

(b)(1)(ii), (b)(3)(ii)(C)(I), (b)(3)(iii)(A), and (b)(5)(ii), *Example 4*, paragraphs (a), (b), and (c) of this section, see § 1.1502-32T(b)(3)(ii)(C)(I), (b)(3)(iii)(A), and (b)(5)(ii), *Example 4*, paragraphs (a), (b), and (c) as contained in 26 CFR part 1 revised as of April 1, 2004.

(8) *Determination of stock basis in reorganization with boot.* Paragraph (b)(5)(ii) *Example 6* of this section applies only with respect to determinations of the basis of the stock of a subsidiary on or after January 23, 2006. For determinations of the basis of the stock of a subsidiary before January 23, 2006, see § 1.1502-32(b)(5)(ii) *Example 6* as contained in the 26 CFR part 1 edition revised as of April 1, 2005.

(9) *Allocations of investment adjustments, including adjustments attributable to certain loss transfers; certain conforming amendments.* Paragraphs (a)(2), (b)(3)(ii)(C)(2), (c)(1), (c)(2)(i), (c)(2)(ii)(A), (c)(3), and (c)(4)(i) of this section are applicable for determinations of the basis of stock of a subsidiary on or after September 17, 2008.

(i) [Reserved]. For further guidance, see § 1.1502-32T(i) through (j)(1).

(j) *Effective/applicability date.* Paragraph (b)(4)(iv) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see § 1.1502-32T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see § 1.1502-32 as contained in 26 CFR part 1 in effect on April 1, 2006.

(k) [Reserved]. For further guidance, see § 1.1502-32T(k).

[T.D. 8560, 59 FR 41685, Aug. 15, 1994]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1.1502-32, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and on GPO Access.

### § 1.1502-33 Earnings and profits.

(a) *In general*—(1) *Purpose.* This section provides rules for adjusting the earnings and profits of a subsidiary (S) and any member (P) owning S's stock. These rules modify the determination

of P's earnings and profits under applicable rules of law, including section 312, by adjusting P's earnings and profits to reflect S's earnings and profits for the period that S is a member of the consolidated group. The purpose for modifying the determination of earnings and profits is to treat P and S as a single entity by reflecting the earnings and profits of lower-tier members in the earnings and profits of higher-tier members and consolidating the group's earnings and profits in the common parent. References in this section to earnings and profits include deficits in earnings and profits.

(2) *Application of other rules of law, duplicative adjustments.* See § 1.1502-80(a) regarding the general applicability of other rules of law and a limitation on duplicative adjustments. The rules of this section are in addition to other rules of law. For example, the allowance for depreciation is determined in accordance with section 312(k). P's earnings and profits must not be adjusted under this section and other rules of law in a manner that has the effect of duplicating an adjustment. For example, if S's earnings and profits are reflected in P's earnings and profits under paragraph (b) of this section, and S transfers its assets to P in a liquidation to which section 332 applies, S's earnings and profits that P succeeds to under section 381 must be adjusted to prevent duplication.

(b) *Tiering up earnings and profits*—(1) *General rule.* P's earnings and profits are adjusted under this section to reflect changes in S's earnings and profits in accordance with the applicable principles of § 1.1502-32, consistently applied, and an adjustment to P's earnings and profits for a tax year under this paragraph (b)(1) is treated as earnings and profits of P for the tax year in which the adjustment arises. Under these principles, for example, the adjustments are made as of the close of each consolidated return year, and as of any other time if a determination at that time is necessary to determine the earnings and profits of any person. Similarly, S's earnings and profits are allocated under the principles of § 1.1502-32(c), and the adjustments are applied in the order of the tiers, from

the lowest to the highest. However, modifications to the principles include:

(i) The amount of P's adjustment is determined by reference to S's earnings and profits, rather than S's taxable and tax-exempt items (and therefore, for example, the deferral of a negative adjustment for S's unabsorbed losses does not apply).

(ii) The tax sharing rules under paragraph (d) of this section apply rather than those of § 1.1502-32(b)(3)(iv)(D).

(2) *Affiliated earnings and profits.* The reduction in S's earnings and profits under section 312 from a distribution of earnings and profits accumulated in separate return years of S that are not separate return limitation years does not tier up to P's earnings and profits. Thus, the increase in P's earnings and profits under section 312 from receipt of the distribution is not offset by a corresponding reduction.

(3) *Examples*—(i) *In general.* For purposes of the examples in this section, unless otherwise stated, P owns all of the only class of S's stock, the stock is owned for the entire year, S owns no stock of lower-tier members, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, preferred stock is described in section 1504(a)(4), all transactions are between unrelated persons, and tax liabilities are disregarded.

(ii) *Tiering up earnings and profits.* The principles of this paragraph (b) are illustrated by the following examples.

