

all other Federal income tax purposes, the deemed liquidation remains subject to section 332.

(2) *Limitation on amount of loss.* The amount of B's loss or deduction under this paragraph (f)(5)(ii)(C) is limited as follows—

(i) The aggregate amount of loss recognized with respect to T stock cannot exceed the amount of S's intercompany income or gain that is in excess of S's intercompany deduction or loss with respect to shares of T stock having the same material terms as the shares giving rise to S's intercompany income or gain; and

(ii) The aggregate amount of loss recognized under this paragraph (f)(5)(ii)(C) from T's deemed liquidation cannot exceed the net amount of deduction or loss (if any) that would be taken into account from the deemed liquidation if section 331 applied with respect to all T shares.

(3) *Asset sale, etc.* The principles of this paragraph (f)(5)(ii)(C) apply, with appropriate adjustments, if T transfers all of its assets to a nonmember and completely liquidates in a transaction comparable to the section 338(h)(10) transaction described in paragraph (f)(5)(ii)(C)(I) of this section. For example, if S sells all of T's stock to B at a gain followed by T's merger into a nonmember in exchange for a cash payment to B in a transaction treated for Federal income tax purposes as T's sale of its assets to the nonmember and complete liquidation, the merger is ordinarily treated as a comparable transaction.

(D) *Section 355.* If B distributes the T stock in an intercompany transaction to which section 355 applies (including an intercompany transaction to which 355 applies because of the application of paragraph (f)(3) of this section), the redetermination of the basis of the T stock under section 358 could cause S's gain or loss to be taken into account under this section. This paragraph (f)(5)(ii)(D) applies to treat B's distribution as subject to sections 301 and 311 (as modified by this paragraph (f)), rather than section 355. The election will prevent S's gain or loss from being taken into account immediately to the extent matching remains possible, but B's gain or loss from the distribution will also be taken into account under this section.

(E) *Election.* An election to apply this paragraph (f)(5)(ii) is made in a separate statement entitled "[Insert Name and Employer Identification Number of Common Parent] HEREBY ELECTS THE APPLICATION OF § 1.1502–13(f)(5)(ii)." The election must include a description of S's intercompany

transaction and T's liquidation (or other transaction). It must specify which provision of § 1.1502–13(f)(5)(ii) applies and how it alters the otherwise applicable results under this section (including, for example, the amount of S's intercompany items and the amount deferred or offset as a result of this § 1.1502–13(f)(5)(ii)). A separate election must be made for each application of this paragraph (f)(5)(ii). The election must be signed by the common parent and filed with the group's income tax return for the year of T's liquidation (or other transaction). The Commissioner may impose reasonable terms and conditions to the application of this paragraph (f)(5)(ii) that are consistent with the purposes of this section.

(6) [Reserved]

(7) *Examples.* The application of this section to intercompany transactions with respect to stock of members is illustrated by the following examples.

*Example 1. Dividend exclusion and property distribution.* (a) *Facts.* S owns land with a \$70 basis and \$100 value. On January 1 of Year 1, P's basis in S's stock is \$100. During Year 1, S declares and makes a dividend distribution of the land to P. Under section 311(b), S has a \$30 gain. Under section 301(d), P's basis in the land is \$100. On July 1 of Year 3, P sells the land to X for \$110.

(b) *Dividend elimination and stock basis adjustments.* Under paragraph (b)(1) of this section, S's distribution to P is an intercompany distribution. Under paragraph (f)(2)(ii) of this section, P's \$100 of dividend income is not included in gross income. Under § 1.1502–32, P's basis in S's stock is reduced from \$100 to \$0 in Year 1.

(c) *Matching rule and stock basis adjustments.* Under the matching rule (treating P as the buying member and S as the selling member), S takes its \$30 gain into account in Year 3 to reflect the \$30 difference between P's \$10 gain taken into account and the \$40 recomputed gain. Under § 1.1502–32, P's basis in S's stock is increased from \$0 to \$30 in Year 3.

