

(c) *Timing and attributes resulting from the stock sale.* Under paragraph (c)(3) of this section, M is treated as owning and selling B's stock for purposes of the matching rule even though, as divisions, M could not own and sell stock in B. Under paragraph (j)(3) of this section, both M's B stock and B's land can cause S's intercompany gain to be taken into account under the matching rule. Thus, S takes \$6 of its gain into account in Year 5 to reflect the \$6 difference between M's \$2 gain taken into account from its sale of B stock and the \$8 recomputed gain. Under paragraph (j)(4) of this section, the attributes of this gain are determined by treating S, M, and B as divisions of a single corporation. Under paragraph (c)(1) of this section, S's \$6 gain and M's \$2 gain are treated as long-term capital gain. The gain would be capital on a separate entity basis (assuming that section 341 does not apply), and this treatment is not inconsistent with treating S, M, and B as divisions of a single corporation because the stock sale and subsequent land sale are unrelated transactions and B remains a member following the sale.

(d) *Timing and attributes resulting from the land sale.* Under paragraph (j)(3) of this section, S takes \$6 of its gain into account in Year 8 under the matching rule to reflect the \$6 difference between B's \$2 gain taken into account from its sale of an interest in the land and the \$8 recomputed gain. Under paragraph (j)(4) of this section, the attributes of this gain are determined by treating S, M, and B as divisions of a single corporation and taking into account the activities of S, M, and B with respect to the land. Thus, both S's gain and B's gain might be ordinary income as a result of B's activities. (If B subsequently sells the balance of the land, S's gain taken into account is limited to its remaining \$18 of intercompany gain.)

(e) *Sale of successor stock resulting in deconsolidation.* The facts are the same as in paragraph (a) of this *Example 1*, except that M sells 60% of the B stock to X for \$66 on December 1 of Year 5 and B becomes a nonmember. Under the matching rule, M's sale of B stock results in \$18 of S's gain being taken into account (to reflect the difference between M's \$6 gain taken into account and the \$24 recomputed gain). Under the acceleration rule, however, the entire \$30 gain is taken into account (to reflect B becoming a nonmember, because its basis in the land reflects M's \$100 cost basis from the prior intercompany transaction). Under paragraph (j)(4) of this section, the attributes of S's gain are determined by treating S, M, and B as divisions of a single corporation. Because M's cost basis in the land will be reflected by B as a nonmember, all of S's gain is treated as from the land (rather than a portion being from B's stock), and B's activities with respect to the land might therefore result in S's gain being ordinary income.

*Example 2. Intercompany sale of member stock followed by recapitalization.* (a) *Facts.* Before becoming a member of the P group, S owns P stock with a basis of \$70. On January 1 of Year 1, P buys all of S's stock. On July 1 of Year 3, S sells the P stock to M for \$100. On December 1 of Year 5, P acquires M's original P stock in exchange for new P stock

in a recapitalization described in section 368(a)(1)(E).

(b) *Timing and attributes.* Although P's basis in the stock acquired from M is eliminated under paragraph (f)(4) of this section, the new P stock received by M is exchanged basis property (within the meaning of section 7701(a)(44)) having a basis under section 358 equal to M's basis in the original P stock. Under the successor asset rule of paragraph (j)(1) of this section, references to M's original P stock include references to M's new P stock. Because it is still possible to take S's intercompany item into account under the matching rule with respect to the successor asset, S's gain is not taken into account under the acceleration rule as a result of the basis elimination under paragraph (f)(4) of this section. Instead, the gain is taken into account based on subsequent events with respect to M's new P stock (for example, a subsequent distribution or redemption of the new stock).

*Example 3. Back-to-back intercompany transactions—matching.* (a) *Facts.* S holds land for investment with a basis of \$70. On January 1 of Year 1, S sells the land to M for \$90. M also holds the land for investment. On July 1 of Year 3, M sells the land for \$100 to B, and B holds the land for sale to customers in the ordinary course of business. During Year 5, B sells all of the land to customers for \$105.