*Example 1. Tier-up and distribution of earnings and profits.* (a) *Facts.* P forms S in Year 1 with a \$100 contribution. S has \$100 of earnings and profits for Year 1 and no earnings and profits for Year 2. During Year 2, S declares and distributes a \$50 dividend to P.

(b) *Analysis.* Under paragraph (b)(1) of this section, S's \$100 of earnings and profits for Year 1 increases P's earnings and profits for Year 1. P has no additional earnings and profits for Year 2 as a result of the \$50 distribution in Year 2, because there is a \$50 increase in P's earnings and profits as a result of the receipt of the dividend and a corresponding \$50 decrease in S's earnings and profits under section 312(a) that is reflected in P's earnings and profits under paragraph (b)(1) of this section.

(c) *Distribution of current earnings and profits.* The facts are the same as in paragraph (a) of this *Example 1*, except that S distrib-

utes the \$50 dividend at the end of Year 1 rather than during Year 2. Under paragraph (b)(1) of this section, P's earnings and profits are increased by \$100 (S's \$50 of undistributed earnings and profits, plus P's receipt of the \$50 distribution). Thus, S's earnings and profits increase by \$50 and P's earnings and profits increase by \$100.

(d) *Affiliated earnings and profits.* The facts are the same as in paragraph (a) of this *Example 1*, except that P and S do not begin filing consolidated returns until Year 2. Because P and S file separate returns for Year 1, P's basis in S's stock remains \$100 under § 1.1502-32 and this section, S has \$100 of earnings and profits, and none of S's earnings and profits is reflected in P's earnings and profits under paragraph (b) of this section. S's distribution in Year 2 ordinarily would reduce S's earnings and profits but not increase P's earnings and profits. (P's \$50 of earnings and profits from the dividend would be offset by S's \$50 reduction in earnings and profits that tiers up under paragraph (b) of this section.) However, under paragraph (b)(2) of this section, the negative adjustment for S's distribution to P does not apply. Thus, S's distribution reduces its earnings and profits by \$50 but increases P's earnings and profits by \$50. (If S's earnings and profits had been accumulated in a separate return limitation year, paragraph (b)(2) of this section would not apply and the distribution would reduce S's earnings and profits but not increase P's earnings and profits.)

(e) *Earnings and profits deficit.* Assume instead that after P forms S in Year 1 with a \$100 contribution, S borrows additional funds and has a \$150 deficit in earnings and profits for Year 1. The corresponding loss for tax purposes is not absorbed in Year 1, and is included in the group's consolidated net operating loss carried forward to Year 2. Under paragraph (b)(1) of this section, however, S's \$150 deficit in earnings and profits decreases P's earnings and profits for Year 1 by \$150. (Absorption of the loss in a later tax year has no effect on the earnings and profits of P and S.)

*Example 2. Section 355 distribution.* (a) *Facts.* P owns all of S's stock and S owns all of T's stock. For Year 1, T has \$100 of earnings and profits. Under paragraph (b)(1) of this section, the earnings and profits of T tier up to S and to P. S and P have no other earnings and profits for Year 1. S distributes T's stock to P at the end of Year 1 in a distribution to which section 355 applies.

(b) *Analysis.* Because S's distribution of T's stock is a distribution to which section 355 applies, the applicable principles of § 1.1502-32(b)(2)(iv) do not require P's earnings and profits to be adjusted by reason of the distribution. In addition, although S's earnings and profits may be reduced under section 312(h) as a result of the distribution, the applicable principles of § 1.1502-32(b)(3)(iii) do

not require P's earnings and profits to be adjusted to reflect this reduction in S's earnings and profits.

*Example 3. Allocating earnings and profits among shares.* P owns 80% of S's stock throughout Year 1. For Year 1, S has \$100 of earnings and profits. Under paragraph (b)(1) of this section, \$80 of S's earnings and profits is allocated to P based on P's ownership of S's stock. Accordingly, \$80 of S's earnings and profits for Year 1 is reflected in P's earnings and profits for Year 1.

(c) *Special rules.* For purposes of this section—

(1) *Stock of members.* For purposes of determining P's earnings and profits from the disposition of S's stock, P's basis in S's stock is adjusted to reflect S's earnings and profits determined under paragraph (b) of this section, rather than under §1.1502-32. For example, P's basis in S's stock is increased by positive earnings and profits and decreased by deficits in earnings and profits. Similarly, P's basis in S's stock is not reduced for distributions to which paragraph (b)(2) of this section applies (affiliated earnings and profits). P may have an excess loss account in S's stock for earnings and profits purposes (whether or not there is an excess loss account under §1.1502-32), and the excess loss account is determined, adjusted, and taken into account in accordance with the principles of §§1.1502-19 and 1.1502-32.

(2) *Intercompany transactions.* Intercompany items and corresponding items are not reflected in earnings and profits before they are taken into account under §1.1502-13. See §1.1502-13 for the applicable rules and definitions.

(3) *Example.* The principles of this paragraph (c) are illustrated by the following example.

