



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

December 7, 1998

CC:DOM:FS:CORP
TL-N-4916-98

UILC: 1.1502.13-00
1.1502.20-00

Number: 199911007
Release Date: 3/19/1999

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Deborah A. Butler
Assistant Chief Counsel CC:DOM:FS

SUBJECT: 1.1502-13 & -20 Loss Recognition and Disallowance

This Field Service Advice responds to your memorandum dated September 3, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

B =

S =

X =

Date 1 =

Date 2 =

\$ b =

\$ c =

\$ d =

b

ISSUE 1

Whether Treas. Reg. § 1.1502-13(f)(2)(iii) provides S with a recognized loss on S's intercompany dividend distribution of its X stock to B.

CONCLUSION 1

Treas. Reg. § 1.1502-13(f)(2)(iii) provides S with a recognized loss on S's intercompany dividend distribution of its X stock to B. However, the Treas. Reg. § 1.1502-20 loss disallowance rules apply to disallow all, or part, of this loss.¹

ISSUE 2

To what extent does Treas. Reg. § 1.1502-20 disallow the loss that S recognized on its distribution of the X stock to P?

CONCLUSION 2

Further factual development of this case is necessary to determine whether Treas. Reg. § 1.1502-20 applies to disallow all, or only part, of the loss that S recognized on its distribution of the X stock to B.

FACTS

B is the parent of a consolidated group of corporations (the "group"). This group includes B's wholly owned subsidiary S, and S's wholly owned subsidiary, X.

On Date 1, S distributed (by means of a dividend) all of its X stock to B. At the time of distribution, S's basis in the X stock was \$ b. X's fair market value at such time was \$ c, which value was less than \$b. Accordingly, S realized a loss of \$d on the distribution of the X stock to B.

On Date 2, B distributed its S stock to its shareholders in a tax free I.R.C. § 355 reorganization. B continues to retain all of the X stock.

For the b taxable year, S claimed a capital loss of \$ d on the distribution of the X stock to B. Subsequently, S claimed that its original calculation of its basis in the X stock was too low and that it thus entitled to an additional loss. The amount of additional claimed loss, and the reason for S's claiming this additional loss, was not provided to us.

ISSUE 1

¹We are assuming section 355 does not apply to the transaction.

Whether Treas. Reg. § 1.1502-13(f)(2)(iii) provides S with a recognized loss on S's intercompany dividend distribution of its X stock to B.

DISCUSSION

We agree with your conclusion that Treas. Reg. § 1.1502-13(f)(2)(iii) provides that the principles of I.R.C. § 311(b) apply to S's loss on its intercompany dividend distribution of stock. S has a recognized loss on the distribution, which S takes into account under the acceleration rules of Treas. Reg. § 1.1502-13(d) immediately before S becomes a nonmember. However, we add that the Treas. Reg. § 1.1502-20 loss disallowance rules apply to disallow all, or part, of this loss.

ISSUE 2

To what extent does Treas. Reg. § 1.1502-20 apply to disallow the loss that S recognized on its distribution of the X stock to P?

DISCUSSION

We believe that part or all of the loss that S recognized on the distribution of its stock in X is disallowed under Treas. Reg. § 1.1502-20. We are interested in the further development of this issue, and you should seek a supplemental field service advice on the Treas. Reg. § 1.1502-20 issue once you have developed the facts of this case. An overview of the Treas. Reg. § 1.1502-20 regulations is instructive.

As a general rule, Treas. Reg. § 1.1502-20(a) provides that no deduction is allowed for any loss recognized by a member with respect to the disposition of stock of a subsidiary. "Disposition" means any event in which gain or loss is recognized, in whole or in part. Treas. Reg. § 1.1502-20(a)(2). Accordingly, in the instant case, Treas. Reg. § 1.1502-20(a) applies to the loss that S recognized on the distribution of its X stock to B since this was an event in which S, a member, recognized loss with respect to the stock of its subsidiary, X.

Although the general rule under Treas. Reg. § 1.1502-20(a)(1) broadly provides that all of the loss is subject to disallowance, Treas. Reg. § 1.1502-20(c) limits the amount of loss that is disallowed under Treas. Reg. § 1.1502-20(a)(1) with respect to a share of stock to the sum of the amounts in the following three accounts: (1) income or gain (or its equivalent), net of directly related expenses, that is allocated to the share from "extraordinary gain dispositions" ("EGD"); (2) the amount of positive basis (investment) adjustments with respect to the share under Treas. Reg. § 1.1502-32 for each consolidated return year, but only to the extent such amounts exceed the EGD factor for that year ("PIA"); and (3) the amount of any duplicated

loss with respect to the share. Treas. Reg. § 1.1502-20(c). The facts suggest that the taxpayer in the instant case may have a duplicated loss amount, in addition to possible EGD or PIA amounts, that are disallowed under Treas. Reg. § 1.1502-20(c).

