, Iowa, authorizing the transportation of: General commodities, excluding household goods, commodities in bulk, and other specified commodities, between Minden, Iowa, and Omaha, Nebr., serving the intermediate points of Neola, Underwood, and Weston, Iowa. R. A. Porter, 201 First National Bank Building, Council Bluffs, Iowa 51501. attorney for applicants.

No. MC–FC–68994. By order of August 31, 1966, the Transfer Board approved the transfer to Feed Transporters, Inc., Oshkosh, Wis., of the operating rights in permit No. MC–126056, issued October 15, 1964, to C. Richard Trine, Pittsford, Mich., and authorizing the transportation of: Animal and poultry feed, over irregular routes, from Burlington, Wis., to points in the Lower Peninsula of Michigan; also, commodities used in the manufacture of animal and poultry feed, insecticides, and poultry, and livestock remedies, from points in the Lower Peninsula of Michigan to Burlington, Wis. Edward Solie, 4513 Vernon Boulevard, Madison, Wis., attorney for applicants.

No. MC–FC–69027. By order of August 31, 1966, the Transfer Board approved the transfer to Edward L. Trasferini, doing business as Rich's Express, Malaga, N.J., of that portion of certificate No. MC–2263, issued June 10, 1965, to Laurel Transport Corp., Rio Grande, N.J., authorizing the transportation of: General commodities, with usual exceptions, over irregular routes, between Philadelphia, Pa., on the one hand, and, on the other, points in Cumberland, Gloucester, and Salem Counties, N.J. Morris J. Winokur, 1920 Two Penn Center Plaza, Philadelphia, Pa. 19120, and H. Charles Ephraim, 1411 K Street NW., Washington, D.C. 20005, attorneys for applicants.

No. MC–FC–69028. By order of August 31, 1966, the Transfer Board approved the transfer to Laurel Transport Corp., Rio Grande, N.J., of certificate No. MC–87661, issued October 19, 1949, to Edward L. Trasferini, doing business as Rich's Express, Malaga, N.J., authorizing the transportation of: General commodities, except dangerous explosives, articles of unusual dimensions, bulk commodities, and commodities contaminating to other lading, over irregular routes, between points and places in the Philadelphia, Pa., commercial zone, as defined in 17 M.C.C. 533, on the one hand, and, on the other, Vineland, Millville, Minotola, Landisville, Newfield, Clayton, Glassboro, Malaga, Woodbury, Runnemede, Bridgeton, Pitman, Iona, and Franklinville, N.J. Morris J. Winokur, 1920 Two Penn Center Plaza, Philadelphia, Pa. 19120, and H. Charles Ephraim, 1411 K Street NW., Washington, D.C. 20005, attorney for applicants.

[SEAL] H. NEIL GARSON,
*Secretary.*

[F.R. Doc. 66–9853; Filed, Sept. 7, 1966; 8:52 a.m.]

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[Notice 1408–A]

## MOTOR CARRIER TRANSFER PROCEEDINGS

SEPTEMBER 2, 1966.

Application filed for temporary authority under section 210(a)(b) in connection with transfer application under section 212(b) and transfer rules (49 CFR Part 179):

No. MC–FC–69050. (Correction) In FEDERAL REGISTER notice of September 1, 1966, on page 11585, the *MC–FC–No. 69058* was erroneously given, and in lieu of that number, *MC–FC–69050* should be shown as correct for CARDINAL AIR SERVICE CORPORATION, seeking temporary authority to lease the operating rights of ESTATE OF CLIFFORD EARL FARNSWORTH, DECEASED, JANE ELIZABETH DEYOUNG FARNSWORTH, EXECUTRIX, doing business as FARNSWORTH'S AIR FREIGHT SERVICE.

[SEAL] H. NEIL GARSON,
*Secretary.*

[F.R. Doc. 66–9854; Filed, Sept. 7, 1966; 8:52 a.m.]

# CUMULATIVE LIST OF PARTS AFFECTED—SEPTEMBER

**The following numerical guide is a list of the parts of each title of the Code of Federal Regulations affected by documents published to date during September.**

## 3 CFR

Page

PROCLAMATIONS:
Nov. 5, 1906 (revoked in part by PLO 4083) 11755
33 (revoked in part by PLO 4083) 11755
1066 (revoked in part by PLO 4083) 11755
3739 11639
3740 11705
3741 11707

EXECUTIVE ORDER:
April 17, 1926 (revoked in part by PLO 4077) 11547
6143 (revoked in part by PLO 4077) 11547
6276 (revoked in part by PLO 4077) 11547
6583 (revoked in part by PLO 4077) 11547
7373 (revoked by PLO 4079) 11547
11142 (superseded by EO 11302) 11741
11301 11709
11302 11741

## 5 CFR

213 11545, 11651
511 11545
534 11545, 11651

## 7 CFR

51 11546
52 11591
68 11653
215 11743
701 11591
724 11655
811 11711
831 11591
908 11656, 11743
910 11656
924 11657
926 11657
927 11657
931 11657
946 11743
948 11658, 11712, 11743
981 11744
1446 11592

PROPOSED RULES:
55 11666
110 11614
112 11614
113 11614
905 11553
932 11758
1013 11669

## 8 CFR

103 11713
212 11714
213 11714
214 11714, 11744

## 8 CFR—Continued

Page

221 11714
243 11744
299 11714

## 9 CFR

131 11607

PROPOSED RULES:
324 11614
325 11614

## 12 CFR

1 11641

## 13 CFR

121 11651

## 14 CFR

39 11593, 11641, 11714, 11715
71 11546, 11594, 11595, 11715–11717, 11743
75 11745
91 11641
95 11745
97 11596
151 11605, 11747

PROPOSED RULES:
39 11615
71 11615, 11616, 11724, 11725, 11759–11761
75 11725
121 11725

## 16 CFR

13 11719, 11747, 11750–11754
15 11607

## 19 CFR

10 11593

## 21 CFR

19 11717
29 11754
120 11754
121 11608–11610, 11718
166 11754
191 11719

## 22 CFR

42 11755

## 26 CFR

1 11794

PROPOSED RULES:
1 11845, 11850

## 28 CFR

Page

0 11720

## 29 CFR

800 11720

## 32 CFR

579 11642
1455 11651

## 32A CFR

NSA (Ch. XVIII):
AGE–4 11651

## 33 CFR

80 11722
95 11722

## 43 CFR

2230 11546
3320 11548

PUBLIC LAND ORDERS:
156 (revoked by PLO 4079) 11547
750 (revoked in part by PLO 4076) 11546
4019 (corrected by PLO 4081) 11755
4076 11546
4077 11547
4078 11547
4079 11547
4080 11755
4081 11755
4082 11755
4083 11755

## 46 CFR

222 11607
510 11652

PROPOSED RULES:
10 11665
11 11665
12 11665
531 11616

## 47 CFR

0 11755
74 11720

PROPOSED RULES:
73 11761
91 11726

## 49 CFR

71–79 11756
77 11549
101 11550

## 50 CFR

10 11658
32 11551, 11552, 11610–11612, 11662, 11663, 11721, 11722, 11756, 11757.

# FEDERAL REGISTER

VOLUME 31 • NUMBER 174

Thursday, September 8, 1966 • Washington, D.C.

PART II

Department of the Treasury
Internal Revenue Service



## Consolidated Return Regulations

# Rules and Regulations

## Title 26—INTERNAL REVENUE

### Chapter I—Internal Revenue Service, Department of the Treasury

SUBCHAPTER A—INCOME TAX

[T.D. 6894]

### PART 1—INCOME TAX; TAXABLE YEAR BEGINNING AFTER DECEMBER 31, 1953

### Consolidated Return Regulations

On October 1, 1965, notice of proposed rule making with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) under Subchapter A of Chapter 6 of the Internal Revenue Code of 1954 (relating to consolidated returns), was published in the FEDERAL REGISTER (30 F.R. 190). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, §§ 1.1502–14, 1.1502–19, 1.1502–25, 1.1502–31, 1.1502–32, and 1.1502–33 are hereby withdrawn and the remainder of the amendment as proposed is hereby adopted, subject to the changes set forth below:

PARAGRAPH 1. That part of the table of contents, as set forth in the notice of proposed rule making, which precedes "Regulations Applicable to Taxable Years Prior to January 1, 1966" is revised.

PAR. 2. Section 1.1502–1 is revised.

PAR. 3. Section 1.1502–2 is revised.

PAR. 4. Section 1.1502–3 is changed by revising the title, paragraph (a)(2), the title of paragraph (c), paragraph (c)(2)(i) and (ii), example (2) of paragraph (d), paragraph (e)(2), the title of paragraph (f)(2), and example (1) of paragraph (f)(3).

PAR. 5. Section 1.1502–4 is changed by revising the title, that part of paragraph (d)(1) which precedes (i), paragraph (e)(1), and the title of paragraph (f).

PAR. 6. Section 1.1502–5 is changed by revising paragraph (a), that part of paragraph (b)(1) which precedes (i), and example (1) of paragraph (c).

PAR. 7. Section 1.1502–12 is changed by revising paragraph (a) and by adding paragraph (o).

PAR. 8. Section 1.1502–13 is changed by revising paragraph (a)(1)(ii), paragraph (a)(2)(iii), paragraph (b)(1), paragraph (c)(1)(i), paragraph (c)(1)(ii)(*b*), and paragraph (c)(3), (4), (5), and (6), by deleting paragraph (d)(3) and (4), by adding a new paragraph (d)(3), by revising paragraph (e)(1) and (3) and paragraph (f), and by revising example (2), example (3), example (6)(i), example (7)(i), example (11)(i), and example (18)(i) of paragraph (h), by reserving paragraph (i) and by adding paragraph (j).

PAR. 9. Section 1.1502–14 is reserved.

PAR. 10. Section 1.1502–15 is revised.

PAR. 11. Section 1.1502–17 is changed by revising paragraph (a).

PAR. 12. Section 1.1502–18 is changed by revising paragraphs (a), (b), and (c), by revising examples (1), (2), (3), and (4) of paragraph (d), by revising paragraph (e)(2), and paragraph (f)(1), (2), and (3), and by adding paragraph (f)(5).

PAR. 13. Section 1.1502–19 is reserved.

PAR. 14. Section 1.1502–21 is changed by revising the title of paragraph (c), by revising paragraph (d)(3), and by revising paragraph (e)(1)(i).

PAR. 15. Section 1.1502–22 is changed by revising paragraph (a)(3), by deleting paragraph (a)(4), and by revising the title to paragraph (c).

PAR. 16. Section 1.1502–24 is changed by revising paragraph (c).

PAR. 17. Sections 1.1502–25, 1.1502–31, 1.1502–32, and 1.1502–33 are reserved.

PAR. 18. Section 1.1502–34 is revised.

PAR. 19. Section 1.1502–36 is redesignated as § 1.1502–41, and the designation of reserved sections is revised accordingly.

PAR. 20. Section 1.1502–75 is changed by revising paragraph (a), the title of paragraph (b), paragraph (c)(1)(i), paragraph (c)(1)(iii) (*a*), (*b*), and (*c*), paragraph (c)(3), by deleting paragraph (d)(2)(iii), by adding a new subparagraph (3) to paragraph (d), and by revising paragraph (g)(2)(i) and paragraph (h)(2).

PAR. 21. Section 1.1502–76 is changed by revising paragraph (a)(1), paragraph (b), examples (2) and (3) of paragraph (b)(3), paragraph (b)(4)(ii), paragraph (c)(2), and example (1) of paragraph (c)(3).

PAR. 22. Section 1.1502–77 is changed by revising paragraphs (c) and (d).

PAR. 23. Section 1.1502–79 is changed by revising paragraph (a), the title of paragraph (c), paragraph (c)(1), and the title of paragraph (c)(2).

PAR. 24. Section 1.1502–80 is revised.

PAR. 25. Section 1.1502–31A is changed by revising paragraph (b)(3)(i) and by revising paragraph (b)(21) (i) and (ii).

[SEAL] HAROLD T. SWARTZ,
*Acting Commissioner of Internal Revenue.*

Approved: September 2, 1966.

STANLEY S. SURREY,
*Assistant Secretary of the Treasury.*

The Income Tax Regulations (26 CFR Part 1) under subchapter A of chapter 6 of the Internal Revenue Code of 1954, relating to consolidated returns, are amended by revising the regulations under section 1502 to read as follows:

CONSOLIDATED RETURN REGULATIONS


Sec.
1.1502 Statutory provisions; regulations.
1.1502–0 Effective date.
1.1502–1 Definitions.

CONSOLIDATED TAX LIABILITY

1.1502–2 Computation of tax liability.
1.1502–3 Consolidated investment credit.
1.1502–4 Consolidated foreign tax credit.
1.1502–5 Estimated tax.
1.1502–6 Liability for tax.
1.1502–7 to 1.1502–10 [Reserved]

(COMPUTATION OF CONSOLIDATED TAXABLE INCOME)

1.1502–11 Consolidated taxable income.

COMPUTATION OF SEPARATE TAXABLE INCOME

1.1502–12 Separate taxable income.
1.1502–13 Intercompany transactions.
1.1502–14 [Reserved]
1.1502–15 Limitation on certain deductions.
1.1502–16 Mine exploration expenditures.
1.1502–17 Methods of accounting.
1.1502–18 Inventory adjustment.
1.1502–19 to 1.1502–20 [Reserved]

COMPUTATION OF CONSOLIDATED ITEMS

1.1502–21 Consolidated net operating loss deduction.
1.1502–22 Consolidated net capital gain or loss.
1.1502–23 Consolidated section 1231 net gain or loss.
1.1502–24 Consolidated charitable contributions deduction.
1.1502–25 [Reserved]
1.1502–26 Consolidated dividends received deduction.
1.1502–27 Consolidated section 247 deduction.
1.1502–28 to 1.1502–30 [Reserved]

BASIS, STOCK OWNERSHIP, AND EARNINGS AND PROFITS RULES

1.1502–31 to 1.1502–33 [Reserved]
1.1502–34 Special aggregate stock ownership rules.
1.1502–35 to 1.1502–40 [Reserved]

SPECIAL TAXES AND TAXPAYERS

1.1502–41 Determination of consolidated net long-term capital gain and consolidated net short-term capital loss.
1.1502–42 to 1.1502–74 [Reserved]

ADMINISTRATIVE PROVSIONS AND OTHER RULES

1.1502–75 Filing of consolidated returns.
1.1502–76 Taxable year of members of group.
1.1502–77 Common parent agent for subsidiaries.
1.1502–78 Tentative carryback adjustment.
1.1502–79 Separate return years.
1.1502–80 Applicability of other provisions of law.

REGULATIONS APPLICABLE TO TAXABLE YEARS PRIOR TO JANUARY 1, 1966

1.1502–0A Introductory.
1.1502–1A Privilege of making consolidated returns.
1.1502–2A Definitions.
1.1502–3A Applicability of other provisions of law.

Sec.
1.1502–4A to 1.1502–9A [Reserved]
1.1502–10A Exercise of privilege.
1.1502–11A Consolidated returns for subsequent years.
1.1502–12A Making consolidated return and filing other forms.
1.1502–13A Change in affiliated group during taxable year.
1.1502–14A Accounting period of an affiliated group.
1.1502–15A Liability for tax.
1.1502–16A Common parent corporation agent for subsidiaries.
1.1502–17A Waivers.
1.1502–18A Failure to comply with regulations.
1.1502–19A Tentative carryback adjustments.
1.1502–20A to 1.1502–29A [Reserved]
1.1502–30A Computation of tax.
1.1502–31A Basis of tax computation.
1.1502–32A Method of computation of income for period of less than 12 months.
1.1502–33A Gain or loss from sale of stock, or bonds or other obligations.
1.1502–34A Sale of stock; basis for determining gain or loss.
1.1502–35A Sale of bonds or other obligations; basis for determining gain or loss.
1.1502–36A Limitation on allowable losses on sale of stock, or bonds, or other obligations.
1.1502–37A Liquidations; recognition of gain or loss.
1.1502–38A Basis of property.
1.1502–39A Inventories.
1.1502–40A Bad debts.
1.1502–41A Sale and retirement by corporation of its bonds.
1.1502–42A Capital loss limitations and carryover.
1.1502–43A Credit for foreign taxes.
1.1502–44A Methods of accounting.
1.1502–45A Mine exploration expenditures.
1.1502–46A Depreciation.
1.1502–47A Election to deduct accrued taxes.
1.1502–48A Liability for tax under section 531.
1.1502–49A Additions to tax for failure to pay estimated tax.
1.1502–50A Gain on sale of bonds and other evidences of indebtedness.
1.1502–51A Credit for investment in certain depreciable property.

## § 1.1502 Statutory provisions; regulations.

SEC. 1502. *Regulations.* The Secretary or his delegate shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

## § 1.1502–0 Effective date.

(a) The provisions of §§ 1.1502–1 through 1.1502–80 shall be applicable to taxable years beginning after December 31, 1965.

(b) The provisions of §§ 1.1502–0A through 1.1502–51A shall be applicable to taxable years beginning before January 1, 1966.

## § 1.1502–1 Definitions.

(a) *Group.* The term "group" means an affiliated group of corporations as defined in section 1504. See § 1.1502–75 (d) as to when a group remains in existence.

(b) *Member.* The term "member" means a corporation (including the common parent) which is included within such group.

(c) *Subsidiary.* The term "subsidiary" means a corporation other than the common parent which is a member of such group.

(d) *Consolidated return year.* The term "consolidated return year" means a taxable year for which a consolidated return is filed or required to be filed by such group.

(e) *Separate return year.* The term "separate return year" means a taxable year of a corporation for which it files a separate return or for which it joins in the filing of a consolidated return by another group.

(f) *Separate return limitation year*—(1) *In general.* Except as provided in subparagraphs (2) and (3) of this paragraph, the term "separate return limitation year" means any separate return year of a member or of a predecessor of such member. The term "predecessor" means a transferor or distributor of assets to a member in a transaction to which section 381(a) applies.

(2) *Exceptions.* The term "separate return limitation year" shall not include—

(i) A separate return year of the corporation which is the common parent for the consolidated return year to which the tax attribute is to be carried,

(ii) A separate return year of any subsidiary which was a member of the group for each day of such year, or

(iii) A separate return year of a predecessor of any member if such predecessor was a member of the group for each day of such year,

provided that an election under section 1562 (relating to privilege to elect multiple surtax exemptions) was not effective for such year. An election under section 1562 which is effective for a taxable year beginning in 1963 and ending in 1964 shall be disregarded.

(3) *Reverse acquisitions.* In the event of an acquisition to which § 1.1502–75(d)(3) applies, all taxable years of the first corporation and of each of its subsidiaries ending on or before the date of the acquisition shall be treated as separate return limitation years, and the separate return years (if any) of the second corporation and each of its subsidiaries shall not be treated as separate return limitation years (unless they were so treated immediately before the acquisition). For example, if corporation P merges into corporation T, and the persons who were stockholders of P immediately before the merger, as a result of owning the stock of P, own more than 50 percent of the fair market value of the outstanding stock of T, then a loss incurred before the merger by T (even though it is the common parent), or by a subsidiary of T, is treated as having been incurred in a separate return limitation year. Conversely, a loss incurred before the merger by P, or by a subsidiary of P in a separate return year during all of which such subsidiary was a member of the group of which P was the common parent and for which section 1562 was not effective, is treated as having been incurred in a year which is not a separate return limitation year.

(g) *Consolidated return change of ownership*—(1) *In general.* A consolidated return change of ownership occurs during any taxable year (referred to in this subparagraph as the "year of change") of the corporation which is the common parent for the taxable year to which the tax attribute is to be carried, if, at the end of the year of change—

(i) Any one or more of the persons described in section 382(a)(2) own a percentage of the fair market value of the outstanding stock of such corporation which is more than 50 percentage points greater than such person or persons owned at—

(*a*) The beginning of such taxable year, or

(*b*) The beginning of the preceding taxable year, and

(ii) The increase in percentage points at the end of such year is attributable to—

(*a*) A purchase (within the meaning of section 382(a)(4)) by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

(*b*) A decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corporation, except a decrease resulting from a redemption to pay death taxes to which section 303 applies.

For purposes of subdivision (i) (*a*) and (*b*) of this subparagraph, the beginning of the taxable years specified therein shall be the beginning of such taxable years or October 1, 1965, whichever occurs later.

(2) *Operating rules.* For purposes of this paragraph—

(i) The term "stock" means all shares except nonvoting stock which is limited and preferred as to dividends, and

(ii) Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that section 318(a)(2)(C) and (3)(C) shall be applied without regard to the 50-percent limitation contained therein.

(3) *Old members.* The term "old members" of a group means—

(i) Those corporations which were members of such group immediately preceding the first day of the taxable year in which the consolidated return change of ownership occurs, or

(ii) If the group was not in existence prior to the taxable year in which the consolidated return change of ownership occurs, the corporation which is the common parent for the taxable year to which the tax attribute is to be carried.

(4) *Reverse acquisitions.* If there has been a consolidated return change of ownership of a corporation under sub-

paragraph (1) of this paragraph and the stock or assets of such corporation are subsequently acquired by another corporation in an acquisition to which § 1.1502–75(d)(3) applies so that the group of which the former corporation is the common parent is treated as continuing in existence, then the "old members", as defined in subparagraph (3) of this paragraph, of such group immediately before the acquisition shall continue to be treated as "old members" immediately after the acquisition. For example, assume that corporations P and S comprise group PS, and PS undergoes a consolidated return change of ownership. Subsequently, the stock of P, the common parent, is acquired by corporation T, the common parent of group TU, in an acquisition to which section 368(a)(1)(B) and § 1.1502–75(d)(3) apply. The PS group is treated as continuing in existence with T as the common parent. P and S continue to be treated as old members, as defined in subparagraph (3) of this paragraph.

CONSOLIDATED TAX LIABILITY

**§ 1.1502–2 Computation of tax liability.**

The tax liability of a group for a consolidated return year shall be determined by adding together—

(a) The tax imposed by section 11 on the consolidated taxable income for such year (see § 1.1502–11 for the computation of consolidated taxable income);

(b) The tax imposed by section 541 on the consolidated undistributed personal holding company income;

(c) If paragraph (b) of this section does not apply, the aggregate of the taxes imposed by section 541 on the separate undistributed personal holding company income of the members which are personal holding companies;

(d) If paragraph (b) of this section does not apply, the tax imposed by section 531 on the consolidated accumulated taxable income;

(e) The tax imposed by section 594(a) in lieu of the taxes imposed by section 11 or 1201 on the taxable income of a life insurance department of the common parent of a group which is a mutual savings bank;

(f) The tax imposed by section 802(a) on consolidated life insurance company taxable income;

(g) The tax imposed by section 831(a) on the consolidated insurance company taxable income of the members which are subject to such tax;

(h) The tax imposed by section 1201, in lieu of the taxes computed under paragraphs (a) and (g) of this section, computed by reference to the excess of the consolidated net long-term capital gain over the consolidated net short-term capital loss (see § 1.1502–41 for the determination of the consolidated net long-term capital gain and the consolidated net short-term capital loss);

(i) [Reserved]

(j) The tax imposed by section 1333 on war loss recoveries; and

by allowing as a credit against such taxes the investment credit under section 38 (see § 1.1502–3), and the foreign tax credit under section 33 (see § 1.1502–4). For purposes of this section, the surtax exemption of the group for a consolidated return year is $25,000, or if a lesser amount is allowed under section 1561, such lesser amount. See § 1.1561–2(a)(2). For increase in tax due to the application of section 47, see § 1.1502–3(f).

**§ 1.1502–3 Consolidated investment credit.**

(a) *Determination of amount of consolidated credit*—(1) *In general.* The credit allowed by section 38 for a consolidated return year of a group shall be equal to the consolidated credit earned. The consolidated credit earned is equal to the aggregate of the credit earned (as determined under subparagraph (2) of this paragraph) by all members of the group for the consolidated return year.

(2) *Determination of credit earned.* The credit earned of a member is an amount equal to 7 percent of such member's qualified investment (determined under section 46(c)). For purposes of computing a member's qualified investment, the basis of property shall not include any gain or loss realized with respect to such property by another member in an intercompany transaction (as defined in § 1.1502–13(a)(1)), whether or not such gain or loss is deferred. Thus, if section 38 property acquired in an intercompany transaction has a basis of $100 to the purchasing member, and if the selling member has a $20 gain with respect to such property, the basis of such property for purposes of computing the purchaser's qualified investment is only $80. Such $80 basis shall also be used for purposes of applying section 47 to such property. See paragraph (f) of this section.

(3) *Consolidated limitation based on amount of tax.* (i) Notwithstanding the amount of the consolidated credit earned for the taxable year, the consolidated credit allowed by section 38 to the group for the consolidated return year is limited to—

(*a*) So much of the consolidated liability for tax as does not exceed $25,000, plus

(*b*) 25 percent of the consolidated liability for tax in excess of $25,000.

The $25,000 amount referred to in (*a*) and (*b*) of the preceding sentence shall be reduced by any part of such $25,000 amount apportioned, under paragraph (f)(6) of § 1.46–1, to members of the affiliated group (as defined in section 46(a)(5) which do not join in the filing of the consolidated return. The amount determined under this subparagraph shall be referred to in this section as the "consolidated limitation based on amount of tax."

(ii) If an organization to which section 593 applies or a cooperative organization described in section 1381(a) joins in the filing of the consolidated return, the $25,000 amount referred to in subdivision (i) (*a*) and (*b*) of this subparagraph (or such $25,000 amount reduced by any part of such amount apportioned to members of the affiliated group, as defined in section 46(a)(5), which do not join in the filing of the consolidated return) shall be apportioned equally among the members of the group filing the consolidated return. The amount so apportioned equally to any such organization shall then be decreased in accordance with the provisions of section 46(d). Finally, the sum of all such equal portions (as decreased under section 46(d)) of each member of the group shall be substituted for the $25,000 amount referred to in subdivision (i) (*a*) and (*b*) of this subparagraph.

(4) *Consolidated liability for tax.* For purposes of subparagraph (3) of this paragraph, the consolidated liability for tax shall be the income tax imposed for the taxable year upon the group by chapter 1 of the Code, reduced by the consolidated foreign tax credit allowable under § 1.1502–4. The tax imposed by section 531 (relating to imposition of accumlated earnings tax) or by section 541 (relating to imposition of personal holding company tax) shall not be considered tax imposed by chapter 1 of the Code. In addition, any increase in tax resulting from the application of section 47 (relating to certain dispositions, etc., of section 38 property) shall not be treated as tax imposed by chapter 1 for purposes of computing the consolidated liability for tax.

(b) *Carryback and carryover of unused credits*—(1) *Allowance of unused credit as consolidated carryback or carryover.* A group shall be allowed to add to the amount allowable as a credit under paragraph (a)(1) of this section for any consolidated return year an amount equal to the aggregate of the consolidated investment credit carryovers and carrybacks to such year. The consolidated investment credit carryovers and carrybacks to the taxable year shall consist of any consolidated unused credits of the group, plus any unused credits of members of the group arising in separate return years of such members, which may be carried over or back to the taxable year under the principles of section 46(b). However, such consolidated carryovers and carrybacks shall not include any consolidated unused credits apportioned to a corporation for a separate return year pursuant to paragraph (c) of § 1.1502–79 and shall be subject to the limitations contained in paragraphs (c) and (e) of this section. A consolidated unused credit for any consolidated return year is the excess of the consolidated credit earned over the consolidated limitation based on amount of tax for such year.

(2) *Absorption rules.* For purposes of determining the amount, if any, of an unused credit (whether consolidated or separate) which can be carried to a taxable year (consolidated or separate), the amount of such unused credit which is absorbed in a prior consolidated return year under section 46(b) shall be determined by—

(i) Applying all unused credits which can be carried to such prior year in the order of the taxable years in which such

unused credits arose, beginning with the taxable year which ends earliest, and

(ii) Applying all such unused credits which can be carried to such prior year from taxable years ending on the same date on a pro rata basis.

(c) *Limitation on investment credit carryovers and carrybacks from separate return limitation years*—(1) *General rule.* In the case of an unused credit of a member of the group arising in a separate return limitation year (as defined in paragraph (f) of § 1.1502–1) of such member (and in a separate return limitation year of any predecessor of such member), the amount which may be included under paragraph (b) of this section (computed without regard to the limitation contained in paragraph (e) of this section) shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph with respect to a member of the group is the excess, if any, of—

(i) The limitation based on amount of tax of the group, minus such limitation recomputed by excluding the items of income, deduction, and foreign tax credit of such member, over

(ii) The sum of (*a*) the investment credit earned by such member for such consolidated return year, and (*b*) the unused credits attributable to such member which may be carried to such consolidated return year arising in unused credit years ending prior to the particular separate return limitation year.

(d) *Examples.* The provisions of paragraphs (a), (b), and (c) of this section may be illustrated by the following examples:

*Example (1).* Corporation P is incorporated on January 1, 1966. On that same day P incorporates corporation S, a wholly owned subsidiary. P and S file consolidated returns for calendar years 1966 and 1967. P's and S's credit earned, the consolidated credit earned, and the consolidated limitation based on amount of tax for 1966 and 1967 are as follows:

| | Credit earned | Consolidated credit earned | Consolidated limitation based on amount of tax |
|---|---|---|---|
| 1966: | | | |
| P | $60,000 | $90,000 | $100,000 |
| S | 30,000 | | |
| 1967: | | | |
| P | 40,000 | 65,000 | 50,000 |
| S | 25,000 | | |

(i) P's and S's credit earned for 1966 are aggregated and the group's consolidated credit earned, $90,000, is allowable in full to the group as a credit under section 38 for 1966 since such amount is less than the consolidated limitation based on amount of tax for 1966, $100,000.

(ii) Since the consolidated limitation based on amount of tax for 1967 is $50,000, only $50,000 of the $65,000 consolidated credit earned for such year is allowable to the group under section 38 as a credit for 1967. The consolidated unused credit for 1967 of $15,000 ($65,000 less $50,000) is a consolidated investment credit carryback and carryover to the years prescribed in section 46(b). In this case the consolidated unused credit is a consolidated investment credit carryback to 1966 (since P and S were not in existence in 1964 and 1965) and a consolidated investment credit carryover to 1968 and subsequent years. The portion of the consolidated unused credit for 1967 which is allowable as a credit for 1966 is $10,000. This amount shall be added to the amount allowable as a credit to the group for 1966. The balance of the consolidated unused credit for 1967 to be carried to 1968 is $5,000. These amounts are computed as follows:

| | | | |
|---|---|---|---|
| Consolidated carryback to 1966 | | | $15,000 |
| 1966 consolidated limitation based on tax | | $100,000 | |
| Less: Consolidated credit earned for 1966 | $90,000 | | |
| Consolidated unused credits attributable to years preceding 1967 | 0 | 90,000 | |
| Limit on amount of 1967 consolidated unused credit which may be added as a credit for 1966 | | | 10,000 |
| Balance of 1967 consolidated unused credit to be carried to 1968 | | | 5,000 |

*Example (2).* (i) Assume the same facts as in example (1), except that all the stock of corporation T, also a calendar year taxpayer, is acquired by P on January 1, 1968, and that P, S, and T file a consolidated return for 1968. In 1966 T had an unused credit of $10,000 which has not been absorbed and is available as an investment credit carryover to 1968. Such carryover is from a separate return limitation year. P's and S's credit earned for 1968 is $10,000 each and T's credit earned is $8,000; the consolidated credit earned is therefore $28,000. The group's consolidated limitation based on amount of tax for 1968 is $50,000. Such limitation recomputed by excluding the items of income, deduction, and foreign tax credit of T is $30,000. Thus, the amount determined under paragraph (c)(2)(i) of this section is $20,000 ($50,000 minus $30,000). Accordingly, the limitation on the carryover of T's unused credit is $12,000, the excess of $20,000 over $8,000 (the sum of T's credit earned for the taxable year and any carryovers from prior unused credit years (none in this case)). Therefore T's $10,000 unused credit from 1966 may be carried over to the consolidated return year without limitation.

(ii) The group's consolidated credit earned for 1968, $28,000, is allowable in full as a credit under section 38 since such amount is less than the consolidated limitation based on amount of tax, $50,000.

(iii) The group's consolidated investment credit carryover to 1968 is $15,000, consisting of the consolidated unused credits of the group ($5,000), plus T's separate return year unused credit ($10,000). The entire $15,000 consolidated carryover shall be added to the amount allowable to the group as a credit under section 38 for 1968, since such amount is less than $22,000 (the excess of the consolidated limitation based on tax, $50,000, over the sum of the consolidated credit earned for 1968, $28,000, and unused credits arising in prior unused credit years, zero).

*Example (3).* Assume the same facts as in example (2), except that the amount determined under paragraph (c)(2)(i) of this section is $12,000. Therefore, the limitation on the carryover of T's unused credit is $4,000. Accordingly, the consolidated investment credit carryover is only $9,000 since the amount of T's separate return year unused credit which may be added to the group's $5,000 consolidated unused credit is $4,000. These amounts are computed as follows:

| | | | |
|---|---|---|---|
| T's carryover to 1968 | | | $10,000 |
| Consolidated limitation based on amount of tax minus recomputed limitation | | $12,000 | |
| Less: T's credit earned for 1968 | $8,000 | | |
| Unused credits attributable to T arising in unused credit years preceding 1966 | 0 | 8,000 | |
| Limit on amount of 1966 unused credit of T which may be added to consolidated investment credit carryover | | | 4,000 |
| Balance of 1966 unused credit of T to be carried to 1969 (subject to the limitation contained in paragraph (c) of this section) | | | 6,000 |

(e) *Limitation on investment credit carryovers where there has been a consolidated return change of ownership*—(1) *General rule.* If a consolidated return change of ownership (as defined in paragraph (g) of § 1.1502–1) occurs during the taxable year or an earlier taxable year, the amount which may be included under paragraph (b) of this section in the consolidated investment credit carryovers to the taxable year with respect to the aggregate unused credits attributable to old members of the group (as defined in paragraph (g)(3) of § 1.1502–1) arising in taxable years (consolidated or separate) ending on the same day and before the taxable year in which the consolidated return change of ownership occurred shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph shall be the excess of the consolidated limitation based on the amount of tax for the taxable year, recomputed by including only the items of income, deduction, and foreign tax credit of the old members, over the sum of—

(i) The aggregate investment credits earned by the old members for the taxable year, and

(ii) The aggregate unused investment credits attributable to the old members which may be carried to the taxable year arising in unused credit years ending prior to the particular unused credit year or years.

(f) *Early dispositions, etc., of section 38 property*—(1) *Dispositions of section 38 property during and after consolidated return year.* If property is subject to section 47(a) (1) or (2) with respect to a member during a consolidated return year, any increase in tax shall be added to the tax liability of the group under § 1.1502–2 (regardless of whether the property was placed in service in a consolidated or separate return year). Also, if property is subject to section 47(a) (1) or (2) with respect to a corporation during a taxable year for which such corporation files on a separate return basis, any increase in tax shall be added to the tax liability of such corporation (regardless of whether such property was placed in service in a consolidated or separate return year).

(2) *Exception for transfer to another member.* (i) Except as provided in subdivisions (ii) and (iii) of this subparagraph, a transfer of section 38 property from one member of the group to another member of such group during a consolidated return year shall not be treated as a disposition or cessation within the meaning of section 47(a)(1). If such section 38 property is disposed of, or otherwise ceases to be section 38 property or becomes public utility property with respect to the transferee, before the close of the estimated useful life which was taken into account in computing qualified investment, then section 47(a) (1) or (2) shall apply to the transferee with respect to such property (determined by taking into account the period of use, qualified investment, other dispositions, etc., of the transferor). Any increase in tax due to the application of section 47(a) (1) or (2) shall be added to the tax liability of such transferee (or the tax liability of a group, if the transferee joins in the filing of a consolidated return).

(ii) Except as provided in subdivision (iii) of this subparagraph, if section 38 property is disposed of during a consolidated return year by one member of the group to another member of such group which is an organization to which section 593 applies or a cooperative organization described in section 1381(a), the tax under chapter 1 of the Code for such consolidated return year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would result solely from treating such property, for purposes of determining qualified investment, as placed in service by such organization to which section 593 applies or such cooperative organization described in section 1381(a), as the case may be, but with due regard to the use of the property before such transfer.

(iii) Section 47(a)(1) shall apply to a transfer of section 38 property by a corporation during a consolidated return year if such corporation is liquidated in a transaction to which section 334(b)(2) applies.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

*Example (1).* P, S, and T file a consolidated return for calendar year 1967. In such year S places in service section 38 property having an estimated useful life of more than 8 years. In 1968, P, S, and T file a consolidated return and in such year S sells such property to T. Such sale will not cause section 47(a)(1) to apply.

*Example (2).* Assume the same facts as in example (1), except that P, S, and T filed separate returns for 1967. The sale from S to T will not cause section 47(a)(1) to apply.

*Example (3).* Assume the same facts as in example (1), except that P, S, and T continue to file consolidated returns through 1971 and in such year T disposes of the property to individual A. Section 47(a)(1) will apply to the group and any increase in tax shall be added to the tax liability of the group. For the purposes of determining the actual period of use by T, such period shall include S's period of use.

*Example (4).* Assume the same facts as in example (3), except that T files a separate return in 1971. Again, the actual periods of use by S and T will be combined in applying section 47. If the disposition results in an increase in tax under section 47(a)(1), such additional tax shall be added to the separate tax liability of T.

*Example (5).* Assume the same facts as in example (1), except that in 1969, P sells all the stock of T to a third party. Such sale will not cause section 47(a)(1) to apply.

**§ 1.1502–4 Consolidated foreign tax credit.**

(a) *In general.* The credit under section 901 for taxes paid or accrued to any foreign country or possession of the United States shall be allowed to the group only if the common parent corporation chooses to use such credit in the computation of the tax liability of the group for the consolidated return year. If this choice is made, no deduction may be taken on the consolidated return for such taxes paid or accrued by any member of the group. See section 275(a)(4).

(b) *Limitation effective under section 904 (a) for the group—(1) Common parent's limitation effective for group.* The determination of whether the overall limitation or the per-country limitation applies for a consolidated return year shall be made by reference to the limitation effective with respect to the common parent corporation for such year. If the limitation effective with respect to a member for its immediately preceding separate return year differs from the limitation effective with respect to the common parent corporation for the consolidated return year, then such member shall, if the overall limitation is effective with respect to the common parent, be deemed to have made an election to use such overall limitation, or, if the per-country limitation is effective with respect to the common parent, be deemed to have revoked its election to use the overall limitation. Consent of the Secretary or his delegate (if otherwise required) is hereby given to such member for such election or revocation. Any such election or revocation shall apply only prospectively beginning with such consolidated return year.

(2) *Limitation effective for subsequent years.* The limitation effective with respect to a member for the last year for which it joins in the filing of a consolidated return with a group shall remain in effect for a subsequent separate return year and may be changed by such corporation for such subsequent year only in accordance with the provisions of section 904(b) (and this paragraph if it joins in the filing of a consolidated return with another group). Any retroactive change in the limitation by the common parent corporation for such member's last consolidated return year shall change the election effective with respect to such member for such last period. Thus, if the common parent (P) elects the overall limitation with respect to calendar year 1966, such election would be effective with respect to its subsidiary S for 1966. If S leaves the group at the beginning of calendar year 1967, such election shall be effective for 1967 with respect to S (unless S revokes such election for 1967 or a subsequent year in accordance with section 904 (b), or this paragraph if it joins in the filing of a consolidated return with another group). However, if P retroactively changes back to the per-country limitation with respect to 1966, such limitation would be effective with respect to S for 1966 and subsequent years (unless S elects the overall limitation for any such subsequent year).

(c) *Computation of consolidated foreign tax credit.* The foreign tax credit for the consolidated return year shall be determined on a consolidated basis under the principles of sections 901 through 905 and section 960. For example, if the per-country limitation applies to the consolidated return year, taxes paid or accrued for such year (including those deemed paid or accrued under sections 902 and 960 (a) and paragraph (e) of this section) to each foreign country or possession by the members of the group shall be aggregated. If the overall limitation applies, taxes paid or accrued for such year (including those deemed paid or accrued) to all foreign countries and possessions by members of the group shall be aggregated. If the overall limitation applies and a member of the group qualifies as a Western Hemisphere trade corporation, see section 1503(b).

(d) *Computation of limitation on credit.* For purposes of computing the group's applicable limitation under section 904(a), the following rules shall apply:

(1) *Computation of taxable income from foreign sources.* The numerator of the applicable limiting fraction under section 904(a) shall be an amount (not in excess of the amount determined under subparagraph (2) of this paragraph) equal to the aggregate of the separate taxable incomes of the members from sources within each foreign country or possession of the United States (if the per-country limitation is applicable), or from sources without the United States (if the overall limitation is applicable), determined under § 1.1502–12, adjusted for the following items taken into account in the computation of consolidated taxable income:

(i) The portion of the consolidated net operating loss deduction, the consolidated charitable contributions deduction, the consolidated dividends received deduction, and the consolidated section 922 deduction, attributable to such foreign source income;

(ii) Any such foreign source net capital gain (determined without regard to any net capital loss carryover);

(iii) Any such foreign source net capital loss and section 1231 net loss, reduced by the portion of the consolidated net capital loss attributable to such foreign source loss; and

(iv) The portion of any consolidated net capital loss carryover attributable to such foreign source income which is absorbed in the taxable year.

(2) *Computation of entire taxable income.* The denominator of the applicable limiting fraction under section 904(a) (that is, the entire taxable income of the group) shall be the consolidated taxable income of the group computed in accordance with § 1.1502–11.

(3) *Computation of tax against which credit is taken.* The tax against which the limiting fraction under section 904 (a) is applied shall be the consolidated tax liability of the group determined under § 1.1502–2, but without regard to paragraphs (b), (c), (d), and (j) thereof, and without regard to any credit against such liability.