*Example. Adjustments to stock basis.* (a) *Facts.* P forms S in Year 1 with a \$100 contribution. For Year 1, S has \$75 of taxable income and \$100 of earnings and profits. For Year 2, S has no taxable income or earnings and profits, and S declares and distributes a \$50 dividend to P. P sells all of S's stock for \$150 at the end of Year 2.

(b) *Analysis.* Under paragraph (c)(1) of this section, P's basis in S's stock for earnings and profits purposes immediately before the sale is \$150 (the \$100 initial basis, plus S's \$100 of earnings and profits for Year 1, minus the \$50 distribution of earnings and profits in Year 2). Thus, P recognizes no gain or loss

from the sale of S's stock for earnings and profits purposes.

(c) *Earnings and profits deficit.* Assume instead that S has a \$100 tax loss and earnings and profits deficit for Year 1. The tax loss is not absorbed in Year 1 and is included in the group's consolidated net operating loss carried forward to Year 2. Under paragraph (b) of this section, S's \$100 deficit in earnings and profits decreases P's earnings and profits for Year 1. Under paragraph (c) of this section, P decreases its basis in S's stock for purposes of determining earnings and profits from \$100 to \$0. (If S had borrowed an additional \$50 that it also lost in Year 1, P would have decreased its earnings and profits for Year 1 by the additional \$50, and P would have had a \$50 excess loss account in S's stock for earnings and profits purposes, which would be taken into account in determining P's earnings and profits from its sale of S's stock.)

(d) *Affiliated earnings and profits.* Assume instead that P and S do not begin filing consolidated returns until Year 2. Under paragraph (b) of this section, the negative adjustment under §1.1502-32(b) for distributions does not apply to S's distribution of earnings and profits accumulated in a separate return year that is a not separate return limitation year. Thus, P's basis in S's stock for earnings and profits purposes remains \$100, and P has \$50 of earnings and profits from the sale of S's stock.

(d) *Federal income tax liability—(1) In general—(i) Extension of tax allocations.* Section 1552 allocates the tax liability of a consolidated group among its members for purposes of determining the amounts by which their earnings and profits are reduced for taxes. Section 1552 does not reflect the absorption by one member of another member's tax attributes (e.g., losses, deductions and credits). For example, if P's \$100 of income is offset by S's \$100 of deductions, consolidated tax liability is \$0 and no amount is allocated under section 1552. However, the group may elect under this paragraph (d) to allocate additional amounts to reflect the absorption by one member of the tax attributes of another member. Permissible methods are set forth in paragraphs (d)(2) through (4) of this section, and election procedures are provided in paragraph (d)(5) of this section. Allocations under this paragraph (d) must be reflected annually on permanent records (including work papers). Any computations of separate return tax liability are subject to the principles of section 1561.

(ii) *Effect of extended tax allocations.* The amounts allocated under this paragraph (d) are treated as allocations of tax liability for purposes of §1.1552-1(b)(2). For example, if P's taxable income is offset by S's loss, and tax liability is allocated under the percentage method of paragraph (d)(3) of this section, P's earnings and profits are reduced as if its income were subject to tax, P is treated as liable to S for the amount of the tax, and corresponding adjustments are made to S's earnings and profits. If the liability of one member to another is not paid, the amount not paid generally is treated as a distribution, contribution, or both, depending on the relationship between the members.

(2) *Wait-and-see method.* The wait-and-see method under this paragraph (d)(2) is derived from Securities and Exchange Commission procedures. In the year that a member's tax attribute is absorbed, the group's consolidated tax liability is allocated in accordance with the group's method under section 1552. When, in effect, the member with the tax attribute could have absorbed the attribute on a separate return basis in a later year, a portion of the group's consolidated tax liability for the later year that is otherwise allocated to members under section 1552 is reallocated. The reallocation takes into account all consolidated return years to which this paragraph (d) applies (the computation period), and is determined by comparing the tax allocated to a member during the computation period with the member's tax liability determined as if it had filed separate returns during the computation period.

(i) *Cap on allocation under section 1552.* A member's allocation under section 1552 for a tax year may not exceed the excess, if any, of—

(A) The total of the tax liabilities of the member for the computation period (including the current year), determined as if the member had filed separate returns; over

(B) The total amount allocated to the member under section 1552 and this paragraph (d) for the computation period (except the current year).

(ii) *Reallocation of capped amounts.* To the extent that the amount allocated to a member under section 1552 exceeds

the limitation under paragraph (d)(2)(i) of this section, the excess is allocated among the remaining members in proportion to (but not to exceed the amount of) each member's excess, if any, of—

(A) The total of the tax liabilities of the member for the computation period (including the current year), determined as if the member had filed separate returns; over

(B) The total amount allocated to the member under section 1552 and this paragraph (d) for the computation period (including for the current year only the amount allocated under section 1552).