(d) *Loss property.* The facts are the same as in paragraph (a) of this *Example 1*, except that S has a \$130 (rather than \$70) basis in the land. Under paragraph (f)(2)(iii) of this section, the principles of section 311(b) apply to S's loss from the intercompany distribution. Thus, S has a \$30 loss that is taken into account under the matching rule in Year 3 to reflect the \$30 difference between P's \$10 gain taken into account and the \$20 recomputed loss. (The results are the same under section 267(f).) Under § 1.1502–32, P's basis in S's stock is reduced from \$100 to \$0 in Year 1, and from \$0 to a \$30 excess loss account in Year 3. (If P had distributed the land to its shareholders, rather than selling the land to X, P would take its \$10 gain under section 311(b) into account, and S would take its \$30 loss into account under the matching rule with \$10 offset by P's gain and \$20 recharacterized as a noncapital, nondeductible amount.)

(e) *Entitlement rule.* The facts are the same as in paragraph (a) of this *Example 1*, except that, after P becomes entitled to the distribution but before the distribution is made, S issues additional stock to the public and becomes a nonmember. Under paragraph (f)(2)(i) of this section, the determination of whether a distribution is an intercompany distribution is made under the entitlement rule of paragraph (f)(2)(iv) of this section. Treating S's distribution as made when P becomes entitled to it results in the distribution being an intercompany distribution. Under paragraph (f)(2)(ii) of this section, the distribution is not included in P's gross income. S's \$30 gain from the distribution is intercompany gain that is taken into account under the acceleration rule immediately before S becomes a nonmember. Thus, there is a net \$70 decrease in P's basis in its S stock under § 1.1502–32 (\$100 decrease for the distribution and a \$30 increase for S's \$30 gain). See also § 1.1502–20(b) (additional stock basis reductions applicable to certain deconsolidations). Under paragraph (f)(2)(iv) of this section, P does not take the distribution into account again under separate return rules when received, and P is not entitled to a dividends received deduction.

*Example 2. Excess loss accounts.* (a) *Facts.* S owns all of T's only class of stock with a \$10 basis and \$100 value. S has substantial earnings and profits, and T has \$10 of earnings and profits. On January 1 of Year 1, S declares and distributes a dividend of all of the T stock to P. Under section 311(b), S has a \$90 gain. Under section 301(d), P's basis in the T stock is \$100. During Year 3, T borrows \$90 and declares and makes a \$90 distribution to P to which section 301 applies, and P's basis in the T stock is reduced under § 1.1502–32 from \$100 to \$10. During Year 6, T has \$5 of earnings that increase P's basis in the T stock under § 1.1502–32 from \$10 to \$15. On December 1 of Year 9, T issues additional stock to X and, as a result, T becomes a nonmember.

(b) *Dividend exclusion.* Under paragraph (f)(2)(ii) of this section, P's \$100 of dividend income from S's distribution of the T stock, and its \$10 of dividend income from T's \$90 distribution, are not included in gross income.

(c) *Matching and acceleration rules.* Under § 1.1502–19(b)(1), when T becomes a nonmember P must include in income the amount of its excess loss account (if any) in T stock. P has no excess loss account in the T stock. Therefore P's corresponding item from the deconsolidation of T is \$0. Treating S and P as divisions of a single corporation, the T stock would continue to have a \$10 basis after the distribution, and the adjustments under § 1.1502–32 for T's \$90 distribution and \$5 of earnings would result in a \$75 excess loss account. Thus, the recomputed corresponding item from the deconsolidation is \$75. Under the matching rule, S takes \$75 of its \$90 gain into account in Year 9 as a result of T becoming a nonmember, to reflect the difference between P's \$0 gain taken into account and the \$75 recomputed gain. S's remaining \$15 of gain is taken into account under the matching and acceleration rules based on subsequent