(e) *Carryover and carryback of unused foreign tax—(1) Allowance of unused foreign tax as consolidated carryover or carryback.* The aggregate of the consolidated unused foreign tax carryovers and carrybacks to the taxable year, to the extent absorbed for such year under the principles of section 904(d), shall be deemed to be paid or accrued to a foreign country or possession for such year. The consolidated unused foreign tax carryovers and carrybacks to the taxable year shall consist of any consolidated unused foreign tax, plus any unused foreign tax of members for separate return years of such members, which may be carried over or back to the taxable year under the principles of section 904 (d) and (e). However, such consolidated carryovers and carrybacks shall not include any consolidated unused foreign taxes apportioned to a corporation for a separate return year pursuant to § 1.1502–79(d) and shall be subject to the limitations contained in paragraphs (f) and (g) of this section. A consolidated unused foreign tax is the excess of the foreign taxes paid or accrued by the group (or deemed paid or accrued by the group, other than by reason of section 904(d)) over the applicable limitation for the consolidated return year.

(2) *Absorption rules.* For purposes of determining the amount, if any, of an unused foreign tax (consolidated or separate) which can be carried to a taxable year (consolidated or separate), the amount of such unused tax which is absorbed in a prior consolidated return year under section 904(d) shall be determined by—

(i) Applying all unused foreign taxes which can be carried to such prior year in the order of the taxable years in which such unused taxes arose, beginning with the taxable year which ends earliest, and

(ii) Applying all such unused taxes which can be carried to such prior year from taxable years ending on the same date on a pro rata basis.

(f) *Limitation on unused foreign tax carryover or carryback from separate return limitation years—(1) General rule.* In the case of an unused foreign tax of a member of the group arising in a separate return limitation year (as defined in paragraph (f) of § 1.1502–1) of such member, the amount which may be included under paragraph (e) of this section (computed without regard to the limitation contained in paragraph (g) of this section) shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph with respect to a member of the group is the excess, if any, of—

(i) The section 904(a) limitation of the group, minus such limitation recomputed by excluding the items of income and deduction of such member, over

(ii) The sum of (*a*) the foreign taxes paid (or deemed paid, other than by reason of section 904(d)) by such member for the consolidated return year, and (*b*) the unused foreign tax attributable to such member which may be carried to such consolidated return year arising in taxable years ending prior to the particular separate return limitation year.

(g) *Limitation on unused foreign tax carryover where there has been a consolidated return change of ownership—(1) General rule.* If a consolidated return change of ownership (as defined in paragraph (g) of § 1.1502–1) occurs during the taxable year or an earlier taxable year, the amount which may be included under paragraph (e) of this section in the consolidated unused foreign tax carryovers to the taxable year with respect to the aggregate unused credits attributable to the old members of the group (as defined in paragraph (g)(3) of § 1.1502–1) arising in taxable years (consolidated or separate) ending on the same day and before the taxable year in which the consolidated return change of ownership occurred shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph shall be the excess of the section 904(a) limitation of the group for the taxable year, recomputed by including only the items of income and deduction of the old members of the group, over the sum of—

(i) The aggregate foreign taxes paid (or deemed paid, other than by reason of section 904(d)) by the old members for the taxable year, and

(ii) The aggregate unused foreign tax attributable to the old members which can be carried to the taxable year arising in taxable years ending prior to the particular unused foreign tax year or years.

(h) *Amount of credit with respect to interest income.* If any member of the group has interest income described in section 904(f)(2) (for a year for which it filed on a consolidated or separate basis), the group's foreign tax credit with respect to such interest shall be computed separately in accordance with the principles of section 904(f) and this section.

(i) [Reserved]

(j) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example (1).* Domestic corporation P is incorporated on January 1, 1966. On that same day it also incorporates domestic corporations S and T, wholly owned subsidiaries. P, S, and T file consolidated returns for 1966 and 1967 on the basis of a calendar year. T engages in business solely in country A. S transacts business solely in countries A and B. P does business solely in the United States. During 1966 T sold an item of inventory to P at a profit of $2,000. Under § 1.1502–13 such profit is deferred and none of the circumstances of restoration contained in paragraph (d), (e), or (f) of § 1.1502–13 have occurred as of the close of 1966. The taxable income for 1966 from foreign and United States sources, and the foreign taxes paid on such foreign income are as follows:

| Corporation | U.S. taxable income | Country A | | Country B | | Total Taxable income |
|---|---|---|---|---|---|---|
| | | Taxable income | Foreign tax paid | Taxable income | Foreign tax paid | |
| P | $40,000 | | | | | $40,000 |
| T | | $20,000 | $12,000 | | | 20,000 |
| S | | 10,000 | 6,000 | $10,000 | $3,000 | 20,000 |
| | | | | | | 80,000 |

Such taxable income was computed by taking into account the rules provided in § 1.1502–12. Thus, the $2,000 deferred profit is not included in T's taxable income for 1966 (but will be included for the taxable year for which one of the events specified in paragraph (d), (e), or (f) of § 1.1502–13 occurs). The consolidated taxable income of the group (computed in accordance with § 1.1502–11) is $80,000. The consolidated tax liability against which the credit may be taken (computed in accordance with paragraph (d)(3) of this section) is $31,900.

(i) Assuming P chooses to use the foreign taxes paid as a credit and the group is subject to the per-country limitation, the group may take as a credit against the consolidated tax liability $11,962.50 of the amount paid to country A, plus the $3,000 paid to country B. Such amounts are computed as follows: The aggregate taxes paid to country A of $18,000 is limited to $11,962.50 ($31,900 times $30,000/$80,000). The unused foreign tax with respect to country A is $6,037.50 ($18,000 less $11,962.50), and is a consolidated unused foreign tax which shall be carried to the years prescribed by section 904(d). A credit of $3,000 is available with respect to the taxes paid to country B since such amount is less than the limitation of $3,987.50 ($31,900 times $10,000/$80,000).

(ii) Assuming the overall limitation is in effect for the taxable year, the group may take $15,950 as a credit, computed as follows: The aggregate taxes paid to all foreign countries of $21,000 is limited to $15,950 ($31,900 times $40,000/$80,000). The unused foreign tax is $5,050 ($21,000 less $15,950), and is a consolidated unused foreign tax which shall be carried to the years prescribed by section 904(d).

*Example (2).* Assume the same facts as in example (1), except that T has a $10,000 long-term capital gain (derived from a sale to a nonmember in country A) and P has a $10,000 long-term capital loss (derived from a sale to a nonmember in the United States). Notwithstanding that the consolidated net capital gain of the group is zero, T's capital gain shall be reflected in full in the computation of taxable income from foreign sources.

*Example (3).* Assume the same facts as in example (1), except that the group had a consolidated section 172 deduction of $8,000 which is attributable to a net operating loss sustained by T. The $8,000 consolidated net operating loss deduction is offset against T's income from country A, thus reducing T's taxable income from country A to $12,000.

### § 1.1502–5 Estimated tax.

(a) *General rule—(1) Consolidated estimated tax.* If a group files a consolidated return for two consecutive tax-

able years, it shall file its declaration of estimated tax on a consolidated basis for each subsequent taxable year, until such time as separate returns are properly filed under § 1.1502–75(c). Until such time, the group shall be treated as a single corporation for purposes of sections 6016 and 6154 (relating to declaration and payment of estimated tax by corporations). If separate returns are filed by the members for a taxable year, the amount of any estimated tax payments made with respect to a consolidated declaration of estimated tax for such year shall be credited against the separate tax liabilities of the members in any manner designated by the common parent which is satisfactory to the Commissioner. The consolidated declaration of estimated tax shall be filed, and payments shall be made, to the district director with whom the common parent would file a separate return. A statement should be attached to the declaration setting forth the name, address, taxpayer account number, and district director of each member.

(2) *Estimated tax on a separate basis.* If a group is not required to file a consolidated declaration of estimated tax for a taxable year, then each member shall be treated as a separate corporation for such taxable year for purposes of sections 6016 and 6154, except as otherwise provided in section 243(b)(3)(C)(v). If a consolidated return is filed for such year, the amount of any estimated tax payments made for such year shall be credited against the tax liability of the group.

(b) *Additions to tax for failure to pay estimated tax under section 6655—(1) Consolidated declaration of estimated tax required to be filed.* If a group is required to file a consolidated declaration of estimated tax for the taxable year under paragraph (a)(1) of this section, then—

(i) If such group files a consolidated return for the taxable year, it shall be limited to a single $100,000 exemption for purposes of applying section 6655 to payments of estimated tax for such year. For purposes of section 6655(d)(1), the "tax shown on the return" shall be the tax shown on the consolidated return for the preceding taxable year, and for purposes of section 6655(d)(2), the "facts shown on the return" shall be the facts shown on the consolidated return for the preceding taxable year.

(ii) If such group does not file a consolidated return for the taxable year, each member of the group shall, except as otherwise provided in section 243(b)(3)(C)(v), be entitled to a separate $100,000 exemption for purposes of applying section 6655 to payments of estimated tax for such year. For purposes of section 6655(b)(2), the "amount, if any, of the installment paid" by any member shall be an amount apportioned to such member in a manner designated by the common parent which is satisfactory to the Commissioner. For purposes of section 6655(d)(1), the "tax shown on the return" for any member shall be the portion of the tax shown on the consolidated return for the preceding year allocable to such member under subparagraph (3) of this paragraph. For purposes of section 6655(d)(2), the "facts shown on the return" shall be the facts shown on the consolidated return for the preceding year and the tax computed under such section shall be allocated under the rules of subparagraph (3) of this paragraph.

(2) *Separate declaration of estimated tax.* If the members of a group are treated as separate corporations for the taxable year under paragraph (a)(2) of this section, then, except as otherwise provided in section 243(b)(3)(C)(v), each such member is entitled to a separate $100,000 exemption for purposes of applying section 6655 to payments of estimated tax for such year, whether or not the group files a consolidated return for such year. If the group files a consolidated return for such year, then for purposes of section 6655(b)(1), the "tax shown on the return" for any member shall be the portion of the tax shown on the consolidated return allocable to such member under subparagraph (3) of this paragraph. If the group filed a consolidated return for the preceding taxable year, then for purposes of section 6655(d)(1), the "tax shown on the return" for any member shall be the portion of the tax shown on the consolidated return for such preceding year allocable to such member under subparagraph (3) of this paragraph. For purposes of section 6655(d)(2), the "facts shown on the return" shall be the facts shown on the consolidated return for the preceding year and the tax computed under such section shall be allocated under the rules of subparagraph (3) of this paragraph.

(3) *Rules for allocation of consolidated tax liability.* For purposes of subparagraphs (1) and (2) of this paragraph, the tax shown on a consolidated return shall be allocated to the members of the group under the method which the group has elected pursuant to section 1552.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example (1).* Corporations P and S–1 file a consolidated return for the first time for calendar year 1966. P and S–1 also file consolidated returns for 1967 and 1968. For 1966 and 1967 P and S–1 may file separate declarations of estimated tax, and they are entitled to separate $100,000 exemptions. For 1968, however, the group must compute its estimated tax on a consolidated basis, and it is limited to a single $100,000 exemption. In determining whether P and S–1 come within the exception provided in section 6655(d)(1) for 1968, the "tax shown on the return" is the tax shown on the consolidated return for 1967.

*Example (2).* Assume the same facts as in example (1). Assume further that corporation S–2 was a member of the group during 1967, and joined in the filing of the consolidated return for such year, but ceased to be a member of the group on September 15, 1968. In determining whether the group (which no longer includes S–2) comes within the exception provided in section 6655(d)(1) for 1968, the "tax shown on the return" is the tax shown on the consolidated return for 1967.

*Example (3).* Assume the same facts as in example (1). Assume further that corporation S–2 becomes a member of the group on June 1, 1968, and joins in the filing of the consolidated return for 1968. In determining whether the group (which now includes S–2) comes within the exception provided in section 6655(d)(1) for 1968, the "tax shown on the return" is the tax shown on the consolidated return for 1967. Any tax of S–2 for any separate return year is not included as a part of the "tax shown on the return" for purposes of applying section 6655(d)(1).

*Example (4).* Corporations X and Y filed consolidated returns for the calendar years 1966 and 1967 and separate returns for 1968. X and Y are each entitled to a separate $100,000 exemption for 1968 for purposes of applying section 6655. In determining whether X or Y comes within the exception provided in section 6655(d)(1) for 1968, the "tax shown on the return" is the amount of tax shown on the consolidated return for 1967 allocable to X and to Y in accordance with paragraph (b)(3) of this section.

**§ 1.1502–6 Liability for tax.**

(a) *Several liability of members of group.* Except as provided in paragraph (b) of this section, the common parent corporation and each subsidiary which was a member of the group during any part of the consolidated return year shall be severally liable for the tax for such year computed in accordance with the regulations under section 1502 prescribed on or before the due date (not including extensions of time) for the filing of the consolidated return for such year.

(b) *Liability of subsidiary after withdrawal.* If a subsidiary has ceased to be a member of the group and if such cessation resulted from a bona fide sale or exchange of its stock for fair value and occurred prior to the date upon which any deficiency is assessed, the district director may, if he believes that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former subsidiary in an amount not exceeding the portion of such deficiency which the district director may determine to be allocable to it. If the district director makes assessment and collection of any part of a deficiency from such former subsidiary, then for purposes of any credit or refund of the amount collected from such former subsidiary the agency of the common parent under the provisions of § 1.1502–77 shall not apply.

(c) *Effect of intercompany agreements.* No agreement entered into by one or more members of the group with any other member of such group or with any other person shall in any case have the effect of reducing the liability prescribed under this section.

**§§ 1.1502–7 to 1.1502–10 [Reserved]**

COMPUTATION OF CONSOLIDATED TAXABLE INCOME

**§ 1.1502–11 Consolidated taxable income.**

The consolidated taxable income for a consolidated return year shall be determined by taking into account—

(a) The separate taxable income of each member of the group (see § 1.1502–

12 for the computation of separate taxable income);

(b) Any consolidated net operating loss deduction (see § 1.1502–21 for the computation of the consolidated net operating loss deduction);

(c) Any consolidated net capital gain (see § 1.1502–22 for the computation of the consolidated net capital gain);

(d) Any consolidated section 1231 net loss (see § 1.1502–23 for the computation of the consolidated section 1231 net loss);

(e) Any consolidated charitable contributions deduction (see § 1.1502–24 for the computation of the consolidated charitable contributions deduction);

(f) Any consolidated section 922 deduction (see § 1.1502–25 for the computation of the consolidated section 922 deduction);

(g) Any consolidated dividends received deduction (see § 1.1502–26 for the computation of the consolidated dividends received deduction); and

(h) Any consolidated section 247 deduction (see § 1.1502–27 for the computation of the consolidated section 247 deduction).

COMPUTATION OF SEPARATE TAXABLE INCOME

**§ 1.1502–12 Separate taxable income.**

The separate taxable income of a member of a group shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations except that—

(a) Transactions between members and transactions with respect to stock, bonds, or other obligations of members shall be reflected according to the provisions of §§ 1.1502–13 and 1.1502–14;

(b) Any deduction which is disallowed under § 1.1502–15 shall be taken into account as provided in that section;

(c) The deduction allowable under section 615 shall be taken into account to the extent provided in § 1.1502–16;

(d) The method of accounting under which such computation is made and the adjustments to be made because of any change in method of accounting shall be determined under § 1.1502–17;

(e) Inventory adjustments shall be made as provided in § 1.1502–18;

(f) Any amount included in income under § 1.1502–19 shall be taken into account;

(g) In the computation of the deduction under section 167, property shall not lose its character as new property as a result of a transfer from one member of the group to another member during a consolidated return year;

(h) No net operating loss deduction shall be taken into account;

(i) [Reserved]

(j) No capital gains or losses shall be taken into account;

(k) No gains and losses subject to section 1231 shall be taken into account;

(l) No deduction under section 170 with respect to charitable contributions shall be taken into account;

(m) No deduction under section 922 (relating to the deduction for Western Hemisphere trade corporations) shall be taken into account;

(n) No deductions under section 243 (a)(1), 244(a), 245, or 247 (relating to deductions with respect to dividends received and dividends paid) shall be taken into account; and

(o) Basis shall be determined under §§ 1.1502–31 and 1.1502–32, and earnings and profits shall be determined under § 1.1502–33. The term "separate taxable income" shall include a case in which the determination under this section results in an excess of deductions over gross income.

**§ 1.1502–13 Intercompany transactions.**

(a) *Definitions.* For purposes of §§ 1.1502–1 through 1.1502–80—

(1) *"Intercompany transaction."* (i) Except as provided in subdivision (ii) of this subparagraph, the term "intercompany transaction" means a transaction during a consolidated return year between corporations which are members of the same group immediately after such transaction. Thus, for example, an intercompany transaction would include a sale of property by one member of a group (hereinafter referred to as the "selling member") to another member of the same group ("purchasing member"), the performance of services by one member of a group ("selling member") for another member of the same group ("purchasing member"), or the payment of interest by one member of a group ("purchasing member") to another member of the same group ("selling member"), during a consolidated return year.

(ii) The term "intercompany transaction" does not include a distribution by one member of a group to another member of the same group with respect to the distributing member's stock, or a contribution to capital on which no gain is realized. Thus, for example, dividend distributions, redemptions, and liquidations are not intercompany transactions. The term also does not include sales and other dispositions of, and bad debts with respect to, obligations of other members of the group. See § 1.1502–14, relating to amounts received with respect to stock, bonds, or other obligations of a member of the group.

(2) *"Deferred intercompany transaction".* The term "deferred intercompany transaction" means—

(i) The sale or exchange of property,

(ii) The performance of services in a case where the amount of the expenditure for such services is capitalized (for example, a builder's fee, architect's fee, or other similar cost which is included in the basis of property), or

(iii) Any other expenditure in a case where the amount of the expenditure is capitalized (for example, prepaid rent, or interest which is included in the basis of property), in an intercompany transaction.

(b) *Treatment of intercompany transactions other than deferred intercompany transactions*—(1) *General rule.* Gain or loss on intercompany transactions (other than deferred intercompany transactions) shall not be deferred or eliminated. Thus, for example, if, during a consolidated return year, a purchasing member makes an interest payment on an indebtedness to a selling member in an intercompany transaction, the purchasing member shall take the deduction for interest into account and the selling member shall take the interest income into account.

(2) *Special rule.* If, in an intercompany transaction (other than a deferred intercompany transaction), one member would otherwise properly take an item of income or a deduction into account for a consolidated return year earlier than the year (whether consolidated or separate) for which another member of the group can properly take into account the corresponding item of income or deduction, then both the item of income and the deduction shall be taken into account for the later year (whether consolidated or separate). On the other hand, if one member properly takes an item of income or a deduction into account for a separate return year earlier than the consolidated return year for which the other member can properly take into account the corresponding item of income or deduction, then such other member shall take the corresponding deduction or item of income into account for such later consolidated return year.

(c) *Deferral of gain or loss on deferred intercompany transactions*—(1) *General rule.* (i) To the extent gain or loss on a deferred intercompany transaction is recognized under the Code for a consolidated return year, such gain or loss shall be deferred by the selling member (hereinafter referred to as "deferred gain or loss").

(ii) The following rules apply with respect to the deferral of gain or loss on deferred intercompany transactions:

(*a*) The selling member may not report gain on the installment method under section 453;

(*b*) A selling member shall take into account the gain or loss on a deferred intercompany transaction in accordance with the provisions of paragraphs (d), (e), and (f) of this section, notwithstanding that such selling member, under its method of accounting, would not otherwise recognize such gain or loss until a later taxable year. Thus, for example, a selling member must take into account its gain on a deferred intercompany transaction for the first taxable year for which the purchasing member is allowed a deduction for depreciation with respect to the property involved, even though the selling member, under its method of accounting, would not otherwise recognize such gain until a later taxable year.

(iii) See paragraphs (d), (e), and (f) of this section, relating to the time and manner of restoring deferred gain or loss. See paragraph (a) of § 1.1502–31, relating to basis of property acquired in a deferred intercompany transaction.

(2) *Determination of amount of deferred gain or loss.* In determining the amount of deferred gain or loss, the cost of property, services, or any other expenditure shall include both direct costs and indirect costs which are properly includible in the cost of goods sold or

cost of the services or other expenditure. See § 1.471–3 for costs properly includible in cost of goods sold.

(3) *Election not to defer.* A group may elect with the consent of the Commissioner not to defer gain or loss on any deferred intercompany transactions with respect to all property or any class or classes of property. Applications for such consent must be filed with the Commissioner of Internal Revenue, Washington, D.C. 20224, on or before the due date of the consolidated return (not including extensions of time) for the taxable year to which the election is to apply. An election under this subparagraph shall, unless revoked with the consent of the Commissioner, apply to all members of the group for the consolidated return year for which made and all subsequent consolidated return years ending prior to the first year for which such group does not file a consolidated return.

(4) *Character and source of deferred gain or loss.* (i) Except as provided in subdivision (ii) of this subparagraph, the character and source of deferred gain or loss on a deferred intercompany transaction shall be determined at the time of the deferred intercompany transaction as if such transaction had not occurred during a consolidated return year.

(ii) Deferred gain or loss taken into account by the selling member under paragraph (d)(1) of this section, or (as a result of abandonment) under paragraph (f) of this section, shall be treated as ordinary income or loss.

(5) *Accounting for deferred gain or loss.* The amount of deferred gain or loss shall be reflected on permanent records (including work papers). From such permanent records the group must be able to identify the character and source of the deferred gain or loss to the selling member, and must be able to apply the restoration rules of paragraphs (d), (e), and (f) of this section.

(6) *Inheritance of deferred gain or loss.* If the assets of a selling member are acquired by one or more other members in an acquisition to which section 381(a) applies, the member acquiring the greatest portion of the assets (measured by fair market value) of the selling member shall be subject to the provisions of paragraphs (d), (e), and (f) of this section with respect to the entire remaining balance of the deferred gain or loss. If two or more members acquire the same portion (which is greater than that acquired by any other members), the common parent shall select which such member shall be subject to the provisions of paragraphs (d), (e), and (f) of this section. For purposes of this section, a member which inherits the balance of the deferred gain or loss under this subparagraph shall be treated as the selling member.

(d) *Restoration of deferred gain or loss for property subject to depreciation, amortization, or depletion*—(1) *General rule.* (i) If property (including a capitalized expenditure for services, or any other capitalized expenditure) acquired in a deferred intercompany transaction is, in the hands of any member of the group, subject to depreciation, amortization, or depletion, then, for each taxable year (whether consolidated or separate) for which a depreciation, amortization, or depletion deduction is allowed to any member of the group with respect to such property, a portion (as determined under subdivision (ii) of this subparagraph) of the deferred gain or loss attributable to such property shall be taken into account by the selling member.

(ii) The portion of the deferred gain or loss attributable to any property which shall be taken into account by the selling member shall be an amount equal to—

(*a*) The amount of gain or loss deferred by the selling member at the time of the deferred intercompany transaction (and if a member has transferred the property to another member of the group, the remaining balance at the time of such transfer), multiplied by

(*b*) A fraction, the numerator of which is the amount of the depreciation, amortization, or depletion deduction with respect to such property allowed to any member of the group for the year (whether consolidated or separate), and the denominator of which is the depreciable basis (i.e., basis reduced by salvage value required to be taken into account, if any) of such property in the hands of such member immediately after such property was transferred to such member.

(2) *Multiple asset accounts.* In the case of property contained in a multiple asset account (or in single asset accounts for which an average rate is used), for purposes of subparagraph (1)(ii)(*b*) of this paragraph the depreciation deduction allowed for a particular taxable year shall be determined by reference to the rate and method of depreciation applied to such multiple asset account (or average rate and method of depreciation applied to such single asset accounts). Thus, if property with an estimated useful life of 3 years is placed in a multiple asset account which is depreciated on the straight-line method at a rate of 20 percent, the depreciation deduction allowed for each taxable year shall be assumed to be 20 percent of the basis of such property (reduced by the salvage value taken into account).

(3) *Reduction or deferred gain or loss.* The deferred gain or loss shall be reduced by the amount taken into account by the selling member under subparagraph (1) of this paragraph. If the deferred gain includes any ordinary income, the reduction shall first be applied against the ordinary income. Thus, for example, if the selling member has deferred gain of $100, of which $70 is capital gain and $30 is ordinary income, the first $30 taken into account by the selling member under subparagraph (1) of this paragraph shall be applied against the ordinary income, and any additional amounts so taken into account shall be applied against the capital gain.

(e) *Restoration of deferred gain or loss for installment obligations and sales*—(1) *Installment obligations.* If an installment obligation (within the meaning of section 453(d)) is transferred in a deferred intercompany transaction, then on each date on which the obligation is satisfied the selling member shall take into account an amount equal to the deferred gain or loss on such transfer, multiplied by a fraction, the numerator of which is the portion of such obligation satisfied on such date, and the denominator of which is the aggregate unpaid installments immediately after the deferred intercompany transaction.

(2) *Installment sales.* If—

(i) Property acquired in a deferred intercompany transaction is disposed of outside the group, and

(ii) The purchasing member-vendor reports its income on the installment method under section 453,

then on each date on which the purchasing member-vendor receives an installment payment the selling member shall take into account an amount equal to the deferred gain or loss attributable to such property (after taking into account any prior reductions under paragraph (d)(4) of this section) multiplied by a fraction, the numerator of which is the installment payment received and the denominator of which is the total contract price.

(3) *Reduction of deferred gain or loss.* The deferred gain or loss shall be reduced by the amount taken into account by the selling member under subparagraph (1) or (2) of this paragraph. If the deferred gain includes any ordinary income, the reduction shall first be applied against the ordinary income.

(f) *Restoration of deferred gain or loss on dispositions, etc.*—(1) *General rule.* The remaining balance (after taking into account any prior reductions under paragraphs (d)(4) and (e)(3) of this section) of the deferred gain or loss attributable to property, services, or other expenditure shall be taken into account by the selling member as of the earliest of the following dates:

(i) The date on which such property is disposed of outside the group (including abandoned) other than in a transaction described in paragraph (e)(2) of this section (but not including a normal retirement, as defined in paragraph (b) of § 1.167(a)–8, from an average-life multiple asset account or from a single asset account for which an average rate is used). If such property is of a kind which would properly be included in the inventory of a member if on hand at the close of its taxable year, such member shall determine whether or not such item of property has been disposed of outside the group by reference to its method of inventory identification (e.g., first-in, first-out, last-in, first-out, or specific identification);

(ii) In the case of a transaction described in paragraph (e)(2) of this section, the date on which the installment debt is written off, satisfied, discharged, or disposed of outside the group or the property sold is repossessed (except as provided in section 1038), whichever occurs earliest;

(iii) Immediately preceding the time when either the selling member or the

member which owns the property ceases to be a member of the group;

(iv) In the case of property which is stock in trade or other property of a kind which would be properly included in inventory of the member which owns the property if on hand at the close of such member's taxable year, or held primarily for sale to customers in the ordinary course of such member's trade or business, the first day of the first separate return year of the selling member or the member which owns the property;

(v) In the case of an obligation (other than an obligation of a member of the group), the date on which such obligation is satisfied or becomes worthless;

(vi) In the case of stock, the date on which such stock is redeemed (whether or not it is canceled, retired, or held as treasury stock) or becomes worthless.

(vii) If consolidated returns are filed by the group for fewer than three consecutive taxable years immediately preceding a separate return year of the common parent, the first day of such separate return year; or

(viii) In the case of inventory, the date on which its value is written down to market (if the lower-of-cost-or-market method is used by the purchaser), but only to the extent of such write-down.

(2) *Exception.* Subparagraph (1)(iii) of this paragraph shall not apply in a case where—

(i) The selling member, or the member which owns the property as the case may be, ceases to be a member of the group by reason of an acquisition to which section 381(a) applies, and the acquiring corporation is a member, or

(ii) The group is terminated, and immediately after such termination the corporation which was the common parent owns the property involved and is the selling member or is treated as the selling member under paragraph (c)(6) of this section.

Paragraphs (d) and (e) of this section and this paragraph shall apply to such selling member. Thus, for example, subparagraph (1)(iii) of this paragraph shall not apply in a case where corporation P, the common parent of a group consisting of P and corporations S and T, sells an asset to S in a deferred intercompany transaction, and subsequently all of the assets of S are distributed to P in complete liquidation of S. Moreover, if, after the liquidation of S, P sold T, subparagraph (1)(iii) of this paragraph would not apply even though P ceases to be a member of the group.

(3) *Certain divestitures.* If, pursuant to a final judgment or a final order of a court or an agency of the Federal or a State government, any member or members are required to divest themselves of control of any other member and, as a result, any member ceases to be a member, the Commissioner may enter into a closing agreement under section 7121 with the group. Such closing agreement may provide that any deferred gain or loss which would otherwise be taken into account under subparagraph (1)(iii) of this paragraph shall instead be taken into account over an appropriate period of time related to the period of time within which the deferred income would have been taken into account had the divestiture not taken place, but not in excess of 10 years. Ordinarily, application for such closing agreement will not be granted where such divestiture is occasioned by the acquisition after August 31, 1966, of control of a corporation or of assets. In no event will any such application be granted unless the group establishes to the satisfaction of the Commissioner that the collection of the tax liability attributable to any deferred gain will not be jeopardized by the delay.

(g) *Holding period.* In determining the period for which a purchasing member has held property acquired in a deferred intercompany transaction, the period such property was held by the selling member shall not be included.

(h) *Examples.* This section may be illustrated by the following examples:

*Example (1).* (i) Corporations P and S file consolidated returns on a calendar year basis. On January 10, 1966, S sells land, which it has used in its trade or business, to P for $100,000. Immediately before the sale the basis of the land in S's hands is $60,000. P holds the land primarily for sale to customers in the ordinary course of its trade or business. On July 12, 1967, P sells the land to A, an individual.

(ii) The sale by S to P is a deferred intercompany transaction; S defers its $40,000 gain on the land ($100,000 less $60,000), which is gain from the sale of property described in section 1231. As of July 12, 1967, S takes the $40,000 deferred gain into account since on such date the property is disposed of outside the group. Such $40,000 gain is taken into account in determining the consolidated section 1231 net gain or loss for 1967 under § 1.1502-23.

*Example (2).* Corporations P and S file consolidated returns on a calendar year basis. On August 1, 1966, P transfers property with a fair market value of $100,000 and an adjusted basis in its hands of $85,000 to S in exchange for stock and $10,000 cash. Under section 351(b), only $10,000 of the $15,000 gain is recognized by P. The transfer is a deferred intercompany transaction; P defers the $10,000 gain recognized under section 351(b).

*Example (3).* Corporations P and S file consolidated returns on a calendar year basis and report income on the cash basis. On July 1, 1966, S pays P $1,000 interest on a loan made in 1961. The payment of interest is an intercompany transaction other than a deferred intercompany transaction; S does not defer or eliminate the $1,000 deduction for interest, and P does not defer or eliminate the $1,000 item of interest income. Thus, consolidated taxable income for 1966 reflects interest income of $1,000 and a corresponding deduction for interest of $1,000.

*Example (4).* (i) Corporations P, S, and T file consolidated returns on a calendar year basis. On January 1, 1966, S, which is in the business of manufacturing machinery, sells a machine to P for $1,000. The cost of the machine is $800. P uses the machine in its trade or business and depreciates it on the straight-line method over an estimated useful life of 10 years. Salvage value of $200 is taken into account. Thus, its annual depreciation deduction with respect to the machine is $80 ($800 ($1,000 less $200 salvage) divided by 10). On January 1, 1969, P sells the machine to A, an individual.

(ii) The sale by S to P is a deferred intercompany transaction; S defers its $200 gain on the machine ($1,000 less $800), which is characterized as ordinary income. For each of the 3 taxable years (1966, 1967, and 1968) prior to the sale to A, S takes into account $20 of its deferred gain, computed as follows:

$$\$200 \text{ deferred gain} \times \frac{\$80 \text{ depreciation deduction}}{\$800 \text{ basis to P subject to depreciation}}$$

Such $20 gain retains its character as ordinary income.

(iii) As of January 1, 1969, S takes the $140 remaining balance of the deferred gain ($200 less $60) into account since on such date the machine is disposed of outside the group. Such $140 gain retains its character as ordinary income.

*Example (5).* (i) The facts are the same as in example (4) except that beginning with 1968 P and S file separate returns.

(ii) Assuming that P, S, and T filed a consolidated return for 1965, the result is the same as in example (4). Thus, for each of the years 1966, 1967, and 1968 S takes into account $20 of its deferred gain and as of January 1, 1969, S takes the remaining $140 ($200 less $60) into account.

(iii) Assuming that P, S, and T filed separate returns for 1965, as of January 1, 1968, S takes the $160 remaining balance of the deferred gain ($200 less $40) into account since P filed a separate return for 1968 and the group had filed consolidated returns for only 2 consecutive years preceding 1968.

*Example (6).* (i) The facts are the same as in example (4) except that on January 1, 1969, P sells the machine to T for $660 in a transaction in which gain is recognized. T uses the machine in its trade or business and depreciates it on the straight-line method over an estimated useful life of 10 years. No salvage value is taken into account. Thus, T's annual depreciation deduction with respect to the machine is $66 ($660 divided by 10).

(ii) The sale by S to P is a deferred intercompany transaction; S defers its $200 gain on the machine ($1,000 less $800), which is characterized as ordinary income. For each of the 3 years (1966, 1967, and 1968) prior to the sale to T, S takes into account $20 of its deferred gain.

(iii) The sale by P to T is also a deferred intercompany transaction; P defers its $100 loss on the machine (adjusted basis of $760 ($1,000 less $240 total depreciation) less $660).

(iv) For 1969 S takes into account $14 of its deferred gain, computed as follows:

$$\$140 \text{ remaining balance of deferred gain} \times \frac{\$66 \text{ depreciation deduction}}{\$660 \text{ basis to T subject to depreciation}}$$

(v) For 1969 P takes into account $10 of its deferred loss, computed as follows:

$$\$100 \text{ deferred loss} \times \frac{\$66 \text{ depreciation deduction}}{\$660 \text{ basis to T subject to depreciation}}$$

*Example (7).* (i) Corporations P and S file consolidated returns on a calendar year basis. On May 2, 1966, S sells a machine with an adjusted basis of $50 to P for $100 in a transaction in which gain is recognized. S used the machine in its trade or business. For purposes of depreciation, P places the machine, which has an estimated useful life of 3 years, in an average life multiple asset account which is depreciated on the straight-line method at a rate of 20 percent. Under P's consistent depreciation practice it takes a full year's depreciation on all purchases made in the first half of its taxable year.

(ii) The sale by S to P is a deferred intercompany transaction; S defers its $50 gain on the machine ($100 less $50). For each of the taxable years 1966, 1967, 1968, 1969, and 1970 S takes into account $10 of its deferred gain, computed as follows:

$$\$50 \text{ deferred gain} \times \frac{\$20 \text{ depreciation deduction}}{\$100 \text{ basis to P subject to depreciation}}$$

Such $10 is characterized as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231, notwithstanding the character of the $50 gain determined at the time of the sale.

*Example (8).* The facts are the same as in example (7) and in addition during 1969 the machine is disposed of outside the group. Such disposal is treated as a normal retirement (as defined in paragraph (b) of § 1.167(a)-8). The result is the same as in example (7). Thus, S takes into account $10 for each of the years 1966, 1967, 1968, 1969, and 1970 even though the property was disposed of in 1969.

*Example (9).* (i) The facts are the same as in example (7) except that the multiple asset account is depreciated over a 5-year average useful life on the double declining balance method.

(ii) For 1966 S takes into account $20 of its deferred gain, computed as follows:

$$\$50 \text{ deferred gain} \times \frac{\$40\ (\$100 \times 40\%) \text{ depreciation deduction}}{\$100 \text{ basis to P subject to depreciation}}$$

For 1967 S takes into account $12 of its deferred gain, computed as follows:

$$\$50 \text{ deferred gain} \times \frac{\$24\ (\$60\ (\$100 \text{ less } \$40) \times 40\%) \text{ depreciation deduction}}{\$100 \text{ basis to P subject to depreciation}}$$

*Example (10).* (i) P Corporation and S Corporation, its wholly-owned subsidiary, file consolidated returns on a calendar year basis. On January 10, 1966, S sells land, with a basis of $60,000, to P for $100,000. As of the close of business on June 10, 1969, P sells 25 percent of the outstanding stock of S to A, an individual.

(ii) The sale by S to P is a deferred intercompany transaction; S defers its $40,000 gain on the land ($100,000 less $60,000). As of June 10, 1969, S takes the $40,000 gain into account for 1969 since it ceases to be a member of the group as of the close of business on such date.

*Example (11).* (i) Corporations P and S file consolidated returns on a calendar year basis. On January 15, 1966, P sells an obligation payable in installments, with a basis of $48 in its hands, to S for $60. At the time of the sale the debtor owes 3 annual installments of $20 payable each year on July 1. Such installments are paid timely.

(ii) The sale by P to S is a deferred intercompany transaction; P defers its $12 gain on the obligation ($60 less $48).

(iii) For each of the years 1966, 1967, and 1968 P takes into account $4 of its deferred gain, computed as follows:

$$\$12 \text{ deferred gain} \times \frac{\$20 \text{ portion satisfied}}{\$60 \text{ aggregate unpaid portions}}$$

*Example (12).* (i) Corporations P and S file consolidated returns on a calendar year basis. On January 2, 1966, S, a manufacturer, sells a machine to P, a distributor, for $2,000. The machine cost S $1,200. On February 1, 1966, P sells the machine to A, an individual, for $2,200 and, under section 453, reports its income thereon on the installment plan. A makes monthly payments of $110 starting with March 1966.

(ii) The sale by S to P is a deferred intercompany transaction; S defers its $800 gain ($2,000 less $1,200).

(iii) For 1966 S takes into account $400 of its deferred gain, computed as follows:

$$\$800 \text{ deferred gain} \times \frac{\$1,100 \text{ installment payments received}}{\$2,200 \text{ total contract price}}$$

*Example (13).* Corporations P and S file consolidated returns on a calendar year basis for 1966 and 1967. S reports income on the accrual method while P reports income on the cash method. On December 31, 1966, S would properly accrue interest of $1,000 which is payable to P. On February 1, 1967, S pays P the $1,000. Both the deduction and the item of income are taken into account for 1967, the later year. Thus, S takes the $1,000 interest deduction into account for 1967, which is the year P also takes the $1,000 item of interest income into account. Consolidated taxable income for 1967 reflects both interest income of $1,000 and a corresponding deduction for interest of $1,000.

*Example (14).* The facts are the same as in example (13) except that for 1967 S and P file separate returns. The result is the same as in example (13).

*Example (15).* (i) The facts are the same as in example (13) except that for 1966 P and S file separate returns.

(ii) For 1966 S takes into account the $1,000 deduction for interest; for 1967 P takes into account the $1,000 item of interest income.

*Example (16).* Corporations P and S file consolidated returns on a calendar year basis. On January 10, 1968, P sells an issue of its $100 par value bonds. S purchases a bond from P for $110. S does not elect under section 171 to amortize the $10 premium. P may not take the $10 premium into account as income until it redeems the bond since S cannot properly take a deduction for the $10 premium until the bond is redeemed.

*Example (17).* (i) Corporations P, S, and M file consolidated returns on a calendar year basis. On November 20, 1962, S sold land, with a basis of $60,000, to P for $100,000. Under paragraph (b)(1) of § 1.1502-31A the $40,000 gain was eliminated. Thus, S did not take into account such $40,000 gain for 1962 and P's basis in the land is only $60,000. On February 10, 1966, P sells the land to A, an individual, for $104,000.

(ii) P takes the entire $44,000 gain ($104,000 less $60,000) on the land into account for 1966 since the deferral rules provided in paragraph (c) of this section, as well as the corresponding basis rules provided in paragraph (a) of § 1.1502-31, were not effective with respect to the sale of such land.

(iii) If, on February 10, 1966, P had sold the land to M for $104,000, P would defer its $44,000 gain on the land since the sale by P to M would be a deferred intercompany transaction.

*Example (18).* (i) Corporations P and S file separate returns on a calendar year basis for 1966 and file consolidated returns on a calendar year basis beginning with 1967. On January 2, 1966, S, a dealer in machinery, sells a machine to P for $2,000 and, under section 453, reports the income thereon on the installment plan. The machine cost S $1,200. P makes monthly payments of $100 starting with January 1966.

(ii) The sale by S to P is not an intercompany transaction since the sale did not occur during a consolidated return year. Therefore, S takes into account the gross profit on each of the 20 monthly payments under section 453.

(i) [Reserved]

(j) *Regulated public utilities.* Subject to the provisions of section 7121, the Commissioner may enter into a closing agreement which, notwithstanding the provisions of §§ 1.1502-13, 1.1502-31, and 1.1502-33, determines the consequences of deferred intercompany transactions or of any matters relating to or affected by such transactions, provided that—

(1) The purchasing members are domestic regulated public utilities as defined in section 7701(a) (4) and (33),

(2) In the taxable year immediately preceding the first taxable year for which this section is effective there was in effect among the members an arrangement relating to intercompany transactions which had a significant effect upon regulated rates of the public utility members of the group, and the accounting of the public utility members under the arrangement was accepted or approved by a regulatory agency having jurisdiction over the accounts of such members, and

(3) The Commissioner is satisfied that the terms of such closing agreement will not for any taxable year result in a reduction of the tax liability of the group (including former members) or of the shareholders of any members (or former members).

A request for such an agreement must be made on or before November 15, 1966.

**§ 1.1502-14 [Reserved]**

**§ 1.1502-15 Limitations of certain deductions.**

(a) *Limitation on built-in deductions*—(1) *General rule.* Built-in deductions (as defined in subparagraph (2) of this paragraph) for a taxable year shall be subject to the limitation of § 1.1502-21 (c) (determined without regard to such deductions and without regard to net operating loss carryovers to such year) and the limitation of § 1.1502-22(c) (determined without regard to such deductions and without regard to capital loss carryovers to such year). If as a result of applying such limitations, built-in deductions are not allowable in such consolidated return year, such deductions shall be treated as a net operating loss or net capital loss (as the case may be) sustained in such year and shall be carried to those taxable years (consolidated or separate) to which a consolidated net

operating loss or a consolidated net capital loss could be carried under §§ 1.1502–21, 1.1502–22, and 1.1502–79, except that such losses shall be treated as losses subject to the limitations contained in § 1.1502–21(c) or § 1.1502–22(c) (as the case may be). Thus, for example, if member X sells a capital asset during a consolidated return year at a $1,000 loss and such loss is treated as a built-in deduction, then such loss shall be subject to the limitation contained in § 1.1502–22(c), which, in general, would allow such loss to be offset only against X's own net capital gain. Assuming X had no net capital gain reflected in such year (after taking into account its capital losses, other than capital loss carryovers and the built-in deduction), such $1,000 loss shall be treated as a net capital loss and shall be carried over for 5 years under § 1.1502–22, subject to the limitation contained in § 1.1502–22(c) for consolidated return years.