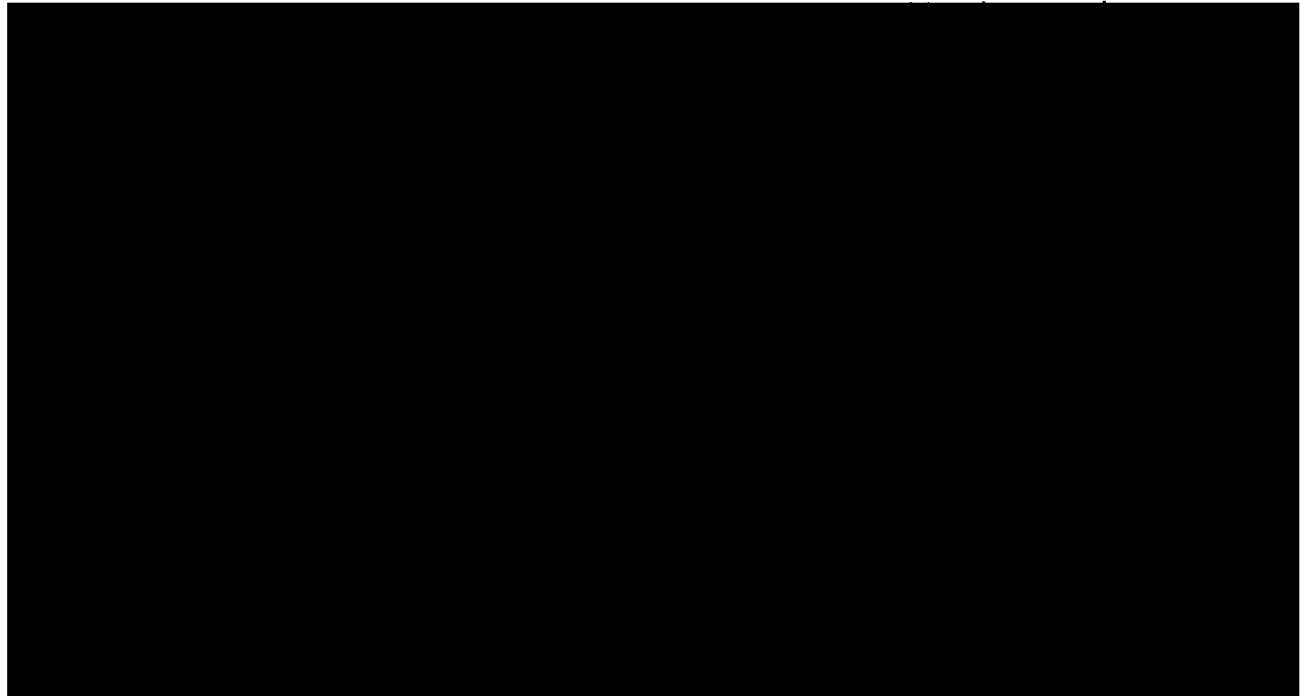
Extraordinary gains: Loss on the sale of a share of stock is disallowed to the extent of the amount of income or gain (or its equivalent), net of directly related expenses (e.g. commissions, legal fees, state income taxes), that is allocated to the share from actual or deemed gain dispositions occurring after November 18, 1990, of (1) capital assets; (2) I.R.C. § 1231(b) property (e.g., depreciable property or land used in a trade or business; (3) bulk sales of nondepreciable business assets, such as inventory, copyrights, or receivables used in the same trade or business; (4) sale of business assets described in I.R.C. § 1060(c); (5) any positive I.R.C. § 481 adjustment, including one attributable to a change in method of accounting occurring on or after November 19, 1990, but the adjustment is attributable to pre-November 19, 1990 periods (e.g., recovery of LIFO reserve; (6) income from discharge of indebtedness; and (7) any other event (or item) identified in revenue rulings and revenue procedures. Treas. Reg. § 1.1502-20(c)(2)(i). These extraordinary gain dispositions apply only to the extent that immediately before the disposition of the share, they are directly or indirectly reflected in the basis of the share. For this purpose, an amount is reflected in the basis of a share if the share's basis would have been different without the amount. However, amounts included in any loss carryover are taken into account in the year they arise rather than the year absorbed. Treas. Reg. § 1.1502-20(c)(2)(iii).

