

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG–134420–10]

RIN 1545–BJ87

#### Revising Consolidated Return Regulations and Controlled Group of Corporations Regulations To Reflect Statutory Changes, Modernize Language, and Enhance Clarity

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations that affect affiliated groups of corporations that file consolidated Federal income tax returns. These regulations would modify the consolidated return regulations to clarify that, in the case of certain transfers between members of a consolidated group, a transferee's assumption of certain liabilities will not reduce the transferor's basis in the transferee's stock received in the transfer. Final regulations modifying other consolidated return regulations are published in the Rules section of this issue of the **Federal Register**.

**DATES:** Written or electronic comments as well as requests for a public hearing must be received by March 31, 2025. Requests for a public hearing must be submitted as prescribed in the "Comments and Requests for a Public Hearing" section.

**ADDRESSES:** Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at <http://www.regulations.gov> (indicate IRS and REG–134420–10). Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (Treasury Department) and the IRS will publish for public availability any comment

submitted electronically or on paper to its public docket.

*Send paper submissions to:* CC:PA:01:PR (REG–134420–10), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

#### FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, contact William W. Burhop at (202) 317–5363 or Kelton P. Frye at (202) 317–5135 (not toll-free numbers); concerning the submission of comments and/or requests for a public hearing, contact the Publications and Regulations Section of the Office of Associate Chief Counsel (Procedure and Administration) by email at [publichearings@irs.gov](mailto:publichearings@irs.gov) (preferred) or by phone at (202) 317–5306 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### Authority

Section 1502 authorizes the Secretary of the Treasury or her delegate (Secretary) to prescribe consolidated return regulations for an affiliated group of corporations that join in filing (or that are required to join in filing) a consolidated return (consolidated group) to clearly reflect the Federal income tax liability of the consolidated group and to prevent avoidance of such tax liability. *See* § 1.1502–1(h) (defining the term "consolidated group"). For purposes of carrying out those objectives, section 1502 also permits the Secretary to prescribe rules that may be different from the provisions of chapter 1 of the Code (chapter 1) that would apply if the corporations composing the consolidated group filed separate returns. Additionally, section 7805(a) of the Code authorizes the Secretary to "prescribe all needful rules and regulations for the enforcement of [the Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."

##### Background

This notice of proposed rulemaking contains proposed regulations under section 1502 of the Internal Revenue Code (Code) that would revise the Income Tax Regulations (26 CFR part 1) issued under section 1502 (consolidated return regulations). Terms used in the consolidated return regulations generally are defined in § 1.1502–1.

#### I. Section 357(c) and § 1.1502–80(d)

Section 1.1502–80 provides generally that: (i) the Code, or other law, is applicable to a consolidated group to the extent the consolidated return regulations do not exclude its application; and (ii) to the extent not excluded, other rules operate in addition to, and may be modified by, the consolidated return regulations. *See* § 1.1502–80(a)(1). Section 1.1502–80(d) provides that section 357(c) of the Code does not apply to any transaction to which § 1.1502–13 and other specified sections of the consolidated return regulations apply.

As discussed in the preamble to proposed regulations (REG–137519–01) published in the **Federal Register** (66 FR 57021, 57022) on November 14, 2001 (proposed consolidated section 357(c) regulations), because section 357(c) does not apply to certain intragroup section 351 exchanges (that is, exchanges between members of a consolidated group to which section 351 of the Code applies) under § 1.1502–80(d), a concern arose that no liabilities can technically be excluded under section 357(c)(3). Therefore, in such an intragroup section 351 exchange, the transferor's basis in the stock of the transferee received in the transfer first would be reduced by liabilities assumed by the transferee, including those liabilities described in section 357(c)(3) that would not have reduced basis had section 357(c) applied. The transferor's basis in the stock of the transferee then would be reduced a second time under the principles of § 1.1502–32 at the time the liability does in fact give rise to a deduction on the part of the transferee and is taken into account on the consolidated return. This result ultimately could cause the transferor to recognize an amount of gain on the sale of the stock of the transferee that does not clearly reflect income.

The Treasury Department and the IRS published the proposed consolidated section 357(c) regulations to eliminate potential duplicative stock basis reductions arising from such transactions. As discussed in the preamble to the proposed consolidated section 357(c) regulations, those proposed regulations were published to clarify that, in certain transfers described in section 351 of the Code between members of a consolidated group, a transferee's assumption of

liabilities described in section 357(c)(3)(A), other than those also described in section 357(c)(3)(B), will not reduce the transferor's basis in the transferee's stock received in the exchange.

