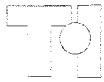


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Final Regulations Issued Concerning Consolidated Return Stock Basis Adjustments

by Robert W. Wood • San Francisco

Proposed regulations issued in November of 1992 have now been finalized under Section 1502. These reg-

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ulations revise the consolidated return investment adjustment system, including rules for earnings and profits and excess loss accounts. Although the final regulations follow many of the provisions of the proposed rules, a number of changes were made in response to comments on the proposed rules.

Negative Adjustments

Although the final regulations generally require a negative stock basis adjustment for expiring losses (as had been required under the proposed regulations), the final rules include a special provision allowing an acquiring group to waive a subsidiary's loss carryovers from separate return limitation years. In addition, the final regulations provide that if a subsidiary became a member of a group before the effective date of the final regulations and had a loss carryover from a separate return limitation year at that time, the group will not be required to treat expiration of the loss carryover as a negative adjustment under this provision.

Moreover, the final rules add other provisions to treat expired loss carryovers as continuing to exist for purposes of determining whether a positive adjustment is permitted for cancellation of indebtedness income, and whether an excess loss account must be taken into account because of the subsidiary's worthlessness.

Identification

The final rules require a consolidated group to identify the amount waived (or the amount not waived) in a statement filed with the group's consolidated return for the year a subsidiary becomes a member of the group. Although the group may waive any carryover it chooses — and indeed may waive amounts carried over from different years — the final rules do not allow groups to identify the

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under the investment adjustment rules in effect at the time of the distribution.

Anti-Avoidance Rules

Like the proposed regulations, the final regulations retain an anti-avoidance rule, although this has been ameliorated in at least some respects. Indeed, the regulations now include a few examples of avoidance techniques that do not run afoul of the anti-avoidance rule.

Other Provisions

One of the ameliorations contained in the final regulations concerns reporting of stock basis adjustments. The proposed rules had required reporting; the final regulations require taxpayers to maintain annual books and records necessary for accurate basis adjustments, but drop the reporting.

The final regulations are generally effective for determinations and transactions in tax years beginning on or after January 1, 1995. However, once the final regulations kick in, stock basis and E & P are determined and redetermined as if the regulations had always been in effect. ■

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waived amount (or the unwaived amount) through a formula. In other words, dollar amounts must be used, although the Service is requesting comments on whether formulas should be allowed.

E & P

Despite commentary that the Service should be more liberal, the final rules retain the concept from the proposed regulations that a negative stock basis adjustment must be made for all distributions. Commentators had argued that such an adjustment was inappropriate where distributions by a subsidiary were of E & P from affiliated, nonconsolidated years. However, the Service noted that the subsidiary's stock basis is not reduced as a result of a distribution of E & P accumulated in separate return years, as long as the distribution is made in a tax year beginning before January 1, 1995, and the distribution does not cause a negative adjustment

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