6. The Acceleration Rule

The acceleration rule requires S and B to take into account their items from an intercompany transaction to the extent the items cannot be taken into account to produce the effect of treating S and B as divisions of a single corporation. The acceleration rule applies, for example, when either S or B leaves the group. Under the proposed regulations, the attributes of S's items from intercompany property transactions are determined under the principles of the matching rule ''as if B resold the property to a nonmember affiliate.'' Under this rule, S's gain from the sale of depreciable property is always treated as ordinary income under section 1239. This treatment is appropriate if the property remains in the group, as it would, for example, if the acceleration rule applies because S leaves the group. Many commentators objected to this treatment of S's attributes in other situations, arguing, for example, that if B leaves the group while it still owns the property, the rules should treat the property as sold to a person whose relationship to the group is the same as B's relationship to the group after it becomes a nonmember. The commentators argued that section 1239 should not apply if B is unrelated.

In response to these comments, the final regulations revise the acceleration rule to provide that if the property is owned by a nonmember immediately after the event causing acceleration occurs, S's attributes are determined under the principles of the matching rule as if B had sold the property to that nonmember. In applying this rule, if the nonmember is related for purposes of any provision of the Code or regulations to any party to the intercompany transaction (or any related transaction) or to P, the nonmember is treated as related to B for purposes of that provision. Accordingly, that relationship may affect the attributes of S's intercompany item.

Under both the prior regulations and the proposed regulations, if S sells an asset to B at a gain and B then transfers the asset to a partnership, S's gain is taken into account under the acceleration rule. Some commentators argued that gain should not be taken into account, at least to the extent of the member's share of the asset owned through the partnership, treating the partnership, in effect, as an aggregate of its partners, rather than as an entity. One commentator argued that continued deferral would be similar to the treatment currently available under the remedial allocation method under § 1.704–3 if appreciated property is transferred to the partnership without a prior intercompany transfer.

The final regulations retain the rule of the proposed regulations. One of the purposes of the acceleration rule is to prevent basis created in an intercompany transaction from affecting nonmembers prior to the time the group takes into account the transaction that created the basis. Allowing property that B purchased from S at a gain to be contributed to a partnership without acceleration would allow the basis created in the intercompany transaction to be reflected by the partnership prior to the group taking into account the gain. While rules could be developed to prevent this basis from affecting nonmembers in most circumstances, the rules would be unduly complex. For example, the rules would have to take into account the allocation of liabilities under section 752 and basis adjustments under section 755. Moreover, these rules would not resemble the remedial allocation method under § 1.704–3 but instead would more closely resemble the deferred sale method under the proposed regulations under section 704(c). However, this method was explicitly rejected when final regulations were issued. See § 1.704–3(a)(1).

7. Transactions Involving Stock of Members

a. Single Entity Treatment of Stock

In contrast to their predominantly single entity approach, the proposed regulations generally retain separate entity treatment of stock of members. For example, section 1032, which enables a member to sell its own stock without recognition of gain or loss, is not extended to sales of the stock of other members. Notice 94–49 (1994–1 C.B. 358) discusses the difficulties of extending single entity treatment to stock.

Several comments recommended greater single entity treatment of stock. Some recommended a limited approach under which single entity treatment would apply only to stock of the common parent. Under this approach section 1032 treatment would be expanded so that any member could sell stock of the common parent without recognizing any gain or loss. As a corollary, gain or loss would be recognized when a corporation owning stock of the common parent joined the group, treating the stock, in effect, as redeemed.

This suggestion was generally not adopted in the final regulations, because single entity treatment of P stock would significantly increase the complexity of the regulations and would require significant additional guidance dealing with the effect of this treatment on other provisions of the Code. For example, the regulations would have to coordinate single entity treatment of P stock with the reorganization provisions of the Code and applicable case law. Similarly, the regulations would have to address situations in which the common parent of the group changes, as well as a variety of collateral consequences.

Nevertheless, the Treasury and the IRS believe that limited single entity treatment of stock is needed to prevent disparities caused by separate entity treatment. Therefore, temporary regulations published elsewhere in this issue of the **Federal Register** provide a limited single entity approach to P stock that generally limits the ability of a group to create loss with respect to P stock and eliminates gain in certain circumstances. The feasibility of expanding single entity treatment for stock of members will continue to be studied. Comments and suggestions on this subject are welcome.

b. Liquidations

The proposed regulations provide that if S sells stock of a corporation (T) to B and T later liquidates into B in a transaction to which section 332 applies, S's intercompany gain is taken into account under the matching rule, even though the T stock is never held by a nonmember after the intercompany transaction. This treatment is similar to the treatment under prior regulations and has applied to liquidations under section 332 since 1966 and to deemed liquidations under 338(h)(10) since 1986, although the proposed regulations provide relief not previously available for these transactions.

Some commentators suggested that this rule should be eliminated because it could lead to two layers of tax inside the consolidated group. The final regulations, however, retain the rule (with the elective relief as described below). As more fully explained in Notice 94–49, the location of items within a group is a core principle underlying the operation of these regulations, which like the prior regulations, adopt a deferred sale approach, not a carryover basis approach. Taking intercompany gain into account in the event of a subsequent nonrecognition transaction is necessary to prevent the transfer and liquidation of subsidiaries from being used to affect consolidated taxable income or tax liability by changing the location of items within a group (a result that would be equivalent to a