(2) *Built-in deductions.* For purposes of this paragraph, the term "built-in deductions" for a consolidated return year means those deductions or losses of a corporation which, but for this section, would be recognized in such year, or which are recognized in a separate return year and carried over in the form of a net operating or net capital loss to such year, but which are economically accrued in a separate return limitation year (as defined in § 1.1502–1(f)). Such term does not include deductions or losses incurred both economically and taxwise in a year which is not a separate return limitation year, including those deductions and losses incurred in rehabilitating such corporation. Thus, for example, assume P is the common parent of a group filing consolidated returns on the basis of a calendar year and that P purchases all of the stock of S on December 31, 1966. Assume further that on December 31, 1966, S owns a capital asset with an adjusted basis of $100 and a fair market value of $50. If the group files a consolidated return for 1967, and S sells the asset for $30, $50 of the $70 loss is treated as a built-in deduction, since it was economically accrued in a separate return limitation year. If S sells the asset for $80 instead of $30, the $20 loss is treated as a built-in deduction. On the other hand, if such asset is a depreciable asset and is not sold by S, depreciation deductions attributable to the $50 difference between basis and fair market value are treated as built-in deductions.

(3) *Exceptions.* (i) This paragraph shall not limit built-in deductions which would otherwise be recognized in a taxable year if—

(*a*) The date on which the corporation with the built-in deductions became a member occurred more than 10 years before the first day of such taxable year, or

(*b*) Immediately before the date the corporation became a member, the aggregate of the adjusted basis of all the assets (other than cash, any marketable security the fair market value of which was not less than 95 percent of its adjusted basis, and goodwill) of such corporation did not exceed the fair market value of such assets by more than 15 percent.

(ii) If the corporation with the built-in deduction became a member before October 1, 1965, the provisions of § 1.1502–31A(b)(9) shall apply in lieu of the provisions of this section.

(b) [Reserved]

### § 1.1502–16 Mine exploration expenditures.

(a) *In general.* If the aggregate amount of the expenditures, to which section 615(a) applies, which are paid or incurred by the members of the group during any consolidated return year exceeds the lesser of—

(1) $100,000, or

(2) $400,000 minus all such expenditures deducted (or deferred) by corporations which are members of the group during the taxable year (and individuals or corporations which have transferred any mineral property to any such member within the meaning of section 615(c)(2)(B)) for taxable years ending after December 31, 1950, and prior to the taxable year,

then the deduction (or amount deferrable) under section 615 and paragraph (c) of § 1.1502–12 for each member shall be no greater than an allocable portion of such lesser amount (hereinafter referred to as the "consolidated exploration limitation"). Such allocable portion shall be determined under paragraph (b) of this section.

(b) *Allocable portion of limitation.* A member's allocable portion of the consolidated exploration limitation for a consolidated return year shall be—

(1) The amount allocated by the common parent pursuant to a plan, but in no event shall a member be allocated more than the amount it could have deducted (or deferred) had it filed a separate return. Such allocation plan must be included in a statement which also contains the total exploration expenditures of each member for the taxable year, and the expenditures of each member which could have been deducted (or deferred) under section 615 if the member had filed a separate return. Such statement must be attached to a consolidated return filed on or before the due date of such return (including extensions of time), and may not be changed after such date, or

(2) If no statement is filed in accordance with subparagraph (1), then the portion of the consolidated exploration limitation allocable to each member incurring such expenditures is an amount equal to such limitation multiplied by a fraction, the numerator of which is the amount which could have been deducted (or deferred) under section 615 by such member had it filed a separate return and the denominator of which is the aggregate of such amounts for all members of the group.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example (1).* Corporation X and its wholly-owned subsidiaries, corporations Y and Z, filed a consolidated return for the calendar year 1966. None of the corporations have incurred exploration expenditures described in section 615 in previous years. During 1966, X incurred exploration expenditures of $30,000, Y of $20,000 and Z of $40,000. The amount deductible (or deferrable) under section 615 for purposes of computing separate taxable income under § 1.1502–12 will be the amount actually expended by each corporation.

*Example (2).* Assume the same facts as in example (1) except that during 1966 X incurred exploration expenditures of $25,000, Y of $75,000 and Z of $125,000. The consolidated exploration limitation under paragraph (a) of this section is $100,000 since the aggregate amounts incurred by the members of the group exceed $100,000 and such amount is less than the limitation described in paragraph (a)(2) of this section ($400,000). X may allocate the $100,000 in any manner among the three members, except that X may not be allocated more than $25,000 nor Y more than $75,000, the amounts actually expended by X and Y and which they could have deducted (or deferred) had they filed a separate return. If the allocation is not made in accordance with paragraph (b)(1) of this section, the $100,000 limitation will be allocated under paragraph (b)(2) as follows:

| *Corporation* | *Expenditure* | *Fraction* | *Limitation* | *Allocable Portion* |
|---|---|---|---|---|
| X | $25,000 | 25,000/200,000 | ×$100,000 | =$12,500 |
| Y | $75,000 | 75,000/200,000 | ×$100,000 | =$37,500 |
| Z | $125,000 | 100,000/200,000 | ×$100,000 | =$50,000 |

The denominator of $200,000 was calculated as follows:

X=$25,000
Y=$75,000
Z=$100,000 (maximum amount allowed if filed separately)
Total $200,000

*Example (3).* Assume the same facts as in example (2) and that on January 1, 1967, X acquired all of the stock of corporation T which prior to its taxable year beginning January 1, 1967, had previously deducted (or deferred) $310,000 of exploration expenditures. Assume further that in 1967 X incurred $25,000 of exploration expenditures, Y $50,000, T $50,000 and Z none. A consolidated return is filed for 1967. None of the expenditures may be deducted (or deferred) under section 615 since the consolidated exploration limitation is zero. The limitation is zero since the aggregate amount of previously deducted (or deferred) exploration expenditures by the members of the group exceeds $400,000. (The total of such expenditures is $410,000, of which $310,000 is attributable to T and, assuming the allocation of the limitation in example (2) is made under paragraph (b)(2) of this section, of which $12,500 is attributable to X, $37,500 to Y, and $50,000 to Z.)

*Example (4).* Assume the same facts as in example (3) except that on December 31, 1966, X sold all of the stock of Z to an unrelated party. The consolidated exploration limitation for 1967 will be $40,000, computed by subtracting from $400,000 the aggregate amount of previously deducted (or deferred) exploration expenditures incurred by the members of the group prior to 1967. (The total of such expenditures is $360,000, of which $12,500 is attributable to X, $37,500 to Y and $310,000 to T. Amounts previously deducted (or deferred) by Z are not taken into account since it was not a member of

the group at any time during 1967. Amounts previously deducted (or deferred) by Z shall be taken into account by it for subsequent separate return years.)

**§ 1.1502–17 Methods of accounting.**

(a) *General rule.* The method of accounting to be used by each member of the group shall be determined in accordance with the provisions of section 446 as if such member filed a separate return. For treatment of depreciable property after a transfer within the group, see paragraph (g) of § 1.1502–12.

(b) *Adjustments required where method of accounting changed.* In any case in which a member of a group changes its method of accounting for a consolidated return year, the provisions of section 481(a) shall be applicable. If the requirements of section 481(b) are met because the adjustments under section 481(a) are substantial, the increase in tax for any prior year shall be computed upon the basis of a consolidated return or a separate return, whichever was filed for such prior year.

(c) *Example.* The provisions of this section may be illustrated by the following example:

*Example.* X and its wholly-owned subsidiary Y filed separate returns for their calendar years ending December 31, 1965. During calendar year 1965, X employed an accrual method of accounting, established a reserve for bad debts, and elected under section 171 to amortize bond premiums with respect to its fully taxable bonds. During calendar year 1965, Y employed the cash receipts and disbursements method, used the specific charge-off method with respect to its bad debts, and did not elect to amortize bond premiums under section 171 with respect to its bonds. X and Y filed a consolidated return for 1966. For 1966 X and Y must continue to compute income under their respective methods of accounting (unless a change in method under section 446 is made).

(a) *Definition of intercompany profit amount.* For purposes of this section, the term "intercompany profit amount" for a taxable year means an amount equal to the profits of a corporation (other than those profits which such corporation has elected not to defer pursuant to § 1.1502–13(c)(3)) arising in transactions with other members of the group with respect to goods which are, at the close of such corporation's taxable year, included in the inventories of other members of the group. See § 1.1502–13(c)(2) with respect to the determination of profits. See the last sentence of § 1.1502–13(f)(1)(i) for rules for determining which goods are considered to be disposed of outside the group and therefore not included in inventories of other members.

(b) *Addition of initial inventory amount to taxable income.* If a corporation—

(1) Is a member of a group filing a consolidated return for the taxable year,

(2) Was a member of such group for its immediately preceding taxable year, and

(3) Filed a separate return for such preceding year,

then the intercompany profit amount of such corporation for such separate return year (hereinafter referred to as the "initial inventory amount") shall be added to the income of such corporation for the consolidated return year (or years) in which the goods to which the initial inventory amount is attributable are disposed of outside the group or such corporation becomes a nonmember. Such amount shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(c) *Recovery of initial inventory amount*—(1) *Unrecovered inventory amount.* The term "unrecovered inventory amount" for any consolidated return year means the lesser of—

(i) The intercompany profit amount for such year, or

(ii) The initial inventory amount.

However, if a corporation ceases to be a member of the group during a consolidated return year, its unrecovered inventory amount for such year shall be considered to be zero.

(2) *Recovery during consolidated return years.* (i) To the extent that the unrecovered inventory amount of a corporation for a consolidated return year is less than such amount for its immediately preceding year, such decrease shall be treated for such year by such corporation as a loss from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(ii) To the extent that the unrecovered inventory amount for a consolidated return year exceeds such amount for the preceding year, such increase shall be treated as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(3) *Recovery during first separate return year.* For the first separate return year of a member following a consolidated return year, the unrecovered inventory amount for such consolidated return year (minus any part of the initial inventory amount which has not been added to income pursuant to paragraph (b) of this section) shall be treated as a loss from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

(d) *Examples.* The provisions of paragraphs (a), (b), and (c) of this section may be illustrated by the following examples:

*Example (1).* Corporations P, S, and T report income on the basis of a calendar year. Such corporations file separate returns for 1965. P manufactures widgets which it sells to both S and T, who act as distributors. The inventories of S and T at the close of 1965 are comprised of widgets which they purchased from P and with respect to which P derived profits of $5,000 and $8,000, respectively. P, S, and T file a consolidated return for 1966. During 1966, P sells widgets to S and T with respect to which it derives profits of $7,000 and $10,000, respectively. The inventories of S and T as of December 31, 1966, are comprised of widgets on which P derived net profits of $4,000 and $8,000, respectively. P's initial inventory amount is $13,000, P's intercompany profit amount for 1965 (such $13,000 amount is the profits of P with respect to goods sold to S and T and included in their inventories at the close of 1965). Assuming that S and T identify their goods on a first-in, first-out basis, the entire opening inventory amount of $13,000 is added to P's income for 1966 as gain from the sale or exchange of property which is neither a capital asset nor properly described in section 1231, since the goods to which the initial inventory amount is attributable were disposed of in 1966 outside the group. However, since P's unrecovered inventory amount for 1966, $12,000 (the intercompany profit amount for the year, which is less than the initial inventory amount), is less than the unrecovered inventory amount for 1965, $13,000, this decrease of $1,000 is treated by P for 1966 as a loss from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

*Example (2).* Assume the same facts as in example (1) and that at the close of 1967, a consolidated return year, the inventories of S and T are comprised of widgets on which P derived profits of $5,000 and $3,000, respectively. Since P's unrecovered inventory amount for 1967, $8,000, is less than $12,000, the unrecovered inventory amount for 1966, this decrease of $4,000 is treated by P for 1967 as a loss from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

*Example (3).* Assume the same facts as in examples (1) and (2) and that in 1968, a consolidated return year, P's intercompany profit amount is $11,000. P will report $3,000 (the excess of $11,000, P's unrecovered inventory amount for 1968, over $8,000, P's unrecovered inventory amount for 1967) for 1968 as a gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

*Example (4).* Assume the same facts as in examples (1), (2), and (3) and that in 1969 P, S, and T file separate returns. P will report $11,000 (its unrecovered inventory amount for 1968, $11,000, minus the portion of the initial inventory amount which has not been added to income during 1966, 1967, and 1968, zero) as a loss from the sale or exchange of property which is neither a capital asset nor property described in section 1231.

*Example (5).* Corporations P and S file a consolidated return for the first time for the calendar year 1966. P manufactures machines and sells them to S, which sells them to users throughout the country. At the close of 1965, S has on hand 20 machines which it purchased from P and with respect to which P derived profits of $3,500. During 1966, P sells 6 machines to S on which it derives profits of $1,300, and S sells 5 machines which it had on hand at the beginning of the year (S specifically identifies the machines which it sells) and on which P had derived profits of $900. P's initial inventory amount is $3,500, of which $900 is added to P's income in 1966 as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231, since such $900 amount is attributable to goods disposed of in 1966 outside the group, which goods were included in S's inventory at the close of 1965. If P and S continue to file consolidated returns, the remaining $2,600 of the initial inventory amount will be added to P's income as the machines on which such profits were derived are disposed of outside the group.

*Example (6).* Assume that in example (5) S had elected to inventory its goods under section 472 (relating to last-in, first-out inventories). None of P's initial inventory amount of $3,500 would be added to P's income in 1966, since none of the goods to which such amount is attributable would be considered to be disposed of during such year under the last-in, first-out method of identifying inventories.

(e) *Section 381 transfer.* If a member of the group is a transferor or distributor of assets to another member of the group within the meaning of section 381(a), then the acquiring corporation shall be treated as succeeding to the initial inventory amount of the transferor or distributor corporation to the extent that as of the date of distribution or transfer such amount has not yet been added to income. Such amount shall then be added to the acquiring corporation's income under the provisions of paragraph (b) of this section. For purposes of applying paragraph (c) of this section—

(1) The initial inventory amount of the transferor or distributor corporation shall be added to such amount of the acquiring corporation as of the close of the acquiring corporation's taxable year in which the date of distribution or transfer occurs, and

(2) The unrecovered inventory amount of the transferor or distributor corporation for its taxable year preceding the taxable year of the group in which the date of distribution or transfer occurs shall be added to such amount of the acquiring corporation.

(f) *Transitional rules*—(1) *In general.* If—

(i) A group filed a consolidated return for the taxable year immediately preceding the first taxable year to which this section applies,

(ii) Any member of such group made an opening adjustment to its inventory pursuant to paragraph (b) of § 1.1502-39A, and

(iii) Paragraph (c) of § 1.1502–39A has not been applicable for any taxable year subsequent to the taxable year for which such adjustment was made,

then subparagraphs (2) and (3) of this paragraph shall apply.

(2) *Closing adjustment to inventory.* (i) For the first consolidated return year to which this section applies, the increase in inventory prescribed in paragraph (c) of § 1.1502–39A shall be made as if such year were a separate return year.

(ii) For the first separate return year of a member to which this section applies, the adjustment to inventory (whether an increase or a decrease) prescribed in paragraph (c) of § 1.1502–39A, minus any adjustment already made pursuant to subdivision (i) of this subparagraph, shall be made to the inventory of such member.

(3) *Addition and recovery of initial inventory amount.* Each selling member shall treat as an initial inventory amount its share of the net amount by which the inventories of all members are increased pursuant to subparagraph (2)(i) of this paragraph for the first taxable year to which this section applies. A member's share shall be such net amount multiplied by a fraction, the numerator of which is its initial inventory amount (computed under paragraph (b) as if such taxable year were its first consolidated return year), and the denominator of which is the sum of such initial inventory amounts of all members. Such initial inventory amount shall be added to the income of such selling member and shall be recovered at the time and in the manner prescribed in paragraphs (b) and (c) of this section.

(4) *Example.* The provisions of this paragraph may be illustrated by the following example:

*Example.* (i) Corporations P, S, and T file consolidated returns for calendar 1966, having filed consolidated returns continuously since 1962. P is a wholesale distributor of groceries selling to chains of supermarkets, including those owned by S and T. The opening inventories of S and T for 1962 were reduced by $40,000 and $80,000, respectively, pursuant to paragraph (b) of § 1.1502–39A. At the close of 1965, S and T have on hand in their inventories goods on which P derived profits of $80,000 and $90,000, respectively. The inventories of S and T at the close of 1966 include goods which they purchased from P during the year on which P derived profits of $85,000 and $105,000, respectively.

(ii) The opening inventories of S and T for 1966, the first year to which this section applies, are increased by $40,000 and $80,000, respectively, pursuant to the provisions of subparagraph (2)(i) of this paragraph. P will take into account (as provided in paragraphs (b) and (c) of this section) an initial inventory amount of $120,000 as of the beginning of 1966, the net amount by which the inventories of S and T were increased in such year. Since the increases in the inventories of S and T are the maximum allowable under paragraph (c) of § 1.1502–39A (i.e., the amount by which such inventories were originally decreased), no further adjustments will be made pursuant to subparagraph (2)(ii) of this paragraph to such inventories in the event that separate returns are subsequently filed.

(5) *Election not to eliminate.* If a group filed a consolidated return for the taxable year immediately preceding the first taxable year to which this section applies, and for such preceding year the members of the group did not eliminate gain or loss on intercompany inventory transactions pursuant to the adoption under § 1.1502–31A(b)(1) of a consistent accounting practice taking into account such gain or loss, then for purposes of this section each member shall be treated as if it had filed a separate return for such immediately preceding year.

**§§ 1.1502–19 and 1.1502–20 [Reserved]**

COMPUTATION OF CONSOLIDATED ITEMS

**§ 1.1502–21 Consolidated net operating loss deduction.**

(a) *In general.* The consolidated net operating loss deduction shall be an amount equal to the aggregate of the consolidated net operating loss carryovers and carrybacks to the taxable year (as determined under paragraph (b) of this section).

(b) *Consolidated net operating loss carryovers and carrybacks*—(1) *In general.* The consolidated net operating loss carryovers and carrybacks to the taxable year shall consist of any consolidated net operating losses (as determined under paragraph (f) of this section) of the group, plus any net operating losses sustained by members of the group in separate return years, which may be carried over or back to the taxable year under the principles of section 172(b). However, such consolidated carryovers and carrybacks shall not include any consolidated net operating loss apportioned to a corporation for a separate return year pursuant to paragraph (a) of § 1.1502–79, and shall be subject to the limitations contained in paragraphs (c), (d), and (e) of this section and to the limitation contained in § 1.1502–15.

(2) *Rules for applying section 172(b)(1)*—(i) *Regulated transportation corporations.* For purposes of applying section 172(b)(1)(C) (relating to net operating losses sustained by regulated transportation corporations), in the case of a consolidated net operating loss sustained in a taxable year for which a member of the group was a regulated transportation corporation (as defined in section 172(j)(1)), the portion, if any, of such consolidated net operating loss which is attributable to such corporation (as determined under paragraph (a)(4) of § 1.1502–79) shall be a carryover to the sixth taxable year following the loss year only if such corporation is a regulated transportation corporation for such sixth year, and shall be a carryover to the seventh taxable year following the loss year only if such corporation is a regulated transportation corporation for both such sixth and seventh years.

(ii) *Trade expansion losses.* In the case of a carryback of a consolidated net operating loss from a taxable year for which a member of the group has been issued a certification under section 317 of the Trade Expansion Act of 1962 and with respect to which the requirements of section 172(b)(3)(A) have been met, section 172(b)(1)(A)(ii) shall apply only to the portion of such consolidated net operating loss attributable to such member.

(iii) *Foreign expropriation losses.* An election under section 172(b)(3)(C) (relating to 10-year carryover of portion of net operating loss attributable to a foreign expropriation loss) may be made for a consolidated return year only if the sum of the foreign expropriation losses (as defined in section 172(k)) of the members of the group for such year equals or exceeds 50 percent of the consolidated net operating loss for such year. If such election is made, the amount which may be carried over under section 172(b)(1)(D) is the smaller of (*a*) the sum of such foreign expropriation losses, or (*b*) the consolidated net operating loss.

(3) *Absorption rules.* For purposes of determining the amount, if any, of a net operating loss (whether consolidated or separate) which can be carried to a taxable year (consolidated or separate), the amount of such net operating loss which is absorbed in a prior consolidated return year under section 172(b)(2) shall be determined by—

(i) Applying all net operating losses which can be carried to such prior year in the order of the taxable years in which such losses were sustained, beginning with the taxable year which ends earliest, and

(ii) Applying all such losses which can be carried to such prior year from taxable years ending on the same date on

a pro rata basis, except that any portion of a net operating loss attributable to a foreign expropriation loss to which section 172(b)(1)(D) applies shall be applied last.

(c) *Limitation on net operating loss carryovers and carrybacks from separate return limitation years*—(1) *General rule.* In the case of a net operating loss of a member of the group arising in a separate return limitation year (as defined in paragraph (f) of § 1.1502–1) of such member (and in a separate return limitation year of any predecessor of such member), the amount which may be included under paragraph (b) of this section (computed without regard to the limitation contained in paragraph (d) of this section) in the consolidated net operating loss carryovers and carrybacks to a consolidated return year of the group shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph with respect to a member of the group is the excess, if any, of—

(i) Consolidated taxable income (computed without regard to the consolidated net operating loss deduction), minus such consolidated taxable income recomputed by excluding the items of income and deduction of such member, over

(ii) The net operating losses attributable to such member which may be carried to the consolidated return year arising in taxable years ending prior to the particular separate return limitation year.

(3) *Examples.* The provisions of this paragraph and paragraphs (a) and (b) of this section may be illustrated by the following examples:

*Example (1).* (i) Corporation P formed corporations S and T on January 1, 1965. P, S, and T filed separate returns for the calendar year 1965, a year for which an election under section 1562 was effective. T's return for that year reflected a net operating loss of $10,000. The group filed a consolidated return for 1966 reflecting consolidated taxable income of $30,000 (computed without regard to the consolidated net operating loss deduction). Among the transactions occurring during 1966 were the following:

(*a*) P sold goods to T deriving deferred profits of $7,000 on such sales, $2,000 of which was restored to consolidated taxable income on the sale of such goods to outsiders;

(*b*) T sold a machine to S deriving a deferred profit of $5,000, $1,000 of which was restored to consolidated taxable income as a result of S's depreciation deductions;

(*c*) T distributed a $3,000 dividend to P; and

(*d*) In addition to the transactions described above, T had other taxable income of $6,000.

(ii) The carryover of T's 1965 net operating loss to 1966 is subject to the limitation contained in this paragraph, since 1965 was a separate return limitation year (an election under section 1562 was effective for such year). Thus, only $7,000 of T's $10,000 net operating loss is a consolidated net operating loss carryover to 1966, since such carryover is limited to consolidated taxable income (computed without regard to the consolidated net operating loss deduction), $30,000, minus such consolidated taxable income recomputed by excluding the items of income and deduction of T, $23,000 (i.e., consolidated taxable income computed without regard to the $1,000 restoration of T's deferred gain and T's $6,000 of other income). In making such recomputation, no change is made in the effect on consolidated taxable income of P's sale to T, or of the dividend from T to P.

*Example (2).* (i) Corporation P was formed on January 1, 1966. P filed separate returns for the calendar years 1966 and 1967 reflecting net operating losses of $4,000 and $12,000, respectively. P purchased corporation S on March 15, 1967. S was formed on February 1, 1966, and filed a separate return for the taxable year ending January 31, 1967. S also filed a short period return for the period from February 1 to December 31, 1967, and joined with P in filing a consolidated return for 1968. S sustained net operating losses of $5,000 and $6,000 for its taxable years ending January 31, 1967, and December 31, 1967, respectively. An election under section 1562 was not effective for P and S during the period involved. Consolidated taxable income for 1968 (computed without regard to the consolidated net operating loss deduction) was $16,000; such consolidated taxable income recomputed by disregarding the items of income and deduction of S was $9,000.

(ii) In order of time, the following losses are absorbed in 1968:

(*a*) P's $4,000 net operating loss for the calendar year 1966 (such loss is not subject to the limitation contained in this paragraph since P is the common parent corporation for 1968);

(*b*) S's $5,000 net operating loss for the year ended January 31, 1967. Such loss is subject to the limitation contained in this paragraph, since S was not a member of the group on each day of such year. However, such loss can be carried over and absorbed in full since such limitation is $7,000 (consolidated taxable income computed without regard to the consolidated net operating loss deduction, $16,000, minus such consolidated taxable income recomputed, $9,000); and

(*c*) $6,000 of P's net operating loss and $1,000 of S's net operating loss for the taxable years ending December 31, 1967. This is determined by applying the losses from such year which can be carried to 1968 (P's $12,000 loss and $2,000 of S's $6,000 loss, since such $6,000 loss is limited under this paragraph) on a pro rata basis against the amount of such losses which can be absorbed in that year, $7,000 (consolidated taxable income of $16,000 less the $9,000 of losses absorbed from prior years). The carryover of S's loss to 1968 is subject to the limitation contained in that paragraph, since S was not a member of the group on each day of its taxable year ending December 31, 1967. Such loss is limited to $2,000, the excess of $7,000 (as determined under (ii)(*b*)) over $5,000 (S's carryover from the year ended January 31, 1967). If a consolidated return is filed in 1969, the consolidated net operating loss carryovers will consist of P's unabsorbed loss of $6,000 ($12,000 minus $6,000) from 1967 and, subject to the limitation contained in this paragraph, S's unabsorbed loss of $5,000 ($6,000 minus $1,000) from its year ended December 31, 1967.

(d) *Limitation on carryovers where there has been a consolidated return change of ownership*—(1) *General rule.* If a consolidated return change of ownership (as defined in paragraph (g) of § 1.1502–1) occurs during the taxable year or an earlier taxable year, the amount which may be included under paragraph (b) of this section in the consolidated net operating loss carryovers to the taxable year with respect to the aggregate of the net operating losses attributable to old members of the group (as defined in paragraph (g)(3) of § 1.1502–1) arising in taxable years (consolidated or separate) ending on the same day and before the taxable year in which the consolidated return change of ownership occurred shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph shall be the excess of—

(i) The consolidated taxable income for the taxable year (determined without regard to the consolidated net operating loss deduction) recomputed by including only the items of income and deduction of the old members of the group, over

(ii) The sum of the net operating losses attributable to the old members of the group which may be carried to the taxable year arising in taxable years ending prior to the particular loss year or years.

(3) *Example.* The provisions of this paragraph may be illustrated by the following example:

*Example.* (i) Corporation P is formed on January 1, 1967, and on the same day it forms corporation S. P and S file a consolidated return for the calendar year 1967, reflecting a consolidated net operating loss of $500,000. On January 1, 1968, individual X purchases all of the outstanding stock of P. X subsequently contributes $1,000,000 to P and P purchases the stock of corporation T. P, S, and T file a consolidated return for 1968 reflecting consolidated taxable income of $600,000 (computed without regard to the consolidated net operating loss deduction). Such consolidated taxable income recomputed by including only the items of income and deduction of P and S is $350,000.

(ii) Since a consolidated return change of ownership took place in 1968 (there was more than a 50 percent change of ownership of P), the amount of the consolidated net operating loss from 1967 which can be carried over to 1968 is limited to $350,000, the excess of $350,000 (consolidated taxable income recomputed by including only the items of income and deduction of the old members of the group, P and S) over zero (the amount of the consolidated net operating loss carryovers attributable to the old members of the group arising in taxable years ending before 1967).

(e) *Limitations on net operating loss carryovers under section 382*—(1) *Section 382(a).* (i) If at the end of a taxable year (consolidated or separate) there has been an increase in ownership of the stock of the common parent of a group (within the meaning of section 382(a)(1)(A) and (B)), and any member of the group has not continued to carry on a trade or business substantially the same as that conducted before any such increase (within the meaning of section 382(a)(1)(C)), then the portion of any consolidated net operating loss sustained in prior taxable years attributable to such member (as determined under paragraph (a)(3) of § 1.1502–79) shall not be allowed as a carryover to such taxable year or to any subsequent taxable year.

(ii) If the provisions of section 382(a) disallow the deduction of a net operating

loss carryover from a separate return year of a member of the group to a subsequent taxable year, no amount shall be included under paragraph (b) of this section as a consolidated net operating loss carryover to such a subsequent consolidated return year with respect to such separate return year of such member.

(iii) The provisions of this subparagraph may be illustrated by the following example:

*Example.* P, S, and T file a consolidated return for the calendar year 1969, reflecting a consolidated net operating loss attributable in part to each member. P owns 80 percent of S's stock and S owns 80 percent of T's stock. On January 1, 1970, A purchases 50 percent of P's stock. During 1970 T's business is discontinued. Since there has been a 50 percentage point increase in ownership of P, the common parent of the group, and since T has not continued to carry on the same trade or business after such increase, the portion of the 1969 consolidated net operating loss attributable to T shall not be included in any net operating loss deduction for 1970 or for any subsequent taxable years, whether consolidated or separate.

(2) *Section 382(b).* If a net operating loss carryover from a separate return year of a predecessor of a member of the group to the taxable year is reduced under the provisions of section 382(b), the amount included under paragraph (b) of this section with respect to such predecessor shall be so reduced.

(f) *Consolidated net operating loss.* The consolidated net operating loss shall be determined by taking into account the following:

(1) The separate taxable income (as determined under § 1.1502–12) of each member of the group, computed without regard to any deduction under section 242;

(2) Any consolidated net capital gain;

(3) Any consolidated section 1231 net loss;

(4) Any consolidated charitable contributions deduction;

(5) Any consolidated dividends received deduction (determined under § 1.1502–26 without regard to paragraph (a)(2) of that section); and

(6) Any consolidated section 247 deduction (determined under § 1.1502–27 without regard to paragraph (a)(1)(ii) of that section).

**§ 1.1502–22 Consolidated net capital gain or loss.**

(a) *Computation—(1) Consolidated net capital gain.* The consolidated net capital gain for the taxable year shall be determined by taking into account—

(i) The aggregate of the capital gains and losses (determined without regard to gains or losses to which section 1231 applies or net capital loss carryovers) of the members of the group for the consolidated return year,

(ii) The consolidated section 1231 net gain for such year (computed in accordance with § 1.1502–23), and

(iii) The consolidated net capital loss carryovers to such year (as determined under paragraph (b) of this section).

(2) *Consolidated net capital loss.* The consolidated net capital loss shall be determined under subparagraph (1) of this paragraph but without regard to subdivision (iii) thereof.

(3) *Special rules.* For purposes of this section, capital gains and losses on intercompany transactions and transactions with respect to stock, bonds, and other obligations of a member of the group shall be reflected as provided in §§ 1.1502–13, 1.1502–14, and 1.1502–19, and capital losses shall be limited as provided in § 1.1502–15.

(4) [Reserved]

(5) *Example.* The provisions of this paragraph may be illustrated by the following example:

*Example.* (i) Corporations P, S, and T file consolidated returns on a calendar year basis for 1966 and 1967. The members had the following transactions involving capital assets during 1967: P sold an asset with a $10,000 basis to S for $17,000 and none of the circumstances of restoration described in paragraph (d), (e), or (f) of § 1.1502–13 occurred by the end of the consolidated return year; S sold an asset to individual A for $7,000 which S had purchased during 1966 from P for $10,000, and with respect to which P had deferred a gain of $2,000; T sold an asset with a basis of $10,000 to individual B for $25,000. The group has a consolidated net capital loss carryover to the taxable year of $10,000.

(ii) The consolidated net capital gain of the group is $4,000, determined as follows: P's net capital gain of $2,000, representing the deferred gain on the sale to S during the taxable year 1966, restored into income during taxable year 1967 (the $7,000 gain on P's deferred intercompany transaction is not taken into account for the current year), plus T's net capital gain of $15,000, minus S's net capital loss of $3,000 and the consolidated net capital loss carryover of $10,000.

(b) *Consolidated net capital loss carryovers—(1) In general.* The consolidated net capital loss carryovers to the taxable year shall consist of any consolidated net capital losses of the group, plus any net capital losses of members of the group arising in separate return years of such members, which may be carried to the taxable year under the principles of section 1212(a). However, such consolidated carryovers shall not include any consolidated net capital loss apportioned to a corporation for a separate return year pursuant to paragraph (b) of § 1.1502–79 and shall be subject to the limitations contained in paragraphs (c) and (d) of this section. For purposes of section 1212(a)(1), the portion of any consolidated net capital loss for any taxable year attributable to a foreign expropriation capital loss is the amount of the foreign expropriation capital losses of all the members for such year (but not in excess of the consolidated net capital loss for such year).

(2) *Absorption rules.* For purposes of determining the amount, if any, of a net capital loss (whether consolidated or separate) which can be carried to a taxable year (consolidated or separate), the amount of such net capital loss which is absorbed in a prior consolidated return year under section 1212(a)(1) shall be determined by—

(i) Applying all net capital losses which can be carried to such prior year in the order of the taxable years in which such losses were sustained, beginning with the taxable year which ends earliest, and

(ii) Applying all such losses which can be carried to such prior year from taxable years ending on the same date on a pro-rata basis, except that any portion of a net capital loss attributable to a foreign expropriation capital loss to which section 1212(a)(1)(B) applies shall be applied last.

(c) *Limitation on net capital loss carryovers from separate return limitation years—(1) General rule.* In the case of a net capital loss of a member of the group arising in a separate return limitation year (as defined in paragraph (f) of § 1.1502–1) of such member (and in a separate return limitation year of any predecessor of such member), the amount that may be included under paragraph (b) of this section (computed without regard to the limitation contained in paragraph (d) of this section) shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph with respect to a member of the group is the excess, if any, of—

(i) The consolidated net capital gain for the taxable year (computed without regard to any net capital loss carryovers), minus such consolidated net capital gain for the taxable year recomputed by excluding the capital gains and losses and the gains and losses to which section 1231 applies of such member, over

(ii) The net capital losses attributable to such member which can be carried to the taxable year arising in taxable years ending prior to the particular separate return limitation year.

(d) *Limitation on capital loss carryovers where there has been a consolidated return change of ownership—(1) General rule.* If a consolidated return change of ownership (as defined in paragraph (g) of § 1.1502–1) occurs during the taxable year or an earlier taxable year, the amount which may be included under paragraph (b) of this section in the consolidated net capital loss carryovers to the taxable year with respect to the aggregate of the net capital losses attributable to old members of the group (as defined in paragraph (g)(3) of § 1.1502–1) arising in taxable years (consolidated or separate) ending on the same day and before the taxable year in which the consolidated return change of ownership occurred shall not exceed the amount determined under subparagraph (2) of this paragraph.

(2) *Computation of limitation.* The amount referred to in subparagraph (1) of this paragraph shall be the excess of—

(i) The consolidated net capital gain (determined without regard to any net capital loss carryovers for the taxable year) recomputed by including only capital gains and losses and gains and losses to which section 1231 applies of the old members of the group, over

(ii) The aggregate net capital losses attributable to the old members of the group which may be carried to the taxable year arising in taxable years ending prior to the particular loss year or years.

**§ 1.1502–23 Consolidated section 1231 net gain or loss.**

The consolidated section 1231 net gain or loss for the taxable year shall be determined by taking into account the aggregate of the gains and losses to which section 1231 applies of the members of the group for the consolidated return year. Section 1231 gains and losses on intercompany transactions shall be reflected as provided in § 1.1502–13. Section 1231 losses shall be limited as provided in § 1.1502–15.

**§ 1.1502–24 Consolidated charitable contributions deduction.**

(a) *Determination of amount of consolidated charitable contributions deduction.* The deduction allowed by section 170 for the taxable year shall be the lesser of—

(1) The aggregate deductions of the members of the group allowable under section 170 (determined without regard to section 170(b)(2)), plus the consolidated charitable contribution carryovers to such year, or

(2) Five percent of the adjusted consolidated taxable income as determined under paragraph (c) of this section.

(b) *Carryover of excess charitable contributions.* The consolidated charitable contribution carryovers to any consolidated return year shall consist of any excess consolidated charitable contributions of the group, plus any excess charitable contributions of members of the group arising in separate return years of such members, which may be carried over to the taxable year under the principles of section 170(b) (2) and (3). However, such consolidated carryovers shall not include any excess charitable contributions apportioned to a corporation for a separate return year pursuant to paragraph (e) of § 1.1502–79.

(c) *Adjusted consolidated taxable income.* For purposes of this section, the adjusted consolidated taxable income of the group for any consolidated return year shall be the consolidated taxable income computed without regard to this section, section 242, section 243(a) (2) and (3), § 1.1502–25, § 1.1502–26, and § 1.1502–27, and without regard to any consolidated net operating loss carrybacks to such year.

**§ 1.1502–25 [Reserved]**

**§ 1.1502–26 Consolidated dividends received deduction.**

(a) *In general.* The consolidated dividends received deduction for the taxable year shall be the lesser of—

(1) The aggregate of the deductions of the members of the group allowable under sections 243(a)(1), 244(a) and 245 (computed without regard to the limitation provided in section 246(b)), or

(2) 85 percent of the consolidated taxable income computed without regard to the consolidated net operating loss deduction, consolidated section 247 deduction, and the consolidated dividends received deduction.

Subparagraph (2) of this paragraph shall not apply for any consolidated return year for which there is a consolidated net operating loss. (See paragraph (f) of § 1.1502–21 for the definition of a consolidated net operating loss.)

(b) *Intercompany dividends.* The amount determined under paragraph (a) of this section shall be determined without regard to dividends received from other members of the group during a consolidated return year. (See paragraph (a)(1) of § 1.1502–14 for rules relating to intercompany dividends.)

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example (1).* Corporations P, S, and S–1 filed a consolidated return for the calendar year 1966 showing consolidated taxable income of $100,000 (determined without regard to the consolidated net operating loss deduction, consolidated dividends received deduction, and the consolidated section 247 deduction). Such corporations received dividends during such year from nonmember domestic corporations as follows:

| Corporation: | *Dividends* |
|---|---|
| P | $6,000 |
| S | 10,000 |
| S–1 | 34,000 |
| Total | 50,000 |

The dividends received deduction allowable to each member under section 243(a)(1) (computed without regard to the limitation in section 246(b)) is as follows: P has $5,100 (85 percent of $6,000), S has $8,500 (85 percent of $10,000), and S–1 has $28,900 (85 percent of $34,000), or a total of $42,500. Since $42,500 is less than $85,000 (85 percent of $100,000), the consolidated dividends received deduction is $42,500.

*Example (2).* Assume the same facts as in example (1) except that consolidated taxable income (computed without regard to the consolidated net operating loss deduction, consolidated dividends received deduction, and the consolidated section 247 deduction) was $40,000. The aggregate of the dividends received deductions, $42,500, computed without regard to section 246(b), results in a consolidated net operating loss of $2,500. See section 172(d)(6). Therefore, paragraph (a)(2) of this section does not apply and the consolidated dividends received deduction is $42,500.

**§ 1.1502–27 Consolidated section 247 deduction.**

(a) *Amount of deduction.* The consolidated section 247 deduction for the taxable year shall be an amount computed as follows:

(1) First, determine the amount which is the lesser of—

(i) The aggregate of the dividends paid (within the meaning of section 247(a)) during such year by members of the group which are public utilities (within the meaning of section 247(b)(1)) on preferred stock (within the meaning of section 247(b)(2)), other than dividends paid to other members of the group, or

(ii) The aggregate of the taxable income (or loss) (as determined under paragraph (b) of this section) of each such member which is a public utility.

(2) Then, multiply the amount determined under subparagraph (1) of this paragraph by the fraction specified in section 247(a)(2).

(b) *Computation of taxable income.* For purposes of paragraph (a)(1)(ii) of this section, the taxable income (or loss) of a member of the group described in paragraph (a)(1)(i) shall be determined under § 1.1502–12, adjusted for the following items taken into account in the computation of consolidated taxable income:

(1) The portion of the consolidated net operating loss deduction, the consolidated charitable contributions deduction, and the consolidated dividends received deduction, attributable to such member;

(2) Such member's net capital gain (determined without regard to any net capital loss carryover attributable to such member);

(3) Such member's net capital loss and section 1231 net loss, reduced by the portion of the consolidated net capital loss attributable to such member; and

(4) The portion of any consolidated net capital loss carryover attributable to such member which is absorbed in the taxable year.

**§§ 1.1502–28 to 1.1502–30 [Reserved]**

BASIS, STOCK OWNERSHIP, AND EARNINGS AND PROFITS RULES

**§§ 1.1502–31 to 1.1502–33 [Reserved]**

**§ 1.1502–34 Special aggregate stock ownership rules.**

For purposes of §§ 1.1502–1 through 1.1502–80, in determining the stock ownership of a member of the group in another corporation (the "issuing corporation") for purposes of determining the application of section 165(g)(3)(A), 332(b)(1), 333(b), 351(a), or 904(f), in a consolidated return year, there shall be included stock owned by all other members of the group in the issuing corporation. Thus, assume that members A, B, and C each own 33⅓ percent of the stock issued by D. In such case, A, B, and C shall each be treated as meeting the 80-percent stock ownership requirement for purposes of section 332, and no member can elect to have section 333 apply. Furthermore, the special rule for minority shareholders in section 337(d) cannot apply with respect to amounts received by A, B, or C in liquidation of D.

**§§ 1.1502–35 to 1.1502–40 [Reserved]**

SPECIAL TAXES AND TAXPAYERS

**§ 1.1502–41 Determination of consolidated net long-term capital gain and consolidated net short-term capital loss.**

(a) *Consolidated net long-term capital gain.* The consolidated net long-term capital gain shall be determined by taking into account (1) those gains and losses to which paragraph (a)(1) of § 1.1502–22 applies which are treated as long term under section 1222, and (2) the consolidated section 1231 net gain (computed in accordance with § 1.1502–23).

(b) *Consolidated net short-term capital loss.* The consolidated net short-term capital loss shall be determined by taking into account (1) those gains and losses to which paragraph (a)(1) of § 1.1502–22 applies which are treated as short term under section 1222, and (2) the consolidated net capital loss carryovers to the taxable year (as determined under paragraph (b) of § 1.1502–22).