## II. 2023 Proposed Regulations

On August 7, 2023, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–134420–10) in the **Federal Register** (88 FR 52057) under sections 52(a), 414(b), 1502, 1503, 1552, and 1563 of the Code (2023 proposed regulations). The 2023 proposed regulations primarily would revise the consolidated return regulations and the controlled group of corporations regulations (i) to eliminate obsolete or otherwise outdated provisions, (ii) to modernize the language and improve the clarity of the regulations, and (iii) to facilitate taxpayer compliance. The 2023 proposed regulations are adopted as final regulations (T.D. 10018) published in the Rules section in this issue of the **Federal Register**.

The preamble to the 2023 proposed regulations stated that the proposed rule in the proposed consolidated section 357(c) regulations is unnecessary because §§ 1.1502–32 and 1.1502–80 prevent any duplicative stock basis reduction. Accordingly, the 2023 proposed regulations withdrew the proposed consolidated section 357(c) regulations.

## III. Comment Received

A commenter stated that, in light of the withdrawal of the proposed consolidated section 357(c) regulations, it is unclear whether the transferor's basis in the transferee stock should be reduced for an assumed section 357(c)(3)(A) liability: (i) at the time of the section 351 exchange under section 358 of the Code, with no further basis reduction under § 1.1502–32(b) when the assumed section 357(c)(3)(A) liability generates a deduction that is absorbed (front-end adjustment); or (ii) at the time the deduction for the assumed section 357(c)(3)(A) liability is absorbed that reduces basis under § 1.1502–32(b), with no prior basis reduction under section 358 at the time of the section 351 exchange (back-end adjustment). The commenter recommended the back-end adjustment approach for various reasons, including the additional compliance costs and complexity associated with tracking and monitoring the transferee's § 1.1502–32(b) basis adjustments (potentially over multiple years, and potentially across multiple groups) under the front-end adjustment approach. The commenter

also expressed the view that the back-end adjustment approach is the prevailing approach currently applied by taxpayers.

## Explanation of Provisions

The withdrawal of the proposed consolidated section 357(c) regulations was not intended to suggest that a front-end adjustment approach is required. To reflect the Treasury Department's and the IRS's view regarding the appropriate timing for the single basis reduction for an assumed section 357(c)(3)(A) liability, and to clarify that a back-end adjustment is appropriate, this document would repropose the proposed consolidated section 357(c) regulations in modified form.

## Proposed Applicability Date

Pursuant to section 1503(a) of the Code, these proposed regulations would apply to consolidated return years for which the due date of the return (without regard to extensions) is after [date of publication of final regulations in the **Federal Register**].

## Special Analyses

### I. Regulatory Planning and Review

Pursuant to the Memorandum of Agreement, Review of Treasury Regulations under Executive Order 12866 (June 9, 2023), tax regulatory actions issued by the IRS are not subject to the requirements of section 6 of Executive Order 12866, as amended. Therefore, a regulatory impact assessment is not required.

### II. Paperwork Reduction Act

These regulations update the regulations under section 1502 to clarify the timing of a single basis adjustment required by statute. Therefore, the proposed regulations would not impose additional reporting burden beyond what is otherwise required by existing statutes, regulations, and forms. The total burden associated with the proposed regulations, if finalized in their current form, would be \$0.

### III. Regulatory Flexibility Act

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), the Secretary of the Treasury certifies that the proposed regulations would not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the proposed regulations would apply only to corporations that file consolidated Federal income tax returns, and that such corporations tend to be larger businesses. Therefore, the proposed regulations would not create additional obligations for, or impose an

economic impact on, small entities. Accordingly, the Secretary certifies that these proposed regulations will not have significant economic impact on a significant number of small entities.

Pursuant to section 7805(f) of the Code, the proposed regulations have been submitted to the Chief Counsel for the Office of Advocacy of the Small Business Administration for comment on its impact on small business.

## IV. Unfunded Mandates Reform Act

Section 202 of the Unfunded Mandates Reform Act of 1995 requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a State, local, or Tribal government, in the aggregate, or by the private sector, of \$100 million in 1995 dollars, updated annually for inflation. The proposed regulations do not propose any rule that would include any Federal mandate that may result in expenditures by State, local, or Tribal governments, or by the private sector in excess of that threshold.

## V. Executive Order 13132: Federalism

Executive Order 13132 (Federalism) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. The proposed regulations do not propose rules that would have federalism implications, impose substantial direct compliance costs on State and local governments, or preempt State law within the meaning of the Executive order.

## Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All commenters are strongly encouraged to submit comments electronically. The Treasury Department and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket on <https://www.regulations.gov>.

A public hearing will be scheduled if requested in writing by any person who

timely submits electronic or written comments. Requests for a public hearing are encouraged to be made electronically. If a public hearing is scheduled, a notice of the date and time for the public hearing will be published in the **Federal Register**.

**Drafting Information**

The principal authors of this document are William W. Burhop and Kelton P. Frye of the Office of Associate Chief Counsel (Corporate). Other personnel from the Treasury Department and the IRS participated in its development.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Proposed Amendments to the Regulations**

Accordingly, the Treasury Department and the IRS propose to amend 26 CFR part 1 as follows:

**PART 1—INCOME TAXES**

■ **Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*

■ **Par. 2.** Section 1.1502–80 is amended by revising paragraph (d)(1) and adding paragraphs (d)(3) and (4) to read as follows:

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

\* \* \* \* \*

(d) \* \* \*

(1) *In general.* Section 357(c) does not apply to any transaction to which § 1.1502–13 applies if it occurs in a consolidated return year beginning on or after [date of publication of final regulations in the **Federal Register**]. Notwithstanding the foregoing, for

purposes of determining the transferor’s basis in property under section 358(a) received in a transfer described in section 351, section 358(d)(2) operates to exclude liabilities described in section 357(c)(3)(A), other than those also described in section 357(c)(3)(B), from the computation of the amount of liabilities assumed that is treated as money received under section 358(d)(1), if the transfer occurs in a consolidated return year beginning after [date of publication of final regulations in the **Federal Register**]. This paragraph (d) does not apply to a transaction if the transferor or transferee becomes a nonmember as part of the same plan or arrangement. The transferor (or transferee) is treated as becoming a nonmember once it is no longer a member of a consolidated group that includes the transferee (or transferor). For purposes of this paragraph (d), any reference to a transferor or transferee includes, as the context may require, a reference to a successor or predecessor.

\* \* \* \* \*

(3) *Examples.* The principles of paragraph (d)(1) of this section are illustrated by the following examples.

(i) *Example 1—(A) Facts.* P, S, and T are members of a consolidated group. P owns all the stock of S and T with bases of \$30 and \$20, respectively. S has a \$30 basis in its assets and \$40 of liabilities. S merges into T in a transaction described in section 368(a)(1)(A) (and in section 368(a)(1)(D)).

(B) *Analysis.* Section 357(c) does not apply to the merger. P’s basis in T’s stock increases to \$50 (\$30 + \$20), and T succeeds to S’s \$30 basis in the assets transferred subject to the \$40 liability. Similarly, if S instead transferred its assets and liabilities to a newly formed subsidiary in a transaction to which section 351 applies, section 357(c) does not apply, and S’s basis in the

subsidiary’s stock is a \$10 excess loss account.

(ii) *Example 2—(A) Facts.* P owns all the stock of S1. S1 has assets with a total fair market value equal to \$100 and an aggregate basis of \$30. S1 has \$40 of liabilities, \$5 of which are described in section 357(c)(3)(A), but not section 357(c)(3)(B), and \$35 of which are not described in section 357(c)(3)(A). S1 transfers its assets to a newly formed subsidiary, S2, in exchange for stock of S2 and S2’s assumption of the liabilities of \$40 in a transaction to which section 351 applies. P, S1, and S2 are members of a consolidated group.

(B) *Analysis.* Section 357(c) does not apply to cause S1 to recognize gain in connection with the transfer. For purposes of determining S1’s basis in the S2 stock it received in the exchange, section 358(d)(2) operates to exclude \$5 of the liabilities from the computation of the amount of liabilities assumed that are treated as money received under section 358(d)(1). S1’s basis in the S2 stock received in the exchange is a \$5 excess loss account (reflecting its \$30 basis in the assets transferred reduced by \$35, the amount of liabilities assumed that are not described in section 357(c)(3)(A)).

(4) *Applicability dates.* Paragraphs (d)(1) and (3) of this section apply to consolidated return years for which the due date of the return (without regard to extensions) is after [date of publication of final regulations in the **Federal Register**]. For rules that apply to earlier taxable years, see § 1.1502–80(d) as contained in 26 CFR part 1, revised April 1, 2024.

\* \* \* \* \*

**Douglas W. O’Donnell,**  
*Deputy Commissioner.*

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