(b) *Timing.* Under paragraph (b)(1) of this section, S's sale of the land to M and M's sale of the land to B are both intercompany transactions. S is the selling member and M is the buying member in the first intercompany transaction, and M is the selling member and B is the buying member in the second intercompany transaction. Under paragraph (j)(4) of this section, S, M and B are treated as divisions of a single corporation for purposes of determining the timing of their items from the intercompany transactions. See also paragraph (j)(2) of this section (B is treated as a successor to M for purposes of taking S's intercompany gain into account). Thus, S's \$20 gain and M's \$10 gain are both taken into account in Year 5 to reflect the difference between B's \$5 gain taken into account with respect to the land and the \$35 recomputed gain (the gain that B would have taken into account if the intercompany sales had been transfers between divisions of a single corporation, and B succeeded to S's \$70 basis).

(c) *Attributes.* Under paragraphs (j)(4) of this section, the attributes of the intercompany items and corresponding items of S, M, and B are also determined by treating S, M, and B as divisions of a single corporation. For example, the attributes of S's and M's intercompany items are determined by taking B's activities into account.

*Example 4. Back-to-back intercompany transactions—acceleration.* (a) *Facts.* During Year 1, S performs services for M in exchange for \$10 from M. S incurs \$8 of employee expenses. M capitalizes the \$10 cost of S's services under section 263 as part of M's cost to acquire real property from X. Under its separate entity method of accounting, S would take its income and expenses into account in Year 1. M holds the real property for investment and, on July 1 of Year 5, M

sells it to B at a gain. B also holds the real property for investment. On December 1 of Year 8, while B still owns the real property, P sells all of M's stock to X and M becomes a nonmember.

(b) *M's items.* M takes its gain into account immediately before it becomes a nonmember. Because the real property stays in the group, the acceleration rule redetermines the attributes of M's gain under the principles of the matching rule as if B sold the real property to an affiliated corporation that is not a member of the group for a cash payment equal to B's adjusted basis in the real property, and S, M, and B were divisions of a single corporation. Thus, M's gain is capital gain.

(c) *S's items.* Under paragraph (b)(2)(ii) of this section, S includes the \$8 of expenses in determining its \$2 intercompany income. In Year 1, S takes into account \$8 of income and \$8 of expenses. Under paragraph (j)(4) of this section, appropriate adjustments must be made to treat both S's performance of services for M and M's sale to B as occurring between divisions of a single corporation. Thus, S's \$2 of intercompany income is not taken into account as a result of M becoming a nonmember, but instead will be taken into account based on subsequent events (e.g., under the matching rule based on B's sale of the real property to a nonmember, or under the acceleration rule based on P's sale of the stock of S or B to a nonmember). See the successor person rules of paragraph (j)(2) of this section (B is treated as a successor to M for purposes of taking S's intercompany income into account).

(d) *Sale of S's stock.* The facts are the same as in paragraph (a) of this *Example 4*, except that P sells all of S's stock (rather than M's stock) and S becomes a nonmember on July 1 of Year 5. S's remaining \$2 of intercompany income is taken into account immediately before S becomes a nonmember. Because S's intercompany income is not from an intercompany sale, exchange, or distribution of property, the attributes of the intercompany income are determined on a separate entity basis. Thus, S's \$2 of intercompany income is ordinary income. M does not take any of its intercompany gain into account as a result of S becoming a nonmember.

(e) *Intercompany income followed by intercompany loss.* The facts are the same as in paragraph (a) of this *Example 4*, except that M sells the real property to B at a \$1 loss (rather than a gain). M takes its \$1 loss into account under the acceleration rule immediately before M becomes a nonmember. But see § 1.267(f)-1 (which might further defer M's loss if M and B remain in a controlled group relationship after M becomes a nonmember). Under paragraph (j)(4) of this section appropriate adjustments must be made to treat the group as if both intercompany transactions occurred between divisions of a single corporation. Accordingly, P's sale of M stock also results in S taking into account \$1 of intercompany income as capital gain to offset M's \$1 of corresponding capital loss. The remaining \$1 of S's intercompany income is taken into account based on subsequent events.