no gain or loss would be recognized under section 1032.

Although the circular ownership described in this structure could result in the recognition of gains as well as losses on the sale of P stock, taxpayers can easily avoid most gains. For example, if the P stock held by S appreciates, P can issue P stock and avoid recognizing gain under section 1032. Other transactions involving circular ownership are subject to specific relief. See, for example, Rev. Rul. 80–76, 1980–1 C.B. 15 (no gain on S's use of P stock to compensate S's employee); Prop. Reg. § 1.1032–2(b) (no gain or loss on S's use of certain P stock in triangular reorganizations).

Through planning techniques and relief provisions, taxpayers may use circular ownership structures to claim artificial losses and to avoid reporting of gains. As a result, taxpayers frequently have the benefit of single entity treatment for gains but separate entity treatment for losses. The Treasury and the IRS have concluded, therefore, that pending further study of single entity treatment of stock generally, temporary regulations are necessary to provide greater single entity treatment for losses by preventing groups from inappropriately claiming losses on the sale of stock of the common parent.

As mentioned above, in transactions where S intends to use P stock for a legitimate business purpose, S can generally avoid the recognition of gain. Nonetheless, structuring transactions to avoid the gain adds additional costs and uncertainties to these transactions. Therefore, these temporary regulations also include provisions to prevent taxpayers from being subject to inappropriate taxation on gains in certain transactions.

Explanation of Provisions

These temporary regulations are limited to transactions involving P stock. While similar artificial losses or gains may arise in transactions involving circular ownership with respect to the stock of a subsidiary, existing regulations address many issues with respect to losses in S stock. See § 1.1502–20. For purposes of these temporary regulations, P stock is any stock of the common parent held by another member, or any stock of a member (the issuer) that was the common parent if the stock was held by another member while the issuer was the common parent.

These temporary regulations provide that losses recognized with respect to P stock held by a member are permanently disallowed. Similarly, if a member, M, owns P stock, the stock is subsequently owned by a nonmember, and immediately before the stock is owned by the nonmember M's basis in the share exceeds its fair market value, then (unless the loss is disallowed under the general rule) M's basis in the share is reduced immediately before the share is held by the nonmember. For example, if M owns shares of P stock with a basis in excess of their fair market value and M becomes a nonmember, M's basis in the P shares is reduced to fair market value immediately before M becomes a nonmember. Similar principles apply to options and other positions with respect to P stock.

To qualify for the relief from gain, the member must acquire P stock directly from P through a contribution to capital or a transaction qualifying under section 351(a), and must, pursuant to a plan, transfer the stock immediately to an unrelated nonmember in a taxable transaction (other than in exchange for P stock). In addition, the common parent must remain the common parent and the member must remain a member.

These temporary regulations provide relief from gain by providing S with a fair market value basis in the P stock. To properly reflect the transaction in the basis of other members, (including P's basis in its S stock) these regulations treat S as if it purchased the stock from P with cash contributed by P. No inference is intended whether circular cash flows would be respected apart from this regulation. Similarly, no inference is intended with respect to other methods of avoiding gain on S's use of P stock.

The Treasury and the IRS request comments as to transactions outside the scope of the regulations. In particular, comments are requested as to whether any such transactions should be given relief from gain recognition. In addition, comments are requested on whether greater single entity treatment of stock should be adopted more generally.

These temporary regulations are effective for transactions on or after the date they are filed with the **Federal Register**.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations only affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. The rules do not significantly alter the reporting or recordkeeping duties of small entities. Accordingly, a regulatory flexibility analysis is not required. It has also been determined that under section 553(d) of the Administrative Procedure Act (5 U.S.C. chapter 5) there is good cause for these regulations to be effective immediately to insure transactions in P stock are appropriately reflected. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

These regulations were drafted by personnel from the Treasury Department and the IRS.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended 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 * * * Section 1.1502–13T also issued under 26 U.S.C. 1502 * * *

Par. 2. Section 1.1502–13T is added to read as follows:

§ 1.1502–13T Intercompany transactions temporary.

(a) through (f)(5) [Reserved] For further guidance, see 1.1502–13.

(f)(6) *Stock of common parent.* In addition to the general rules of this section, this paragraph (f)(6) applies to parent stock (P stock) and positions in parent stock held by another member. For this purpose, P stock is any stock of the common parent held by another member or any stock of a member (the issuer) that was the common parent if the stock was held by another member while the issuer was the common parent.

(i) *Loss stock*—(A) *Recognized loss.* Any loss recognized, directly or indirectly, by a member with respect to P stock is permanently disallowed and does not reduce earnings and profits. See § 1.1502–32(b)(3)(iii)(A) for a corresponding reduction in the basis of the member's stock.

(B) *Other cases.* If a member, M, owns P stock, the stock is subsequently owned by a nonmember, and