(iii) *Reallocation of excess capped amounts.* If the reductions under paragraph (d)(2)(i) of this section exceed the amounts allocable under paragraph (d)(2)(ii) of this section, the excess is allocated among the members in accordance with the group's method under section 1552 without taking this paragraph (d)(2) into account.

(3) *Percentage method.* The percentage method under this paragraph (d)(3) allocates tax liability based on the absorption of tax attributes, without taking into account the ability of any member to subsequently absorb its own tax attributes. The allocation under this method is in addition to the allocation under section 1552.

(i) *Decreased earnings and profits.* A member's allocation under section 1552 for any year is increased, thereby decreasing its earnings and profits, by a fixed percentage (not to exceed 100%) of the excess, if any, of—

(A) The member's separate return tax liability for the consolidated return year as determined under §1.1552-1(a)(2)(ii); over

(B) The amount allocated to the member under section 1552.

(ii) *Increased earnings and profits.* An amount equal to the total decrease in earnings and profits under paragraph (d)(3)(i) of this section (including amounts allocated as a result of a carryback) increases the earnings and profits of the members whose attributes are absorbed, and is allocated among them in a manner that reasonably reflects the absorption of the tax attributes.

(4) *Additional methods.* The absorption by one member of the tax attributes of another member may be reflected under any other method approved in writing by the Commissioner.

(5) *Election of allocation method—(i) In general.* Tax liability may be allocated under this paragraph (d) only if an election is filed with the group's first return. The election must—

(A) Be made in a separate statement entitled "ELECTION TO ALLOCATE TAX LIABILITY UNDER § 1.1502-33(d)";

(B) State the allocation method elected under § 1.1502-33(d) and under section 1552;

(C) If the percentage method is elected, state the percentage (not to exceed 100%) to be used; and

(D) If a method is permitted under paragraph (d)(4) of this section, provide the date and control number of the private letter ruling issued by the Internal Revenue Service approving such method.

(ii) *Consent—(A) Electing or changing methods.* An election for a later year, or an election to change methods, may be made only with the written consent of the Commissioner.

(B) *Prior law elections.* An election in effect for the last tax year beginning before January 1, 1995, remains in effect under this section. However, a group may elect to conform its earnings and profits computations to the method described in § 1.1502-32(b)(3)(iv)(D) (the percentage method, using a 100% allocation), whether or not it has previously made an election for earnings and profits purposes. If a conforming election is made, the group must make all adjustments necessary to prevent amounts from being duplicated or omitted. The conforming election is made by attaching a statement entitled "ELECTION TO CONFORM TAX ALLOCATIONS UNDER §§ 1.1502-32 and 1.1502-33(d)" to the consolidated group's return for its first tax year beginning on or after January 1, 1995. The statement must be signed by the common parent, and must specify whether the method is conformed only for years beginning on or after January 1, 1995 or as if the method were in effect for all prior years. The statement must also describe the adjustments made by rea-

son of the change (e.g., to reflect prior use of earnings and profits).

(6) *Examples.* The principles of this paragraph (d) are illustrated by the following examples.

*Example 1. Wait-and-see method.* (a) *Facts.* P owns all of the stock of S1 and S2. The P group uses the wait-and-see method of allocation under paragraph (d)(2) of this section in conjunction with § 1.1552-1(a)(1). For Year 1, each member's taxable income, both for purposes of § 1.1552-1(a)(1) and redetermined as if the member had filed separate returns, is as follows: P \$0, S1 \$2,000, and S2 (\$1,000). Thus, the P group's consolidated tax liability for Year 1 is \$340 (assuming a 34% tax rate).

(b) *Analysis.* Under § 1.1552-1(a)(1)(i), the tax liability of the P group is allocated among the members in accordance with the portion of the consolidated taxable income attributable to each member having taxable income. Thus, all of the P group's \$340 consolidated tax liability is allocated to S1. As a result, S1 decreases its earnings and profits under section 1552 by \$340 (even if S1 does not pay the tax liability). No further allocations are made under paragraph (d)(2) of this section because S2 cannot yet absorb its loss on a separate return basis.

(c) *Payment of tax liability.* If S1 pays the \$340 tax liability, there is no further effect on the income, earnings and profits, or stock basis of any member. If P pays the \$340 tax liability (and the payment is not a loan from P to S1), P is treated as making a \$340 contribution to the capital of S1; if S2 pays the \$340 tax liability (and the payment is not a loan from S2 to S1), S2 is treated as making a \$340 distribution to P with respect to its stock, and P is treated as making a \$340 contribution to the capital of S1. See § 1.1552-1(b)(2).