§§ 1.1502–42 to 1.1502–74 [Reserved]

ADMINISTRATIVE PROVISIONS AND OTHER RULES

§ 1.1502–75 Filing of consolidated returns.

(a) *Privilege of filing consolidated returns*—(1) *Exercise of privilege for first consolidated return year.* A group which did not file a consolidated return for the immediately preceding taxable year may file a consolidated return in lieu of separate returns for the taxable year, provided that each corporation which has been a member during any part of the taxable year for which the consolidated return is to be filed consents (in the manner provided in paragraph (b) of this section) to the regulations under section 1502. If a group wishes to exercise its privilege of filing a consolidated return, such consolidated return must be filed not later than the last day prescribed by law (including extensions of time) for the filing of the common parent's return. Such consolidated return may not be withdrawn after such last day (but the group may change the basis of its return at any time prior to such last day).

(2) *Continued filing requirement.* A group which filed (or was required to file) a consolidated return for the immediately preceding taxable year is required to file a consolidated return for the taxable year unless it has an election to discontinue filing consolidated returns under paragraph (c) of this section.

(b) *How consent for first consolidated year exercised.*—(1) *General rule.* The consent of a corporation referred to in paragraph (a)(1) of this section shall be made by such corporation joining in the making of the consolidated return for such year. A corporation shall be deemed to have joined in the making of such return for such year if it files a Form 1122 in the manner specified in paragraph (h)(2) of this section.

(2) *Consent under facts and circumstances.* If a member of the group fails to file Form 1122, the Commissioner may under the facts and circumstances determine that such member has joined in the making of a consolidated return by such group. The following circumstances, among others, will be taken into account in making this determination:

(i) Whether or not the income and deductions of the member were included in the consolidated return;

(ii) Whether or not a separate return was filed by the member for that taxable year; and

(iii) Whether or not the member was included in the affiliations schedule, Form 851.

If the Commissioner determines that the member has joined in the making of the consolidated return, such member shall be treated as if it had filed a Form 1122 for such year for purposes of paragraph (h)(2) of this section.

(3) *Failure to consent due to mistake.* If any member has failed to join in the making of a consolidated return under either subparagraph (1) or (2) of this paragraph, then the tax liability of each member of the group shall be determined on the basis of separate returns unless the common parent corporation establishes to the satisfaction of the Commissioner that the failure of such member to join in the making of the consolidated return was due to a mistake of law or fact, or to inadvertence. In such case, such member shall be treated as if it had filed a Form 1122 for such year for purposes of paragraph (h)(2) of this section, and thus joined in the making of the consolidated return for such year.

(c) *Election to discontinue filing consolidated returns*—(1) *Good cause*—(i) *In general.* Notwithstanding that a consolidated return is required for a taxable year, the Commissioner, upon application by the common parent made not later than the 19th day before the due date for the filing of the consolidated return (including extensions of time), may for good cause shown grant permission to a group to discontinue filing consolidated returns. Any such application shall be made to the Commissioner of Internal Revenue, Washington, D.C. 20224.

(ii) *Substantial adverse change in law affecting tax liability.* Ordinarily, the Commissioner will grant a group permission to discontinue filing consolidated returns if the net result of all amendments to the Code or regulations with effective dates commencing within the taxable year has a substantial adverse effect on the consolidated tax liability of the group for such year relative to what the aggregate tax liability would be if the members of the group filed separate returns for such year. Thus, for example, assume P and S filed a consolidated return for the calendar year 1966 and that the provisions of the Code have been amended by a bill which was enacted by Congress in 1966, but which is first effective for taxable years beginning on or after January 1, 1967. Assume further that P makes a timely application to discontinue filing consolidated returns. In order to determine whether the amendments have a substantial adverse effect on the consolidated tax liability for 1967, relative to what the aggregate tax liability would be if the members of the group filed separate returns for 1967, the difference between the tax liability of the group computed on a consolidated basis and taking into account the changes in the law effective for 1967 and the aggregate tax liability of the members of the group computed as if each such member filed separate returns for such year (also taking into account such changes) shall be compared with the difference between the tax liability of such group for 1967 computed on a consolidated basis without regard to the changes in the law effective in such year and the aggregate tax liability of the members of the group computed as if separate returns had been filed by such members for such year without regard to the changes in the law effective in such year.

(iii) *Other factors.* In addition, the Commissioner will take into account other factors in determining whether good cause exists for granting permission to discontinue filing consolidated returns beginning with the taxable year, including—

(*a*) Changes in law or circumstances, including changes which do not affect Federal income tax liability,

(*b*) Changes in law which are first effective in the taxable year and which result in a substantial reduction in the consolidated net operating loss (or consolidated unused investment credit) for such year relative to what the aggregate net operating losses (or investment credits) would be if the members of the group filed separate returns for such year, and

(*c*) Changes in the Code or regulations which are effective prior to the taxable year but which first have a substantial adverse effect on the filing of a consolidated return relative to the filing of separate returns by members of the group in such year.

(2) *Discretion of Commissioner to grant blanket permission*—(i) *Permission to all groups.* The Commissioner, in his discretion, may grant all groups permission to discontinue filing consolidated returns if any provision of the Code or regulations has been amended and such amendment is of the type which could have a substantial adverse effect on the filing of consolidated returns by substantially all groups, relative to the filing of separate returns. Ordinarily, the permission to discontinue shall apply with respect to the taxable year of each group which includes the effective date of such an amendment.

(ii) *Permission to a class of groups.* The Commissioner, in his discretion, may grant a particular class of groups permission to discontinue filing consolidated returns if any provision of the Code or regulations has been amended and such amendment is of the type which could have a substantial adverse effect on the filing of consolidated returns by substantially all such groups relative to the filing of separate returns. Ordinarily, the permission to discontinue shall apply with respect to the taxable year of each group within the class which includes the effective date of such an amendment.

(3) *Time and manner for exercising election.* If, under subparagraph (1) or (2) of this paragraph, a group has an election to discontinue filing consolidated returns for any taxable year and such group wishes to exercise such election, then the common parent must file a separate return for such year on or before the last day prescribed by law (including extensions of time) for the filing of the consolidated return for such year. See section 6081 (relating to extensions of time for filing returns).

(d) *When group remains in existence*—(1) *General rule.* A group shall

be considered as remaining in existence if the common parent corporation remains as the common parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group in a prior year and whether or not one or more corporations have ceased to be subsidiaries at any time after the group was formed. Thus, for example, assume that individual A forms corporation P. P acquires 100 percent of the stock of corporation S on January 1, 1965, and P and S file a consolidated return for the calendar year 1965. On May 1, 1966, P acquires 100 percent of the stock of S–1, and on July 1, 1966, P sells the stock of S. The group (consisting originally of P and S) remains in existence in 1966 since P has remained as the common parent and at least one subsidiary (now S–1) remains affiliated with it.

(2) *Common parent no longer in existence*—(i) *Mere change in identity.* For purposes of this paragraph, the common parent corporation shall remain as the common parent irrespective of a mere change in identity, form, or place of organization of such common parent corporation (see section 368(a)(1)(F)).

(ii) *Transfer of assets to subsidiary.* The group shall be considered as remaining in existence notwithstanding that the common parent is no longer in existence if the members of the affiliated group succeed to and become the owners of substantially all of the assets of such former parent and there remains one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation and which was a member of the group prior to the date such former parent ceases to exist.

(3) *Reverse acquisitions*—(i) *In general.* If a corporation (hereinafter referred to as the "first corporation") or any member of a group of which the first corporation is the common parent acquires after October 1, 1965—

(*a*) Stock of another corporation (hereinafter referred to as the second corporation), and as a result the second corporation becomes (or would become but for the application of this subparagraph) a member of a group of which the first corporation is the common parent, or

(*b*) Substantially all the assets of the second corporation,

in exchange (in whole or in part) for stock of the first corporation, and the stockholders (immediately before the acquisition) of the second corporation, as a result of owning stock of the second corporation, own (immediately after the acquisition) more than 50 percent of the fair market value of the outstanding stock of the first corporation, then any group of which the first corporation was the common parent immediately before the acquisition shall cease to exist as of the date of acquisition, and any group of which the second corporation was the common parent immediately before the acquisition shall be treated as remaining in existence (with the first corporation becoming the common parent of the group). Thus, assume that corporations P and S comprised group PS (P being the common parent), that P was merged into corporation T (the common parent of a group composed of T and corporation U), and that the shareholders of P immediately before the merger, as a result of owning stock in P, own 90 percent of the fair market value of T's stock immediately after the merger. The group of which P was the common parent is treated as continuing in existence with T and U being added as members of the group, and T taking the place of P as the common parent.

(ii) For purposes of subdivision (i) of this subparagraph, if the first corporation, and any members of a group of which the first corporation is the common parent, have continuously owned for a period of at least 5 years ending on the date of the acquisition an aggregate of at least 25 percent of the fair market value of the outstanding stock of the second corporation, then the first corporation (and any subsidiary which owns stock of the second corporation immediately before the acquisition) shall, as a result of owning such stock, be treated as owning (immediately after the acquisition) a percentage of the fair market value of the first corporation's outstanding stock which bears the same ratio to (*a*) the percentage of the fair market value of all the stock of the second corporation owned immediately before the acquisition by the first corporation and its subsidiaries as (*b*) the fair market value of the total outstanding stock of the second corporation immediately before the acquisition bears to (*c*) the sum of (*1*) the fair market value, immediately before the acquisition, of the total outstanding stock of the first corporation, and (2) the fair market value, immediately before the acquisition, of the total outstanding stock of the second corporation (other than any such stock owned by the first corporation and any of its subsidiaries). For example, assume that corporation P owns stock in corporation T having a fair market value of $100,000, that P acquires the remaining stock of T from individuals in exchange for stock of P, that immediately before the acquisition the total outstanding stock of T had a fair market value of $150,000, and that immediately before the acquisition the total outstanding stock of P had a fair market value of $200,000. Assuming P owned at least 25 percent of the fair market value of T's stock for 5 years, then for purposes of this subparagraph, P is treated as owning (immediately after the acquisition) 40 percent of the fair market value of its own outstanding stock, determined as follows:

$$\frac{\$150{,}000}{\$200{,}000+\$50{,}000}\times 66\tfrac{2}{3}\%=40\%$$

Thus, if the former individual stockholders of T own, immediately after the acquisition more than 10 percent of the fair market value of the outstanding stock of P as a result of owning stock of T, the group of which T was the common parent is treated as continuing in existence with P as the common parent, and the group of which P was the common parent before the acquisition ceases to exist.

(e) *Failure to include subsidiary.* If a consolidated return is required for the taxable year under the provisions of paragraph (a)(2) of this section, the tax liability of all members of the group for such year shall be computed on a consolidated basis even though—

(1) Separate returns are filed by one or more members of the group, or

(2) There has been a failure to include in the consolidated return the income of any member of the group.

If subparagraph (1) of this paragraph applies, the amounts assessed or paid upon the basis of separate returns shall be considered as having been assessed or paid upon the basis of a consolidated return.

(f) *Inclusion of one or more corporations not members of the group*—(1) *Method of determining tax liability.* If a consolidated return includes the income of a corporation which was not a member of the group at any time during the consolidated return year, the tax liability of such corporation will be determined upon the basis of a separate return (or a consolidated return of another group, if paragraph (a)(2) or (b)(3) of this section applies), and the consolidated return will be considered as including only the income of the corporations which were members of the group during that taxable year. If a consolidated return includes the income of two or more corporations which were not members of the group but which constitute another group, the tax liability of such corporations will be computed in the same manner as if separate returns had been made by such corporations unless the Commissioner upon application approves the making of a consolidated return for the other group or unless under paragraph (a)(2) of this section a consolidated return is required for the other group.

(2) *Allocation of tax liability.* In any case in which amounts have been assessed and paid upon the basis of a consolidated return and the tax liability of one or more of the corporations included in the consolidated return is to be computed in the manner described in subparagraph (1) of this paragraph, the amounts so paid shall be allocated between the group composed of the corporations properly included in the consolidated return and each of the corporations the tax liability of which is to be computed on a separate basis (or on the basis of a consolidated return of another group) in such manner as the corporations which were included in the consolidated return may, subject to the approval of the Commissioner, agree upon or in the absence of an agreement upon the method used in allocating the tax liability of the members of the group under the provisions of section 1552(a).

(g) *Computing periods of limitation*—(1) *Income incorrectly included in consolidated return.* If—

(i) A consolidated return is filed by a group for the taxable year, and

(ii) The tax liability of a corporation whose income is included in such return must be computed on the basis of a separate return (or on the basis of a consolidated return with another group),

then for the purpose of computing any period of limitation with respect to such separate return (or such other consolidated return), the filing of such consolidated return by the group shall be considered as the making of a return by such corporation.

(2) *Income incorrectly included in separate returns.* If a consolidated return is required for the taxable year under the provisions of paragraph (a)(2) of this section, the filing of separate returns by the members of the group for such year shall not be considered as the making of a return for the purpose of computing any period of limitation with respect to such consolidated return unless there is attached to each such separate return a statement setting forth—

(i) The most recent taxable year of the member for which its income was included in a consolidated return, and

(ii) The reasons for the group's belief that a consolidated return is not required for the taxable year.

(h) *Method of filing return and forms*—(1) *Consolidated return made by common parent corporation.* The consolidated return shall be made on Form 1120 for the group by the common parent corporation. The consolidated return, with Form 851 (affiliations schedule) attached, shall be filed with the district director with whom the common parent would have filed a separate return.

(2) *Filing of Form 1122 for first year.* If, under the provisions of paragraph (a)(1) of this section, a group wishes to exercise its privilege of filing a consolidated return, then a Form 1122 must be executed by each subsidiary and must be attached to the consolidated return for such year. In addition, each subsidiary must file a signed copy of Form 1122 on or before the due date for the filing of the common parent's return for such year (including extensions of time) with the district director with whom such subsidiary would have filed its separate return. Form 1122 shall not be required for a taxable year if a consolidated return was filed (or was required to be filed) by the group for the immediately preceding taxable year.

(3) *Persons qualified to execute returns and forms.* Each return or form required to be made or prepared by a corporation must be executed by the person authorized under section 6062 to execute returns of separate corporations.

**§ 1.1502-76 Taxable year of members of group.**

(a) *Taxable year of members of group*—(1) *Change to parent's taxable year.* The consolidated return of a group must be filed on the basis of the common parent's taxable year, and each subsidiary must adopt the common parent's annual accounting period for the first consolidated return year for which the subsidiary's income is includible in the consolidated return. If any member is on a 52-53-week taxable year, the rule of the preceding sentence shall, with the advance consent of the Commissioner, be deemed satisfied if the taxable years of all members of the group end within the same 7-day period. Any request for such consent shall be filed with the Commissioner of Internal Revenue, Washington, D.C. 20224, not later than the 30th day before the due date (not including extensions of time) for the filing of the consolidated return.

(2) *Includible insurance company as member of group.* If an includible insurance company required by section 843 to file its return on the basis of a calendar year is a member of the group and if the common parent of such group files its return on the basis of a fiscal year, then the first consolidated return which includes the income of such insurance company may be filed on the basis of the common parent's fiscal year, provided, however, that if such insurance company is a member of the group on the last day of the common parent's taxable year all members of the group change to a calendar year basis effective immediately after the close of such fiscal year.

(b) *Income to be included in returns for taxable year*—(1) *Inclusion of income in consolidated return.* The consolidated return of a group must include the income of the common parent for that corporation's entire taxable year (excluding any portion of such taxable year for which its income is properly included in the consolidated return of another group) and, except as provided in subparagraph (5) of this paragraph, the income of each subsidiary for the portion of such taxable year during which it was a member of the group.

(2) *Separate return for period not included in a consolidated return.* If the consolidated return of a group properly includes the income of a corporation for only a portion of such corporation's taxable year (determined without regard to a change of its taxable year under paragraph (a) of this section), then the income for the portion of such taxable year not included in the consolidated return must be included in a separate return (or, if such corporation is a member of another group which files a consolidated return for such portion of such year, then in such consolidated return).

(3) *Examples.* The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

*Example (1).* Corporations X and Y filed separate returns for the calendar year 1965. As of the close of June 30, 1966, X acquired all of the stock of Y. If X files a consolidated return for 1966, it must include in such return its income for the entire taxable year and the income of Y for the period July 1, 1966, through December 31, 1966. Y must include its income for the period January 1, 1966, through June 30, 1966, in a separate return.

*Example (2).* Corporations P and S, a group of corporations, filed a consolidated return for the calendar year 1966. As of the close of June 30, 1967, all of the stock of S was sold to individual A. P must file a consolidated return for 1967 including P's income for the entire taxable year and the income of S for the period of January 1, 1967, through June 30, 1967. S must file a separate return for the period July 1, 1967, through December 31, 1967.

*Example (3).* Assume the same facts as in example (2) plus the additional fact that as of the close of July 31, 1967, P acquired all the stock of corporation T (which filed separate returns on the basis of a fiscal year ending November 30), and that P and T filed a consolidated return for 1967. P must file two consolidated returns for 1967. The consolidated return of P and S for 1967 must include P's income for the entire taxable year, excluding that portion of such year (August 1 through December 31) for which its income is includible in the consolidated return of P and T. The consolidated return of P and T for 1967 must include P's income for its entire taxable year, excluding that portion of the taxable year (January 1 through July 31) for which P's income is included in the consolidated return of P and S, and including the income of T for the period August 1 through December 31. T must file a separate return for the period December 1, 1966, through July 31, 1967.

(4) *Allocation of income between separate and consolidated returns.* (i) If the taxable income of a member for a taxable year (determined without regard to a change of its year under paragraph (a) of this section) must be included in part in a consolidated return and in part in a separate return (or a consolidated return of another group), the taxable income to be reported in each such return shall be determined on the basis of its income shown on its permanent records (including work papers).

(ii) If the portion of an item of income or deduction to be reported in each such return cannot be clearly determined from the permanent records, the portion of such item to be included in each such return shall be the amount of the item for the full taxable year (determined without regard to the change of year) multiplied by a fraction, the numerator of which is the number of days for which the member's income is to be included in such return and the denominator of which is the total number of days in such year.

(5) *Period of 30 days or less may be disregarded.* For purposes of the regulations under section 1502—

(i) If within 30 days after the beginning of a corporation's taxable year (determined without regard to the required change to the parent's taxable year) it becomes a member of a group, then such corporation may at its option be considered to have become a member of the group as of the beginning of the first day of such corporation's taxable year, or

(ii) If, during a consolidated return year of a group, a corporation (other than a corporation created or organized in such year by a member of the group) has been a member of such group for a period of 30 days or less, then such corporation may at its option be considered as not having been a member of the group during such year.

(6) *Examples.* The provisions of subparagraph (5) of this paragraph may be illustrated by the following examples:

*Example (1).* Corporation P, a common parent corporation, filed a consolidated return for the calendar year 1965. As of the

close of July 14, 1966, P acquired all of the stock of corporation S. S filed its separate returns on the basis of the fiscal year ending June 30. P files a consolidated return for 1966. Since S became a member of the group within 30 days after the beginning of its taxable year, S may at its option include its income in such consolidated return for the period July 1, 1966 (the beginning of its taxable year), through December 31, 1966, in lieu of the period July 15, 1966, through December 31, 1966.

*Example* (2). Assume the same facts as in example (1) except that P acquired all of the stock of S as of the close of December 14, 1966. Since S has been a member of the group for a period of 30 days or less during the group's calendar year 1966, S may at its option not include any of its income in the consolidated return filed for 1966.

(c) *Time for making separate returns for periods not included in consolidated return*—(1) *Consolidated return filed by due date for separate return.* If the group has filed a consolidated return on or before the due date for the filing of a subsidiary's separate return (including extensions of time and determined without regard to any change of its taxable year required under paragraph (a) of this section), then the separate return for any portion of the subsidiary's taxable year for which its income is not included in the consolidated return of the group must be filed no later than the due date of such consolidated return (including extensions of time).

(2) *Consolidated return not filed by due date for separate return.* If the group has not filed a consolidated return on or before the due date for the filing of a subsidiary corporation's separate return (including extensions of time and determined without regard to any change of its taxable year required under paragraph (a) of this section), then on or before such due date such subsidiary shall file a separate return either for the portion of its taxable year for which its income would not be included in a consolidated return if such a return were filed, or for its complete taxable year. However, if a separate return is filed for such portion of its taxable year and the group subsequently does not file a consolidated return, such subsidiary corporation shall file a substituted return for its complete taxable year not later than the due date (including extensions of time) prescribed for the filing of the common parent's return. On the other hand, if the return is filed for the subsidiary's complete taxable year and the group later files a consolidated return, such subsidiary must file an amended return not later than the due date (including extensions of time) for the filing of the consolidated return of the group. Such amended return shall be for that portion of such subsidiary's taxable year which is not included in the consolidated return. If, under this subparagraph, a substituted return must be filed, then the return previously filed shall not be considered a return within the meaning of section 6011. If, under this subparagraph, a substituted or amended return must be filed, then, for purposes of sections 6513(a) and 6601(a), the last date prescribed for payment of tax shall be the due date (not including extensions of time) for the filing of the subsidiary's separate return (determined without regard to this subparagraph and without regard to any change of its taxable year required under paragraph (a) of this section).

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

*Example* (1). Corporation P, which filed a separate return for the calendar year 1966, acquires all of the stock of corporation S as of the close of December 31, 1966. Corporation S reports its income on the basis of a fiscal year ending March 31. On June 15, 1967, the due date for the filing of a separate return by S (assuming no extensions of time), a consolidated return has not been filed for the group (P and S). On such date S may either file a return for the period April 1, 1966, through December 31, 1966, or it may file a return for the complete fiscal year ending March 31, 1967. If S files a return for the short period ending December 31, 1966, and if the group elects not to file a consolidated return for the calendar year 1967, S, on or before March 15, 1968 (the due date of P's return, assuming no extensions of time), must file a substituted return for the complete fiscal year ending March 31, 1967, in lieu of the return previously filed for the short period. Interest is computed from June 15, 1967. If, however, S files a return for the complete fiscal year ending March 31, 1967, and the group elects to file a consolidated return for the calendar year 1967, then S must file an amended return covering the period from April 1, 1966, through December 31, 1966, in lieu of the return previously filed for the complete fiscal year. Interest is computed from June 15, 1967.

*Example* (2). Assume the same facts as in example (1) except that corporation P acquires all of the stock of corporation S at the close of September 30, 1967, and that P files a consolidated return for the group for 1967 on March 15, 1968 (not having obtained any extensions of time). Since a consolidated return has been filed on or before the due date (June 15, 1968) for the filing of the separate return for the taxable year ending March 31, 1968, the return of S for the short taxable year beginning April 1, 1967, and ending September 30, 1967, should be filed no later than March 15, 1968.

(d) *Taxable year of less than 12 months.* Any period of less than 12 months for which either a separate return or a consolidated return is filed under the provisions of this section shall be considered as a separate taxable year.

**§ 1.1502–77 Common parent agent for subsidiaries.**

(a) *Scope of agency of common parent corporation.* The common parent, for all purposes other than the making of the consent required by paragraph (a)(1) of § 1.1502–75, shall be the sole agent for each subsidiary in the group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year. No subsidiary shall have authority to act for or to represent itself in any such matter. For example, any election available to a subsidiary corporation in the computation of its seperate taxable income must be made by the common parent, as must any change in an election previously made by the subsidiary corporation; all correspondence will be carried on directly with the common parent; the common parent shall file for all extensions of time including extensions of time for payment of tax under section 6164; notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each subsidiary in the group; notice and demand for payment of taxes will be given only to the common parent and such notice and demand will be considered as a notice and demand to each subsidiary; the common parent will file petitions and conduct proceedings before the Tax Court of the United States, and any such petition shall be considered as also having been filed by each such subsidiary. The common parent will file claims for refund or credit, and any refund will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such subsidiary; and the common parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such subsidiary. Notwithstanding the provisions of this paragraph, any notice of deficiency, in respect of the tax for a consolidated return year, will name each corporation which was a member of the group during any part of such period (but a failure to include the name of any such member will not affect the validity of the notice of deficiency as to the other members); any notice and demand for payment will name each corporation which was a member of the group during any part of such period (but a failure to include the name of any such member will not affect the validity of the notice and demand as to the other members); and any levy, any notice of

a lien, or any other proceeding to collect the amount of any assessment, after the assessment has been made, will name the corporation from which such collection is to be made. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year, and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time. Notwithstanding the provisions of this paragraph, the district director may, upon notifying the common parent, deal directly with any member of the group in respect of its liability, in which event such member shall have full authority to act for itself.

(b) *Notification of deficiency to corporation which has ceased to be a member of the group.* If a subsidiary has ceased to be a member of the group and if such subsidiary files written notice of such cessation with the district director with whom the consolidated return is filed, then such district director upon request of such subsidiary will furnish it with a copy of any notice of deficiency in respect of the tax for a consolidated return year for which it was a member and a copy of any notice and demand for payment of such deficiency. The filing of such written notification and request by a corporation shall not have the effect of limiting the scope of the agency of the common parent provided for in paragraph (a) of this section and a failure by such district director to comply with such written request shall not have the effect of limiting the tax liability of such corporation provided for in § 1.1502–6.

(c) *Effect of waiver given by common parent.* Unless the district director agrees to the contrary, an agreement entered into by the common parent extending the time within which an assessment may be made or levy or proceeding in court begun in respect of the tax for a consolidated return year shall be applicable—

(1) To each corporation which was a member of the group during any part of such taxable year, and

(2) To each corporation the income of which was included in the consolidated return for such taxable year, notwithstanding that the tax liability of any such corporation is subsequently computed on the basis of a separate return under the provisions of § 1.1502–75.

(d) *Effect of dissolution of common parent corporation.* If the common parent corporation contemplates dissolution, or is about to be dissolved, or if for any other reason its existence is about to terminate, it shall forthwith notify the district director with whom the consolidated return is filed of such fact and designate, subject to the approval of such district director, another member to act as agent in its place to the same extent and subject to the same conditions and limitations as are applicable to the common parent. If the notice thus required is not given by the common parent, or the designation is not approved by the district director, the remaining members may, subject to the approval of such district director, designate another member to act as such agent, and notice of such designation shall be given to such district director. Until a notice in writing designating a new agent has been approved by such district director, any notice of deficiency or other communication mailed to the common parent shall be considered as having been properly mailed to the agent of the group; or, if such district director has reason to believe that the existence of the common parent has terminated, he may, if he deems it advisable, deal directly with any member in respect of its liability.

### § 1.1502–78 Tentative carryback adjustments.

(a) *General rule.* If a group sustains a consolidated net operating loss for any taxable year, then any application under section 6411 for a tentative carryback adjustment of the taxes for a consolidated return year or years preceding the loss year shall be made by the common parent corporation to the extent such consolidated net operating loss is not apportioned to a corporation for a separate return year pursuant to paragraph (a) of § 1.1502–79. In the case of the portion of a consolidated net operating loss to which the preceding sentence does not apply, and in the case of a net operating loss sustained in a separate return year which may be carried back to a consolidated return year, the corporation or corporations to which any such loss is attributable shall make any application under section 6411.

(b) *Special rules*—(1) *Payment of refund.* Any refund allowable under an application referred to in paragraph (a) of this section shall be made directly to and in the name of the corporation filing the application, except that in all cases where the loss is deducted from the consolidated taxable income of a consolidated return year, any refund shall be made directly to and in the name of the common parent corporation. The payment of any such refund shall discharge any liability of the Government with respect to such refund.

(2) *Several liability.* If a group filed a consolidated return for a taxable year for which there was an adjustment by reason of an application under section 6411, and if a deficiency is assessed against such group under section 6213(b)(2), then each member of such group shall be severally liable for such deficiency including any interest or penalty assessed in connection with such deficiency.

(c) *Examples.* The provisions of paragraphs (a) and (b) of this section may be illustrated by the following examples:

*Example (1).* Corporations P, S, and S–1 filed a consolidated return for the calendar year 1966. P, S, and S–1 also filed a consolidated return for the calendar year 1969. The group incurred a consolidated net operating loss in 1969 attributable to S–1 which may be carried back to 1966 as a consolidated net operating loss carryback. If a tentative carryback adjustment is desired, P, the common parent, must file an application under section 6411 and any refund will be made to P.

*Example (2).* Assume the same facts as in example (1) except that P, S, and S–1 filed separate returns for the calendar year 1969, even though they were members of the same group for such year. S–1 incurred a net operating loss in 1969 which may be carried back to 1966. If a tentative carryback adjustment is desired, S–1 must file an application under section 6411 and any refund from such application will be made to P.

*Example (3).* Corporations X, Y, and Z filed a consolidated return for the calendar year 1966. Z ceased to be a member of the group in 1967. Z filed a separate return for 1968 while X and Y filed a consolidated return for such year. The group incurred a consolidated net operating loss in 1968 attributable to Y, which may be carried back to 1966. Z also incurred a net operating loss for 1968 which may be carried back to 1966. If a tentative carryback adjustment is claimed with respect to the consolidated net operating loss, X, the common parent, must file an application under section 6411. If a tentative carryback adjustment is desired with respect to Z's loss, Z must file an application. Any refunds attributable to either application will be made to X. If an assessment is made under section 6213(b)(2) to recover an excessive tentative allowance made with respect to calendar year 1966, X, Y, and Z are severally liable for such assessment.

*Example (4).* Corporations L and M filed a consolidated return for the calendar year 1966. Corporation N filed a separate return for such year. Later, N became a member of the group and filed a consolidated return with the group for the calendar year 1968. The group incurred a consolidated net operating loss in 1968 attributable to N which may be carried back to N's separate return for 1966. If a tentative carryback adjustment is desired, N must file an application under section 6411 and any refund will be made directly to N.

### § 1.1502–79 Separate return years.

(a) *Carryover and carryback of consolidated net operating losses to separate return years*—(1) *In general.* (i) If a consolidated net operating loss can be carried under the principles of section 172(b) and paragraph (b) of § 1.1502–21 to a separate return year of a corporation (or could have been so carried if such corporation were in existence) which was a member in the year in which such loss arose, then the portion of such consolidated net operating loss attributable to such corporation (as determined under subparagraph (3) of this paragraph) shall be apportioned to such corporation (and any successor to such corporation in a transaction to which section 381(a) applies) and shall be a net operating loss carryover or carryback to such separate return year; accordingly, such portion shall not be included in the consolidated net operating loss carryovers or carrybacks to the equivalent consolidated return year. Thus, for example, if a member filed a separate return for the third year preceding a

consolidated return year in which a consolidated net operating loss was sustained and if any portion of such loss is apportioned to such member for such separate return year, such portion may not be carried back by the group to its third year preceding such consolidated return year.

(ii) If a corporation ceases to be a member during a consolidated return year, any consolidated net operating loss carryover from a prior taxable year must first be carried to such consolidated return year, notwithstanding that all or a portion of the consolidated net operating loss giving rise to the carryover is attributable to the corporation which ceases to be a member. To the extent not absorbed in such consolidated return year, the portion of the consolidated net operating loss attributable to the corporation ceasing to be a member shall then be carried to such corporation's first separate return year.

(2) *Nonapportionment to certain members not in existence.* Notwithstanding subparagraph (1) of this paragraph, the portion of a consolidated net operating loss attributable to a member shall not be apportioned to a prior separate return year for which such member was not in existence and shall be included in the consolidated net operating loss carrybacks to the equivalent consolidated return year of the group (or, if such equivalent year is a separate return year, then to such separate return year), provided that such member was a member of the group immediately after its organization.

(3) *Portion of consolidated net operating loss attributable to a member.* The portion of a consolidated net operating loss attributable to a member of a group is an amount equal to the consolidated net operating loss multiplied by a fraction, the numerator of which is the separate net operating loss of such corporation, and the denominator of which is the sum of the separate net operating losses of all members of the group in such year having such losses. For purposes of this subparagraph, the separate net operating loss of a member of the group shall be determined under § 1.1502–12 (except that no deduction shall be allowed under section 242), adjusted for the following items taken into account in the computation of the consolidated net operating loss:

(i) The portion of the consolidated dividends received deduction, the consolidated charitable contributions deductions, and the consolidated section 247 deduction, attributable to such member;

(ii) Such member's net capital gain (determined without regard to any net capital loss carryover attributable to such member);

(iii) Such member's net capital loss and section 1231 net loss, reduced by the portion of the consolidated net capital loss attributable to such member (as determined under paragraph (b)(2) of this section); and

(iv) The portion of any consolidated net capital loss carryover attributable to such member which is absorbed in the taxable year.

(4) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

*Example (1).* (i) Corporation P was formed on January 1, 1966. P filed a separate return for the calendar year 1966. On March 15, 1967, P formed corporation S. P and S filed a consolidated return for 1967. On January 1, 1968, P purchased all the stock of corporation T, which had been formed in 1967 and had filed a separate return for its taxable year ending December 31, 1967.

(ii) P, S, and T join in the filing of a consolidated return for 1968, which return reflects a consolidated net operating loss of $11,000. $2,000 of such consolidated net operating loss is attributable to P, $3,000 to S, and $6,000 to T. Such apportionment of the consolidated net operating loss was made on the basis of the separate net operating losses of each member as determined under subparagraph (3) of this paragraph.

(iii) $5,000 of the 1968 consolidated net operating loss can be carried back to P's separate return for 1966. Such amount is the portion of the consolidated net operating loss attributable to P and S. Even though S was not in existence in 1966, the portion attributable to S can be carried back to P's separate return year, since S (unlike T) was a member of the group immediately after its organization. The 1968 consolidated net operating loss can be carried back against the group's income in 1967 except to the extent (i.e., $6,000) that it is apportioned to T for its 1967 separate return year and to the extent that it was absorbed in P's 1966 separate return year. The portion of the 1968 consolidated net operating loss attributable to T ($6,000) is a net operating loss carryback to its 1967 separate return.

*Example (2).* (i) Assume the same facts as in example (1). Assume further that on June 15, 1969, P sells all the stock of T to an outsider, that P and S file a consolidated return for 1969 (which includes the income of T for the period January 1 through June 15), and that T files a separate return for the period June 16 through December 31, 1969.

(ii) The 1968 consolidated net operating loss, to the extent not absorbed in prior years, must first be carried to the consolidated return year 1969. Any portion of the $6,000 amount attributable to T which is not absorbed in T's 1967 separate return year or in the 1969 consolidated return year shall then be carried to T's separate return year ending December 31, 1969.

(b) *Carryover of consolidated net capital loss to separate return years*—(1) *In general.* If a consolidated net capital loss can be carried under the principles of section 1212 (a) and paragraph (b) of § 1.1502–22 to a separate return year of a corporation (or could have been so carried if such corporation were in existence) which was a member of the group in the year in which such consolidated net capital loss arose, then the portion of such consolidated net capital loss attributable to such corporation (as determined under subparagraph (2) of this paragraph) shall be apportioned to such corporation (and any successor to such corporation in a transaction to which section 381(a) applies) under the principles of paragraph (a) (1), (2) and (3) of this section and shall be a net capital loss carryover to such separate return year.

(2) *Portion of consolidated net capital loss attributable to a member.* The portion of a consolidated net capital loss attributable to a member of a group is an amount equal to such consolidated net capital loss multiplied by a fraction, the numerator of which is the net capital loss of such member, and the denominator of which is the sum of the net capital losses of those members of the group having net capital losses. For purposes of this subparagraph, the net capital loss of a member of the group shall be determined by taking into account the following:

(i) Such member's net capital gain or loss (determined without regard to any net capital loss carryover); and

(ii) Such member's section 1231 net loss, reduced by the portion of the consolidated section 1231 net loss attributable to such member.

(c) *Carryover and carryback of consolidated unused investment credit to separate return years*—(1) *In general.* If a consolidated unused investment credit can be carried under the principles of section 46(b) and paragraph (b) of § 1.1502–3 to a separate return year of a corporation (or could have been so carried if such corporation were in existence) which was a member of the group in the year in which such unused credit arose, then the portion of such consolidated unused credit attributable to such corporation (as determined under subparagraph (2) of this paragraph) shall be apportioned to such corporation (and any successor to such corporation in a transaction to which section 381(a) applies) under the principles of paragraph (a) (1) and (2) of this section and shall be an investment credit carryover or carryback to such separate return year.

(2) *Portion of consolidated unused investment credit attributable to a member.*—(i) *Investment credit carryback.* In the case of a consolidated unused credit which is an investment credit carryback, the portion of such consolidated unused credit attributable to a member of the group is an amount equal to such consolidated unused credit multiplied by a fraction, the numerator of which is the credit earned of such member for the consolidated unused credit year, and the denominator of which is the consolidated credit earned for such unused credit year.

(ii) *Investment credit carryover.* In the case of a consolidated unused credit which is an investment credit carryover, the portion of such consolidated unused credit attributable to a member of the group is an amount equal to such consolidated unused credit multiplied by a fraction, the numerator of which is the

credit earned with respect to any section 38 property placed in service in the consolidated unused credit year and owned by such member (whether or not placed in service by such member) at the close of the last day as of which the taxable income of such member is included in a consolidated return filed by the group, and the denominator of which is the consolidated credit earned for such unused credit year.

(d) *Carryover and carryback of consolidated unused foreign tax*—(1) *In general.* If a consolidated unused foreign tax can be carried under the principles of section 904(d) and paragraph (e) of § 1.1502–4 to a separate return year of a corporation (or could have been so carried if such corporation were in existence) which was a member of the group in the year in which such unused foreign tax arose, then the portion of such consolidated unused foreign tax attributable to such corporation (as determined under subparagraph (2) of this paragraph) shall be apportioned to such corporation (and any successor to such corporation in a transaction to which section 381(a) applies) under the principles of paragraph (a) (1) and (2) of this section and shall be deemed paid or accrued in such separate return year to the extent provided in section 904(d).

(2) *Portion of consolidated unused foreign tax attributable to a member.* The portion of a consolidated unused foreign tax for any year attributable to a member of a group is an amount equal to such consolidated unused foreign tax multiplied by a fraction, the numerator of which is the foreign taxes paid or accrued for such year (including those taxes deemed paid or accrued, other than by reason of section 904(d)) to each foreign country or possession (or to all foreign countries or possessions if the overall limitation is effective) by such member, and the denominator of which is the aggregate of all such taxes paid or accrued for such year (including those taxes deemed paid or accrued, other than by reason of section 904(d)) to each such foreign country or possession (or to all foreign countries or possessions if the overall limitation is effective) by all the members of the group.

(e) *Carryover of consolidated excess charitable contributions to separate return years*—(1) *In general.* If the consolidated excess charitable contributions for any taxable year can be carried under the principles of section 170(b)(2) and paragraph (b) of § 1.1502–24 to a separate return year of a corporation (or could have been so carried if such corporation were in existence) which was a member of the group in the year in which such excess contributions arose, then the portion of such consolidated excess charitable contributions attributable to such corporation (as determined under subparagraph (2) of this paragraph) shall be apportioned to such corporation (and any successor to such corporation in a transaction to which section 381(a) applies) under the principles of paragraph (a) (1) and (2) of this section and shall be a charitable contribution carryover to such separate return year.

(2) *Portion of consolidated excess charitable contributions attributable to a member.* The portion of the consolidated excess charitable contributions attributable to a member of a group is an amount equal to such consolidated excess contributions multiplied by a fraction, the numerator of which is the charitable contributions paid by such member for the taxable year, and the denominator of which is the aggregate of all such charitable contributions paid for such year by all the members of the group.

(f) *Intercompany transactions*—(1) *Intercompany transactions other than deferred intercompany transactions.* In certain cases a member of the group must take into account in a separate return year an item of income or a deduction which it otherwise would have taken into account in earlier consolidated return years. See paragraph (b)(2) of § 1.1502–13.

(2) *Deferred intercompany transactions.* See paragraphs (d), (e), and (f) of § 1.1502–13 for rules with respect to restoration of deferred gains and losses in separate return years.

**§ 1.1502–80 Applicability of other provisions of law.**

The Code, or other law, shall be applicable to the group to the extent the regulations do not exclude its application. Thus, for example, in a transaction to which section 381(a) applies, the acquiring corporation will succeed to the tax attributes described in section 381(c). Furthermore, sections 269, 304, and 482 apply for any consolidated return year.

REGULATIONS APPLICABLE TO TAXABLE YEARS PRIOR TO JANUARY 1, 1966

**§ 1.1502–0A Introductory.**

The regulations prescribed under section 1502 of the Internal Revenue Code of 1954 are applicable in the case of all corporations (with certain statutory exceptions) to taxable years beginning after December 31, 1953, and ending after August 16, 1954, and with respect to such taxable years, the regulations under section 1502 supersede 26 CFR (1939) part 24 (Regulations 129). Any provision of the regulations under such section, the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) or in terms of taxable years ending after a specific date (occurring after December 31, 1953), shall apply to taxable years ending after such specific date. Each such provision shall in the case of a taxable year subject to 26 CFR (1939) part 24 (Regulations 129), be deemed included in 26 CFR (1939) part 24 (Regulations 129) but shall be applicable only to taxable years ending after such specific date. The provisions of 26 CFR (1939) part 24 (Regulations 129), superseded by provisions of the regulations under section 1502, the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in the regulations under such section but shall be applicable only to the period prior to the taking effect of the corresponding provision of the regulations under such section.

**§ 1.1502–1A Privilege of making consolidated returns.**

(a) Section 1501 gives to the corporations of an affiliated group the privilege of making a consolidated income tax return for the taxable year in lieu of separate returns. This privilege is given, however, upon the condition that all corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to the regulations under section 1502 applicable to such taxable year and any amendments thereof duly prescribed prior to the last day prescribed by law for the filing of the return; and the making of the consolidated return is considered as such consent.