Positive investment adjustments: In calculating the maximum amount of disallowable loss, the regulations consider positive investment adjustments. A positive adjustment under Treas. Reg. § 1.1502-32 is the sum of the amounts under Treas. Reg. § 1.1502-32(b)(2)(i) through (iii) for the consolidated return year (the adjustment determined without taking distributions into account). An amount is reflected as a positive investment adjustment only to the extent that immediately before the disposition of the share, the amount is directly or indirectly reflected in the basis of the share. For this purpose, an amount is reflected in the basis of a share if the share's basis would have been different without the amount. However, amounts included in any loss carryover are taken into account in the year they arise rather than the year absorbed. Solely for tax years ending on or before September 13, 1991, a negative investment adjustment of one tax year may under certain circumstances effectively offset some or all of a positive investment adjustment of another tax year. See Treas. Reg. § 1.1502-20(c)(2)(v). However, for tax years ending after September 13, 1991, the positive investment adjustment for each tax year in which a positive adjustment exists is included in its entirety and cannot be netted with any negative investment adjustments for any other tax years.

Duplicated loss: The amount of duplicated loss apportioned to each share is essentially the portion of the loss carryforwards and net built-in losses attributed to the share. Treas. Reg. § 1.1502-20(c)(2)(vi). This amount is determined immediately after a disposition by first adding (1) the aggregate adjusted basis of the subsidiary's assets, but not the adjusted basis of its stock or securities in a group member; (2) any losses attributable to the subsidiary and carried to its first taxable year after disposition; and (3) any deferred deductions (such as passive losses under I.R.C. § 469) of the subsidiary or its lower-tier subsidiaries. No provision is made for any deferred gains. The total amount is then reduced by the sum of (1) the value of the subsidiary's stock; (2) the liabilities of the subsidiary; and (3) any other relevant items.²