(d) *Year 2.* For Year 2, each member's taxable income, under § 1.1552-1(a)(1)(ii) and redetermined as if the member had filed separate returns, without taking into account any carryover from Year 1, is as follows: P \$0, S1 \$1,000, and S2 \$3,000. Thus, the P group's consolidated tax liability for Year 2 is \$1,360 (assuming a 34% tax rate). Of this amount, section 1552 would allocate \$340 to S1 and \$1,020 to S2. However, under paragraph (d)(2)(i) of this section, no more than \$680 may be allocated to S2. This is because S2 would have had an aggregate tax liability of \$680 if it had filed separate returns for Years 1 and 2 (a \$0 tax liability for Year 1, and a \$680 tax liability for Year 2, taking into account a \$1,000 net operating loss carryover from Year 1). Under paragraph (d)(2)(ii) of this section, the entire excess of \$340 which would otherwise be allocated to S2 under § 1.1552-1(a)(1) is allocated to S1. This is because S1 would have had an additional \$340 of aggregate tax liability if it had

filed separate returns for Years 1 and 2 (a \$680 tax liability for Year 1, and a \$340 tax liability for Year 2, not taking into account S2's \$1,000 net operating loss for Year 1). The effect of the allocation of \$680 to S1 and \$680 to S2 is determined under § 1.1552-1(b)(2).

*Example 2. Percentage method.* (a) *Facts.* The facts are the same as in *Example 1*, but the P group uses the percentage method of allocation under paragraph (d)(3) of this section, with a percentage of 100%. In addition, the taxable incomes and losses of the members are the same if computed as provided in § 1.1552-1(a)(2)(ii).

(b) *Analysis.* Under § 1.1552-1(a)(2)(ii), \$340 of tax liability is allocated to S1 for Year 1. Under paragraph (d)(3)(i) of this section, S1 is allocated another \$340 of tax liability because S1 would have had a \$680 tax liability if it had filed separate returns but only \$340 is allocated to S1 under section 1552. Thus, S1's earnings and profits are decreased by the \$680 total. Under paragraph (d)(3)(ii) of this section, S2's earnings and profits are increased by \$340 because the additional \$340 allocated to S1 under paragraph (d)(3)(i) of this section is attributable to the absorption of S2's losses.

(c) *Payment of tax liability.* If S1 pays the \$340 tax liability of the P group and pays \$340 to S2, the Year 1 tax liability results in no further adjustments to the income, earnings and profits, or basis of any member's stock. If S1 pays the \$340 tax liability of the P group and pays the other \$340 to P instead of S2 because, for example, of an agreement among the members, S2 is treated as distributing \$340 to P with respect to its stock in the year that S1 makes the payment to P. See § 1.1552-1(b)(2).

(d) *Year 2.* For Year 2, \$340 is allocated to S1 and \$1,020 is allocated to S2 under section 1552. No additional amounts are allocated under paragraph (d)(3) of this section.

(e) *Deconsolidations—(1) In general.* Immediately before it becomes a nonmember, S's earnings and profits are eliminated to the extent they were taken into account by any member under this section. If S's earnings and profits are eliminated under this paragraph (e)(1), no corresponding adjustment is made to the earnings and profits of P (or any other member) under paragraph (b) of this section or to any basis in a member's stock under paragraph (c) of this section. For this purpose, S is treated as becoming a nonmember on the first day of its first separate return year (including another group's consolidated return year).

(2) *Acquisition of group—(1) Application.* This paragraph (e)(2) applies only if a consolidated group (the termi-

nating group) ceases to exist as a result of—

(A) The acquisition of either the assets of the common parent of the terminating group in a reorganization described in section 381(a)(2), or the stock of the common parent of the terminating group; or

(B) The application of the principles of § 1.1502-75(d)(2) or (d)(3).

(ii) *General rule.* Paragraph (e)(1) of this section does not apply solely by reason of the termination of a group because it is acquired, if there is a surviving group that is, immediately thereafter, a consolidated group. Instead, the surviving group is treated as the terminating group for purposes of applying this paragraph (e) to the terminating group. This treatment does not apply, however, to members of the terminating group that are not members of the surviving consolidated group immediately after the terminating group ceases to exist (e.g., under section 1504(a)(3) relating to reconsolidation, or section 1504(c) relating to includible insurance companies).

(3) *Certain corporate separations and reorganizations.* The adjustments under paragraph (e)(1) of this section must be modified to the extent necessary to effectuate the principles of section 312(h). Thus, P's earnings and profits rather than S's earnings and profits may be eliminated immediately before S becomes a nonmember. P's earnings and profits are eliminated to the extent that its earnings and profits reflect S's earnings and profits after applying section 312(h) immediately after S becomes a nonmember (determined without taking this paragraph (e) into account).

(4) *Special uses of earnings and profits.* Paragraph (e)(1) of this section does not apply for purposes of determining—

(i) The extent to which a distribution is charged to reserve accounts under section 593(e);

(ii) The extent to which a distribution is taxable to the recipient under sections 805(a)(4) and 832; and

(iii) Any other special use identified in guidance published in the Internal Revenue Bulletin.

(5) *Example.* The principles of this paragraph (e) are illustrated by the following example.

