

immediately before the stock is owned by the nonmember, M's basis in the share exceeds its fair market value, then to the extent paragraph (f)(6)(i)(A) of this section does not apply, M's basis in the share is reduced to the share's fair market value immediately before the share is held by the nonmember. For example, if M owns shares of P stock with a \$100x basis and M becomes a nonmember at a time when the P shares have a value of \$60x, M's basis in the P shares is reduced to \$60x immediately before M becomes a nonmember. Similarly, if M contributes the P stock to a nonmember in a transaction subject to section 351, M's basis in the shares is reduced to \$60x immediately before the contribution. See § 1.1502-32(b)(3)(iii)(B) for a corresponding reduction in the basis of M's stock.

(ii) *Gain stock.* If a member, M, would otherwise recognize gain on a qualified disposition of P stock, then immediately before the qualified disposition, M is treated as purchasing the P stock from P for fair market value with cash contributed to M by P (or, if necessary, through any intermediate members). A disposition is a qualified disposition only if—

(A) The member acquires the P stock directly from the common parent (P) through a contribution to capital or a transaction qualifying under section 351(a) (or, if necessary, through a series of such transactions involving only members);

(B) Pursuant to a plan, the member transfers the stock immediately to a nonmember that is not related, within the meaning of section 267(b) or 707(b), to any member of the group;

(C) No nonmember receives a substituted basis in the stock within the meaning of section 7701(a)(42);

(D) The P stock is not exchanged for P stock;

(E) P neither becomes nor ceases to be the common parent as part of, or in contemplation of, the plan or disposition; and

(F) M neither becomes nor ceases to be a member as part of, or in contemplation of, the plan or disposition.

(iii) *Options, warrants and other rights.* Paragraph (f)(6)(i) of this section applies to options, warrants, forward contracts, or other positions with respect to P stock (including, for example, cash-settled positions). For example, if S purchases (from any party) a warrant on P stock and the warrant lapses, any loss recognized by S is permanently disallowed. Similarly, if S purchases a warrant on P stock and S becomes a nonmember at a time when the value of the warrant is less than S's

basis in the warrant, S's basis in the warrant is reduced to its fair market value immediately before S becomes a nonmember.

(iv) *Effective date.* This paragraph (f)(6) applies to transactions on or after July 12, 1995 (notwithstanding whether the intercompany transaction, if any, occurred prior to that date).

**Michael P. Dolan,**

*Acting Commissioner of Internal Revenue.*

Approved: June 29, 1995.

**Leslie Samuels,**

*Assistant Secretary of the Treasury.*

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## 26 CFR Parts 1 and 602

[TD 8597]

RIN 1545-AT58

### Consolidated Groups and Controlled Groups—Intercompany Transactions and Related Rules

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

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations amending the intercompany transaction system of the consolidated return regulations. The final regulations also revise the regulations under section 267(f), limiting losses and deductions from transactions between members of a controlled group. Amendments to other related regulations are also included in this document.

**DATES:** These regulations are effective July 18, 1995.

For dates of applicability, see the **EFFECTIVE DATES** section under the **SUPPLEMENTARY INFORMATION** portion of the preamble and the effective date provisions of the new or revised regulations.

#### FOR FURTHER INFORMATION CONTACT:

Concerning the regulations relating to consolidated groups generally, Roy Hirschhorn of the Office of Assistant Chief Counsel (Corporate), (202) 622-7770; concerning stock and obligations of members of consolidated groups, Victor Penico of the Office of Assistant Chief Counsel (Corporate), (202) 622-7750; concerning insurance issues, Gary Geisler of the Office of Assistant Chief Counsel (Financial Institutions and Products), (202) 622-3970; concerning international issues, Philip Tretiak of the Office of Associate Chief Counsel (International), (202) 622-3860; and concerning controlled groups, Martin Scully, Jr. of the Office of Assistant Chief Counsel (Income Tax and

Accounting), (202) 622-4960. (These numbers are not toll-free numbers.)

#### SUPPLEMENTARY INFORMATION:

##### A. Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1433. The estimated average annual burden per respondent is .5 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

##### B. Background

This document contains final regulations under section 1502 of the Internal Revenue Code of 1986 (Code) that comprehensively revise the intercompany transaction system of the consolidated return regulations. Amendments are also made to related regulations, including the regulations under section 267(f), which apply to transactions between members of a controlled group.

The proposed regulations were published in the **Federal Register** on April 15, 1994 (59 FR 18011). The notice of hearing on the proposed regulations, Notice 94-49, 1994-1 C.B. 358, 59 FR 18048, contains an extensive discussion of the issues considered in developing the proposed regulations. The IRS received many comments on the proposed regulations and held public hearings on May 4, 1994 and August 8, 1994.

After consideration of the comments and the statements made at the hearings, the proposed regulations are adopted as revised by this Treasury decision. The principal comments and revisions are discussed below. However, a number of other changes have been made to the proposed regulations. References in the preamble to P, S, and B are references to the common parent, the selling member, and the buying member, respectively. No inference is intended as to the operation of the prior regulations or other rules.