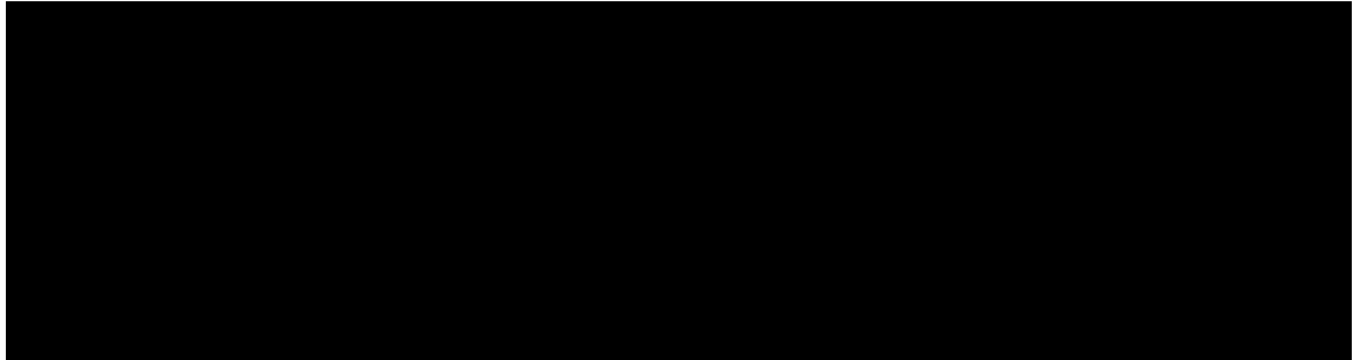
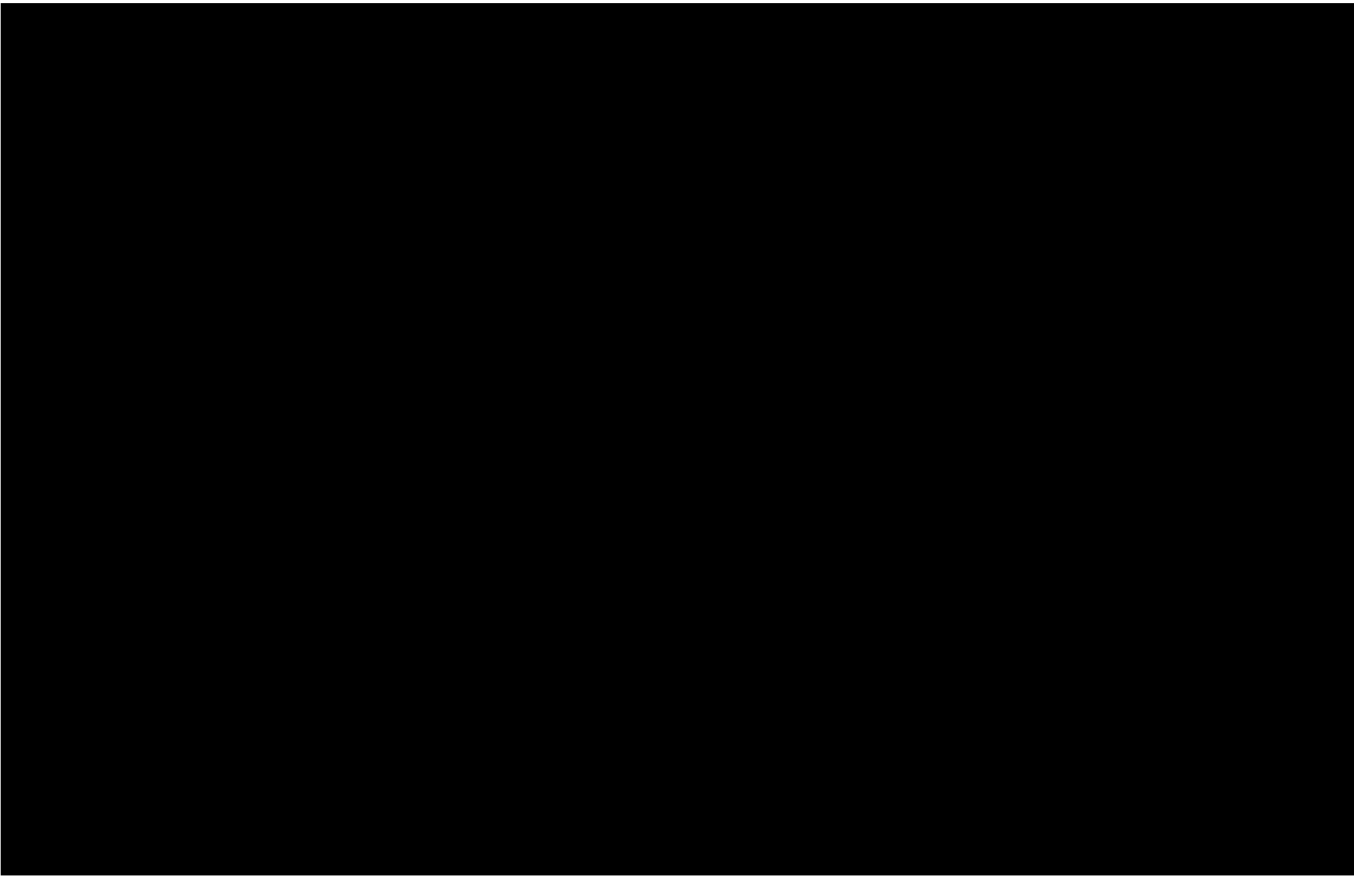
CASE DEVELOPMENT, LITIGATION HAZARDS AND OTHER CONSIDERATIONS

In order for you to calculate the maximum loss disallowance in your case, many facts have to be developed. We have provided a list of questions, the answers to which should assist you in developing the loss disallowance rules.



² Under Treas. Reg. § 1.1502-20(c)(2)(vi), the amounts determined under this paragraph with respect to a subsidiary include its allocable share of corresponding amounts with respect to all lower tier subsidiaries.

³ See footnote 2.



There are examples in the regulations under Treas. Reg. § 1.1502-20(c)(4) that illustrate the principles of paragraph (c)(1). We recommend you review these examples and get back to us if you have any questions regarding: (1) the application of the loss disallowance rules, and (2) what additional facts you may need to develop the Treas. Reg. § 1.1502-20 loss disallowance issue.

⁴We assume that X did not own a subsidiary from its inception until the date of S's distribution of the X stock. However, if X did own a subsidiary, the facts you would need to develop become more involved, and you should contact us.

If you have any further questions, please call (202)622-7930.

Deborah A. Butler
Assistant Chief Counsel

By: _____
STEVEN J. HANKIN
Acting Branch Chief
Corporate Branch
Field Service Division