(b) With respect to a taxable year to which 26 CFR (1939) Part 24 (Regulations 129), as amended by the regulations under section 1502 is applicable, the regulations to which consent is made are those in 26 CFR (1939) Part 24 (Regulations 129), as amended, and as further amended by the regulations under such section. With respect to a taxable year to which the regulations under section 1502 are applicable, the regulations to which consent is made are the regulations under such section as changed to the extent that portions of 26 CFR (1939) Part 24 (Regulations 129) are applicable. For example, in the case of a fiscal year ending October 31, 1954, the Internal Revenue Code of 1939 and 26 CFR (1939) Part 24 (Regulations 129) are applicable to a consolidated return filed for such year. In such case, if the first distribution in pursuance of a plan of complete liquidation of a member of the affiliated group occurs on or after June 22, 1954, § 1.1502–38A is applicable in lieu of 26 CFR (1939) 24.38 (Regulations 129). On the other hand, if such a distribution occurs before June 22, 1954, 26 CFR (1939) 24.38 (Regulations 129) is applicable. Similarly, in the case of a return filed for the calendar year 1954, the Internal Revenue Code of 1954 and the regulations under section 1502 are applicable. In such case, if the first distribution in pursuance of a plan of complete liquidation of a member of the affiliated group occurs prior to June 22, 1954, 26 CFR (1939) 24.38 (Regulations 129) is applicable in lieu of § 1.1502–38A. If such distribution occurs on or after June 22, 1954, § 1.1502–38A is applicable.

(c) The last day prescribed by law for the filing of the return includes the

last day of the period of any extension of time granted by the Commissioner.

(d) The tax liability of the members of the affiliated group for the taxable year involved will be determined in accordance with the provisions of the regulations to which consent is given and without regard to any changes of the rules therein prescribed made subsequent to the last day prescribed by law for the filing of the return for such year.

§ 1.1502–2A Definitions.

(a) *Code.* The term "Code" means the Internal Revenue Code of 1954 and the sections of statutory law referred to in the regulations under section 1502 unless otherwise stated, are sections of that Code.

(b) *Affiliated group.* (1) The term "affiliated group" is defined in section 1504 and includes the common parent corporation and every other corporation for the period during which such corporation is a member of the affiliated group within the meaning of such section. It does not include any corporation which is not an "includible corporation" as defined by section 1504(b). An includible corporation is defined by such section to mean any corporation, except—

(i) A corporation exempt under section 501 from the taxes imposed by subtitle A;

(ii) An insurance company subject to taxation under section 802 or 821 (except as provided in section 1504(c));

(iii) A foreign corporation (except as provided in section 1504(d));

(iv) A corporation entitled to the benefits of section 931 by reason of receiving a large percentage of its income from sources within possessions of the United States;

(v) A corporation organized under the China Trade Act of 1922 (15 U.S.C. ch. 4);

(vi) A regulated investment company or a real estate investment trust subject to tax under subchapter M, chapter 1 of the Code;

(vii) An unincorporated business enterprise subject to tax as a corporation under section 1361; and

(viii) For periods before September 24, 1959, an electing small business corporation as defined in section 1371(b).

The consolidated income tax return must include every includible corporation which, under the provisions of section 1504, is a member of the affiliated group. No corporation which is connected by stock ownership with an affiliated group of includible corporations through a nonincludible corporation may be included in the consolidated return of such group. In no case may a consolidated return be filed by subsidiary corporations as an affiliated group unless the common parent corporation through which the subsidiaries are connected is a member of the group. For instance, there will not be recognized as an affiliated group two domestic industrial corporations, the common parent corporation of which is a regulated investment company subject to tax under part I, subchapter M, chapter 1 of the Code.

(2) An insurance company subject to tax under section 831 is an includible corporation and may be included in an affiliated group, together with corporations other than insurance companies taxable under section 802 or 821. Insurance companies subject to tax under section 802 or 821 are not includible corporations under section 1504(b). Under section 1504(c), however, a domestic insurance company taxable under section 802 may be included in an affiliated group comprised solely of other domestic insurance companies taxable under section 802; it may not be included in an affiliated group with other corporations. An affiliated group of domestic insurance companies taxable under section 802 may not include a domestic insurance company taxable under section 821 or 831.

(3) In the case of a domestic corporation owning or controlling, directly or indirectly, 100 percent of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of Canada or of Mexico and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for income tax purposes as a domestic corporation. The option to treat such foreign corporation as a domestic corporation so that it may be included in a consolidated return must be exercised at the time of making the consolidated return, and cannot be exercised at any time thereafter. If the election is exercised to treat such foreign corporation as a domestic corporation, it must be included in the consolidated return of the affiliated group of which it is a member for each consecutive year thereafter for which such group makes or is required to make a consolidated return.

(4) An affiliated group of corporations, within the meaning of section 1504, is formed at the time that the common parent corporation, which is an includible corporation, becomes the owner directly of stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) of another includible corporation; a corporation becomes a member of such an affiliated group at the time that one or more members of such group become the owners directly of stock possessing at least 80 percent of the voting power of all classes of its stock and at least 80 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends); and a corporation ceases to be a member of such an affiliated group at the time that the members of such group cease to own directly stock possessing at least 80 percent of the voting power of all classes of its stock, or at least 80 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends).

(c) *Consolidated return period.* The term "consolidated return period" means the taxable year 1929, or any subsequent taxable year, for which a consolidated return is made or is required, income tax return, excess profits tax return, or both, including the period during which a subsidiary corporation is engaged in distributing its assets in liquidation.

(d) *Subsidiary.* The term "subsidiary" means a corporation (other than the common parent corporation) which is a member of the affiliated group during any part of the consolidated return period.

(e) *Tax.* The term "tax" means any tax imposed by chapter 1 of the Code, and includes any interest, penalty, additional amount, or addition to the tax, payable in respect thereof.

(f) *Terms defined in Internal Revenue Code.* Terms which are defined in the Code shall, when used in the regulations under section 1502 have the meaning assigned to them by the Code, unless specifically otherwise defined.

(g) *Regulated public utility.* (1) The term "regulated public utility" means a corporation described in section 1503 (c). It includes a corporation (i) whose operations are an integral part of the furnishing or sale of a product or service described in such section by an interconnected and coordinated public utility system or systems and (ii) whose rates for furnishing products or services to the system or systems are established or approved by a regulatory body described in section 1503 (c) (1). For the purpose of determining whether or not 80 percent of the gross income of the corporation is from the furnishing or sale of such product or service, income received in consideration for the product or service described shall include only income received directly therefrom and income from the furnishing or sale of byproducts and residual products which are directly necessary and incidental to the furnishing of such product or service. In determining under subdivision (i) of this subparagraph whether the operations of a particular corporation constitute an integral part of the "furnishing or sale" of a product or service described in section 1503 (c), the income of a corporation shall be deemed to be from such source only to the extent that it is in consideration for necessary processing of either the product described in section 1503 (c) or the essential facilities used in making available to customers such product or service.

§ 1.1502–3A Applicability of other provisions of law.

Any matter in the determination of which the provisions of the regulations under section 1502 are not applicable shall be determined in accordance with the provisions of the Code or other law applicable thereto.

§§ 1.1502–4A to 1.1502–9A [Reserved]

§ 1.1502–10A Exercise of privilege.

(a) *When privilege must be exercised.* The privilege of making a consolidated return under section 1502 for any taxable year of an affiliated group must be exercised at the time of making the return of the common parent corporation for such year. For this purpose, the return is considered as made on the due

date of such return (including any extensions of time granted by the Commissioner), regardless of the actual previous date of filing. Under no circumstances can such privilege be exercised at any time thereafter. The filing of separate returns for a taxable year does not constitute an election binding upon the corporation in subsequent years. If the privilege is exercised at the time of making the return, separate returns cannot thereafter be made for such year. (See, however, § 1.1502–18A, relating to failure to comply with the regulations under section 1502.)

(b) *Effect of tentative returns.* In no case will the privilege under paragraph (a) of this section be considered as exercised at the time of making a so-called "tentative return" (made, for example, in order to obtain an extension of time for making the return required by law). However, if any such tentative return is made upon the basis of a consolidated return or a separate return, the return required by law must be made upon the same basis, unless upon the making of the return required by law (either a separate return or a consolidated return, as the case may be) the payments theretofore made and to be made are adjusted in a manner satisfactory to the Commissioner.

(c) *Estimated tax.* (1) Except as provided in subparagraph (2) of this paragraph, the provisions of section 6016 (relating to declarations of estimated tax by corporations) and section 6154 (relating to payments of estimated tax by corporations) shall be applicable to the several members of an affiliated group in the same manner and to the same extent as in the case of corporations filing separate returns, whether or not such affiliated group files a consolidated return. The declaration of estimated tax shall be filed and payments shall be made to the district director for the internal revenue district prescribed for the filing of a separate income tax return in the case of each member of the group required to file a declaration of estimated tax. If a consolidated return is filed, the amounts of any payments made with respect to the consolidated return period shall be credited against the tax liability of the affiliated group with respect to the consolidated return period.

(2) If the affiliated group intends to file a consolidated return for the taxable year, the common parent corporation may file a declaration of estimated tax for the group. In such case, all of the several members of the affiliated group shall be treated for the purpose of applying the provisions of sections 6016 and 6154 as a single corporation. Where such a declaration is filed, each subsidiary shall notify the district director for the internal revenue district prescribed for the filing of a separate income tax return by such subsidiary that its estimate is included in the declaration made by the common parent corporation. If the affiliated group does not file a consolidated return for the year for which such a declaration is filed, the payments made with respect to such declaration shall be apportioned among the several members of the group in the manner designated by the common parent corporation for the purpose of determining any addition to the tax provided by section 6655.

(3) In any case in which an affiliated group has made payments with respect to a declaration made on a group basis and such group does not file a consolidated return for the taxable year, the payments made thereon shall be applied against the tax liability of the members of the group in a manner satisfactory to the Commissioner.

(4) See § 1.1502–15A (relating to liability for tax) and § 1.1502–49A (relating to additions to tax for failure to pay estimated tax).

**§ 1.1502–11A Consolidated returns for subsequent years.**

(a) *Consolidated returns required for subsequent years.* If a consolidated return is made under section 1502 for any taxable year, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence unless (1) a corporation (other than a corporation created or organized, directly or indirectly, by a member of the group) has become a member of the group during such subsequent taxable year, or (2) subsequent to the exercise of the election to make consolidated returns, subtitle A of the Code to the extent applicable to corporations, or the regulations under section 1502 which have been consented to, have been amended and any such amendment is of a character which makes substantially less advantageous to affiliated groups as a class the continued filing of consolidated returns, regardless of the effective date of such amendment, or (3) the Commissioner, prior to the time of making the return, upon application made by the common parent corporation and for good cause shown, grants permission to change. For the purpose of subparagraph (2) of this paragraph, the expiration of a provision shall be considered as an amendment to the Code made on the date of such expiration.

(b) *Effect of separate returns when consolidated return is required.* If the making of a consolidated return is required for any taxable year, the tax liability of the members of the affiliated group shall be computed in the same manner as if a consolidated return had been made, even though separate returns are made; amounts assessed upon the basis of separate returns shall be considered as having been assessed upon the basis of a consolidated return; and amounts paid upon the basis of separate returns shall be considered as having been paid by the common parent corporation. In such cases the making of separate returns shall not be considered as the making of a return for the purpose of computing any period of limitation or any deficiency. If a consolidated return for such taxable year is thereafter made, such return shall, for the purpose of computing periods of limitation and any deficiency, be considered as the return for such year.

(c) *When affiliated group remains in existence.* For the purpose of the regulations under section 1502, an affiliated group shall be considered as remaining in existence if the common parent corporation remains as a common parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group at the time the group was formed and whether or not one or more corporations have become subsidiaries or have ceased to be subsidiaries at any time after the group was formed.

(d) *When affiliated group terminates.* For the purpose of the regulations under section 1502, an affiliated group shall be considered as terminated if the common parent corporation ceases to be the common parent or if there is no subsidiary affiliated with it.

**§ 1.1502–12A Making consolidated return and filing other forms.**

(a) *Consolidated return made by common parent corporation.* A consolidated return shall be made on Form 1120 by the common parent corporation for the affiliated group. Such return shall be filed at the time and in the office of the district director for the internal revenue district prescribed for the filing of a separate return by such common parent corporation.

(b) *Authorizations and consents.* Each subsidiary must prepare duplicate originals of Form 1122, consenting to the regulations under section 1502 and authorizing the common parent corporation to make a consolidated return on its behalf for the taxable year and authorizing the common parent (or, in the event of its failure, the Commissioner or the district director) to make a consolidated return on its behalf (as long as it remains a member of the affiliated group), for each year thereafter for which, under paragraph (a) of § 1.1502–11A, the making of a consolidated return is required. One of such forms, as prepared by each subsidiary shall be attached to the consolidated return, as a part thereof; and the other shall be filed, at or before the time the consolidated return is filed, in the office of the district director for the internal revenue district prescribed for the filing of a separate return by such subsidiary. No such consent can be withdrawn or revoked at any time after the consolidated return is filed.

(c) *Affiliations schedule filed by common parent corporation.* The common parent corporation shall prepare Form 851 (Affiliations Schedule), which shall be attached to and made a part of the consolidated return.

(d) *Persons qualified to execute returns and forms.* Each return or form required to be made or prepared by a corporation must be executed by the person authorized under section 6062 to execute returns of separate corporations. In cases where receivers or trustees in bankruptcy are operating the property or business of corporations, each return or form required to be made or prepared by such corporation must be executed by the receiver or trustee, as the case may be, pursuant to an order or instructions of the court, and be accompanied by a copy of such order or instructions.

(e) *Signatures in case subsidiary has left affiliated group.* Since Form 1122 is required even though, during the tax-

able year of the common parent corporation, the subsidiary (because of a dissolution or sale of stock, or otherwise) has ceased to be a member of the affiliated group, it may be advisable for the common parent to obtain the proper signatures to the form prior to the time the subsidiary ceases to be a member of the group.

**§ 1.1502–13A Change in affiliated group during taxable year.**[1]

(a) *General rule.* Except as hereinafter provided, a consolidated return must include the income of the common parent corporation and of each subsidiary for the entire taxable year of the affiliated group.

(b) *Formation of affiliated group after beginning of year.* If an affiliated group is formed after the beginning of the taxable year of the corporation which becomes the common parent corporation, the consolidated return must include the income of the common parent for its entire taxable year (excluding any portion of such year during which its income is included in the consolidated return of another affiliated group) and the income of each subsidiary from the time it became a member of the affiliated group.

(c) *Complete termination of affiliated group prior to close of taxable year.* If an affiliated group is terminated prior to the close of the taxable year of the group, the consolidated return must include the income of the common parent corporation for its entire taxable year (excluding any portion of such year during which its income is included in the consolidated return of another affiliated group) and of each subsidiary for the period prior to the termination. (See paragraphs (c) and (d) of § 1.1502–11A in determining whether the group has terminated.)

(d) *Addition to affiliated group of a subsidiary during year.* If a corporation becomes a member of the affiliated group during the taxable year of the group, the consolidated return must include its income from the time when it became a member of the group.

(e) *Elimination from affiliated group of a subsidiary during year.* If a subsidiary ceases to be a member of the affiliated group during the taxable year of the group, the consolidated return must include its income for the period during which it was a member of the group.

(f) *Period of 30 days or less may be disregarded.* A subsidiary may at its option be considered as having been a member of the affiliated group during the entire taxable year of the group (or during the entire period of the existence of the subsidiary, whichever is shorter) if the period during which it was not a member of such group does not exceed 30 days. If a corporation has been a member of the affiliated group for a period of less than 31 days during the taxable year of the group, it may at its option be considered as not having been a member of the group during the taxable year. An option under this paragraph must be exercised at the time the consolidated return is made.

(g) *Separate returns for periods not included in consolidated return.* If a corporation, during its taxable year (determined without regard to the affiliation), becomes a member of an affiliated group, its income for the portion of such taxable year not included in the consolidated return of such group must be included in a separate return (or, if a member of another affiliated group which makes a consolidated return for such period, then in such consolidated return). If a corporation ceases to be a member of the affiliated group during the taxable year of the group, its income for the period after the time when it ceased to be a member of the group must be included in a separate return (or, if it becomes a member of another affiliated group which makes a consolidated return for such period, then in such consolidated return).

(h) *Time for making separate returns for periods not included in consolidated return.* (1) (i) If the due date for filing a subsidiary's separate return (determined without regard to the affiliation and without regard to extensions of time) precedes the due date for filing the consolidated return of the affiliated group (determined without regard to extensions of time), then, on or before the due date of the subsidiary's separate return, it may make a separate return either for that portion of its taxable year which would not be included in the consolidated return, if such return is filed, or for its complete taxable year. However, if a separate return is filed for only a portion of its taxable year and the group does not elect to make a consolidated return, such subsidiary shall file a return for its complete taxable year not later than the due date (including extensions of time) prescribed for the filing of the consolidated return by the group. There shall be attached to the return for the complete taxable year a statement setting forth that such return is in lieu of the return previously filed. In such case the return previously filed for only a portion of its taxable year shall not be considered a return within the meaning of section 6012. On the other hand, if a return is filed for the subsidiary's complete taxable year and the group later makes a consolidated return, such subsidiary should file an amended return not later than the due date (including extensions of time) for the filing of the consolidated return of the group. Such amended return shall be for that portion of the taxable year which is not included in the consolidated return.

(ii) If the due date for filing a subsidiary's separate return (determined without regard to the affiliation and without regard to extensions of time) is later than the due date for filing the consolidated return of the affiliated group (determined without regard to extensions of time), then the separate return for that portion of the subsidiary's taxable year which is not included in the consolidated return of the group should be filed no later than the due date (including extensions of time) for the filing of the consolidated return.

(2) The provisions of this paragraph may be illustrated by the following examples:

*Example (1).* Corporation P, which reports its income on a calendar year basis, acquires all of the stock of Corporation S on January 1, 1959. Corporation S reports its income on a fiscal year ending March 31. On June 15, 1959, the due date for the filing of a separate return by Corporation S, it is anticipated that Corporation P will elect, on the due date of its return, to file a consolidated return for 1959. On June 15, Corporation S may file either a return for a short taxable year beginning April 1, 1958, and ending December 31, 1958, or it may file a return for the complete fiscal year ending March 31, 1959. If it files a return for the short taxable year and Corporation P does not elect to file a consolidated return, Corporation S must file a return for the complete fiscal year ending March 31, 1959, in lieu of the return previously filed for the short period. Interest is computed on any additional tax from June 15, 1959.

*Example (2).* Assume the same facts as in example (1), except that Corporation P acquires all of the stock of Corporation S on October 1, 1959, and that Corporation P elects to file a consolidated return on March 15, 1960, the due date of its return. The return of Corporation S for the short taxable year beginning April 1, 1959, and ending September 30, 1959, should be filed on March 15, 1960.

**§ 1.1502–14A Accounting period of an affiliated group.**

(a) The taxable year of an affiliated group which makes a consolidated return shall be the same as the taxable year of the common parent corporation; and, except as provided in paragraph (c) of this section, upon having elected to file a consolidated return, each subsidiary corporation shall, not later than the close of the first consolidated taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent.

(b) If a change of accounting period is necessary in order to conform the accounting periods of the common parent and of its subsidiaries, Form 1128 shall be submitted at or before the time of filing the consolidated return for the taxable year in which the subsidiary has first adopted the parent corporation's annual accounting period.

(c) If the common parent corporation of an affiliated group has a fiscal year accounting period and any member of the group is an includible insurance company required by section 843 to file its return on a calendar year, the first consolidated return which includes such insurance company may be filed on the basis of the fiscal year accounting period of the common parent, provided, however, the common parent and the other includible corporations change to a calendar year basis effective immediately after the close of such fiscal year. For this purpose, Form 1128 shall be submitted at or before the time such first consolidated return is filed.

(d) With respect to computations for years involved in the change to the consolidated basis, see § 1.1502–32A.

[1] This section has no bearing upon the question whether a consolidated return may or must be made, but relates only to the effect of changes in the affiliated group during the taxable year.

§ 1.1502–15A Liability for tax.

(a) *Several liability of members of affiliated group.* Except as provided in paragraphs (b) and (c) of this section, the common parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed as provided in § 1.1502–30A, and for any addition to the tax computed as provided in § 1.1502–49A for underpayment of estimated tax for the consolidated return period.

(b) *Liability of a corporation in bankruptcy or receivership.* If, at the time of filing a consolidated return, one or more, but not all, of the members of the affiliated group are in bankruptcy under the laws of the United States or in receivership in any court of the United States or of any State, Territory, or the District of Columbia, then the liability under paragraph (a) of this section of each such member of the group with respect to the period covered by such return shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of such an agreement, an amount equal to its liability for such year computed as if a separate return had been filed.

(c) *Liability of subsidiary after withdrawal.* If a subsidiary has ceased to be a member of the affiliated group, its liability under paragraph (a) of this section shall remain unchanged, except that if such cessation occurred prior to the date upon which any deficiency is assessed and resulted from a bona fide sale of stock for fair value, the Commissioner may, if he believes that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former subsidiary in an amount not exceeding the portion thereof allocable to it upon the bases of income used in the computations, respectively, of the normal tax, the surtax, and any other tax imposed by chapter 1 of the Code included in such deficiency.

(d) *Effect of intercompany agreements.* Any agreement entered into by one or more members of the affiliated group with any other members of such group or with any other person shall in no case have the effect of reducing the liability prescribed under this section.

(e) *Liability of transferee not affected.* This section shall not be considered as extinguishing or diminishing any liability, at law or in equity, of a transferee of property of a taxpayer, including any liability under any provision of law, State or Federal, relating to liabilities pursuant to corporate dissolution or transfer or distribution of assets, whether or not in connection with a merger or consolidation.

§ 1.1502–16A Common parent corporation agent for subsidiaries.

(a) *Scope of agency of common parent corporation.* Except as provided in paragraphs (b) and (c) of this section, the common parent corporation shall be for all purposes (other than the making of the subsidiary consent required by paragraph (b) of § 1.1502–12A) in respect of the tax for the taxable year for which a consolidated return is made or is required, the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation which during any part of such year was a member of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. For example, all correspondence will be carried on directly with the common parent; notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each such corporation; notice and demand for payment of taxes will be given only to the common parent, and such notice and demand shall be considered as a notice and demand to each such corporation; the common parent will file petitions and conduct proceedings before the Tax Court of the United States, and any such petition shall be considered as having also been filed by each such corporation; the common parent will file claims for refund or credit; refunds will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such corporation; and the common parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such corporation. Notwithstanding the provisions of this paragraph, however, any notice of deficiency, in respect of the tax for a consolidated return period, will name each corporation which was a member of the affiliated group during any part of such period, and any assessment (whether of the original tax or of a deficiency) will be made in the name of each such corporation (but a failure to include the name of any such corporation will not affect the validity of the notice of deficiency or the assessment as to the other corporations); any notice and demand for payment will name each corporation which was a member of the affiliated group during any part of such period (but a failure to include the name of any such corporation will not affect the validity of the notice and demand as to the other corporations); and any levy (or warrant or notice in respect thereof), any notice of a lien, or any other proceeding to collect the amount of any assessment, after the assessment has been made, will name the corporation from which such collection is to be made. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year, and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time. Notwithstanding the provisions of this paragraph, the Commissioner may, if he deems it advisable, deal directly with any member of the group in respect of its ability, in which event such member shall have full authority to act for itself.

(b) *Effect of withdrawal of subsidiary.* For the purpose of the assertion, assessment, and collection of any deficiency, and of a credit or refund of any amount paid by a former subsidiary as a deficiency determined under paragraph (c) of § 1.1502–15A, but for no other purpose, the agency of the common parent corporation in respect of any subsidiary which has ceased to be a member of the affiliated group shall be terminated upon the expiration of 30 days (or prior thereto if the Commissioner consents) from the date upon which such subsidiary files written notice with the Commissioner that it has ceased to be a member of the affiliated group and that it is terminating such agency. For example, if a subsidiary has ceased to be a member of the group (and if the 30-day period has expired) prior to the mailing of a notice of deficiency to the common parent, a separate notice of deficiency will be mailed in due course to the subsidiary in respect of its deficiency if it becomes necessary to enforce its liability.

(c) *Effect of dissolution of common parent corporation.* If the common parent corporation contemplates dissolution, or is about to be dissolved, or if for any other reason its existence is about to terminate, it shall forthwith notify the Commissioner of such fact and designate, subject to the approval of the Commissioner, another member of the affiliated group to act as agent in its place to the same extent and subject to the same conditions and limitations as are applicable to the common parent. If the notice thus required is not given by the common parent, the remaining members of the group may, subject to the approval of the Commissioner, designate another member of the group to act as such agent, and notice of such designation shall be given to the Commissioner. Until a notice in writing designating a new agent has been received by the Commissioner, any notice of deficiency or other communication mailed to the common parent shall be considered as having been properly mailed to the agent of the group; or, if the Commissioner has reason to believe that the existence of the common parent has terminated, he may, if he deems it advisable, deal directly with any member of the group in respect of its liability.

§ 1.1502–17A Waivers.

(a) *Effect of waiver given by common parent corporation.* Any consent given by the common parent corporation (or by an agent in accordance with paragraph (c) of § 1.1502–16A) extending the time within which an assessment may be made or levy or proceeding in court begun, in respect of the tax for a consolidated return period, shall be applicable (1) to each corporation which was a member of the affiliated group during any part of such period (whether or not any such corporation has ceased to be a member of the group), and (2)

to each corporation the income of which was included in the consolidated return, or which filed Form 1122, for such period, even though it is subsequently determined that such corporation was not a member of the group.

(b) *Acceptance of waivers from common parent corporation and alleged subsidiary.* In no case will a separate waiver be accepted from a corporation the income of which was included in the consolidated return (for example, a corporation which the Commissioner determines was not a member of the affiliated group), or which filed Form 1122, unless a waiver is also obtained from the common parent, or unless the Commissioner is dealing directly with such corporation to enforce its liability.

**§ 1.1502–18A Failure to comply with regulations.**

(a) *Exclusion of a subsidiary from consolidated return.* If there has been a failure to include in the consolidated return the income of any subsidiary, or a failure to file any of the forms required by these regulations, notice thereof shall be given the common parent corporation by the Commissioner, and the tax liability of each member of the affiliated group shall be determined on the basis of separate returns unless such income is included or such forms are filed within the period prescribed in such notice, or any extension thereof, or unless under § 1.1502–11A a consolidated return is required for such year.

(b) *Common parent corporation incorrectly designated in consolidated return.* If a consolidated return includes a corporation as the common parent and such corporation was not (under the provisions of section 1502), the common parent, the tax liability of each corporation included in the return will be computed in the same manner as if separate returns had been made, unless, upon application, the Commissioner approves the making of a consolidated return, or unless under § 1.1502–11A a consolidated return is required for such year.

(c) *Inclusion of one or more subsidiaries not members of affiliated group.* If a consolidated return includes a corporation as a subsidiary and such corporation was not a member of the affiliated group during the consolidated return period, the tax liability of such corporation will be determined upon the basis of a separate return (but see paragraph (a) of this section), and the consolidated return shall be considered as including only the corporations which were members of the group during such period. If the consolidated return includes two or more corporations which are not members of the group but which constitute a separate affiliated group, the tax liability of the corporations constituting the separate group will be computed in the same manner as if separate returns had been made by such corporations, unless the Commissioner, upon application, approves the making of a consolidated return for the separate group, or unless under § 1.1502–11A a consolidated return is required for the separate group.

(d) *Effect of authorization and consent filed pursuant to notice.* If Form 1122 is filed by any corporation, pursuant to a notice under paragraph (a) of this section, such corporation shall be considered for all purposes as having joined in the making of the consolidated return.

(e) *Allocation of payments in the event of change by one or more corporations to separate returns.* In any case in which amounts have been assessed and paid upon the basis of a consolidated return and the tax liability of one or more of the corporations included in the consolidated return is to be computed in the same manner as if separate returns had been made, the amounts so paid shall be allocated between the affiliated group composed of the corporations properly included in the consolidated return and each of the corporations the tax liability of which is to be computed on a separate basis, in such manner as the corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of an agreement, upon the bases used in the respective computations of the normal tax, the surtax and any other tax imposed by chapter 1 of the Code, as shown upon the consolidated return.

**§ 1.1502–19A Tentative carryback adjustments.**

(a) *Groups with constant membership; consolidated returns only.* In the case of an affiliated group the membership of which remains unchanged and for which consolidated returns are made or are required for the taxable years involved, any statement filed under section 6164 with respect to an expected carryback and any application for a tentative carryback adjustment filed under section 6411 shall be filed by the common parent corporation and shall disclose all material facts and circumstances relating to the group as a whole. Such statement or application shall be filed on the appropriate form prescribed for such purpose, Form 1138 or Form 1139, as the case may be. Any refunds allowable under any such application will be made directly to and in the name of the common parent. The making of any such refund will discharge any liability of the Government in respect thereof to the several affiliated corporations. The common parent corporation and its several subsidiaries shall be severally liable for any amounts assessed pursuant to section 6213(b)(2), together with any interest or penalty assessed in connection therewith.

(b) *Groups with changing membership; cases involving a separate return period.* (1) The membership of an affiliated group may change during a taxable year for which a net operating loss arises, or in the preceding taxable year affected by such net loss. Or an affiliated group making a consolidated return for the year of such net loss may have made separate returns for the preceding year; or a group making separate returns for the year of the net loss may have made a consolidated return for the preceding year. In any such case, the statement provided for in section 6164 and the application for the tentative carryback adjustment provided for in section 6411 shall be a joint statement or application concurred in and executed by each corporation which was a member of the group at any time during either of the taxable years involved in the deferment or adjustment sought. The time for the payment of taxes shall be extended under section 6164 and the adjustment provided for in section 6411 shall be made only in accordance with an agreement of the several corporations involved to be made a part of such statement or application. Any refund allowable under any such application with respect to a consolidated return period will be made directly to and in the name of the common parent corporation, and the making of any such refund will discharge any liability of the Government in respect thereof to the several affiliated corporations. The common parent corporation and its several subsidiaries shall be severally liable for any amounts assessed pursuant to section 6213 (b) (2), together with any interest or penalty assessed in connection therewith.

(2) In the absence of an agreement between the several corporations, or in the event of their failure to set forth the provisions of such an agreement as a part of their statement or application, no extension of time for the payment of any tax under the provisions of section 6164 shall be granted, and no tentative adjustment shall be made under section 6411.

(3) Notwithstanding any agreement between the several affiliated corporations, no tentative adjustment shall be made with respect to either a consolidated or a separate return period in disregard of the several liability of the several corporations with respect to any taxable year for which a consolidated return was made or was required.

**§§ 1.1502–20A to 1.1502–29A [Reserved]**

**§ 1.1502–30A Computation of tax.**

(a) *General rule.* In the case of an affiliated group which makes, or is required to make, a consolidated return for any taxable year, the tax liability of each corporation for the period during such year that it was a member of such group shall be computed, subject to the provisions of paragraph (b) of this section, upon the consolidated taxable income and the consolidated taxable income plus the aggregate of the deductions of the several affiliated corporations allowable under section 242, or, in the case of the taxes imposed by section 531, section 541 (except as provided in paragraph (b) (4) of this section), and section 802, upon the consolidated accumulated taxable income, the consolidated undistributed personal holding company income, the consolidated life insurance company taxable income, the consolidated life insurance company taxable income plus the aggregate of the deductions of the several affiliated corporations allowable under section 242, or the consolidated 1954 life insurance company taxable income, as the case may be, determined in each case in accordance with the regulations under section 1502. In the case of an affiliated group realizing long-term capital gains and computing its tax

under the alternative tax provisions of section 1201, the tax shall be computed with reference to the consolidated taxable income, and the excess of the consolidated net long-term capital gain over the consolidated net short-term capital loss. The tax imposed under section 11 (c) or section 831 shall be increased for any taxable year for which an affiliated group makes or is required to make a consolidated return by 2 percent of the consolidated taxable income (computed without regard to the deduction, if any, provided in section 242 for partially tax-exempt interest).

(b) *Special rules.* The general rule prescribed in paragraph (a) of this section is subject to the following special rules:

(1) *In the case of Western Hemisphere trade corporations and regulated public utilities.* If the affiliated group filing a consolidated return includes a Western Hemisphere trade corporation, as defined in section 921, or a regulated public utility, as defined in section 1503 and paragraph (g) of § 1.1502–2A, the increase of 2 percent provided in section 1503(a) in the corporation surtax rate shall be applied only on that portion of the consolidated taxable income attributable to the members of the group other than the Western Hemisphere trade corporation or the regulated public utility without any increase with respect to any partially tax-exempt interest of such Western Hemisphere trade corporation or such regulated public utility.

(2) *In case of mutual savings banks conducting life insurance business.* If the parent corporation of an affiliated group is a mutual savings bank which, if a separate return were filed, would be subject to the alternative tax of section 594 (a) (relating to a mutual savings bank conducting a life insurance business), the provisions of section 594 (a) shall apply to such group and the alternative tax of such group under section 594 (a) shall be computed with reference to the consolidated taxable income of the group attributable to such parent corporation determined without regard to any items of gross income or deductions properly allocable to the business of the life insurance department, and with reference to the income of such life insurance department determined under the provisions of section 594 (a) (2) and paragraph (b) of § 1.1502–31A.

(3) *Changes in methods of accounting.* In any case in which a member of the affiliated group changes its method of accounting, if the year of the change is a year for which a consolidated return is filed (or is required to be filed), and if the requirements of section 481 (b) are met, then the tax under chapter 1 of the Code attributable to the increase in consolidated taxable income required by paragraph (c) of § 1.1502–44A shall not be greater than the tax under chapter 1 (or the corresponding provisions of prior law) which would result if the provisions of section 481(b) were applied to the corporation required to make the change in accounting method, but with the taxes for any year determined on the basis of the regulations under section 1502 (or prior consolidated returns regulations) if the income of such corporation was included in a consolidated return for such year, or on the basis of a separate return, if the income of such corporation was reported in a separate return for such year.

(4) *Personal holding companies.* In the case of an affiliated group which makes or is required to make a consolidated return for any taxable year, the tax liability of each corporation for the period during such year that it was a member of such group shall not be computed in the case of the tax imposed by section 541 upon the consolidated undistributed personal holding company income if:

(i) The affiliated group is an ineligible affiliated group as defined in section 542 (b) (2),

(ii) The affiliated group includes as a member (including the common parent corporation) an excluded corporation within the meaning of section 542 (c),

(iii) The consolidated personal holding company income is less than 80 percent of the consolidated section 542 gross income, or

(iv) At no time during the last half of the taxable year more than 50 percent in value of the outstanding stock of the parent corporation was owned directly or indirectly by or for not more than 5 individuals within the meaning of section 542 (a) (2).

If the tax liability of each corporation under section 541 is not computed upon the consolidated undistributed personal holding company income solely by reason of the application of subdivision (iii) or (iv) of this subparagraph (or both), no member of the affiliated group shall be subject to the tax under section 541 for such year or part thereof that it was a member of the affiliated group. If the tax liability of each corporation under section 541 is not computed upon the consolidated undistributed personal holding company income by reason of the application of subdivision (i) or (ii) of this subparagraph (whether or not subdivision (iii) or (iv) of this subparagraph, or both, are applicable), then such liability shall be computed by reference to the tax liability of the several members of the affiliated group which are personal holding companies within the meaning of section 542(a) in the same manner as if such corporations had filed separate returns except that paragraph (b) (1) (i) of § 1.1502–31A shall be applicable (except with respect to dividends received from other members of the group) in the computation of gross income, personal holding company income, and undistributed personal holding company income, and section 562(d) shall be applicable in the computation of dividends paid.

### § 1.1502–31A Basis of tax computation.

In the case of an affiliated group of corporations which makes, or is required to make a consolidated return for any taxable year, and except as otherwise provided in the regulations under section 1502, the tax liability determined under § 1.1502–30A shall be determined subject to the definitions and rules of computation set forth in paragraphs (a) and (b) of this section.

(a) *Definitions* — (1) *Consolidated taxable income.* The consolidated taxable income shall be the combined taxable income of the several affiliated corporations:

(i) Minus the sum of:

(*a*) Any consolidated net operating loss deduction,

(*b*) Any consolidated section 1231 net loss, relating to net losses from involuntary conversions subject to section 1231, and from sales or exchanges of property subject to section 1231.

(*c*) Any consolidated charitable contribution deduction, but not in excess of 5 percent of the consolidated taxable income computed without regard to such consolidated charitable contribution deduction, any deductions under part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code, any consolidated net operating loss carrybacks, and any deduction under section 922 (special deduction for Western Hemisphere trade corporations),

(*d*) Any consolidated dividends received deduction,

(*e*) Any consolidated section 922 deduction,

(*f*) Any consolidated section 175 deduction, but not in excess of 25 percent of the consolidated section 175 gross income,

(*g*) Any consolidated section 247 deduction,

(*h*) Any consolidated section 582(c) net loss, and

(*i*) [Reserved]

(*j*) Any consolidated section 181 deduction,

(ii) Plus any consolidated net capital gain, or

(iii) Minus, in the case of an affiliated group including as members one or more corporations subject to the tax imposed by section 831, the combined additional capital loss deductions of such corporations authorized by section 832 (c) (5) (but in an amount not in excess of the consolidated net capital loss).

(2) *Consolidated net operating loss deduction.* The consolidated net operating loss deduction shall be an amount equal to the aggregate of the consolidated net operating loss carryovers and of the consolidated net operating loss carrybacks to the taxable year.

(3) *Consolidated net operating loss carryovers.* (i) The consolidated net operating loss carryovers to the taxable year shall consist of—

(*a*) The consolidated net operating losses, if any, for the five preceding taxable years (and the consolidated net operating losses, if any, for the sixth and seventh preceding taxable years (not including as a sixth or seventh) preceding taxable year any taxable year ending on or before December 31, 1955) to the extent attributable to members of the affiliated group which are, and were in the taxable year in which the loss originated, regulated transportation corporations as defined in section 172(j)(1)), but only to the extent that the consolidated net operating loss for any such preceding taxable year was not attributable to a corporation making a

separate return or joining in a consolidated return filed by another affiliated group for the taxable year and was not absorbed as a carryover or carryback for preceding or intervening taxable years,

and, with respect to a net operating loss sustained by a corporation in a taxable year for which a separate return was filed, or for which such corporation joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (b)(3) of this section,

(b) The amount of the net operating losses, if any, of such corporation for the five preceding taxable years (and the net operating losses, if any, for the sixth and seventh preceding taxable years (not including as a sixth or seventh preceding taxable year any taxable year ending on or before December 31, 1955) if such corporation is, and was in the taxable year in which the loss was sustained, a regulated transportation corporation as defined in section 172(j)(1)), to the extent that the net operating loss for any such preceding taxable year was not absorbed as a carryover or carryback for preceding or intervening taxable years.

(ii) For purposes of subdivision (i) of this subparagraph, there shall not be included as a fifth preceding taxable year any taxable year beginning prior to 1950, unless such preceding taxable year began in 1949 and ended in 1950, and unless all members of the group for such preceding taxable year (or the corporation filing a separate return or joining in a consolidated return filed by another affiliated group) commenced business in 1949; and in such case the amount of the consolidated net operating loss (or net operating loss) for such fifth year shall not be treated as a carryover except to the extent that such loss is allocable to 1950.

(iii) For purposes of this section, a net operating loss attributable to a regulated transportation corporation shall not be a net operating loss carryover to the sixth taxable year following the year in which the loss originated unless, for such sixth taxable year, the corporation to which the loss is attributable is a regulated transportation corporation; and shall not be a carryover to the seventh taxable year following the year in which the loss originated unless for both such sixth and seventh years the corporation to which the loss is attributable is such a regulated transportation corporation.

(iv) In the case of a net operating loss for a taxable year beginning in 1955 and ending in 1956, attributable to a regulated transportation corporation, the amount of such loss which may be carried to—

(a) The sixth taxable year following the loss year shall be the amount which bears the same ratio to the amount which would (without regard to the limitation prescribed in paragraph (b)(3) of this section for such sixth taxable year) be carried to such sixth taxable year as the number of days in the loss year after December 31, 1955, bears to the total number of days in the loss year, and

(b) The seventh taxable year following the loss year shall be the amount which bears the same ratio to the amount which would (without regard to the limitation prescribed in paragraph (b)(3) of this section for such seventh taxable year) be carried to such seventh taxable year as the number of days in the loss year after December 31, 1955, bears to the total number of days in the loss year.

The amounts determined under (a) and (b) of this subdivision shall be subject to the limitation prescribed in paragraph (b)(3) of this section.

(v) See paragraph (b)(21) of this section in any case in which a member of the group is an acquiring corporation in a transaction described in section 381(a) or any member of the group is subject to the limitations provided in section 382.