*Example. (a) Facts.* Individuals A and B own all of P's stock, and P owns all of the stock of S and T, each with a \$500 basis. For Year 1, S has \$100 of earnings and profits and T has \$50 of earnings and profits. Under paragraph (b)(1) of this section, the earnings and profits of S and T tier up to P, and P has \$150 of earnings and profits for Year 1. P sells all of S's stock for \$600 at the close of Year 1.

(b) *Analysis.* Under paragraph (e)(1) of this section, S's \$100 of earnings and profits is eliminated immediately before S becomes a nonmember because the earnings and profits are taken into account under paragraph (b) of this section in P's earnings and profits. However, no corresponding adjustment is made to P's earnings and profits or to P's basis in S's stock for purposes of earnings and profits. P's earnings and profits for Year 1 remain \$150 following the sale of S's stock.

(c) *Forward merger.* The facts are the same as in paragraph (a) of this *Example*, except that, rather than P selling S's stock, S merges into a nonmember in a transaction described in section 368(a)(2)(D). Under paragraph (h) of this section, the nonmember is treated as a successor to S. Thus, as in paragraph (b) of this *Example*, S's \$100 of earnings and profits is eliminated immediately before S ceases to be a member.

(d) *Acquisition of entire group.* The facts are the same as in paragraph (a) of this *Example*, except that X, the common parent of another consolidated group, purchases all of P's stock at the close of Year 1, and P sells S's stock during Year 3. Under paragraph (e)(2) of this section, the earnings and profits of S and T are not eliminated as a result of X purchasing P's stock. However, S's earnings and profits from consolidated return years of both the P group and the X group are eliminated immediately before S becomes a nonmember of the X group.

(e) *Earnings and profits deficit.* The facts are the same as in paragraph (d) of this *Example*, except that S has a \$550 deficit in earnings and profits for Year 1. The effect of paragraph (e)(1) of this section is the same. Under paragraph (c)(1) of this section, P would have an excess loss account in S's stock for earnings and profits purposes under the principles of §§ 1.1502-19 and 1.1502-32, and, under the principles of § 1.1502-19(c)(2), the excess loss account is not taken into account as a result of X's purchase of P's stock. Under paragraph (e)(2) of this section, S's deficit is not eliminated under paragraph (e)(1) of this section immediately before X's purchase of P's stock. However, S's earnings and profits (or deficit) is eliminated immediately before S becomes a nonmember of the X group.

(f) *Section 355 distribution.* The facts are the same as in paragraph (a) of this *Example*, except that, rather than selling S's stock, P distributes S's stock to A at the close of Year 1 in a distribution to which section 355 applies. Under paragraph (e)(3) of this sec-

tion, P's earnings and profits may be reduced under section 312(h) as a result of the distribution. To the extent that P's earnings and profits are reduced, S's earnings and profits are not eliminated under paragraph (e)(1) of this section.

(f) *Changes in the structure of the group—(1) Changes in the common parent—(i) General rule.* If P succeeds another corporation under the principles of § 1.1502-75(d) (2) or (3) as the common parent of a consolidated group (a group structure change), the earnings and profits of P are adjusted immediately after P becomes the new common parent to reflect the earnings and profits of the former common parent immediately before the former common parent ceases to be the common parent. The adjustment is made as if P succeeds to the earnings and profits of the former common parent in a transaction described in section 381(a). See § 1.1502-31 for the basis of the stock of members following a group structure change.

(ii) *Minority shareholders.* If the former common parent's stock is not wholly owned by members of the consolidated group immediately after the former common parent ceases to be the common parent, appropriate adjustments must be made to reflect in the new common parent only an allocable part of the former common parent's earnings and profits.

(iii) *Higher-tier members.* To the extent that earnings and profits are adjusted under this paragraph (f)(1), and the former common parent is owned by members other than P, the earnings and profits of the intermediate subsidiaries must be adjusted in accordance with the principles of this section.

(iv) *Example.* The principles of this paragraph (f)(1) are illustrated by the following example.

*Example. (a) Facts.* X is the common parent of a consolidated group with \$100 of earnings and profits, and P is the common parent of another consolidated group with \$20 of earnings and profits. P acquires all of X's stock at the close of Year 1 in exchange for 70% of P's stock. The exchange is a reverse acquisition under § 1.1502-75(d)(3), and the X group is treated as remaining in existence with P as its new common parent.

(b) *Adjustments for X group earnings and profits.* Under paragraph (f)(1) of this section, P's earnings and profits are adjusted immediately after P becomes the new common parent, to reflect X's \$100 of earnings and

profits immediately before X ceases to be the common parent. The adjustment is made as if P succeeds to X's earnings and profits in a transaction described in section 381(a). Thus, immediately after the acquisition, P has \$120 of accumulated earnings and profits and X continues to have \$100 of accumulated earnings and profits.

