appropriate in the interest of sound tax administration (for example, if a taxpayer misapplies the regulations to avoid matching S's intercompany item with B's corresponding item). See section 10 of Rev. Proc. 92–20.

Paragraph (e)(3) of the final regulations continues the procedure whereby the common parent may request consent from the IRS to report intercompany transactions on a separate entity basis. Rev. Proc. 82–36 (1982–1 C.B. 490), which provides procedures for obtaining consent under the prior regulations, will be updated and revised. Until new procedures are provided, taxpayers may rely on the principles of Rev. Proc. 82–36 in making applications under these final regulations.

If consent under paragraph (e)(3) of these regulations is obtained or revoked, the final regulations provide the Commissioner's consent under section 446(e) for each member to make any changes in methods of accounting necessary to conform members' methods of accounting to the consent or revocation. Any change in method under this provision must be made as of the beginning of the first year for which the consent (or revocation of consent) under paragraph (e)(3) is effective.

A group that has received consent under the prior intercompany transaction regulations not to defer items from deferred intercompany transactions will be considered to have obtained the consent of the Commissioner to take items from the same class (or classes) of intercompany transactions into account on a separate entity basis under these regulations.

4. Single Entity Treatment of Attributes

a. In General

The prior intercompany transaction system used a deferred sale approach that treated the members of a consolidated group as separate entities for some purposes and as a single entity for other purposes. In general, the *amount, location, character,* and *source* of items from an intercompany transaction were given separate entity treatment, but the *timing* of items was determined under rules that produced a single entity effect.

The matching rule of the proposed regulations expands single entity treatment by requiring the redetermination of the *attributes* (such as *character* and *source*) of items to produce a single entity effect. Several comments supported the broader single entity approach taken by the proposed regulations. Other comments asked that separate entity treatment of attributes be retained.

The commentators arguing for retention of separate entity treatment claimed that single entity treatment does not always result in more rational tax treatment, and may not reflect the economic results of a group's activities as accurately as separate entity treatment. They also argued that taxpayers should have the ability to avoid arbitrary results or administrative burdens by separately incorporating business operations. The Treasury and the IRS believe that single entity treatment of both timing and attributes generally results in a clear reflection of consolidated taxable income. In particular, single entity treatment minimizes the effect of an intercompany transaction on consolidated taxable income. In addition, single entity treatment minimizes the tax differences between a business structured divisionally and one structured with separate subsidiaries. The final regulations therefore retain the approach of the proposed regulations and generally adopt single entity treatment of attributes.

Nevertheless, in certain situations it may be appropriate to provide separate entity treatment. The Treasury and the IRS believe that these situations are relatively rare, and that any exceptions from single entity treatment should be specifically provided in regulations. For example, a separate entity election is permitted under Prop. Reg. § 1.1221–2(d) (published in the **Federal Register** on July 18, 1994, 59 FR 36394) in the case of certain hedging transactions. See also § 1.263A–9(g)(5). The Treasury and the IRS welcome comments on other situations in which this type of relief might be appropriate.

b. Conflict or Allocation of Attributes

The proposed regulations provide specific rules for certain cases in which separate entity attributes are redetermined under the matching rule. Some commentators believe that the proposed regulations do not provide sufficient guidance as to the manner in which these rules are to be applied. In response to these comments, the attribute redetermination provisions of the matching rule have been revised.

For example, the regulations have been revised to clarify that the separate entity attributes of S's intercompany item and B's corresponding item are redetermined under the matching rule only *to the extent necessary* to produce the same effect on consolidated taxable income as if the intercompany transaction had been between divisions. Thus, the redetermination is required only to the extent the separate entity attributes differ from the single entity attributes.

The final regulations generally retain the rule of the proposed regulations under which the attributes of B's corresponding item control the attributes of S's intercompany items to the extent the corresponding and intercompany items offset in amount. However, the final regulations provide an exception to this rule to the extent its application would lead to a result that is inconsistent with treating S and B as divisions of a single corporation. To the extent B's corresponding item on a separate entity basis is excluded from gross income or is a noncapital, nondeductible amount (such as a deduction disallowed under section 265), however, the attribute of B's item will always control. This assures the proper operation of attribute limitation provisions contained elsewhere in the regulations.

To the extent B's corresponding item and S's intercompany item do not offset in amount, the final regulations provide that redetermined attributes are allocated to S's intercompany item and B's corresponding item using a method that is reasonable in light of all of the facts and circumstances, including the purposes of these regulations and any other rule affected by the attributes of S's items or B's items. This rule provides taxpayers considerable flexibility to allocate attributes, but the regulations also provide that an allocation method will be treated as unreasonable if it is not used consistently by all members of the group from year to year.

c. Source of Income

Several commentators opposed single entity treatment for determining the source of income or loss from an intercompany transaction, arguing that the separate entity treatment under prior law more accurately measures the source of income of the members of the group. The final regulations, however, retain the single entity treatment of source for the same reasons that the single entity treatment of other attributes is retained. The final regulations modify the example in the proposed regulations to reflect the changes made to the attribute allocation rules.

Some comments suggested that a single entity approach would inappropriately reduce the foreign source income of consolidated groups that produce a natural resource abroad and sell it to customers within the United States. For example, assume that one member extracts a commodity