(4) *Consolidated net operating loss carrybacks.* (i) The consolidated net operating loss carrybacks to the taxable year with respect to net operating losses sustained in taxable years ending after December 31, 1957, shall consist of—

(a) The amount of the consolidated net operating loss, if any, for the first succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year) reduced to the extent absorbed as a carryback, consolidated or separate, as the case may be, for the first two preceding taxable years (and for the third and fourth preceding years with respect to that portion of the consolidated net operating loss attributable to the net operating losses of members for which certifications have been issued under section 317 of the Trade Expansion Act of 1962 and with respect to which the requirements of section 172(b)(3)(A) have been met),

(b) The amount of the consolidated net operating loss, if any, for the second succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year) reduced to the extent absorbed as a carryback, consolidated or separate, as the case may be, for the first preceding taxable year (and for the second and third preceding years with respect to that portion of the consolidated net operating loss attributable to the net operating losses of members for which certifications have been issued under section 317 of the Trade Expansion Act of 1962 and with respect to which the requirements of section 172(b)(3)(A) have been met),

(c) The amount of the consolidated net operating loss, if any, for the third succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group) reduced to the extent absorbed as a carryback, consolidated or separate, as the case may be, for the first two preceding taxable years with respect to that portion of the consolidated net operating loss attributable to the net operating losses of members for which certifications have been issued under section 317 of the Trade Expansion Act of 1962 and with respect to which the requirements of section 172(b)(3)(A) have been met,

(d) That portion of the consolidated net operating loss for the fourth succeeding taxable year which is attributable to the net operating losses of members for which certifications have been issued under section 317 of the Trade Expansion Act of 1962 and with respect to which the requirements of section 172(b)(3)(A) have been met (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year), reduced to the extent absorbed as a carryback, consolidated or separate, as the case may be, for the first preceding taxable year,

(e) That portion of the consolidated net operating loss for the fifth succeeding taxable year which is attributable to the net operating losses of members for which certifications have been issued under section 317 of the Trade Expansion Act of 1962 and with respect to which the requirements of section 172(b)(3)(A) have been met (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year),

and, with respect to a net operating loss sustained by a corporation which, for any of the five succeeding taxable years, files a separate return or joins in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (b)(3) of this section,

(f) The amount of the net operating loss, if any, sustained by such corporation for the first succeeding taxable year, reduced to the extent absorbed in a separate return (or in a consolidated return) for the first two preceding taxable years (and for the third and fourth preceding taxable years if a certification of such loss has been issued under section 317 of the Trade Expansion Act of 1962, and the requirements of section 172(b)(3)(A) have been met),

(g) The amount of the net operating loss, if any, sustained by such corporation for the second succeeding taxable year, reduced to the extent absorbed in a separate return (or in a consolidated return) for the first preceding taxable year (and for the second and third preceding taxable years if a certification of such loss has been issued under section 317 of the Trade Expansion Act of 1962, and the requirements of section 172(b)(3)(A) have been met),

(h) The amount of the net operating loss, if any, sustained by such corporation for the third succeeding taxable year, reduced to the extent absorbed in a separate return (or in a consolidated return) for the first and second preceding taxable years if a certification of such loss has been issued under section 317 of the Trade Expansion Act of 1962, and the requirements of section 172(b)(3)(A) have been met,

(i) [Reserved]

(j) The amount of the net operating loss, if any, sustained by such corpora-

tion for the fourth succeeding taxable year (but only if a certification of such loss for such year has been issued under section 317 of the Trade Expansion Act of 1962, and the requirements of section 172(b)(3)(A) have been met), reduced to the extent absorbed in a separate return (or in a consolidated return) for the first preceding taxable year, and

(*k*) The amount of the net operating loss, if any, sustained by such corporation for the fifth succeeding taxable year (but only if a certification of such loss for such year has been issued under section 317 of the Trade Expansion Act of 1962, and the requirements of section 172(b)(3)(A) have been met).

If the taxable year in which the net operating loss or consolidated net operating loss was sustained is a year beginning in 1957 and ending in 1958, the carryback is subject to section 172(i) or paragraph (b)(4)(v) of this section, respectively. See also paragraph (b)(21) of this section in any case in which a member of the group is an acquiring corporation in a transaction described in section 381(a), or any member of the group is subject to the limitations provided in section 382.

(ii) The consolidated net operating loss carrybacks to the taxable year with respect to net operating losses sustained in taxable years ending before January 1, 1958, shall consist of—

(*a*) The amount of the consolidated net operating loss, if any, for the first succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year) reduced to the extent absorbed as a carryback, consolidated or separate, as the case may be, for the first preceding taxable year;

(*b*) The amount of the consolidated net operating loss, if any, for the second succeeding taxable year to the extent not attributable to those corporations making separate returns in the taxable year;

and, with respect to a net operating loss sustained by a corporation which, for either of the two succeeding taxable years, files a separate return or joins in a consolidated return filed by another affiliated group, but subject to the limitations prescribed in paragraph (b)(3) of this section,

(*c*) The amount of the net operating loss, if any, sustained by such corporation for the first succeeding taxable year reduced to the extent absorbed by such corporation for the first preceding taxable year or, if the income of such corporation is included in the consolidated return for the first preceding taxable year, reduced to the extent absorbed by such consolidated return; and

(*d*) The amount of the net operating loss, if any, sustained by such corporation for the second succeeding taxable year.

See, however, paragraph (b)(21) of this section in any case in which a member of the group is an acquiring corporation in a transaction described in section 381(a) or any member of the group is subject to the limitations provided in section 382.

(5) *Consolidated net operating loss.* The consolidated net operating loss shall be an amount equal to the excess of the sum of:

(i) The combined net operating losses of the several affiliated corporations having net operating losses,

(ii) The consolidated section 175 deduction, but not in excess of 25 percent of the consolidated section 175 gross income,

(iii) The consolidated section 181 deduction,

(iv) The consolidated section 1231 net loss,

(v) The aggregate of the deductions of the several affiliated corporations under sections 243, 244, and 245 (computed without regard to the limitation contained in section 246(b)) and under section 247 (computed without regard to the limitation of subsection (a)(1)(B) of such section), and

(vi) The consolidated section 582(c) net loss,

over the sum of—

(vii) The combined taxable income of the several affiliated corporations having taxable income, computed without regard to any deductions under section 242 (relating to partially tax-exempt interest), and

(viii) The consolidated net capital gain.

(6) *Consolidated section 1231 net loss.* The consolidated section 1231 net loss shall be the excess of the aggregate of the recognized losses of the character described in section 1231 sustained by the several affiliated corporations over the aggregate of the recognized gains of the character described in section 1231 realized by the several affiliated corporations.

(7) *Consolidated charitable contribution deduction.* The consolidated charitable contribution deduction shall be the aggregate of the amount of the deductions of the several affiliated corporations allowable under section 170 for the taxable year (determined without regard to the 5-percent limitation of section 170(b)(2)) and an amount equal to the aggregate of the consolidated charitable contribution carryovers to the taxable year.

(8) *Consolidated charitable contribution carryovers.* The consolidated charitable contribution carryovers to the taxable year shall consist of—

(i) The excess, if any, of the amount of the consolidated charitable contribution deduction (computed without regard to any charitable contribution carryovers) for the two preceding taxable years over the limitation of subparagraph (1)(i)(c) of this paragraph for such years to the extent that the consolidated charitable contribution deduction for any such preceding year was not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group, for the taxable year reduced by—

(*a*) The amount absorbed as a carryover by the consolidated or separate taxable income for the intervening taxable year, and

(*b*) The increase in a consolidated or separate net operating loss carryover resulting from such excess,

and, with respect to any excess of charitable contributions over the applicable 5-percent limitation of a corporation in a taxable year for which a separate return was filed, or for which such corporation joined in a consolidated return filed by another affiliated group—

(ii) The amount of such excesses of such corporation for the two preceding taxable years reduced by:

(*a*) The amount absorbed as a carryover by the consolidated or separate taxable income for the intervening taxable year, and

(*b*) The increase in a consolidated or separate net operating loss carryover resulting from such excess.

(9) *Consolidated net capital gain.* The consolidated net capital gain shall be the excess of the sum of—

(i) The aggregate of the capital gains of the several affiliated corporations,

(ii) The consolidated section 1231 net gain, and

(iii) The consolidated section 582(c) net gain,

over the sum of—

(iv) The aggregate of the capital losses of such corporations, and

(v) The aggregate of the consolidated net capital loss carryovers to the taxable year.

(10) *Consolidated section 1231 net gain.* The consolidated section 1231 net gain shall be the excess of the aggregate of the recognized gains of the character described in section 1231 realized by the several affiliated corporations over the aggregate of the recognized losses of the character described in section 1231 sustained by the several affiliated corporations.

(11) *Consolidated net capital loss carryover.* The consolidated net capital loss carryovers to the taxable year shall consist of:

(i) The consolidated net capital losses, if any, for the 5 preceding taxable years to the extent that such losses were not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group, for the taxable year, and were not absorbed by net capital gains for intervening taxable years pursuant to the provisions of section 1212 or corresponding provisions of prior law, consolidated or separate, as the case may be,

and, with respect to net capital losses sustained by a corporation for taxable years for which separate returns were filed, or for which such corporation joined in a consolidated return filed by another affiliated group,

(ii) The net capital losses, if any, sustained by such corporation for its 5 preceding taxable years to the extent that such losses were not absorbed by the net capital gains of such corporation (or, if the income of such corporation was included in a consolidated return, by the consolidated net capital gain) for intervening taxable years pursuant to the provisions of section 1212 or corresponding provisions of prior law.

(12) *Consolidated net capital loss.* The consolidated net capital loss shall be the excess of the aggregate of the capital losses of the several affiliated corporations over the sum of:

(i) The aggregate of the capital gains of such corporations,

(ii) The consolidated section 1231 net gain, and

(iii) The consolidated section 582(c) net gain,

reduced in the case of an affiliated group including as members one or more corporations subject to the tax imposed by section 831, but only for the purpose of net capital loss carryover computations, by whichever of the following amounts is the lesser—

(iv) The combined additional capital loss deductions of such corporations authorized by section 832(c)(5), or

(v) The consolidated taxable income computed without regard to capital gains and losses and without regard to any deduction for partially tax-exempt interest provided by section 242.

(13) *Consolidated dividends received deduction.* The consolidated dividends received deduction shall be the aggregate of the deductions of the several affiliated corporations allowable under sections 243, 244, and 245 (computed without regard to the limitation of section 246 (b)), but in an amount not greater than 85 percent of the consolidated taxable income computed without regard to the consolidated net operating loss deduction, the consolidated section 247 deduction, and without regard to any consolidated dividends received deduction. The limitation of the previous sentence shall not apply for any taxable year for which there is a consolidated net operating loss.

(14) *Consolidated section 247 deduction.* The consolidated section 247 deduction, relating to dividends paid by public utilities on preferred stock, shall be an amount computed as follows:

(i) First, determine the amount which is the lesser of,

(*a*) The aggregate of the dividends paid by members of the affiliated group which are public utilities within the meaning of section 247(b)(1) on preferred stock within the meaning of section 247(b)(2), or

(*b*) The portion of the consolidated taxable income for the taxable year attributable to such members computed without regard to the consolidated section 247 deduction.

(ii) Then multiply the amount determined under subdivision (i) of this subparagraph by the fraction specified in section 247 (a) (2).

(15) *Consolidated section 922 deduction.* The consolidated section 922 deduction, relating to Western Hemisphere trade corporations, shall be that portion of the consolidated taxable income attributable to those members of the affiliated group which are Western Hemisphere trade corporations (computed without regard to the consolidated section 922 deduction) multiplied by the fraction specified in section 922 (2).

(16) *Consolidated net long-term capital gain.* The consolidated net long-term capital gain shall be the excess of the sum of:

(i) The aggregate of the long-term capital gains of the several affiliated corporations, and

(ii) The consolidated section 1231 net gain,

over

(iii) The aggregate of the long-term capital losses of such corporations.

(17) *Consolidated net short-term capital loss.* The consolidated net short-term capital loss shall be the sum of—

(i) The aggregate of the short-term capital losses of the several affiliated corporations, and

(ii) The consolidated net capital loss carryovers,

minus

(iii) The aggregate of the short-term capital gains of such corporations.

(18) *Consolidated accumulated taxable income.* The consolidated accumulated taxable income shall be the consolidated taxable income computed without regard to any capital loss carryover, without regard to any charitable contribution deduction under section 170, without regard to any net operating loss deduction, and without regard to any deduction under part VIII (section 241 and following, except section 248) subchapter B of chapter 1 of the Code, minus the sum of:

(i) The combined Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E, chapter 2 of the Internal Revenue Code of 1939, for taxable years beginning after December 31, 1940) and income, war profits and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 164(b)(6)), accrued during the taxable year by the several affiliated corporations or deemed to be paid by the several domestic affiliates under section 902(a)(1) or 960(a)(1)(C) for the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law,

(ii) The consolidated charitable contribution deduction computed without regard to section 170(b)(2).

(iii) The excess of the sum of the capital losses of the several affiliated corporations (computed without regard to any capital loss carryover) over the sum of the capital gains of such corporations,

(iv) The excess of the consolidated net long-term capital gain over the consolidated net short-term capital loss (computed without regard to any capital loss carryover) minus the taxes imposed by subtitle A attributable to such excess,

(v) In the case of an affiliated group including one or more holding company affiliates of a bank, as defined in section 2 of the Banking Act of 1933 (12 U.S.C. 221a), the consolidated section 601 deduction, relating to earnings or profits devoted to the acquisition of readily marketable assets, other than bank stock,

(vi) The consolidated accumulated earnings credit, and

(vii) The consolidated section 561 dividends paid deduction.

(19) *Consolidated accumulated earnings credit.* The consolidated accumulated earnings credit shall be:

(i) In the case of an affiliated group which is not a mere holding or investment group, an amount equal to such part of the aggregate of the earnings and profits for the taxable year of the several members of the group as are retained for the reasonable needs of the business of the group, minus the deduction allowed by subparagraph (18)(iv) of this paragraph, but not less than the amount (if any) by which $100,000 ($60,000 if the taxable year begins before January 1, 1958) exceeds the aggregate of the accumulated earnings and profits of the several members of the group at the close of the preceding taxable year, or

(ii) In the case of an affiliated group which is a mere holding or investment group, the amount (if any) by which $100,000 (or $60,000 if the taxable year begins before January 1, 1958) exceeds the aggregate of the accumulated earnings and profits of the several members of the group at the close of the preceding taxable year.

For the purpose of subdivision (i) of this subparagraph, the amount of the earnings and profits for the taxable year of the several members of the group which are retained is the amount by which the aggregate of the earnings and profits of the several members of the group for the taxable year exceed the consolidated section 561 dividends paid deduction for such year. For the purpose of the preceding sentence and subdivision (ii) of this subparagraph, the accumulated earnings and profits of the several members of the group at the close of the preceding taxable year shall be reduced by the dividends paid to other than members of the group under section 563 (a) (relating to dividends paid after the close of the taxable year) which are considered as paid during such taxable year.

(20) *Consolidated section 561 dividend paid deduction.* The consolidated section 561 dividends paid deduction shall be the sum of:

(i) The aggregate of the deductions allowable to the several members of the group with respect to dividends under section 561 (a) (1) and (2) determined without regard to any deductions attributable to payments made or considered to be made of dividends to other members of the group, and

(ii) In case the affiliated group is subject to tax on its consolidated undistributed personal holding company income, the consolidated dividend carryover.

(21) *Consolidated section 542 gross income.* The consolidated section 542 gross income shall be the combined gross income of the several members of the affiliated group computed without regard to any gross income from other members of the group and by including only the excess of the gains of the several members of the group over the losses of the several members of the group from transactions in stocks or securities as described in section 543 (a) (2) and by

including only the excess of the gains of the several members of the group over the losses of the several members of the group with respect to commodity transactions as described in section 543 (a) (3).

(22) *Consolidated personal holding company income.* The consolidated personal holding company income shall be that part of the consolidated section 542 gross income from the sources described in section 543.

(23) *Consolidated undistributed personal holding company income.* The consolidated undistributed personal holding company income shall be the consolidated taxable income computed without regard to any deductions under part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code, without regard to any charitable contribution deduction under section 170, without regard to any net operating loss deduction, and without regard to deductions disallowed by section 545 (b) (8), minus the sum of:

(i) The combined Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E, chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940) and income, war profits and excess profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 164(b) (6)) accrued during the taxable year by the several affiliated corporations or deemed to be paid by the several domestic affiliates under section 902(a) (1) or 960(a) (1) (C) for the taxable year, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by the corresponding sections of prior income tax law;

(ii) In lieu of the deduction provided by subparagraph (1) (i) (c) of this paragraph, the consolidated charitable contribution deduction computed without the application of section 170(b) (2) but limited as provided in section 170(b) (1) (A) and (B) (except that the 10-percent and 20-percent limitations therein shall be applied with respect to the consolidated adjusted gross income);

(iii) The amount of the consolidated net operating loss for the preceding taxable year (computed without the deductions provided in part VIII (section 241 and following), except section 248, subchapter B, chapter 1 of the Code, if the current taxable year begins after December 31, 1957) to the extent not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group for the taxable year, and, with respect to a corporation which filed a separate return or joined in a consolidated return filed by another affiliated group for the preceding taxable year, the net operating loss of such corporation for such preceding taxable year (computed without the deductions provided in part VIII (section 241 and following), except section 248, subchapter B, chapter 1 of the Code, if the current taxable year begins after December 31, 1957) but not in excess of the portion of the consolidated personal holding company income attributable to such corporation for the taxable year;

(iv) The excess of the consolidated net long-term capital gain for the taxable year over the consolidated net short-term capital loss for such year minus the taxes imposed by subtitle A of the Code attributable to such excess;

(v) The aggregate amount subject to the provisions of section 545 (b) (7) used or irrevocably set aside by the several affiliated corporations to pay or retire indebtedness incurred prior to January 1, 1934, not including such portion of any such indebtedness as was owned on January 1, 1934, or at any time thereafter, directly or indirectly, by another member of the group;

(vi) The sum of the amounts deductible by the several members of the affiliated group allowable under section 545 (b) (9), but there shall be added to the consolidated taxable income any amount required to be included in taxable income under such section;

(vii) The consolidated section 561 dividends paid deduction; and

(viii) In the case of an affiliated group including one or more holding company affiliates of a bank, as defined in section 2 of the Banking Act of 1933 (12 U.S.C. 221a), the consolidated section 601 deduction, relating to earnings or profits devoted to the acquisition of readily marketable assets, other than bank stock.

(24) *Consolidated adjusted gross income.* The consolidated adjusted gross income shall be the consolidated taxable income computed without regard to any charitable contributions deductions, any deductions under part VIII (section 241 and following), except section 248, subchapter B, chapter 1 of the Code, any net operating loss carryback to the taxable year, any deductions under section 922, and without deduction of the amount disallowed by section 545(b) (8).

(25) *Consolidated deficiency dividends deduction.* The consolidated deficiency dividends deduction shall be the aggregate of the amounts determined as provided in section 547 with respect to dividends distributed by the several members of the affiliated group pursuant to a determination of liability for personal holding company tax described in section 547, with respect to the consolidated undistributed personal holding company income of the affiliated group for the taxable year of the group computed without regard to any dividends distributed to members of the affiliated group.

(26) *Consolidated dividend carryover.* The consolidated dividend carryover to the taxable year shall be the sum of—

(i) The excess of—

(*a*) The consolidated section 561 dividends paid deduction for the first preceding taxable year, determined without regard to any consolidated dividend carryover, over

(*b*) The consolidated undistributed personal holding company income for such year, determined without regard to any dividends paid deduction and dividend carryover,

to the extent that such deduction and such income are not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group, for the taxable year.

(ii) The amount of the consolidated section 561 dividends paid deduction (determined as provided in subdivision (i) (*a*) of this subparagraph) for the second preceding taxable year reduced by the consolidated undistributed personal holding company income for such year (determined as provided in subdivision (i) (*b*) of this subparagraph) and further reduced by the amount of the consolidated undistributed personal holding company income for the first preceding taxable year determined without regard to any dividend carryover from the second preceding taxable year to the extent that any such consolidated section 561 dividends paid deduction and any such consolidated undistributed personal holding company income are not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group for the taxable year,

and, with respect to taxable years for which a member of the affiliated group filed a separate return or for which such member joined in a consolidated return filed by another affiliated group—

(iii) The excess of the deduction allowable to such corporation under section 561 for dividends paid for the first preceding taxable year (determined without regard to any dividend carryover) over the taxable income of such corporation for such year computed with the adjustments provided in section 545 (or if its income was included in the consolidated return of another affiliated group, that portion of the excess of the consolidated section 561 dividends paid deductions (determined as provided in subdivision (i) (*a*) of this subparagraph) for the first preceding taxable year, over the consolidated undistributed personal holding company income (determined as provided in subdivision (i) (*b*) of this subparagraph) for such year attributable to such corporation), and

(iv) The excess of the deduction allowable to such corporation under section 561 (determined without regard to any dividend carryover) for the second preceding taxable year over the taxable income of such corporation for such year computed with the adjustments provided in section 545 (or if its income was included in the consolidated return of another affiliated group, that portion of the excess of the consolidated section 561 dividends paid deduction (determined as provided in subdivision (i) (*a*) of this subparagraph) for the second preceding taxable year, over the consolidated undistributed personal holding company income (determined as provided in subdivision (i) (*b*) of this subparagraph) for such year, attributable to such corporation) and reduced by—

(*a*) The excess of the amount of its taxable income so computed for the first preceding taxable year over its dividends paid deduction under section 561, determined without regard to any dividend carryover from the second preceding taxable year (or, if its income was included in the consolidated return of an-

other affiliated group, that portion of the amount of such deduction absorbed in such consolidated return of another affiliated group), or

(b) If the income of such corporation is included in the consolidated return for the first preceding taxable year, the excess, if any, of the consolidated undistributed personal holding company income (determined without regard to any dividends paid deduction and dividend carryover) for the first preceding taxable year over the consolidated section 561 dividends paid deduction for such year, determined without regard to any dividend carryover.

(27) *Consolidated section 601 deduction.* The consolidated section 601 deduction relating to bank affiliates, shall be an amount equal to the aggregate of the earnings or profits of members of the group which are holding company affiliates of a bank as defined in section 2 of the Banking Act of 1933 (12 U.S.C. 221a) devoted to the acquisition of readily marketable assets other than bank stock (not including any asset acquired, directly or indirectly, from another member of the group), subject, in the case of each such affiliate, to the limitations imposed by section 601 determined without regard to the qualifications expressed in paragraph (b)(1)(ii) and (iii) of this section.

(28) *Consolidated life insurance company taxable income.* The consolidated life insurance company taxable income in the case of an affiliated group consisting of corporations subject to the tax imposed by section 802 shall be the consolidated taxable income minus the consolidated section 804 deduction and plus the consolidated section 806 adjustment.

(29) *Consolidated section 804 deduction.* The consolidated section 804 deduction relating to the reserve and other policy liabilities shall be the consolidated taxable income multiplied by a figure to be determined and proclaimed by the Secretary for each taxable year pursuant to section 804.

(30) *Consolidated section 806 adjustment.* The consolidated section 806 adjustment relating to certain reserves provided in section 806 shall be an amount equal to 3¼ percent of the combined unearned premiums and unpaid losses of the several affiliated corporations on contracts other than life insurance or annuity contracts computed in the case of each corporation pursuant to the provisions of section 806 but the combined unearned premiums shall not be considered to be less than 25 percent of the combined net premiums on such other contracts written during the taxable year.

(31) *Consolidated 1954 life insurance company taxable income.* The consolidated 1954 life insurance company taxable income in the case of an affiliated group consisting of corporations subject to the tax imposed by section 802 (b) for taxable years beginning in 1954 shall be the consolidated taxable income plus eight times the consolidated section 806 adjustment and minus the consolidated reserve interest credit, if any.

(32) *Consolidated reserve interest credit.* The consolidated reserve interest credit shall be the aggregate of the reserve interest credits of the several members of the affiliated group.

(33) *Consolidated section 175 deduction.* The consolidated section 175 deduction shall be the aggregate of the amount of the deductions of the several affiliated corporations allowable under section 175 for the taxable year (determined without regard to the 25 percent limitation of section 175 (b)) and an amount equal to the aggregate of the consolidated section 175 carryovers to the taxable year.

(34) *Consolidated section 175 gross income.* The consolidated section 175 gross income shall be the combined gross income derived from farming of the several affiliated corporations engaged in the business of farming and having expenditures of the type described in section 175 (a). For this purpose, there shall be eliminated profits and losses on intercompany transactions; and proper adjustment shall be made to eliminate any distortion in the amount of gross income attributable to transactions between members of the affiliated group at markedly fictitious values.

(35) *Consolidated section 175 carryovers.* The consolidated section 175 carryovers to the taxable year shall consist of—

(i) The excess, if any, of the amount of the consolidated section 175 deductions over 25 percent of the consolidated section 175 gross income of preceding taxable years to the extent that such consolidated section 175 deduction for any preceding taxable year was not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year and was not absorbed as a carryover by the consolidated section 175 gross income for preceding taxable years

and, with respect to any excess of deductions under section 175 over the 25 percent limitation of section 175 (b) of a corporation in a taxable year for which a separate return was filed or for which such corporation joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (b)(15) of this section.

(ii) The amount of such excesses of such corporation for preceding taxable years to the extent that such excesses were not absorbed as carryovers for preceding taxable years.

(36) *Consolidated section 582(c) net loss.* The consolidated section 582(c) net loss shall be the excess of the aggregate of the losses of the character described in section 582(c) recognized in a taxable year beginning after December 31, 1958, by the several affiliated corporations which are banks over the aggregate of gains of the character described in section 582(c) recognized in such taxable year by the several affiliated corporations which are banks.

(37) *Consolidated section 582(c) net gain.* The consolidated section 582(c) net gain shall be the excess of the aggregate of the gains of the character described in section 582(c) recognized in a taxable year beginning after December 31, 1958, by the several affiliated corporations which are banks over the aggregate of the losses of the character described in section 582(c) recognized in such taxable year by the several affiliated corporations which are banks.

(38) *Consolidated section 181 deduction.* The consolidated section 181 deduction for the taxable year shall be the sum of—

(i) With respect to the portion of a consolidated unused credit not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for such taxable year, the amount determined under the provisions of section 181, and

(ii) With respect to unused credits arising in unused credit years for which a corporation filed a separate return or joined in a consolidated return filed by another affiliated group, the amount determined under the provisions of section 181.

(b) *Computations.* In the case of affiliated corporations which make, or are required to make, a consolidated return, and except as otherwise provided in the regulations under section 1502:

(1) *Taxable income.* The taxable income of each corporation shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations, except:

(i) There shall be eliminated unrealized profits and losses in transactions between members of the affiliated group and dividend distributions from one member of the group to another member of the group (referred to in the regulations under section 1502 as intercompany transactions);

(ii) No net operating loss deduction shall be taken into account;

(iii) No capital gains or losses shall be taken into account;

(iv) There shall be disregarded all gains and losses from involuntary conversions subject to section 1231, and from sales and exchanges of property subject to section 1231;

(v) In the computation of the deduction under section 171, relating to amortizable bond premium, there shall be disregarded the bonds of one member of the group owned by another member of the group during the taxable year;

(vi) In the computation of the taxable income of a corporation for the taxable year in which it became the common parent corporation of the affiliated group filing a consolidated return, the aggregate deductions of such corporation for such year otherwise allowable in excess of the gross income of such corporation for such year shall be excluded to the extent that such excess is attributable to that portion of such year preceding the date upon which such corporation became the common parent corporation of the group. Any amount excluded under this paragraph shall, to the extent that it constitutes a net operating loss within the provisions of section 172 or a net capital loss within the provisions of section 1222, be considered as a net operating loss or a net capital loss, as the case may be, separately sustained by such corporation and subject to the provisions of paragraph (a)(3)(ii) or (11)(ii) of this section;

(vii) In the case of a corporation which became a member of the affili-

ated group after January 1, 1954, common parent corporation or subsidiary, as the case may be, allowable deductions shall be determined subject to the qualifications prescribed in subparagraph (9) of this paragraph;

(viii) No deduction under section 170 with respect to charitable or other contributions shall be taken into account;

(ix) In the case of the deduction provided in section 615 (relating to mine exploration expenditures), the allowable deduction shall be determined subject to the qualifications prescribed in subparagraph (12) of this paragraph;

(x) In the case of a distribution of inventory to which section 311 (b) is applicable, or in the case of a distribution of property to which section 311 (c) is applicable by one member of the group to another member of the group, the gain recognized under such sections shall be eliminated;

(xi) No deductions under section 243, 244, 245, or 247 (relating to deductions with respect to dividends received and dividends paid) or under section 922 (relating to the special deduction for Western Hemisphere trade corporations), shall be taken into account;

(xii) No deductions under section 175 (relating to soil and water conservation expenditures) shall be taken into account by a member of an affiliated group to which the consolidated section 175 deduction is applicable;

(xiii) In the case of a bank, for taxable years beginning after December 31, 1958, there shall be disregarded all gains and losses from sales and exchanges of property described in section 582(c); and

(xiv) No deduction under section 181 (relating to deduction for certain unused investment credit) shall be taken into account.

Intercompany profits and losses which have been realized by the group through final transactions with persons other than members of the group, and intercompany transactions which do not affect the consolidated taxable income shall not be eliminated. For the purpose of this subparagraph, gain includible in income pursuant to section 357(c) with respect to transfers of assets other than capital assets and other than assets to which section 1231 is applicable, and gain includible in income by reason of the application of paragraph (a)(1)(iii) of § 1.1502–37A, shall not be eliminated. For the purpose of the regulations under section 1502, a transaction not involving a sale or exchange of a capital asset or of property subject to the provisions of section 1231 shall not be considered an intercompany transaction if such transaction occurs in the regular course of the trade or business of the members of the group and if such members adopt, with the consent of the Commissioner and subject to such conditions as he deems proper, a consistent accounting practice of taking into account in the computation of consolidated taxable income the gains and losses reflected in such transactions. As used in this paragraph, the term "taxable income" includes the case in which the allowable deductions of a member (not including any net operating loss deduction) exceed its gross income. For purposes of section 593(b)(2) (relating to addition to reserve for bad debts), taxable income of an organization to which section 593 applies shall be computed as if such organization filed a separate return for the taxable year.

(2) *Other computations on separate basis.* The various other computations required by the regulations under section 1502 to be made by the several affiliated corporations shall be made in the case of each such corporation in the same manner and under the same conditions as if a separate return were to be filed, but with the following exceptions:

(i) *Taxable income.* The taxable income used in any such computation shall be the taxable income of the corporation determined in accordance with the provisions of this section.

(ii) *Dividends received.* In the computation of the dividends received, there shall be excluded all dividends received from other members of the affiliated group.

(iii) *Capital gains and losses.* Capital gains and losses, short-term capital gains and losses, long-term capital gains and losses, and the additional capital loss deduction authorized by section 832 (c)(5) shall be determined without regard to:

(*a*) Gains or losses arising in intercompany transactions (other than gains described in section 357 (c)) and gains recognized to the distributing corporation pursuant to section 311 (c) by reason of distributions by one member of the group to another member of the group,

(*b*) Gains or losses from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231,

(*c*) The net capital loss carryovers provided in section 1212,

(*d*) In the case of a corporation which became a member of the affiliated group subsequent to January 1, 1954, common parent corporation or subsidiary, as the case may be, capital losses to the extent disallowed pursuant to the provisions of subparagraph (9) of this paragraph, and

(*e*) In the case of a bank, for taxable years beginning after December 31, 1958, gains or losses from sales or exchanges of property described in section 582(c).

(iv) *Net operating loss.* In the computation of the net operating loss, as defined in section 172, the provisions of this section pertaining to the determination of taxable income shall apply.

(v) *Dividends paid.* In the computation of dividends paid, there shall be excluded all dividends paid by one member of the group to another, except as provided in paragraph (b)(4) of § 1.1502–30A.

(vi) *Federal income tax.* In the computation of the Federal income tax, there shall be used the consolidated tax, or a proportionate part thereof, if the tax payable is properly computed on the basis of the consolidated return.

(vii) *Dividends paid by public utility.* In the computation of dividends paid on the preferred stock of a public utility, there shall be excluded all dividends paid by such public utility to another member of the group.

(viii) *Gains or losses under section 1231.* Gains and losses from involuntary conversions subject to section 1231, and from sales or exchanges of property subject to section 1231 shall be determined without regard to—

(*a*) Gains and losses from intercompany transactions (other than gains described in section 357 (c)) and gains recognized pursuant to section 311 (c) upon the distribution of property subject to the provisions of section 1231 by one member of the group to another member of the group, and

(*b*) In the case of a corporation which became a member of the affiliated group subsequent to January 1, 1954, common parent corporation or subsidiary, as the case may be, such portion of any such loss as is disallowed pursuant to the provisions of subparagraph (9) of this paragraph.

(ix) *Mutual savings banks, domestic building and loan associations, and cooperative banks.* In the case of a mutual savings bank, a domestic building and loan association, and a cooperative bank:

(*a*) In the computation of total deposits or withdrawable accounts at the close of the taxable year for the purpose of section 593 (relating to the deduction for bad debts), there shall be excluded the total deposits or withdrawable accounts of other members of the group, and

(*b*) In the computation of the deduction provided in section 591 (relating to dividends paid by banking corporations), there shall be excluded amounts paid to, or credited to the accounts of, other members of the group.

(3) *Limitation on net operating loss carryovers and carrybacks from separate return years.* (i) In no case shall there be included in the consolidated net operating loss deduction for the taxable year as consolidated net operating loss carryovers or carrybacks under paragraphs (a)(3)(i)(*b*), (4)(i) (f), (g), (h), (j), and (k), and (ii) (*c*) and (*d*) of this section (relating to net operating losses sustained by a corporation in years for which separate returns were filed, or for which such corporation joined in a consolidated return filed by another affiliated group) an amount exceeding the taxable income of such corporation included in the computation of the consolidated taxable income for the taxable year, adjusted as provided in subdivision (ii) of this subparagraph. This subdivision shall not be applicable to a carryover under paragraph (a)(3)(i)(*b*) of this section of a net operating loss of a corporation—

(*a*) Attributable to a period for which it was included in a consolidated return filed by another affiliated group for a taxable year beginning prior to January 1, 1954, all of whose members are included in the consolidated return filed for the taxable year if all of the members of such other affiliated group would have been members of the affiliated group if the law applicable to the taxable year had been applicable to such prior taxable year,

(b) To taxable years beginning after December 31, 1963, attributable to a taxable year beginning before January 1, 1964, in which such corporation was (on each day of such year) a member of the affiliated group, or

(c) Attributable to a taxable year beginning after December 31, 1963, in which such corporation was (on each day of such year) a member of the affiliated group, provided that an election under section 1562 (relating to privilege of groups to elect multiple surtax exemptions) was not effective for such year.

(ii) For purposes of this subparagraph and subparagraph (21) of this paragraph, the taxable income of a corporation included in the computation of consolidated taxable income shall be decreased by its deductions under sections 181, 243, 244, 245, 247, and 922 (and in the case of a member of an affiliated group to which the consolidated section 175 deduction is applicable, the section 175 deduction), and shall be increased by its separate net capital gain, and shall be increased or decreased, as the case may be, with respect to its separate gains and losses from involuntary conversions subject to the provisions of section 1231, and from sales or exchanges of property subject to the provisions of section 1231.

(4) *Law applicable to computations of net operating loss carryovers and carrybacks.* (i) In determining the amount of any net operating loss carryback or carryover, consolidated or separate, to any taxable year, the necessary computations involving any other taxable year shall be made under the law and regulations applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years whether they begin before, on, or after January 1, 1954.

(ii) In the case of a consolidated net operating loss for a taxable year beginning in 1953 and ending in 1954, the amount of such consolidated net operating loss which shall be carried to the second preceding taxable year shall be the amount which bears the same ratio to such consolidated net operating loss as the number of days in the loss year after December 31, 1953, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the amount absorbed for the second taxable year preceding the loss year shall not exceed the portion of the consolidated net operating loss which is carried to the second preceding taxable year.

(iii) (a) The consolidated net operating loss deduction for a taxable year beginning in 1953 and ending in 1954, shall be the sum of—

(1) That portion of the consolidated net operating loss deduction for such taxable year, computed as though paragraph (a)(2) of § 1.1502-31A applied to such taxable year, which the number of days in such taxable year after December 31, 1953, bears to the total number of days in such taxable year, and

(2) That portion of the consolidated net operating loss deduction for such taxable year, computed in accordance with 26 CFR (1939) 24.31(a)(2) (Regulations 129), which the number of days in such taxable year before January 1, 1954, bears to the total number of days in such taxable year.

(b) The consolidated net income for any taxable year beginning in 1953 and ending in 1954 which is subtracted from the net operating loss for any other taxable year to determine the portion of such net operating loss which is a carryback or a carryover to a particular taxable year shall be determined in accordance with the principles of section 172(f)(4).

(iv) (a) The consolidated net operating loss deduction for a taxable year beginning after December 31, 1953, and ending before August 17, 1954, shall be computed as if the regulations under section 1502 apply to such taxable year.

(b) The consolidated net income for any taxable year beginning after December 31, 1953, and ending before August 17, 1954, which is subtracted from the consolidated net operating loss for any other taxable year to determine the portion of such net operating loss which is a carryback or a carryover to a particular taxable year shall be determined in accordance with section 172(g)(3).

(v) In the case of a consolidated net operating loss for a taxable year beginning in 1957 and ending in 1958, the amount of such consolidated net operating loss which shall be carried to the third preceding taxable year shall be the amount which bears the same ratio to such consolidated net operating loss as the number of days in the loss year after December 31, 1957, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the amount absorbed for the third taxable year preceding the loss year shall not exceed the portion of the consolidated net operating loss which is carried to the third preceding taxable year.

(vi) For purposes of section 141 of the Internal Revenue Code of 1939 and that part of the regulations promulgated thereunder which relate to subchapter D, chapter 1 of such Code, excess profits net income and consolidated section 433(a) excess profits net income shall be computed as if the regulations under section 1502 did not apply and as if such section and such regulations continued to apply to taxable years beginning after December 31, 1953.

(5) *Limitation on absorption of unused dividend carryovers.* If, in the computation of the consolidated dividend carryover for the second consolidated return period in respect of which the income of a corporation is included in the consolidated return of the group, there is involved a separate unused dividend carryover of such corporation for the second preceding taxable year together with a consolidated unused dividend carryover for the second preceding taxable year, or if, for the second consolidated return period in respect of which the income of two or more members of the group is included in the consolidated return of the group, there are involved the separate unused dividend carryovers of such corporations for the second preceding taxable year, no portion of the excess of the consolidated undistributed personal holding company income (determined without regard to any dividends paid deduction and dividend carryover) over the consolidated section 561 dividends paid deduction (determined without regard to any dividend carryover) for the first preceding taxable year shall be taken into account more than once in giving effect to the provisions of paragraph (a) (26) (ii) and (iv) of this section (relating to the computation of that part of the consolidated dividend carryover attributable to the unused dividend carryovers of the second preceding taxable year).

(6) *Apportionment of consolidated net operating loss.* If an affiliated group filing a consolidated return sustains a consolidated net operating loss for the taxable year within the provisions of section 172, relating to the net operating loss deduction, and if—

(i) There are included as members of such group one or more corporations which made separate returns, or joined in a consolidated return filed by another affiliated group, either in a preceding taxable year or in a succeeding taxable year, or

(ii) There are included as members of such group one or more corporations which sustain a net operating loss for the taxable year for which a certification is issued under section 317 of the Trade Expansion Act of 1962 and with respect to which the requirements of section 172(b)(3)(A) are met, or

(iii) In the case of a taxable year ending after December 31, 1955, there are included as members of such group one or more corporations which are regulated transportation corporations for the taxable year (within the meaning of section 172(j)(1)),

then the portion of such consolidated net operating loss attributable to such corporations severally shall be determined, such portion in the case of any such corporation being determined in an amount proportionate to the net losses (capital net losses and ordinary net losses alike) of the several affiliated corporations having net losses, to the extent that such losses were taken into account in the computation of the consolidated net operating loss.

(7) *Apportionment of consolidated net capital loss.* If an affiliated group filing a consolidated return sustains a consolidated net capital loss, and if there are included as members of such group one or more corporations which make separate returns, or join in a consolidated return filed by another affiliated group, in a succeeding taxable year, the portion of such consolidated net capital loss attributable to such corporations severally shall be determined, such portion in the case of any such corporation being an amount which bears the same ratio to the consolidated net capital loss which the net capital loss of such corporation bears to the aggregate of the net capital losses for the taxable year sustained by the several affiliated corporations having net capital losses.

(8) *Limitation on net capital loss carryover from separate return year.* In no case shall there be included in the computation of the consolidated net capital gain for the taxable year as a consolidated net capital loss carryover under paragraph (a) (11) (ii) of this section (relating to net capital losses

separately sustained) an amount exceeding in the aggregate the net capital gains of such corporation (determined without regard to any net capital loss carryover) included in the computation of the consolidated net capital gain for the taxable year increased with respect to its separate net gains from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231.

(9) *Qualifications on deductions where group membership changed after January 1, 1954.* In the case of an affiliated group formed at any time after January 1, 1954, or having among its members in the taxable year one or more subsidiaries which became members of the group subsequent to January 1, 1954, the consolidated taxable income for the taxable year, and for prior and subsequent taxable years to the extent affected by carrybacks and carryovers from the taxable year, shall be determined subject to the following qualifications:

(i) There shall be excluded in the case of the common parent corporation and in the case of any subsidiaries which were members of the group on January 1, 1954, those deductions from gross income otherwise allowable with respect to—

(*a*) Sales or exchanges of capital assets,

(*b*) Involuntary conversions and sales or exchanges of property subject to the provisions of section 1231,

(*c*) Securities subject to the provisions of section 165 (g) (3), or

(*d*) Debts subject to the provisions of section 166,

to the extent that such deductions otherwise allowable exceed in the aggregate—

(*e*) In the case of capital losses, the excess of the aggregate capital gains over the aggregate capital losses of such corporations for the taxable year, or

(*f*) In the case of ordinary losses, the aggregate of the ordinary taxable income of such corporations for the taxable year, increased in an amount equal to any excess of aggregate capital gains over aggregate capital losses of such corporations,

such capital gains and losses and such ordinary taxable income being determined pursuant to the provisions of the regulations under section 1502 but without regard to the provisions of subparagraphs (1) (iv) and (2) (iii) (*b*) of this paragraph and without regard to the losses in question;

(ii) There shall be excluded in the case of a subsidiary corporation which became a member of the affiliated group subsequent to January 1, 1954, those deductions from gross income otherwise allowable with respect to—

(*a*) Sales or exchanges of capital assets,

(*b*) Involuntary conversions and sales or exchanges of property subject to the provisions of section 1231,

(*c*) Securities subject to the provisions of section 165 (g) (3), or

(*d*) Debts subject to the provisions of section 166,

to the extent that such deductions otherwise allowable are attributable to events preceding the date upon which such corporation became a member of the group, and

(*e*) Being capital losses, exceed (*1*) the capital gains reduced by all other capital losses of such corporation for the taxable year, in the case in which such corporation was not, on January 1, 1954, a member of an affiliated group within the meaning of section 1504, or (*2*) in case such corporation was a member of an affiliated group on January 1, 1954, an amount which together with like losses computed subject to the provisions of the regulations under section 1502 in the case of other members of the group during the taxable year which were affiliated with such corporation on January 1, 1954, within the meaning of section 1504 is equal to the aggregate capital gains reduced by the aggregate of all other capital losses of such corporation and of such other members of the group, or

(*f*) Being ordinary losses exceed (*1*) the ordinary taxable income of such corporation for the taxable year increased in an amount equal to any excess of capital gains over capital losses for the taxable year, in the case in which such corporation was not, on January 1, 1954, a member of an affiliated group within the meaning of section 1504, or (*2*) in case such corporation was a member of an affiliated group on January 1, 1954, an amount which, together with like losses computed subject to the provisions of the regulations under section 1502 in the case of other members of the group during the taxable year which were affiliated with such corporation on January 1, 1954, within the meaning of section 1504, is equal to the ordinary taxable income of such corporation for the taxable year increased by the aggregate of the ordinary taxable income and decreased by the aggregate of the ordinary net losses of other members of the affiliated group during the taxable year which were affiliated with such corporation on January 1, 1954, within the meaning of section 1504, and increased further in an amount equal to any excess of aggregate capital gains over aggregate capital losses of such corporations,

such capital gains and losses, and ordinary taxable income and net losses, as the case may be, being determined pursuant to the provisions of the regulations under section 1502 but without regard to the provisions of subparagraphs (1) (iv) and (2) (iii) (*b*) of this paragraph, and without regard to the losses in question.