(c) *Adjustments for P group earnings and profits.* Although the P group terminates on P's acquisition of X's stock, under paragraph (e)(2) of this section, no adjustments are made to the earnings and profits of any subsidiaries in the terminating P group.

(d) *Acquisition of separate return corporation.* The facts are the same as in paragraph (a) of this *Example*, except that, immediately before the acquisition of its stock by P, X is not affiliated with any other corporation. The exchange is a reverse acquisition under §1.1502-75(d)(3), and P is treated as the common parent of the X group. Consequently, the results are the same as in paragraphs (b) and (c) of this *Example*.

(2) *Change in the location of subsidiaries.* If the location of a member within a group changes, appropriate adjustments must be made to the earnings and profits of the members to prevent the earnings and profits from being eliminated. For example, if P transfers all of S's stock to another member in a transaction to which section 351 and §1.1502-13 apply, the transferee's earnings and profits are adjusted immediately after the transfer to reflect S's earnings and profits immediately before the transfer from consolidated return years. On the other hand, if the transferee purchases S's stock from P, the transferee's earnings and profits are not adjusted.

(g) *Anti-avoidance rule.* If any person acts with a principal purpose contrary to the purposes of this section, to avoid the effect of the rules of this section or apply the rules of this section to avoid the effect of any other provision of the consolidated return regulations, adjustments must be made as necessary to carry out the purposes of this section.

(h) *Predecessors and successors.* For purposes of this section, any reference to a corporation or to a share includes a reference to a successor or predecessor as the context may require. A corporation is a successor if its earnings and profits are determined, directly or indirectly, in whole or in part, by reference to the earnings and

profits of another corporation (the predecessor). A share is a successor if its basis is determined, directly or indirectly, in whole or in part, by reference to the basis of another share (the predecessor).

(i) [Reserved]

(j) *Effective/applicability date—(1) General rule.* This section applies with respect to determinations of the earnings and profits of a member (e.g., for purposes of a characterizing a distribution to which section 301 applies) in consolidated return years beginning on or after January 1, 1995. If this section applies, earnings and profits must be determined or redetermined as if this section were in effect for all years (including, for example, the consolidated return years of another consolidated group to the extent the earnings and profits from those years are still reflected). For example, if a distribution by P to a nonmember shareholder in 1990 was a dividend because of an unabsorbed loss carryover attributable to S, P's earnings and profits in tax years beginning after January 1, 1995 are redetermined by taking into account a negative adjustment in the tax year S's loss arose and in 1990 for P's distribution, and any subsequent absorption of the loss has no effect on earnings and profits. Any such determination or redetermination does not, however, affect any prior period. Thus, the shareholder's treatment in 1990 of the distribution as a dividend (and the effect of the distribution on stock basis) is not redetermined under this section. Paragraphs (a)(2) and (e)(2)(i)(A) of this section apply with respect to determinations of the earnings and profits of a member in consolidated return years beginning on or after September 17, 2008. However, taxpayers may apply paragraph (e)(2)(i)(A) of this section with respect to determinations of the earnings and profits of a member in consolidated return years beginning prior to September 17, 2008.

(2) *Dispositions of stock before effective date—(i) In general.* If P disposes of stock of S in a consolidated return year beginning before January 1, 1995, the amount of P's earnings and profits with respect to S are not redetermined under paragraph (j)(1) of this section.



## § 1.1502-33

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See § 1.1502-19 as contained in the 26 CFR part 1 edition revised as of April 1, 1994 for the definition of disposition, and paragraph (j)(5) of this section for the rules applicable to such dispositions.

(ii) *Lower-tier members.* Although P disposes of S's stock in a tax year beginning before January 1, 1995, S's determinations or adjustments with respect to lower-tier members with which it continues to file a consolidated return are redetermined in accordance with the rules of this section (even if S's earnings and profits were previously taken into account by P). For example, assume that P owns all of S's stock, S owns all of T's stock, and T owns all of U's stock. If S sells 80% of T's stock in a tax year beginning before January 1, 1995 (the effective date), the amount of S's earnings and profits from the sale, and the adjustments to stock basis for earnings and profits purposes that are reflected in that amount, are not redetermined if P sells S's stock after the effective date. If S sells the remaining 20% of T's stock after the effective date, S's stock basis adjustments with respect to that T stock are also not redetermined because T became a nonmember before the effective date. However, if T and U continue to file a consolidated return with each other, paragraph (e)(1) of this section did not apply, and T sells U's stock after the effective date, T's earnings and profits with respect to U are redetermined (even though some of the earnings and profits may have been taken into account by S in its prior sale of T's stock before the effective date).

(iii) *Deferred amounts.* For purposes of this paragraph (j)(2), a disposition does not include a transaction to which § 1.1502-13, § 1.1502-13T, § 1.1502-14, or § 1.1502-14T applies. Instead, the transaction is deemed to occur as the earnings and profits (if any) are taken into account.