(iii) The portion of any loss otherwise allowable as a deduction for the taxable year which is disallowed pursuant to the provisions of subdivisions (i) and (ii) of this subparagraph shall, to the extent that it constitutes a net capital loss or a net operating loss, be considered as a net capital loss or a net operating loss, as the case may be, in respect to those members of the group by reference to which the amount of the deduction disallowed under subdivisions (i) and (ii) of this subparagraph was determined, and, for the purpose of the carryback provisions, the year of the loss shall be considered as a taxable year occurring subsequent to the last taxable year in respect of which the income of such members of the group was included in a consolidated return, and, for the purpose of the carryover provisions, as a taxable year occurring prior to the first taxable year in respect of which their income was included in a consolidated return;

(iv) The provisions of subdivisions (i) and (ii) of this subparagraph shall not apply with respect to the common parent corporation of an affiliated group formed subsequent to January 1, 1954, or to the common parent corporation or subsidiaries of a group in existence on January 1, 1954, acquiring new members subsequent to January 1, 1954, or with respect to subsidiaries becoming members of the group subsequent to January 1, 1954—

(*a*) If the group consists solely of the common parent corporation and one or more subsidiaries created, directly or indirectly, by the common parent corporation or by other members of the group;

(*b*) If, immediately after the corporation involved became a member of the group, common parent corporation or subsidiary, as the case may be, stock possessing at least 80 percent of the voting power of all classes of its stock then outstanding and at least 80 percent of each class of its nonvoting stock then outstanding is owned, directly or indirectly, by substantially the same interests by which such stock was owned on January 1, 1954;

(*c*) If the affiliated group involved was formed, or the new subsidiary became a member of the group, as an incident to an involuntary conversion or to a transfer made pursuant to an order of the Securities and Exchange Commission, the Federal Communications Commission, the Interstate Commerce Commission, or a similar regulatory body of State or Federal Government; or

(*d*) To the extent to which, upon consideration of the facts or circumstances presented by the particular case, the Commissioner determines that a consolidated taxable income computed with respect to the affiliated group, but without regard to subdivisions (i) and (ii) of this subparagraph, will not serve to distort the income tax liability of the group or of any of its members.

(10) *Loss to group of investment in an affiliate.* In the case of a loss to one or more members of an affiliated group sustained during the taxable year as the result of the worthlessness of the investment of such members in another affiliate, whether such investment was reflected in the stock, bonds, or open account advances to such other affiliate—

(i) Such losses shall be taken into account in the computation of consolidated taxable income for the year of the loss in an amount not greater in the aggregate than the excess of the consolidated taxable income for such year computed without regard to any such loss over that portion of such consolidated taxable income so computed attributable to such other affiliate; and

(ii) The portion of any such loss otherwise allowable as a deduction for the taxable year which is disallowed pursuant to the provisions of subdivision (i) of this subparagraph shall be considered as a consolidated net operating loss to be taken into account as a consolidated carryback to the two preceding taxable years or, if the loss is sustained in a taxable year ending after December 31, 1957,

the three preceding taxable years and as a consolidated carryover to the five succeeding taxable years, but in an amount not greater for any taxable year than the excess of the consolidated taxable income for such year, computed without regard to such carryover or carryback, as the case may be, over that portion of such consolidated taxable income so computed for such taxable year attributable to such other affiliate.

(11) *Disposal of timber or coal*—(i) *Intercompany transactions.* Section 631 (b) or (c) (relating to the disposal of timber or coal) shall apply to an amount received by a member of the group only to the extent such amount is received by the member of the group as a party to a transaction described in section 631 (b) or (c) with persons not members of the group.

(ii) *Application of sections 531 and 541 to coal royalties.* For the purpose of determining the consolidated accumulated taxable income and the consolidated undistributed personal holding company income the provisions of 631 (c) shall not apply to any amount received by a member of the group upon the disposal of coal.

(12) *Mine exploration expenditures*—(i) *Limitation under section 615 (a).* If the aggregate of the deductions, computed without regard to this sentence, allowable under section 615 (a) to the several members of the group exceeds $100,000,

(*a*) The deduction under that section allowable to any member of the group shall be an amount which bears the same ratio to $100,000 as its deduction computed without regard to this sentence bears to the aggregate of such deductions so computed for the members of the group, except that,

(*b*) If all the members of the group consent in writing, the deduction under that section allowable to such member shall be the deduction under that section computed without regard to this sentence, or such part thereof as the common parent corporation shall determine at the time the consent is filed, provided, however, that the aggregate of the deductions so allowable for all members of the group shall not exceed $100,000.

(ii) *Limitation under 615 (c).* If the limitation provided in section 615 (c) is applicable to any member of the group, such limitation shall be deemed applicable to all members of the group.

(13) *Apportionment of unused dividend carryover and allowance of consolidated deficiency dividends deduction*—(i) *Apportionment of unused dividend carryover.* If an affiliated group filing a consolidated return has an unused consolidated dividend carryover and if there are included as members of such group one or more corporations which make separate returns, or join in a consolidated return filed by another affiliated group or if any member of the group computes its tax liability under section 541 pursuant to the last sentence of paragraph (b) (4) of § 1.1502–30A, in a succeeding taxable year, the portion of such unused consolidated dividend carryover attributable to such corporations severally shall be determined for the purpose of the dividend carryover, such portion in the case of any such corporation shall be determined in an amount proportionate to the deduction for dividends paid and the taxable incomes of the several affiliated corporations (determined with the adjustments provided in section 545) to the extent that such deduction and such taxable income were taken into account in the computation of the consolidated dividend carryover and the consolidated and undistributed personal holding company income.

(ii) *Deficiency dividends deduction.* For the purpose of applying section 547, relating to deficiency dividends, in case the affiliated group is subject to tax on its consolidated undistributed personal holding company income for the taxable year to which the deficiency in personal holding company tax relates, the consolidated deficiency dividends deduction described in paragraph (a) (25) of this section shall be allowed.

(14) *Apportionment of consolidated charitable contribution deduction.* If an affiliated group filing a consolidated return has an excess of the consolidated charitable contribution deduction over the limitation of paragraph (a) (1) (i) (c) of this section for the taxable year, and if there are included as members of such group one or more corporations which make separate returns or join in a consolidated return filed by another affiliated group in a succeeding taxable year, the portion of such excess attributable to such corporations severally shall be determined, such portion in the case of any such corporation being determined in an amount proportionate to such excess as the contributions of each such corporation bear to the aggregate of such contributions.

(15) *Limitation on section 175 carryovers from separate return years.* In no case shall there be included in the consolidated section 175 deductions for the taxable year as consolidated section 175 carryovers under paragraph (a) (35) (ii) of this section (relating to excess section 175 deductions of a corporation for years for which separate returns were filed or for which such corporation joined in a consolidated return filed by another affiliated group), an amount exceeding in the aggregate the amount by which 25 percent of the gross income of such corporation derived from farming included in the computation of the consolidated section 175 gross income for the taxable year exceeds the amount of the expenditures of such corporation of the taxable year deductible under section 175.

(16) *Apportionment of consolidated section 175 deduction.* If an affiliated group filing a consolidated return has an excess of the consolidated section 175 deduction over the limitation of 25 percent of the consolidated section 175 gross income for the taxable year, and if there are included as members of such group one or more corporations which make separate returns, or are joined in a consolidated return filed by another affiliated group, in a succeeding taxable year, the portion of such excesses attributable to such corporations severally shall be determined; such portion in the case of any such corporation being determined in an amount proportionate to such excess as the deductions of each such corporation bears to the aggregate of such deductions.

(17) *Applicability of consolidated section 175 deduction.* An affiliated group shall not be eligible to use the consolidated section 175 deduction unless all of the members of such group which are engaged in the business of farming during the taxable year have adopted, pursuant to section 175 (d), the method described in section 175. In the case of a corporation which is a member of an affiliated group which is not eligible to use the consolidated section 175 deduction, the deduction provided by section 175 shall be used in the computation of the taxable income of such corporation in the same manner and under the same conditions as if a separate return were to be filed, except that the gross income from farming of such corporation shall be determined without regard to profits or losses on intercompany transactions; and proper adjustment shall be made to eliminate any distortion in the amount of gross income attributable to transactions between members of the group at markedly fictitious values.

(18) *Computation of consolidated accumulated taxable income.* In the computation of consolidated accumulated taxable income no amount shall be taken into account with respect to any income or deductions attributable to members of the affiliated group which are subject to tax under section 541 as described in the last sentence of paragraph (b) (4) of § 1.1502–30A.

(19) *Law applicable to the computation of consolidated dividends carryover.* In the computation of the consolidated section 561 dividends paid deduction, the amount of the consolidated dividends carryover from a year to which subtitle A of the Code is not applicable to a taxable year to which such subtitle applies shall be determined under 26 CFR (1939) part 24 (Regulations 129) if a consolidated return was filed for the year in which the dividends were paid or under the provisions of the Internal Revenue Code of 1939 if a separate return was filed for such year.

(20) *Law applicable to computation of deficiency dividends deduction.* If a deficiency is asserted with respect to a taxable year which began before January 1, 1954, the amount of any "deficiency dividend" shall include only amounts which would have been includible in the computation of the consolidated basic surtax credit, as defined in 26 CFR (1939) Part 24 (Regulations 129), or in the computation under the Internal Revenue Code of 1939 of the basic surtax credit for such taxable year, as the case may be.

(21) *Rules with respect to net operating losses under sections 381 and 382.* (i) If, in the computation of the consolidated net operating loss carryover, there is included an amount with respect to a net operating loss of a corporation, sustained in a taxable year for which it filed a separate return or for which such corporation joined in a consolidated return filed for another affiliated group, which is a transferor or distributor of assets to a member of the affiliated group within the meaning of section 381(a), the amount allowable as a carryover with

respect to such transferor or distributor shall not exceed the amount of the taxable income of the acquiring corporation included in the computation of the consolidated taxable income for the taxable year, adjusted as provided in subparagraph (3)(ii) of this paragraph. The preceding sentence shall not apply to a carryover—

(*a*) To taxable years beginning after December 31, 1963, attributable to a net operating loss or losses sustained by a corporation in a taxable year or years beginning before January 1, 1964, in which such corporation was (on each day of any such year) a member of the affiliated group, or

(*b*) Attributable to a taxable year beginning after December 31, 1963, in which the corporation sustaining the loss was (on each day of such year) a member of the affiliated group, provided that an election under section 1562 (relating to privilege of groups to elect multiple surtax exemptions) was not effective for such year.

(ii) If, in addition to the amount described in subdivision (i) of this subparagraph, there is included an amount with respect to a net operating loss sustained by the acquiring corporation in a year for which it filed separate returns or for which it joined in a consolidated return filed by another affiliated group, the losses sustained by both the acquiring corporation and the transferor or distributor corporation which may be taken into account as a net operating loss deduction in determining the consolidated taxable income may not exceed the taxable income of the acquiring corporation included in the computation of the consolidated taxable income for the taxable year, adjusted as provided in subparagraph (3)(ii) of this paragraph. The preceding sentence shall not apply to a carryover—

(*a*) To taxable years beginning after December 31, 1963, attributable to a net operating loss or losses sustained by the acquiring corporation in a taxable year or years beginning before January 1, 1964, in which such corporation was (on each day of any such year) a member of the affiliated group, or

(*b*) Attributable to a net operating loss sustained by the acquiring corporation in a taxable year beginning after December 31, 1963, in which such corporation was (on each day of such year) a member of the affiliated group, provided that an election under section 1562 (relating to privilege of groups to elect multiple surtax exemptions) was not effective for such year.

(iii) For purposes of subdivisions (i) and (ii) of this subparagraph, if the transferor or distributor corporation was a member of another affiliated group which filed a consolidated return, the amount of the consolidated net operating loss of such affiliated group, if any, attributable to such transferor or distributor, shall be treated as the net operating loss of such corporation separately sustained.

(iv) In any case in which a consolidated net operating loss was sustained by an affiliated group which includes a member whose net operating loss is subject to the limitations upon net operating losses provided by section 382, such section shall be applicable with respect to such member as if the portion of such consolidated net operating loss attributable to such corporation were a net operating loss of such corporation separately sustained.

(22) *Rules with respect to capital loss carryovers under section 381.* (i) If in the computation of the consolidated net capital loss carryovers for a taxable year there is included an amount with respect to a net capital loss of a corporation, sustained in a taxable year for which it filed a separate return or for which such corporation joined in a consolidated return filed by another affiliated group, which is a transferor or distributor of property to a member of the affiliated group within the meaning of section 381 (a), the amount allowable with respect to such transferor or distributor shall not exceed the net capital gains of the acquiring corporation (determined without regard to any net capital loss carryover) included in the computation of the consolidated net capital gain for the taxable year increased with respect to its separate gains for involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231.

(ii) If there is included under paragraph (a) (11) (ii) of this section an amount with respect to net capital losses separately sustained by such acquiring corporation in years for which separate returns were filed or for which such corporation joined in a consolidated return filed by another affiliated group, the limitation described in subdivision (i) of this subparagraph shall be applicable with respect to the aggregate of such losses and the losses of its transferor or distributor corporations.

(iii) For purposes of subdivisions (i) and (ii) of this subparagraph, if the transferor or distributor corporation was a member of another affiliated group which filed a consolidated return, the amount of the consolidated net capital loss of such affiliated group, if any, attributable to such transferor or distributor, shall be treated as the net capital loss of such corporation separately sustained.

(c) *Statements and schedules for subsidiaries.* The statement of gross income and deductions and the several schedules required by the instructions on the return must be prepared and filed by the common parent corporation in columnar form so that the details of the items of gross income, deductions, and credits, for each member of the affiliated group, may be readily audited. Such statements and schedules shall include in columnar form a reconciliation of surplus for each such corporation, together with a reconciliation of the consolidated surplus. Consolidated balance sheets as of the beginning and close of the taxable year of the group, taken from the books of the members of the group, shall accompany the consolidated return prepared in a form similar to that required for reconciliation of surplus. If any member of the affiliated group computes its tax under section 541 in the manner provided in paragraph (b)(4) of § 1.1502–30A, a personal holding company schedule for such corporation shall be filed with the consolidated return.

(d) *Net operating loss deduction, excess charitable contributions, excess section 175 deductions, and dividend carryover before or after consolidated return*—(1) *Net operating loss deduction.* The consolidated net operating loss of an affiliated group shall be used in computing the consolidated net operating loss deduction notwithstanding that one or more members of the group in the taxable year in which such loss originates make separate returns (or join in a consolidated return made by another affiliated group) for a subsequent taxable year (or in the case of a carryback computation for a preceding taxable year), but only to the extent that such consolidated net operating loss is not attributable to such corporations. Such portion of such consolidated net operating loss as is attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year (or in the case of a carryback computation for a preceding taxable year) shall be used by such corporations severally as carryovers or as carrybacks in such separate returns or in such consolidated returns of the other affiliated group. Any net operating loss separately sustained by a corporation prior to a first taxable year in respect of which its income is included in the consolidated return of the group (or sustained in either of the two taxable years immediately following a consolidated return year or any of the three taxable years so following if sustained in a taxable year ending after December 31, 1957) shall be used in computing the net operating loss deduction of such corporation (or the consolidated net operating loss deduction of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such net operating loss was not absorbed (either as a carryover or as a carryback) in the computation of the consolidated net operating loss deduction for consolidated return periods.

(2) *Excess charitable contributions.* The excess of the consolidated charitable contributions over the 5-percent limitation of paragraph (a)(1)(i)(c) of this section shall be used in computing the consolidated charitable contribution carryover notwithstanding that one or more members of the group in the taxable year in which such carryover originates make separate returns (or join in a consolidated return made by another affiliated group) for a subsequent taxable year, but only to the extent that such excess charitable contribution is not attributable to such corporations. Such portion of such excess charitable contributions as is attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent tax-

able year shall be used by such corporations severally as carryovers in such separate returns or in such consolidated returns of the other affiliated group. Any excess of charitable contributions of a corporation for the year prior to a first taxable year in respect of which its income is included in the consolidated return of the group shall be used in computing the charitable contribution deduction of such corporation (or the consolidated charitable contribution deduction of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such excess charitable contribution was not absorbed as a carryover in the consolidated charitable contribution deduction for consolidated return periods. In applying this paragraph, the excess of the consolidated charitable contributions over the 5-percent limitation shall be reduced by the increase in a consolidated or separate net operating loss carryover resulting from such excess.

(3) *Excess section 175 deductions.* The excess of the deductions under section 175 over the limitation of 25 percent provided in paragraph (a) (1) (i) (*f*) of this section shall be used in computing the consolidated section 175 carryover notwithstanding that one or more members of the group in the taxable year in which such carryover originates make separate returns (or join in a consolidated return made by another affiliated group) for a subsequent taxable year, but only to the extent that such excess section 175 deduction is not attributable to such corporations. Such portion of such excess section 175 deductions as is attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year shall be used by such corporations severally as carryovers in such separate returns or in such consolidated returns of the other affiliated group. Any excess of section 175 deductions of a corporation for a year prior to a first taxable year in respect of which its income is included in the consolidated return of the group shall be used in computing the section 175 deduction of such corporation (or the consolidated section 175 deduction of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such excess section 175 deduction was not absorbed as a carryover in the computation of a consolidated section 175 deduction for consolidated return periods.

(4) *Unused consolidated dividend carryover.* The unused consolidated dividend carryover shall be used in computing the consolidated dividend carryover notwithstanding that one or more members of the group in the taxable year in which such carryover originates make separate returns (or join in a consolidated return made by another affiliated group) for a subsequent taxable year, but only to the extent that such unused consolidated dividend carryover is not attributable to such corporations. Such portion of such unused consolidated dividend carryover as is attributable to the several corporations making separate returns or computing their tax liability under section 541 pursuant to the last sentence of paragraph (b) (4) of § 1.1502–30A (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year shall be used by such corporations severally as carryovers in such separate returns, in such separate computations under section 541, or in such consolidated returns of the other affiliated group. Any unused dividend carryover of a corporation separately produced for a year prior to a taxable year in respect of which its tax liability under section 541 is computed upon the consolidated undistributed personal holding company income shall be used in computing the dividend carryover of such corporation (or the consolidated dividend carryover of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such unused dividend carryover was not absorbed in the computation of the consolidated section 561 dividends paid deduction for the intervening consolidated return period.

(e) *Taxable year of less than 12 months.* Any period of less than 12 months for which either a separate return or a consolidated return is filed under the provisions of § 1.1502–13A shall be considered as a taxable year.

**§ 1.1502–32A Method of computation of income for period of less than 12 months.**

If a corporation, during the taxable year of the group, becomes a member or ceases to be a member of an affiliated group which makes or is required to make a consolidated return for such year, the income of such corporation to be included in the consolidated return shall be computed on the basis of its income as shown by its books if the accounts are so kept that the income for the period during which it is a member of the group can be clearly and accurately determined. If the accounts are not so kept, the income to be included in the consolidated return shall be computed on the basis of that proportion of its income (subject to the elimination of items exempt from the taxation and the addition of items not allowable as deductions) for the full period covered by its books which the number of days for which its income is included in the consolidated return bears to the number of days in the full period covered by its books; but, in the discretion of the Commissioner, there may be eliminated before the proration is made items of income or deduction clearly and accurately determined to be attributable to particular periods, and, after the proration is made, such eliminated items will be added to (if items of income) or deducted from (if deductible items) the income determined by proration for the period to which such items are applicable.

**§ 1.1502–33A Gain or loss from sale of stock, or bonds or other obligations.**

Gain or loss from the sale or other disposition (whether or not during a consolidated return period), by a corporation which during any period of time has been a member of an affiliated group which makes or is required to make a consolidated return, of any share of stock or any bond or other obligation issued or incurred by another corporation which during any part of such period was a member of the same group, shall be determined, and the extent to which such gain or loss shall be recognized and shall be taken into account shall also be determined, in the same manner, to the same extent, and upon the same conditions as though such corporations had never been affiliated except—

(a) In the case of a disposition (by sale, or in complete or partial liquidation not involving cash in an amount in excess of the adjusted basis of both the stock and the bonds and other indebtedness liquidated, or otherwise) during a consolidated return period to another member of the group (§§ 1.1502–31A and 1.1502–37A);

(b) That the basis for determining the gain or loss, in the case of shares of stock, or in the case of bonds or other obligations, held during any part of a consolidated return period, shall be determined in accordance with §§ 1.1502–34A and 1.1502–35A; and

(c) As provided in § 1.1502–36A (imposing certain limitations upon losses otherwise allowable upon sales of stock, or bonds or other obligations).

**§ 1.1502–34A Sale of stock; basis for determining gain or loss.**

(a) *Scope of section.* This section prescribes the basis for determining the gain or loss upon any sale or other disposition (hereinafter referred to as "sale") by a corporation which is (or has been) a member of an affiliated group which makes (or has made) a consolidated return for any taxable year, of any share of stock issued by another member of such group (whether issued before or during the period that it was a member of the group and whether issued before, during, or after the taxable year 1929), and held by the selling corporation during any part of a period for which a consolidated return is made or required under the regulations under section 1502. For the basis in the case of a sale of bonds, see § 1.1502–35A.

(b) *Sales made while selling corporation is member of affiliated group.* If the sale is made within a period during which the selling corporation is a member of the affiliated group, whether or not during a consolidated return period, and whether or not, as a result of such sale, the issuing corporation ceases to be a member of the group, the basis shall be determined as follows:

(1) The aggregate bases of all shares of stock of the issuing corporation held by each member of the affiliated group (exclusive of the issuing corporation) immediately prior to the sale, shall be determined separately for each member of the group, and adjusted in accordance with the other provisions of subtitle A of the Code, but without regard to any adjustment under the last sentence of

section 1051 relating to losses of the issuing corporation sustained by such corporation after it became a member of the group.

(2) From the combined aggregate bases as determined in subparagraph (1) of this paragraph, there shall be deducted the sum of—

(i) All losses of such issuing corporation sustained during taxable years for which consolidated income tax returns were made or were required (whether the taxable year 1929 or any prior or subsequent taxable year) after such corporation became a member of the affiliated group and prior to the sale of the stock to the extent that such losses could not have been availed of by such corporation as net loss or net operating loss in computing its net income or taxable income, as the case may be, for such taxable years if it had made a separate return for each of such years,

(ii) With respect to each of such taxable years for which consolidated returns were made or were required both for income and for excess profits tax purposes, the excess, if any, of all losses of such issuing corporation for such year, properly adjusted in the computation of consolidated excess profits net income over the amount of such losses for such year computed under subdivision (i) of this subparagraph to the extent that such excess could not have been availed of by such corporation as a net operating loss in computing its excess profits net income for such taxable years if it had made a separate return for each of such years, and

(iii) With respect to each of such taxable years for which consolidated returns were made or were required for excess profits tax purposes only, all losses of such issuing corporation for such year, properly adjusted in the computation of consolidated excess profits net income, to the extent that such losses could not have been availed of by such corporation as a net operating loss in computing its excess profits net income for such taxable years if it had made a separate excess profits tax return for each of such years,

reduced by any losses of the issuing corporation apportioned under this section to its stock sold or otherwise disposed of in a prior transaction, disregarding any transaction between members of the affiliated group during a consolidated income or excess profits tax return period which did not constitute a partial liquidation of the issuing corporation. For any taxable year in which the group sustained a consolidated loss not availed of in prior or subsequent years as a deduction under net loss or net operating loss provisions, the amount deducted under this subparagraph shall be further reduced by an amount equal to that proportion of such consolidated loss which the loss of the issuing corporation for the year in which such loss was sustained bears to the aggregate losses of the members of the group for such year.

(3) The sum of the aggregate bases of all shares of stock, after making the deduction under subparagraph (2) of this paragraph, shall then be apportioned among the members of the affiliated group which hold stock of the issuing corporation, by allocating to each such member that proportion of the sum of the aggregate bases so reduced which the aggregate basis of the stock in the issuing corporation held by such member bears to the sum of the aggregate bases.

(4) The aggregate basis as determined under subparagraph (3) of this paragraph for each member of the affiliated group shall then be equitably apportioned among the several classes of stock of the issuing corporation held by such member according to the circumstances of the case—ordinarily by allocating to each class of such stock that proportion of the aggregate basis which the basis of each class of such stock held by it at the time of the sale is to the sum of the bases of the several classes of such stock held by it.

(5) The basis of each share of stock of each class held by a member of the affiliated group shall then be determined by dividing the basis apportioned to such class under subparagraph (4) of this paragraph by the total number of shares of such class held by it.

(c) *Sales after selling corporation has ceased to be member of affiliated group.* If the sale is made after the selling corporation has ceased to be a member of the affiliated group, such basis shall be determined in accordance with paragraph (b) of this section, except that—

(1) The aggregate basis (under paragraph (b) (1) of this section) shall be determined for all shares of the issuing corporation held by each member of the group immediately prior to the time the selling corporation ceased to be a member of the group (rather than immediately prior to the sale);

(2) The reduction (under paragraph (b) (2) of this section) with respect to losses apportioned to stock sold or otherwise disposed of in prior transactions shall be determined without regard to the transaction which terminated the affiliation and all subsequent transactions;

(3) The allocation (under paragraph (b) (3) of this section) shall be made to each member of the group which held stock of the issuing corporation immediately prior to the time the selling corporation ceased to be a member of the group (rather than to the members holding such stock at the time of the sale); and

(4) The basis of each share of stock held by the selling corporation (determined, as above, as of the time the selling corporation ceased to be a member of the group) shall then be adjusted in accordance with the other provisions of subtitle A of the Code in order to determine the basis at the time of the sale.

(d) *Definition of "loss", "consolidated loss", "net loss", or "net operating loss", and "consolidated excess profits net income".* As used in this section the term "loss" means either the excess over the gross income of the issuing corporation of the sum of its allowable deductions (not including any net loss or net operating loss deduction) allowable in computing consolidated taxable income or the excess over the gross income of the issuing corporation of the sum of its allowable deductions (not including any net loss or net operating loss deduction), plus the proportionate part properly attributable to such corporation of the credits relating to interest on certain Government obligations and dividends received allowable in computing consolidated normal tax net income, the consolidated special class net income or consolidated net income subject to tax determined in accordance with the Internal Revenue Code of 1939 and provisions of consolidated returns regulations applicable to the period. The term "consolidated loss" means the excess of the sum of the losses, separately computed, over the sum of the normal tax net income, the special class net income, the net income subject to tax or the taxable income determined in accordance with the provisions of subtitle A of the Internal Revenue Code of 1954, or the Internal Revenue Code of 1939, or the Revenue Act, and pursuant to the provisions of consolidated returns regulations applicable to the period; the term "net loss" or "net operating loss" means the net loss or net operating loss, as the case may be, determined in accordance with the provisions of subtitle A of the Internal Revenue Code of 1954, or the Internal Revenue Code of 1939, or the Revenue Act, and pursuant to the provisions of consolidated returns regulations applicable to the period; and the term "consolidated excess profits net income" means the consolidated excess profits net income or consolidated section 433 (a) excess profits net income determined in accordance with the provisions of the Internal Revenue Code of 1939 or the Revenue Act and pursuant to the provisions of consolidated returns regulations applicable to the period.

**§ 1.1502–35A Sale of bonds or other obligations; basis for determining gain or loss.**

In the case of a sale or other disposition by a corporation, which is (or has been) a member of an affiliated group which makes (or has made) a consolidated income tax or excess profits tax return for any taxable year, of bonds or other obligations issued or incurred by another member of such group (whether or not issued or incurred while it was a member of the group and whether issued or incurred before, during, or after the taxable year 1929) and held by the selling corporation during any part of a period for which a consolidated return is made or required under the regulations under section 1502, the basis of each bond or obligation, for determining the gain or loss upon such sale or other disposition, determined in accordance with the other provisions of subtitle A of the Code, but without regard to any adjustment under the last sentence of section 1051, shall be decreased (except as otherwise provided in this section) by the excess, if any, of the aggregate of the deductions computed under paragraph (b) (2) or (c) of § 1.1502–34A over the sum of the aggregate bases of the stock of the debtor corporation as computed under paragraph (b) (1) or (c) of § 1.1502–34A as the case may be, held by the members of the group. The adjustment with respect to so much of such deductions as is based upon losses sustained during the taxable year 1929 and subsequent taxable years for which the last day prescribed by law for the filing of the return fell on or before March 1, 1945 (the date on which

Treasury Decision 5441 was filed with the Division of the Federal Register), and availed of on consolidated returns filed for such years shall be made only in those cases in which the sales or other disposition of such bonds or other obligations resulted in a loss. See also § 1.1502–40A relating to disallowance of loss upon intercompany bad debts.

**§ 1.1502–36A Limitation on allowable losses on sale of stock, or bonds, or other obligations.**

(a) *General rule.* No loss shall be allowed under §§ 1.1502–33A, 1.1502–34A, or 1.1502–35A upon the sale or other disposition of stock or bonds or obligations to the extent that such loss is attributable to—

(1) Transfers of assets within the affiliated group (by sale, gift, or otherwise) without consideration or at markedly fictitious values, during the period in which the corporations were affiliated (whether or not a consolidated return was made), or

(2) A distribution during a period in which the corporations were affiliated of earnings or profits accumulated prior to the date upon which the distributing corporation became a member of the group.

(b) *Qualification of general rule.* Paragraph (a) of this section shall not be considered as in any way limiting the operation of the provisions of subtitle A of the Code relating to the basis for determining gain or loss upon the sale or other disposition of property, but as being in amplification of and not in substitution for such provisions; subject, however, to this qualification: that to the extent that the transfers of assets referred to in paragraph (a) of this section are taken into account under the terms of subtitle A in making adjustments in the basis, such transfers will not be taken into account, in denying losses under paragraph (a) of this section.

**§ 1.1502–37A Liquidations; recognition of gain or loss.**

(a) *During consolidated return period.* (1) Gain or loss shall not be recognized upon a distribution during a consolidated return period, by a member of an affiliated group to another member of such group, in cancellation or redemption of all or any portion of its stock, except—

(i) Where such distribution is in complete liquidation and redemption of all of its stock (whether in one distribution or a series) and of its bonds and other indebtedness, if any, and falls without the provisions of section 332, and is the result of a bona fide termination of the business and operations of such member of the group, in which case the adjustments specified in §§ 1.1502–34A and 1.1502–35A shall be made, and § 1.1502–36A shall be applicable;

(ii) Where such a distribution without the provisions of section 332 is one made in cash in an amount in excess of the adjusted basis of the stock, and bonds and other indebtedness, in which case gain shall be recognized to the extent of such excess; or

(iii) Where the basis of the property distributed in the hands of the distributee is determined by reference to section 334(b)(2), in which case gain shall be recognized as provided in section 1245(a)(1).

(2) When the business and operations of the liquidated member of the affiliated group are continued by another member of the group, it shall not be considered a bona fide termination of the business and operations of the liquidated member. With respect to the acquisition of its bonds by the issuing company, see paragraph (b) of § 1.1502–41A.

(3) For the purpose of determining whether an affiliated corporation receiving property in a liquidating distribution qualifies under the provisions of section 332(b)(1), the aggregate amount of the stock of the liquidated corporation owned by the several members of the affiliated group on the date of the adoption of the plan of liquidation and at all times, subsequent thereto and prior to the receipt of the property in liquidation shall be considered as owned by the distributee.

(b) *After consolidated return period.* In case any such distribution is made after a consolidated return period, whether in complete or partial liquidation, except a complete liquidation within the provisions of section 332 (b), with respect to stock and with respect to bonds, debentures, notes, certificates, and other indebtedness of the liquidated corporation acquired prior to or during any taxable year subsequent to 1928 for which a consolidated income or excess profits tax return was filed, the adjustments specified in §§ 1.1502–34A and 1.1502–35A shall be made, and § 1.1502–36A will be applicable.

**§ 1.1502–38A Basis of property.**

(a) *General rule.* Subject to the provisions of paragraphs (b) and (c) of this section and except as otherwise provided in §§ 1.1502–34A, 1.1502–35A, and 1.1502–39A, the basis during a consolidated return period for determining the gain or loss from the sale or other disposition of property, or upon which exhaustion, wear and tear, obsolescence, amortization, and depletion are to be allowed, shall be determined and adjusted in the same manner as if the corporations were not affiliated, whether such property was acquired before or during a consolidated return period. Except as otherwise provided in §1.1502–39A, such basis immediately after a consolidated return period (whether the affiliation has been broken or whether the privilege of making a consolidated return is not exercised) shall be the same as immediately prior to the close of such period.

(b) *Intercompany transactions.* The basis prescribed in paragraph (a) of this section shall not be affected by reason of a transfer during a consolidated return period, other than upon liquidation as provided in paragraph (c) of this section (whether by sale, gift, dividend, or otherwise) from a member of the affiliated group to another member of such group.

(c) *Basis after liquidation.* (1) Where property is acquired upon a distribution described in paragraph (a) of § 1.1502–37A in which gain or loss is recognized to the distributee, the basis of such property shall be its fair market value at date of acquisition.

(2) Where property is acquired upon a liquidation to which section 332 is applicable and if the first distribution in pursuance of the plan of liquidation occurs on or after June 22, 1954—

(i) Unless subdivision (ii) of this subparagraph is applicable, the basis of such property shall be the same as it would be in the hands of the transferor;

(ii) If the basis of such property is determined by reference to section 334(b)(2), such section (and, if applicable, section 1245(c)) shall be applicable in determining the basis of property received on the liquidation (except property received by the liquidating corporation from other members of the affiliated group during a consolidated return period) and to any property transferred by the liquidating corporation to other members of the group during a consolidated return period as if such property had not been transferred and was received in such liquidation. In addition, proper adjustment shall be made with respect to the effect of any other transactions between members of the group during a consolidated return period which creates a distortion of income or a substantial variation in basis of property from the basis such property would have had if there had been no such transactions.

(3) Where property is acquired upon a distribution (not a complete liquidation within the provisions of section 332 (b)) in which gain or loss to the distributee is not recognized as provided in paragraph (a) of § 1.1502–37A the basis of such property shall be the same as the basis of the stock and the bonds and other obligations exchanged therefor, adjusted for—

(i) The transfer of assets within the affiliated group by the distributing corporation (by sale, gift, or otherwise) without consideration or at markedly fictitious values, during the period for which the corporations were affiliated (whether or not a consolidated return was made);

(ii) Distributions during a period in which the corporations were affiliated of earnings or profits accumulated prior to the date upon which the distributing corporation became a member of the group; and

(iii) Cash received in the distribution.

(4) Where property was acquired upon a distribution in which gain or loss to the distributee was recognized pursuant to the provisions of section 333 (a) or the corresponding provisions of the Internal Revenue Code of 1939 or the Revenue Act of 1938, the basis of such property shall be the same as the basis of the stock exchanged therefor, adjusted for—

(i) The transfer of assets within the affiliated group by the distributing corporation (by sale, gift, or otherwise) without consideration or at markedly fictitious values, during the period for which the corporations were affiliated (whether or not a consolidated return was made);

(ii) Distribution during a consolidated return period of earnings or profits accumulated prior to the date upon which the distributing corporation became a member of the group;

(iii) Cash received in the distribution; and

(iv) The amount of gain recognized to the distributee in the liquidation.

(d) *Basis not affected by acquisition or sale of stock.* Neither the acquisition of stock of a corporation nor its sale or other disposition shall affect the basis of the property of such corporation for determining gain or loss or upon which exhaustion, wear and tear, obsolescence, amortization, and depletion are to be allowed.

§ 1.1502–39A Inventories.

(a) *Consolidated return for first year of affiliation.* If the income of an affiliated corporation is included in a consolidated return for the period immediately following the date upon which such corporation became a member of the affiliated group, the value of its opening inventory to be used in computing the consolidated taxable income shall be the proper value of the closing inventory used in computing its taxable income for the preceding taxable year.

(b) *Consolidated return after separate return by affiliates.* If—

(1) A corporation which is a member of the affiliated group for the first consolidated return period was a member of the group in the preceding taxable year, or

(2) A corporation which filed a separate return for its previous taxable year was not a member of the affiliated group within the meaning of section 141 of the Internal Revenue Code of 1939, at any time during the last taxable year of the group not subject to section 1502, but which would have been a member of the group during such period if section 1504 had been applicable and is a member of the affiliated group filing a consolidated return for the first taxable year to which section 1502 is applicable,

the value of its opening inventory to be used in computing the consolidated taxable income for the first consolidated return period shall be the proper value of the closing inventory used in computing its taxable income for the preceding taxable year, decreased in the amount of profits or increased in the amount of losses reflected in such inventories which arose in transactions between members of the affiliated group and which have not been realized by the group through final transactions with persons other than members of the group.

(c) *Separate returns made after consolidated returns.* If a corporation which was a member of an affiliated group in a consolidated return period makes or is required to make a separate return for the succeeding taxable year, the value of its opening inventory to be used in computing its taxable income for such succeeding taxable year shall be the proper value of its closing inventory used in computing consolidated taxable income for the last consolidated return period increased in the amount of profits or decreased in the amount of losses eliminated in the computation of such inventory as profits or losses arising in transactions between members of the affiliated group, but in an amount not exceeding, in the case of profits, either the amount of profits arising from such intercompany transactions reflected in the closing inventory of such corporation for such succeeding taxable year or the amount of such intercompany profits eliminated from its opening inventory for its first consolidated return period pursuant to the provisions of paragraph (b) of this section, and not exceeding, in the case of losses, either the amount of losses arising from intercompany transactions reflected in the closing inventory for such corporation for such succeeding taxable year or the amount of such intercompany losses eliminated from its opening inventory for its first consolidated return period pursuant to the provisions of paragraph (b) of this section.

§ 1.1502–40A Bad debts.

(a) *Deduction during consolidated return period.* No deduction shall be allowed during a consolidated return period to any member of the affiliated group on account of worthlessness in whole or in part of any obligation (including accounts receivable, bonds, notes, debts, and claims of whatsoever nature) of any other corporation which was a member of the group as of the last day of the taxable year or which was liquidated by the group during such year, except as a loss resulting from a bona fide termination of the business and operations of such other corporation, whether in liquidation or otherwise, in which case the loss shall be computed subject to the adjustments specified in § 1.1501–35A and the provisions of § 1.1502–36A shall be applicable.

(b) *Limitation of allowance after consolidated return period.* With respect to obligations (including accounts receivable) of a member of an affiliated group acquired in any way by another member of the group prior to or during any taxable year subsequent to 1928 for which a consolidated income or excess profits tax return was filed, the adjustments prescribed with respect to the allowance of losses upon the sale of bonds shall be applicable to the allowance of any bad debt deduction for any period subsequent to the consolidated return period. See § 1.1502–35A.

§ 1.1502–41A Sale and retirement by corporation of its bonds.

(a) *Issued at discount or premium.* If a corporation which during any taxable year has been a member of an affiliated group which makes or is required to make a consolidated return, has issued its bonds at a discount or premium (whether or not during a consolidated return period), deduction will be allowed for the amortization of the discount, and income included for the amortization of the premium, in the same manner, to the same extent, and upon the same conditions as if the corporation had never been affiliated, except that no deduction for amortization of discount shall be allowed, and no income shall be included for amortization of premium, during a period for which a consolidated return is made, on bonds of one member of the group owned by another member of the group.

(b) *Acquisition of bonds by issuing company.* If a corporation which has been a member of an affiliated group which makes or is required to make a consolidated return, acquires its bonds (whether or not from another member of such group and whether or not during a consolidated return period), gain or loss shall be recognized in the same manner to the same extent and upon the same conditions as if the corporation had never been affiliated, except that, if such bonds are acquired from another member of the group during a consolidated return period, and in a transaction other than a distribution in a liquidation in which gain or loss to the distributee is recognized pursuant to paragraph (a) of § 1.1502–37A in determining the gain or loss to the issuing company from such acquisition, the basis thereof to such other member of the group shall be deemed the purchase price.

§ 1.1502–42A Capital loss limitations and carryover.

(a) The provisions of sections 165, 832(c)(5), 1211, 1212, and 1231 with respect to gains and losses from sales or exchanges of capital assets shall be applied, in respect of such gains and losses sustained during a consolidated return period as if the affiliated group were the taxpayer.

(b) With respect to a net capital loss sustained by a corporation in a taxable year prior to the first consolidated return period in respect of which its income is included in a consolidated return, such loss (in an amount not in excess of the net capital gain of such corporation for succeeding consolidated return periods) shall, for the purposes of section 1212, relating to net capital loss carryovers, be treated as if such net capital loss had been sustained by the affiliated group.

(c) A consolidated net capital loss of an affiliated group for a consolidated return period shall be considered as a consolidated short-term capital loss in subsequent consolidated return periods notwithstanding that one or more corporations, members of the group in the taxable year in which such loss was sustained, make separate returns for subsequent taxable years (or join in a consolidated return made by another affiliated group), but only to the extent that such consolidated net capital loss is not attributable to such corporations; and such portion of such consolidated net capital loss as is attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year shall be considered as a short-term capital loss in such separate returns, or in such consolidated return of the other affiliated group, but only to the extent that such portion of such consolidated net capital loss was not absorbed in intervening taxable years by net capital gains, consolidated or separate, as the case may be. Any net capital loss sustained by a corporation prior to the first taxable year in respect of which its income is included in the consolidated return shall be considered as a short-term capital loss in the separate return of such corporation (or the consolidated return of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such net capital loss was not absorbed in intervening taxable years by net capital gains, consolidated or separate, as the case may be.

§ 1.1502-43A Credit for foreign taxes.

(a) *In general*—(1) *Choice of credit or deduction.* The credit under section 901 for taxes paid or accrued to any foreign country or possession of the United States shall be allowed to an affiliated group filing a consolidated return only if the common parent corporation chooses to use such credit in the computation of the tax liability of the group for the taxable year. If this choice is made, no deduction may be taken under section 164 on the consolidated return for such taxes paid or accrued by any member of the group.

(2) *Amount of credit.* If the per-country limitation on the credit provided in section 904(a)(1) applies in computing the tax liability of the group for the taxable year, the amount of the credit shall be determined under paragraph (b) of this section; if the overall limitation provided in section 904(a)(2) applies, the amount of the credit shall be determined under paragraph (c) of this section. If any member of the group receives "interest income" from sources within any foreign country or any possession, the credit for taxes paid or accrued to such foreign country or possession with respect to such income shall be determined separately under paragraph (d) of this section.

(3) *Definitions.* For purposes of this section—

(i) The term "taxes paid or accrued" includes the amount of taxes deemed paid pursuant to sections 902 and 960(a), and

(ii) The term "interest income" means interest income described in section 904(f)(2) for taxable years beginning after October 16, 1962, but only if such interest income results from transactions consummated after April 2, 1962, and the term "consolidated taxable interest income" means the aggregate interest income of the several members of the affiliated group.

(b) *Amount of credit with respect to noninterest income where per-country limitation applies*—(1) *Taxes allowed as a credit.* Subject to the limitation provided in subparagraph (2) of this paragraph, the credit allowable to an affiliated group filing a consolidated return for taxes paid or accrued with respect to income other than interest income for a taxable year for which the per-country limitation applies shall be an amount equal to the sum of—

(i) The aggregate of the taxes paid or accrued for the taxable year by the several members of the affiliated group to any foreign country or any possession with respect to income other than interest income, and

(ii) The aggregate of the consolidated excess tax paid carryovers and carrybacks to the taxable year under section 904(d) for taxes paid or accrued to such country or possession with respect to income other than interest income.

(2) *Limitation.* The credit allowable under subparagraph (1) of this paragraph for taxes paid or accrued to any foreign country or any possession shall not exceed an amount which bears the same ratio to the total tax of the affiliated group against which the credit is taken as the consolidated taxable income of the group (computed by excluding any consolidated taxable interest income) from sources within such country or possession (but not in excess of the entire consolidated taxable income of the group) bears to the entire consolidated taxable income. The amount computed under the preceding sentence shall be increased as provided in section 960(b), where applicable.

(3) *Consolidated excess tax paid carryovers.* The consolidated excess tax paid carryovers to the current taxable year for taxes paid or accrued to any foreign country or any possession with respect to income other than interest income shall consist of—

(i) The consolidated excess tax paid, with respect to such income, to such country or possession for the five preceding taxable years (not including as a preceding taxable year any taxable year beginning before January 1, 1958) to the extent that such consolidated excess tax paid for any such preceding taxable year was not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year and was not absorbed pursuant to section 904(d) in years preceding the current taxable year (whether or not taken as a credit), and

with respect to the excess tax paid, with respect to income other than interest income, by a corporation in a taxable year for which a separate return was filed, or for which such corporation joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (g) of this section—

(ii) The amount of such excess tax paid by such corporation to such country or possession for the five preceding taxable years (not including as a preceding taxable year any taxable year beginning before January 1, 1958) to the extent that such excess tax paid for any such preceding taxable year was not absorbed pursuant to section 904(d) in years preceding the current taxable year (whether or not taken as a credit).

(4) *Consolidated excess tax paid carrybacks.* The consolidated excess tax paid carrybacks to the current taxable year for taxes paid or accrued to any foreign country or any possession with respect to income other than interest income shall consist of—

(i) The consolidated excess tax paid, with respect to such income, to such country or possession for the first succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year) reduced to the extent absorbed pursuant to section 904(d) in the first preceding taxable year (whether or not taken as a credit), and

(ii) The consolidated excess tax paid, with respect to such income, to such country or possession for the second succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year), and

with respect to the excess tax paid, with respect to income other than interest income, to such country or possession by a corporation which, for either of the two succeeding taxable years, files a separate return or joins in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (g) of this section—

(iii) The amount of such excess tax paid by such corporation for the first succeeding taxable year reduced to the extent absorbed pursuant to section 904(d) by such corporation for the first preceding taxable year (whether or not taken as a credit), or if the income of such corporation is included in a consolidated return for the first preceding taxable year, reduced to the extent absorbed pursuant to section 904(d) by such consolidated return (whether or not taken as a credit), and

(iv) The amount of such excess tax paid by such corporation for the second succeeding taxable year.

(c) *Amount of credit with respect to noninterest income where overall limitation applies*—(1) *Taxes allowed as a credit.* Subject to the limitation provided in subparagraph (2) of this paragraph, the credit allowable to an affiliated group filing a consolidated return for taxes paid or accrued with respect to income other than interest income for a taxable year for which the overall limitation applies shall be equal to the sum of—

(i) The aggregate of the taxes paid or accrued for the taxable year by the several members of the affiliated group to all foreign countries and possessions with respect to income other than interest income, and

(ii) The aggregate of the consolidated excess tax paid carryovers and carrybacks to the taxable year under section 904(d) for taxes paid or accrued to all foreign countries and possessions with respect to income other than interest income.

(2) *Limitation.* The credit allowable under subparagraph (1) of this paragraph for taxes paid or accrued to all foreign countries and possessions shall not exceed an amount which bears the same ratio to the total tax of the affiliated group against which the credit is taken as the consolidated taxable income of the group (computed by excluding any consolidated taxable interest income) from sources without the United States (but not in excess of the entire consolidated taxable income of the group) bears to the entire consolidated taxable income. The amount computed under the preceding sentence shall be increased as provided in section 960(b), where applicable.

(3) *Consolidated excess tax paid carryovers.* The consolidated excess tax paid carryovers to the current taxable year for taxes paid or accrued to all foreign countries and possessions with respect to income other than interest income shall consist of—

(i) The consolidated excess tax paid, with respect to such income, to all such countries and possessions for the five preceding taxable years (not including

as a preceding taxable year any taxable year beginning before January 1, 1961) to the extent that such consolidated excess tax paid for any such preceding taxable year was not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year and was not absorbed pursuant to section 904(d) in years preceding the current taxable year (whether or not taken as a credit), and

with respect to the excess tax paid, with respect to income other than interest income, by a corporation in a taxable year for which a separate return was filed, or for which such corporation joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (g) of this section—

(ii) The amount of such excess tax paid by such corporation to all foreign countries and possessions for the five preceding taxable years (not including as a preceding taxable year any taxable year beginning before January 1, 1961) to the extent that such excess tax paid for any such preceding taxable year was not absorbed pursuant to section 904(d) in years preceding the current taxable year (whether or not taken as a credit).

(4) *Consolidated excess tax paid carrybacks.* The consolidated excess tax paid carrybacks to the current taxable year for taxes paid or accrued to all foreign countries and possessions with respect to income other than interest income shall consist of—

(i) The consolidated excess tax paid, with respect to such income, to all such countries and possessions for the first succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year) reduced to the extent absorbed pursuant to section 904(d) in the first preceding taxable year (whether or not taken as a credit), and

(ii) The consolidated excess tax paid, with respect to such income, to all such countries and possessions for the second succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year), and

with respect to the excess tax paid, with respect to income other than interest income, to all such countries and possessions by a corporation which, for either of the two succeeding taxable years, files a separate return or joins in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (g) of this section—

(iii) The amount of such excess tax paid by such corporation for the first succeeding taxable year reduced to the extent absorbed pursuant to section 904(d) by such corporation for the first preceding taxable year (whether or not taken as a credit), or if the income of such corporation is included in a consolidated return for the first preceding taxable year, reduced to the extent absorbed pursuant to section 904(d) by such consolidated return (whether or not taken as credit), and

(iv) The amount of such excess tax paid by such corporation for the second succeeding taxable year.

(5) *Carrybacks to certain taxable years.* The excess tax paid (whether consolidated or separate) with respect to income other than interest income for any taxable year for which the overall limitation applies may not be carried back to a taxable year beginning before January 1, 1961; and in determining the carryover or carryback to taxable years beginning on or after January 1, 1961, no amount shall be treated as absorbed for taxable years beginning before such date.

(d) *Amount of credit with respect to interest income*—(1) *Taxes allowed as a credit.* Subject to the limitation provided in subparagraph (2) of this paragraph, the credit allowable to an affiliated group filing a consolidated return for taxes paid or accrued with respect to interest income shall be an amount equal to the sum of—

(i) The aggregate of the taxes paid or accrued for the taxable year by the several members of the affiliated group to any foreign country or any possession with respect to interest income, and

(ii) The aggregate of the consolidated excess tax paid carryovers and carrybacks to the taxable year under section 904(d) for taxes paid or accrued to such country or possession with respect to interest income.

(2) *Limitation.* The credit allowable under subparagraph (1) of this paragraph for taxes paid or accrued to any foreign country or any possession shall not exceed an amount which bears the same ratio to the total tax of the affiliated group against which the credit is taken as the consolidated taxable interest income of the group from sources within such country or possession (but not in excess of the entire consolidated taxable income of the group) bears to the entire consolidated taxable income. The amount computed under the preceding sentence shall be increased as provided in section 960(b), where applicable.

(3) *Consolidated excess tax paid carryovers.* The consolidated excess tax paid carryovers to the current taxable year for taxes paid or accrued to any foreign country or any prossession with respect to interest income shall consist of—

(i) The consolidated excess tax paid, with respect to such income, to such country or possession for the five preceding taxable years to the extent that such consolidated excess tax paid for any such preceding taxable year was not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year and was not absorbed pursuant to section 904(d) in years preceding the current taxable year (whether or not taken as a credit), and

with respect to the excess tax paid, with respect to interest income, by a corporation in a taxable year for which a separate return was filed, or for which such corporation joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (g) of this section—

(ii) The amount of such excess tax paid by such corporation to such country or possession for the five preceding taxable years to the extent that such excess tax paid for any such preceding taxable year was not absorbed pursuant to section 904(d) in years preceding the current taxable year (whether or not taken as a credit).

(4) *Consolidated excess tax paid carrybacks.* The consolidated excess tax paid carrybacks to the current taxable year for taxes paid or accrued to any foreign country or any possession with respect to interest income shall consist of—

(i) The consolidated excess tax paid, with respect to such income, to such country or possession for the first succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year) reduced to the extent absorbed pursuant to section 904(d) in the first preceding taxable year (whether or not taken as a credit), and

(ii) The consolidated excess tax paid, with respect to such income, to such country or possession for the second succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the current taxable year), and with respect to the excess tax paid, with respect to interest income, to such country or possession by a corporation which, for either of the two succeeding taxable years, files a separate return or joins in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in paragraph (g) of this section—

(iii) The amount of such excess tax paid by such corporation for the first succeeding taxable year reduced to the extent absorbed pursuant to section 904(d) by such corporation for the first preceding taxable year (whether or not taken as a credit), or if the income of such corporation is included in a consolidated return for the first preceding taxable year, reduced to the extent absorbed pursuant to section 904(d) by such consolidated return (whether or not taken as a credit), and

(iv) The amount of such excess tax paid by such corporation for the second succeeding taxable year.

(5) *Transitional rules for carrybacks and carryovers.* (i) If the total excess tax paid (consolidated or separate) to any foreign country or any possession for a taxable year beginning on or before October 16, 1962, is a carryover to a taxable year beginning after such date, then (*a*) the portion of such carryover attributable to taxes paid or accrued with respect to interest income shall be an amount equal to such carryover multiplied by the ratio which the taxes paid or accrued to such foreign country or possession for such year beginning after October 16, 1962, with respect to interest income, bears to the total amount of the taxes paid or accrued to such foreign country or possession for such year, and

(b) the portion of such carryover attributable to taxes paid or accrued with respect to income other than interest income shall be an amount equal to such carryover multiplied by the ratio which the taxes paid or accrued to such foreign country or possession for such year beginning after October 16, 1962, with respect to income other than interest income, bears to the total amount of the taxes paid or accrued to such foreign country or possession for such year.

(ii) The amount of the total excess tax paid (consolidated or separate) to any foreign country or any possession for a taxable year beginning after October 16, 1962, which is a carryback to a taxable year beginning on or before such date shall be determined without regard to the provisions of this paragraph.

(e) *Consolidated excess tax paid—*(1) *Income other than interest income.* The consolidated excess tax paid to any foreign country or any possession (or to all foreign countries and possessions if the overall limitation provided in section 904(a)(2) applies) for any taxable year with respect to income other than interest income is the excess of the aggregate of the taxes paid or accrued by the several members of the affiliated group to such country or possession (or to all foreign countries and possessions if the overall limitation applies) with respect to income other than interest income over the applicable limitation provided in section 904(a) (1) or (2) (increased to the extent provided in section 960(b)). However, there is no consolidated excess tax paid for a taxable year in which the affiliated group takes a deduction under section 164 for such taxes paid or accrued to a foreign country or possession.

(2) *Interest income.* The consolidated excess tax paid to any foreign country or any possession for any taxable year with respect to interest income is the excess of the aggregate of the taxes paid or accrued by the several members of the affiliated group to such country or possession with respect to interest income over the limitation provided in section 904(a)(1) (increased to the extent provided in section 960 (b)). However, there is no consolidated excess tax paid for a taxable year in which the affiliated group takes a deduction under section 164 for such taxes paid or accrued to a foreign country or possession.

(f) *Excess tax paid—*(1) *Income other than interest income.* The excess tax paid to any foreign country or any possession (or to all foreign countries and possessions if the overall limitation provided in section 904(a)(2) applies) with respect to income other than interest income, by a corporation for any taxable year for which a separate return is filed, is the excess of the taxes paid or accrued by the corporation to such country or possession (or to all foreign countries and possessions if the overall limitation applies) with respect to income other than interest income over the applicable limitation provided in section 904(a) (1) or (2) (increased to the extent provided in section 960(b)). However, there is no excess tax paid for a taxable year in which the corporation takes a deduction under section 164 for such taxes paid or accrued to a foreign country or possession for such taxable year.

(2) *Interest income.* The excess tax paid to any foreign country or any possession with respect to interest income, by a corporation for any taxable year for which a separate return is filed, is the excess of the taxes paid or accrued by the corporation to such country or possession with respect to interest income over the limitation provided in section 904(a)(1) (increased to the extent provided in section 960(b)). However, there is no excess tax paid for a taxable year in which the corporation takes a deduction under section 164 for such taxes paid or accrued to a foreign country or possession.

(g) *Limitation on credit for carryovers and carrybacks of excess tax paid from separate return years.* In no case shall there be included in the credit for taxes paid or accrued to any foreign country or any possession for the taxable year as consolidated excess tax paid carryovers under paragraphs (b)(3)(ii), (c)(3)(ii), and (d)(3)(ii) of this section (relating to excess tax paid by a corporation in years for which separate returns were filed, or for which such corporation joined in a consolidated return filed by another affiliated group) and as consolidated excess tax paid carrybacks under paragraphs (b)(4) (iii) and (iv), (c)(4) (iii) and (iv), and (d)(4) (iii) and (iv) of this section (relating to excess tax paid by a corporation which for either of the two succeeding taxable years files a separate return or joins in a consolidated return filed by another affiliated group), an amount exceeding in the aggregate that which would be allowed as a credit for a carryover or carryback to such corporation if it had filed a separate return for such taxable year.

(h) *Apportionment of consolidated excess tax paid.* If an affiliated group filing a consolidated return has a consolidated excess tax paid with respect to any foreign country or any possession (or with respect to all foreign countries and possessions if the overall limitation applies) for the taxable year attributable to income other than interest income, or has a consolidated excess tax paid with respect to any foreign country or any possession attributable to interest income, and if there are included as members of such group one or more corporations which make separate returns (or join in a consolidated return filed by another affiliated group) for any of the two preceding or five succeeding taxable years, the portion of each such consolidated excess tax paid attributable to such corporations severally shall be determined. The portion of each such consolidated excess tax paid in the case of any such corporation shall be the amount which bears the same ratio to such consolidated excess tax paid as the tax paid or accrued by such corporation to such foreign country or possession (or to all foreign countries and possessions if the overall limitation applies) with respect to income other than interest income, or to such foreign country or possession with respect to interest income, as the case may be, bears to the total tax paid or accrued by the affiliated group to such foreign country or possession (or to all foreign countries and possessions if the overall limitation applies) with respect to income other than interest income, or to such foreign country or possession with respect to interest income, as the case may be.

(i) [Reserved]

(j) *Consolidated excess tax paid before or after consolidated return period.* The consolidated excess tax paid by an affiliated group to any foreign country or any possession (or with respect to all foreign countries and possessions if the overall limitation applies) with respect to income other than interest income, or to any foreign country or any possession with respect to interest income, as the case may be, shall be used in computing the consolidated excess tax paid carryover and carryback of the group notwithstanding that one or more corporations which were members of the group in the taxable year in which such consolidated excess tax paid originates make separate returns (or join in a consolidated return made by another affiliated group) for a subsequent taxable year (or, in the case of a carryback, for a preceding taxable year) but only to the extent that such consolidated excess tax paid is not attributable to such corporation. Such portion of such consolidated excess tax paid as is attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year (or, in the case of a carryback, for a preceding taxable year) reduced to the extent absorbed in earlier years shall be used by such corporations severally as carryovers or as carrybacks in such separate returns or in such consolidated returns of another affiliated group. Any excess tax paid by a corporation prior to the first taxable year in which its income is included in the consolidated return of the group (or paid in either of the two years immediately following a consolidated return year) may be used in computing the carryover or carryback of such corporation (or of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in the consolidated return of another affiliated group, but only to the extent that such excess tax paid was not absorbed (either as a carryover or as a carryback).

(k) *Limitation effective under section 904(a).* The determination of whether the overall limitation or the per-country limitation applies during a consolidated return period shall be made by reference to the limitation effective with respect to the common parent corporation for such period. An election made by the common parent for a year for which it filed a separate return may be changed or revoked during a consolidated return period only in accordance with the provisions of section 904(b). If the limitation effective with respect to any affiliate for a taxable year (immediately preced-

ing the consolidated return period) for which it filed a separate return (or joined in a consolidated return filed by another affiliated group) differs from the limitation effective with respect to the common parent corporation for the consolidated return period, then such affiliate shall, if the overall limitation is effective with respect to the common parent, be deemed to have made an election to use such overall limitation, or, if the per-country limitation is effective with respect to the common parent, be deemed to have revoked its election to use the overall limitation. Consent of the Secretary or his delegate is hereby given to such affiliate for such election or revocation. Any such election or revocation shall apply only prospectively beginning with such consolidated return period. The limitation effective with respect to an affiliate for the consolidated return period immediately preceding a year for which it does not join in the filing of the consolidated return shall, except to the extent otherwise provided in this paragraph, remain in effect for such subsequent year in accordance with the provisions of section 904(b).

(l) *Carryovers or carrybacks from overall year to per-country year, and vice versa.* (1) The excess tax paid (whether consolidated or separate) to any foreign country or any possession of the United States with respect to income other than interest income, in a taxable year for which the per-country limitation under section 904(a)(1) applies, may not be carried to a taxable year for which the overall limitation under section 904(a)(2) applies.

(2) The excess tax paid (whether consolidated or separate) to all foreign countries and possessions with respect to income other than interest income, in a taxable year for which the overall limitation applies, may not be carried to a taxable year for which the per-country limitation applies.

(3) Subject to the provisions of section 904(f)(3) and the regulations thereunder, the excess tax paid (whether consolidated or separate) to any foreign country or any possession with respect to interest income may be carried to a taxable year for which the overall limitation applies in respect of taxes paid or accrued with respect to income other than interest income.

§ 1.1502–44A Methods of accounting.

(a) *In general.* All members of the affiliated group shall adopt that method of accounting which clearly reflects the consolidated taxable income. A method of accounting which does not treat with reasonable consistency all items of gross income and deductions of the various members of the group shall not be regarded as clearly reflecting the consolidated taxable income. For example, one member of the group will not be permitted to report items of income or deductions on the cash method of accounting while another member of the same group reports the same or similar items on the accrual method. The provisions of this paragraph are subject to the exceptions stated in paragraph (b) of this section.

(b) *Combination of methods.* If the members of an affiliated group have established different methods of accounting, each member may retain such method with the consent of the Commissioner: *Provided,* That the consolidated taxable income is clearly reflected: *And provided further,* That intercompany transactions affecting such consolidated taxable income shall be eliminated and adjustments on account of such transactions shall be made with reference to a uniform method of accounting to be selected by the members of the group with the consent of the Commissioner.

(c) *Adjustments required by changes in method of accounting.* In any case in which a member of an affiliated group changes its method of accounting the provisions of section 481 (a) shall be applicable.

§ 1.1502–45A Mine exploration expenditures.

For the purpose of applying the limitation provided in section 615 (c) (whether during a consolidated return period or during a period for which a separate return is made), if during a preceding taxable year for which a consolidated return was made or was required to be made any member of the affiliated group for such preceding taxable year was allowed the deduction provided in section 615 (a) or made the election provided in section 615 (b), each member of the affiliated group for such preceding taxable year shall be deemed to have been allowed such deduction or to have made such election, as the case may be.

§ 1.1502–46A Depreciation.

In the computation of the deduction for depreciation under section 167, property received by one member of the group from another member of the group during a consolidated return period, shall be treated in the same manner as it could be treated if it were held by the transferor.

§ 1.1502–47A Election to deduct accrued taxes.

If all members of the affiliated group were taxpayers which, for each taxable year in which they were subject to the tax imposed by section 500 of the Internal Revenue Code of 1939 deducted Federal income and excess profits taxes when paid for the purpose of computing subchapter A net income under such Code, the affiliated group shall, if the tax liability under section 541 is computed upon the consolidated undistributed personal holding company income, deduct taxes under section 545 when paid unless a member of the common affiliated group elects in its return or the common parent elects in a consolidated return for the group of which it is the common parent for a taxable year ending after June 30, 1954, to deduct the taxes described in section 545, when accrued. In any case in which the common parent corporation or any member of the affiliated group has, prior to the taxable year, elected to deduct such taxes when accrued, each member of the group shall be deemed to have so elected in the first year thereafter in which its income is included in the consolidated personal holding company income. If an election is made by the common parent corporation with respect to a year for which the tax liability under section 541 is computed upon the consolidated undistributed personal holding company income, each member of the group shall be deemed to have made such election in such year. Any such election made or deemed to have been made shall be applicable to each member of the group for the taxable year for which the election is made and for all subsequent taxable years. Any election so made shall be irrevocable.

§ 1.1502–48A Liability for tax under section 531.

In any case in which an affiliated group computes the tax liability under section 541, upon the consolidated undistributed personal holding company income, the tax imposed by section 531 shall not be applicable.

§ 1.1502–49A Additions to tax for failure to pay estimated tax.

(a) Except in the case of an affiliated group described in paragraph (b) of this section, any addition to the tax under section 6655 for underpayment of estimated tax of a member of an affiliated group which files a consolidated return for the taxable year shall be determined by allocating the tax shown on the consolidated return to the several members of the group by any of the methods provided in paragraph (a) of § 1.1552–1 selected by the common parent corporation for the taxable year, without regard to the method elected under section 1552. If the group would use the method of allocation authorized by paragraph (a)(4) of § 1.1552–1, it must be the method elected by the group with the approval of the Commissioner for the purpose of determining earnings and profits. In the application of section 6655 (d) (1) with respect to a member of the group which was included in a consolidated return for the preceding taxable year, whether or not such member is included in a consolidated return for the taxable year, the "tax shown on the return" for the preceding taxable year shall be the portion of the tax shown on such consolidated return determined by allocating such tax to the several members of the group by the procedure described above. In the application of section 6655 (d) (2) if the corporation was included in a consolidated return for the preceding taxable year, the "facts shown on the return" shall be the facts shown on the consolidated return of the group (whether of this or another affiliated group) for the preceding taxable year attributable to such corporation.

(b) In the case of an affiliated group which has filed pursuant to the provisions of paragraph (c)(2) of § 1.1502–10A a declaration of estimated tax for the taxable year for which a consolidated return is filed, any addition to the tax provided by section 6655 shall be determined by reference to the payments made on such declaration and to the tax shown on the consolidated return.

(c) In the application of section 6655 (d) (1) with respect to the affiliated group described in paragraph (b) of this section, the "tax shown on the return" shall be—

(1) If the group filed a consolidated return for the preceding taxable year, the tax shown on such return, or

(2) If the group did not file a consolidated return for the preceding taxable year, the aggregate of the taxes of the several members of the group shown on any separate returns of such corporations for the preceding taxable year, plus the tax shown on a consolidated return for the preceding taxable year attributable to any member of the group which joined in a consolidated return with another affiliated group for such preceding taxable year. The tax attributable to any such corporation which joined in a consolidated return shall be determined by allocating the tax shown on such consolidated return in accordance with the procedure described in paragraph (a) of this section.

(d) In the application of section 6655 (d) (2) with respect to the affiliated group described in paragraph (b) of this section, the "facts shown on the return" shall be—

(1) If the group filed a consolidated return for the preceding taxable year, the facts shown on such return, or

(2) If the group did not file a consolidated return for the preceding taxable year, the facts shown on the separate returns of the members of the affiliated group for the preceding taxable year together with the facts shown on a consolidated return for the preceding taxable year attributable to any member of the group which joined in a consolidated return with another affiliated group for such preceding taxable year.

**§ 1.1502–50A Gain on sale of bonds and other evidences of indebtedness.**

In the application of section 1232(a), if one member of the affiliated group acquires a bond or other evidence of indebtedness from another member of the affiliated group during a consolidated return period, the determination of the amount which is treated as gain from the sale or exchange of property which is not a capital asset shall be made by including in the period of time during which such bond or other evidence of indebtedness was held, the period of time during which it was held by any other corporation which transferred it in a transaction to which paragraph (b)(1)(i) of § 1.1502–31A (or the corresponding provision of prior consolidated returns regulations) is applicable without regard to any period of time before the last sale or exchange of such instrument to which such section is not applicable. In the application of section 1232(c), if a bond or other evidence of indebtedness was acquired from another member of an affiliated group during a consolidated return period, then the bond or other evidence of indebtedness shall be deemed to have been purchased at the time of, and as having a market value with coupons attached, determined by reference to the earliest date of purchase by any other corporation which transferred it in a transaction to which paragraph (b)(1)(i) of § 1.1502–31A (or the corresponding provision of prior consolidated returns regulations) is applicable without regard to any purchase prior to the last purchase to which such section is not applicable.

**§ 1.1502–51A Credit for investment in certain depreciable property.**

(a) *Determination of amount of consolidated credit*—(1) *In general.* Except as otherwise provided in this section, the amount of the consolidated credit allowed by section 38 for the taxable year is the aggregate amount of the "credit earned" for such year of the several members of the affiliated group. Such amount shall be referred to in this section as the "consolidated credit earned". The "credit earned" of each member of the affiliated group is an amount equal to 7 percent of such member's qualified investment (determined under section 46(c)).

(2) *Consolidated limitation based on amount of tax.* (i) Notwithstanding the amount of the consolidated credit earned for the taxable year, the consolidated credit allowed by section 38 to the group for the taxable year is limited to—

(*a*) So much of the consolidated liability for tax as does not exceed $25,000, plus

(*b*) 25 percent of the consolidated liability for tax in excess of $25,000.

The $25,000 amount referred to in (*a*) and (*b*) of the preceding sentence shall be reduced by any part of such $25,000 amount apportioned, under section 46(a)(5), to members of the affiliated group (as defined in section 46(a)(5)) which do not join in the filing of the consolidated return. The amount determined under this subparagraph shall be referred to in this section as the "consolidated limitation based on amount of tax".

(ii) If an organization to which section 593 applies or a cooperative organization described in section 1381(a) joins in the filing of the consolidated return, the $25,000 amount referred to in subdivision (i) (*a*) and (*b*) of this subparagraph (or such $25,000 amount reduced by any part of such amount apportioned to members of the affiliated group which do not join in the filing of the consolidated return) shall be apportioned equally among the members of the affiliated group filing the consolidated return. The portion of such $25,000 amount (or such reduced amount) so apportioned equally to any such organization shall then be decreased to the ratable share of such portion in accordance with the provisions of section 46(d). Finally, for purposes of computing the consolidated limitation based on amount of tax under subdivision (i) (*a*) and (*b*) of this subparagraph, the sum of all such equal portions (as decreased under section 46(d), where applicable) of each member of the affiliated group filing the consolidated return shall be substituted for the $25,000 amount referred to in subdivision (i) (*a*) and (*b*) of this subparagraph.

(3) *Consolidated liability for tax.* For purposes of this section, the consolidated liability for tax shall be the income tax imposed for the taxable year upon the group by chapter 1 of the Code (including the 2-percent tax on consolidated taxable income), reduced by the credit allowable under section 33 (relating to taxes of foreign countries and possessions of the United States). The tax imposed by section 531 (relating to imposition of accumulated earnings tax) or by section 541 (relating to imposition of personal holding company tax) shall not be considered tax imposed by chapter 1 of the Code. In addition, any increase in tax resulting from the application of section 47 (relating to certain dispositions, etc., of section 38 property) shall not be treated as tax imposed by chapter 1 for purposes of computing the consolidated liability for tax.

(b) *Carryback and carryover of consolidated unused credit*—(1) *Allowance of consolidated unused credit as carryback or carryover.* (i) A "consolidated unused credit" is the excess of the consolidated credit earned for the taxable year over the consolidated limitation based on amount of tax for such taxable year. Subject to the limitations contained in subparagraphs (2) and (9)(i) of this paragraph, a consolidated unused credit shall be added to the amount allowable as a credit under section 38 for the years to which the consolidated unused credit can be carried. The year with respect to which a consolidated unused credit arises shall be referred to in this section as the "consolidated unused credit year".

(ii) A consolidated unused credit shall be an investment credit carryback to each of the 3 taxable years preceding the consolidated unused credit year and shall be an investment credit carryover to each of the 5 taxable years succeeding the consolidated unused credit year, except that a consolidated unused credit shall be a carryback only to taxable years ending after December 31, 1961. A consolidated unused credit must be carried first to the earliest of the 8 taxable years to which it may be carried, and then to each of the other 7 taxable years (in order of time) to the extent that the consolidated unused credit may not be added (because of the limitation contained in paragraph (a)(2) of this section) to the amount allowable as a credit under section 38 for a prior taxable year.

(2) *Limitation on allowance of consolidated investment credit carryback or carryover.* The amount of the consolidated investment credit carryback or carryover from any particular unused credit year which may be added to the amount allowable as a credit under section 38 for any of the 3 preceding or 5 succeeding taxable years to which such credit may be carried shall not exceed the amount by which the consolidated limitation based on amount of tax for such preceding or succeeding taxable year exceeds the sum of (i) the consolidated credit earned for such preceding or succeeding year, and (ii) other unused credits carried to such preceding or succeeding year which are attributable to unused credit years prior to the particular unused credit year.

(3) *Effect of net operating loss carryback.* If the effect of a net operating loss carryback is to create a consolidated unused credit, such unused credit shall not be treated as a consolidated investment credit carryback. However, the full amount of the unused credit so arising shall be available for use as an investment credit carryover for the five taxable years following the consolidated unused credit year.

(4) *Taxable years beginning before January 1, 1962, and ending after December 31, 1961.* For purposes of determining the amount of unused credits which may be carried back to a consolidated return year beginning before January 1, 1962, and ending after December 31, 1961, and added to the amount allowable as a credit for such year, the consolidated limitation based on amount of tax for such year, determined without regard to this subparagraph, shall be reduced to an amount which bears the same ratio to such limitation as the number of days in such taxable year after December 31, 1961, bears to the total number of days in such year.

(5) *Consolidated investment credit carryover.* The consolidated investment credit carryover which may be added, subject to the limitation contained in subparagraph (2) of this paragraph, to the amount allowable to the group as a credit under section 38 for any taxable year shall be—

(i) The consolidated unused credits, if any, for the five preceding taxable years to the extent that the consolidated unused credit for any such preceding taxable year is not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year and was not allowed as a credit under section 38 for a preceding or intervening taxable year, and

(ii) With respect to unused credits of a corporation arising in unused credit years for which such corporation filed a separate return or joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed by subparagraph (7) of this paragraph, such unused credits, if any, for the five preceding taxable years to the extent that the unused credit for any such preceding taxable year was not allowed as a credit under section 38 for a preceding or intervening taxable year.

(6) *Consolidated investment credit carryback.* The consolidated investment credit carryback which may be added, subject to the limitation contained in subparagraph (2) of this paragraph, to the amount allowable to the group as a credit under section 38 for any taxable year shall be—

(i) The amount of the consolidated unused credit, if any, for the first succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year), reduced to the extent such consolidated unused credit was allowed as a credit under section 38 for the first two preceding taxable years,

(ii) The amount of the consolidated unused credit, if any, for the second succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year), reduced to the extent such consolidated unused credit was allowed as a credit under section 38 for the first preceding taxable year,

(iii) The amount of the consolidated unused credit, if any, for the third succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year), and

(iv) With respect to an unused credit of a corporation arising in an unused credit year for which such corporation filed a separate return or joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed by subparagraph (7) of this paragraph—

(*a*) The amount of the unused credit, if any, of such corporation for the first succeeding taxable year, reduced to the extent such unused credit was allowed as a credit under section 38 for the first two preceding taxable years,

(*b*) The amount of the unused credit, if any, of such corporation for the second succeeding taxable year, reduced to the extent such unused credit was allowed as a credit under section 38 for the first preceding taxable year, and

(*c*) The amount of the unused credit, if any, of such corporation for the third succeeding taxable year.

(7) *Limitation on investment credit carryover and carryback from separate return years.* (i) For any taxable year, the amount included in the consolidated investment credit carryover of the group, under subparagraph (5) (ii) of this paragraph, and in the consolidated investment credit carryback of the group, under subparagraph (6) (iv) (*a*), (*b*), and (*c*) of this paragraph, shall not exceed the limitation determined under subdivision (ii) of this subparagraph.

(ii) For purposes of subdivision (i) of this subparagraph, the limitation for any taxable year shall be an amount equal to the amount by which the portion of the consolidated limitation based on amount of tax for such taxable year attributable to the corporation which filed a separate return, or joined in the filing of a consolidated return by another affiliated group, in a preceding or succeeding taxable year exceeds the sum of—

(*a*) The credit earned (as defined in paragraph (a) (1) of this section) of such corporation for the taxable year, and

(*b*) The unused credits of such corporation (or attributable to such corporation) which may be carried to the taxable year arising in unused credit years prior to the particular unused credit year.

(iii) For purposes of subdivision (ii) of this subparagraph, the portion of the consolidated limitation based on amount of tax attributable to a corporation shall be the sum of—

(*a*) So much of the consolidated liability for tax attributable to such corporation as does not exceed $25,000 divided by the number of corporations in such affiliated group (as defined in section 46(a)(5)), and

(*b*) 25 percent of so much of the consolidated liability for tax attributable to such corporation as exceeds $25,000 divided by the number of corporations in such affiliated group (as defined in section 46(a)(5)).

(iv) For purposes of subdivision (iii) of this subparagraph, the consolidated liability for tax attributable to a corporation is the consolidated liability for tax for the taxable year multiplied by the ratio which—

(*a*) The taxable income, if any, of such corporation, bears to

(*b*) The aggregate of the taxable incomes of the several members of the affiliated group having taxable income.

For purposes of the preceding sentence, taxable income of a corporation means the taxable income of such corporation included in the computation of consolidated taxable income for the taxable year decreased by its deductions under sections 181, 243, 244, 245, 247, and 922 (and in the case of a member of an affiliated group to which the consolidated section 175 deduction is applicable, the section 175 deduction), increased by its separate net capital gain, and increased or decreased, as the case may be, with respect to its separate gains or losses from involuntary conversions subject to the provisions of section 1231, and from sales or exchanges of property subject to the provisions of section 1231.

(8) *Consolidated unused credit attributable to each of the several members*—(i) *In general.* If an affiliated group filing a consolidated return has a "consolidated unused credit" for a taxable year and if there are included as members of such group one or more corporations which made separate returns, or joined in a consolidated return filed by another affiliated group, for any of the three preceding or five (or six in the case of a section 181 deduction) succeeding taxable years, the portion of such consolidated unused credit for such consolidated unused credit year attributable to such corporations severally shall be determined, such portion in the case of any such corporation being determined under the provisions of subdivisions (ii) and (iii) of this subparagraph.

(ii) *Carryback.* In the case of a carryback of a consolidated unused credit to a taxable year for which the corporation made a separate return or joined in a consolidated return filed by another affiliated group, the portion of such consolidated unused credit for the consolidated unused credit year attributable to such corporation shall be an amount equal to the amount of such consolidated unused credit multiplied by the ratio which—

(*a*) The credit earned (as defined in paragraph (a) (1) of this section) of such corporation for the consolidated unused credit year, bears to

(*b*) The consolidated credit earned (as defined in paragraph (a) (1) of this section) for such consolidated unused credit year.

(iii) *Carryover.* In the case of a carryover of a consolidated unused credit to (or a section 181 deduction for) a taxable year for which the corporation makes a separate return or joins in a consolidated return filed by another affiliated group, the portion of such consolidated unused credit for the consolidated unused credit year attributable to such corporation shall be an amount equal to the amount of such consolidated unused credit multiplied by the ratio which—

(*a*) The portion of the consolidated credit earned with respect to any section 38 property placed in service in the consolidated unused credit year and owned by such corporation (whether or not placed in service by such corporation) at the close of the last day with respect to which the taxable income of such corporation is included in the consolidated return, bears to

(*b*) The consolidated credit earned for such consolidated unused credit year.

(9) *Consolidated unused credit before or after consolidated return period.* (i) The consolidated unused credit of an affiliated group filing a consolidated return shall be used in computing the consolidated investment credit carryover or carryback to (or section 181 deduction for) a subsequent (or preceding) taxable year of the group notwithstanding that one or more members of the group in the consolidated unused credit year make separate returns (or join in a consolidated return made by another affiliated group) for such subsequent (or preceding) taxable year, but only to the extent that such consolidated unused credit is not attributable (as determined under subparagraph (8) of this paragraph) to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for such subsequent (or preceding) taxable year.

(ii) The portion of such consolidated unused credit attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent (or preceding) taxable year (reduced to the extent allowed as a credit under section 38 for a prior taxable year) shall be used by such corporations severally as investment credit carryovers (or carrybacks) to such separate returns or such consolidated returns of another affiliated group or as section 181 deductions on such separate returns (or such consolidated return of another affiliated group).

(10) *Rules with respect to unused credits under section 381.* (i) If, in the computation of the consolidated investment credit carryover, there is included an amount with respect to an unused credit of a corporation, arising in a taxable year for which it filed a separate return or for which such corporation joined in a consolidated return filed by another affiliated group, which is a transferor or distributor of assets within the meaning of section 381(a) to a member of the affiliated group, the amount included in the consolidated investment credit carryover with respect to such transferor or distributor shall not exceed the limitation contained in subparagraph (7) of this paragraph determined with reference to the acquiring corporation. The computation shall be made as described in subparagraph (7) of this paragraph as though the acquiring corporation had an unused credit in a year for which it filed a separate return or for which such acquiring corporation had joined in a consolidated return filed by another affiliated group.

(ii) If, in addition to the amount described in subdivision (i) of this subparagraph, there is included an amount with respect to an unused credit of the acquiring corporation in a year for which it filed a separate return or for which it joined in a consolidated return filed by another affiliated group, the unused credits of both the acquiring corporation and the transferor or distributor corporation which may be taken into account as unused credits in determining the consolidated investment credit carryover may not exceed the limitation, determined with reference to the acquiring corporation, computed in a manner described in subparagraph (7) of this paragraph.

(iii) For purposes of subdivisions (i) and (ii) of this subparagraph, if the transferor or distributor corporation was a member of another affiliated group which filed a consolidated return, the amount of the consolidated unused credit of such affiliated group, if any, attributable to such transferor or distributor, shall be treated as the unused credit of such corporation.

(c) *Early dispositions, etc., of section 38 property*—(1) *Dispositions of section 38 property during and after consolidated return period.* Except as provided in subparagraph (2) of this paragraph—

(i) If property placed in service in a consolidated return period is disposed of or otherwise ceases to be section 38 property, or becomes public utility property, with respect to any corporation during any taxable year (whether consolidated or separate), the provisions of section 47(a) (1) or (2), as the case may be, shall apply (whether such property was placed in service by such corporation or was received by such corporation in an intercompany transaction to which subparagraph (2)(i) of this paragraph applied) and the increase in tax, if any, shall be added to the tax liability of such group or such corporation, as the case may be.

(ii) If property placed in service in a separate return year is disposed of or ceases to be section 38 property, or becomes public utility property, with respect to any corporation during a taxable year for which such corporation joins in the filing of a consolidated return, the provisions of section 47(a) (1) or (2), as the case may be, shall apply and the increase in tax, if any, shall be added to the tax liability of such group.

(2) *Exceptions.* (i) For purposes of sections 46(c) and 47(a)(1), a transfer of section 38 property from one member of an affiliated group to another member of such group in an intercompany transaction during a consolidated return period shall not be treated as a disposition or cessation. The preceding sentence shall not apply to a transfer of section 38 property unless such property was placed in service by a member of the group in a consolidated return period of such group.

(ii) If, in any taxable year, section 38 property placed in service during a consolidated return period is disposed of by one member of an affiliated group to another member of such group which is an organization to which section 593 applies or a cooperative organization described in section 1381(a), the tax under chapter 1 of the Code for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would result solely from treating such property, for purposes of determining qualified investment, as placed in service by such organization to which section 593 applies or such cooperative organization described in section 1381(a), as the case may be, but with due regard to the use of the property before such transfer. The consolidated investment credit carrybacks and carryovers shall be adjusted under the principles of section 47(a)(3) by reason of such change in use.

(Secs. 1502 and 7805 of the Internal Revenue Code of 1954; 68A Stat. 367, 917; 26 U.S.C. 1502 and 7805)

[F.R. Doc. 66-9813; Filed, Sept. 7, 1966; 8:45 a.m.]