(3) *Deconsolidations and group structure changes—(i) In general.* Paragraphs (e) and (f) of this section apply with respect to deconsolidations and group

structure changes occurring in consolidated return years beginning on or after January 1, 1995.

(ii) *Prior period group structure changes.* If there was a group structure change in a consolidated return year beginning before January 1, 1995, and earnings and profits were not determined under § 1.1502-33T(a) as contained in the 26 CFR part 1 edition revised as of April 1, 1994, a distribution in a tax year ending after September 7, 1988, of earnings and profits that are not reflected in the earnings and profits of the distributee member, but would have been so reflected if § 1.1502-33T(a) as contained in the 26 CFR part 1 edition revised as of April 1, 1994 had applied, the negative adjustment under paragraph (b) of this section for distributions does not apply (and there is therefore no offset to the increase in the earnings and profits of the distributee).

(4) *Deemed dividend elections.* If there is a deemed distribution and recontribution pursuant to § 1.1502-32(f)(2) as contained in the 26 CFR part 1 edition revised as of April 1, 1994 in a consolidated return year beginning before January 1, 1995, the deemed distribution and recontribution under the election are treated as an actual distribution by S and recontribution by P as provided under the election.

(5) *Prior law.* For prior determinations, see prior regulations under section 1502 as in effect with respect to the determination. See, e.g., §§ 1.1502-33 and 1.1502-33T as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

(k) *Effective/applicability date.* Paragraph (d)(5)(i)(D) of this section applies to any original consolidated Federal income tax return due (without extensions) after June 14, 2007. For original consolidated Federal income tax returns due (without extensions) after May 30, 2006, and on or before June 14, 2007, see § 1.1502-33T as contained in 26 CFR part 1 in effect on April 1, 2007. For original consolidated Federal income tax returns due (without extensions) on or before May 30, 2006, see

§ 1.1502-33 as contained in 26 CFR part 1 in effect on April 1, 2006.

[T.D. 8560, 59 FR 41695, Aug. 15, 1994, as amended by T.D. 8597, 60 FR 36710, July 18, 1995; T.D. 9264, 71 FR 30603, May 30, 2006; T.D. 9329, 72 FR 32805, June 14, 2007; T.D. 9424, 73 FR 53951, Sept. 17, 2008; 73 FR 62204, Oct. 20, 2008]

**§ 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 a 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), 732(f), 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.

[T.D. 6894, 31 FR 11794, Sept. 8, 1966, as amended by T.D. 8949, 66 FR 32902, June 19, 2001]

**§ 1.1502-35 Transfers of subsidiary stock and deconsolidations of subsidiaries.**

(a) *In general*—(1) *Purpose*. The purpose of this section is to prevent a group from obtaining more than one tax benefit from a single economic loss. The provisions of this section shall be construed in a manner that is consistent with that purpose and in a manner that reasonably carries out that purpose.

(2) *Dates of applicability*. This section applies if—

(i) On or after March 7, 2002, a member recognizes a loss on the disposition of a share of stock of a subsidiary (or, on or after April 10, 2007, a share of stock of a former subsidiary) or a carryover basis asset (subject to paragraph (c)(6) of this section),

(ii) The member’s loss on the share of subsidiary stock or the carryover basis asset is allowed on or before the date that is ten years after the disposition of the share or carryover basis asset, and

(iii) If the disposition is of a share of subsidiary stock, it is not a transfer to which § 1.1502-36 applies.

(b) *Redetermination of basis on certain nondeconsolidating transfers of subsidiary stock and on certain deconsolidations of subsidiaries*—(1) *Redetermination of basis on certain nondeconsolidating transfers of subsidiary stock*. Except as provided in paragraph (b)(3)(i) of this section, if, immediately after a transfer of stock of a subsidiary that has a basis that exceeds its value, the subsidiary remains a member of the group, then the basis in each share of subsidiary stock owned by each member of the group shall be redetermined in accordance with the provisions of this paragraph (b)(1) immediately before such transfer. All of the members’ bases in the shares of subsidiary stock immediately before such transfer shall be aggregated. Such aggregated basis shall be allocated first to the shares of the subsidiary’s preferred stock that are owned by the members of the group immediately before such transfer, in proportion to, but not in excess of, the value of those shares at such time. After allocation of the aggregated basis to all shares of the preferred stock of the subsidiary pursuant to the preceding sentence, any remaining basis shall be allocated among all common shares of subsidiary stock held by members of the group immediately before the transfer, in proportion to the value of such shares at such time.

(2) *Redetermination of basis on certain deconsolidations of subsidiaries*—(i) *Allocation of reallocable basis amount*. Except as provided in paragraph (b)(3)(ii) of this section, if, immediately before a deconsolidation of a subsidiary, any share of stock of such subsidiary owned by a member of the group has a basis that exceeds its value, then the basis in each share of the subsidiary’s stock owned by each member of the group shall be redetermined in accordance with the provisions of this paragraph (b)(2) immediately before such