

**Example 5. Successor group.** (a) *Facts.* On January 1 of Year 1, B borrows \$100 from S in return for B's note providing for \$10 of interest annually at the end of each year, and repayment of \$100 at the end of Year 20. As of January 1 of Year 3, B has paid the interest accruing under the note. On that date, X acquires all of P's stock and the former P group members become members of the X consolidated group.

(b) *Successor.* Under paragraph (j)(5) of this section, although B's note ceases to be an intercompany obligation of the P group, the note is not treated as satisfied and reissued under paragraph (g) of this section as a result of X's acquisition of P stock. Instead, the X consolidated group succeeds to the treatment of the P group for purposes of paragraph (g) of this section, and B's note is treated as an intercompany obligation of the X consolidated group.

(c) *No subgroups.* The facts are the same as in paragraph (a) of this *Example 5*, except that X simultaneously acquires the stock of S and B from P (rather than X acquiring all of P's stock). Paragraph (j)(5) of this section does not apply to X's acquisitions. Unless an exception described in paragraph (g)(3)(i)(B) applies, B's note is treated as satisfied immediately before S and B become nonmembers, and reissued immediately after they become members of the X consolidated group. The amount at which the note is satisfied and reissued under paragraph (g)(3) of this section is based on the fair market value of the note at the time of P's sales to X. Paragraph (g)(4) of this section does not apply to the reissued B note in the X consolidated group, because the new note is always an intercompany obligation of the X consolidated group.

**Example 6. Liquidation—80% distributee.** (a) *Facts.* X has had preferred stock described in section 1504(a)(4) outstanding for several years. On January 1 of Year 1, S buys all of X's common stock for \$60, and B buys all of X's preferred stock for \$40. X's assets have a \$0 basis and \$100 value. On July 1 of Year 3, X distributes all of its assets to S and B in a complete liquidation. Under § 1.1502-34, section 332 applies to both S and B. Under section 337, X has no gain or loss from its liquidating distribution to S. Under sections 336 and 337(c), X has a \$40 gain from its liquidating distribution to B. B has a \$40 basis under section 334(a) in the assets received from X, and S has a \$0 basis under section 334(b) in the assets received from X.

(b) *Intercompany items from the liquidation.* Under the matching rule, X's \$40 gain from its liquidating distribution to B is not taken into account under this section as a result of the liquidation (and therefore is not yet reflected under §§ 1.1502-32 and 1.1502-33). Under the successor person rule of paragraph (j)(2)(i) of this section, S and B are both successors to X. Under section 337(c), X recognizes gain or loss only with respect to the assets distributed to B. Under paragraph (j)(2)(ii) of this section, to be consistent with the purposes of this section, S succeeds to X's \$40 intercompany gain. The gain will be taken into account by S under the matching and acceleration rules of this section based on subsequent events. (The allocation of the intercompany gain to S does

not govern the allocation of any other attributes.)

**Example 7. Liquidation—no 80% distributee.** (a) *Facts.* X has only common stock outstanding. On January 1 of Year 1, S buys 60% of X's stock for \$60, and B buys 40% of X's stock for \$40. X's assets have a \$0 basis and \$100 value. On July 1 of Year 3, X distributes all of its assets to S and B in a complete liquidation. Under § 1.1502-34, section 332 applies to both S and B. Under sections 336 and 337(c), X has a \$100 gain from its liquidating distributions to S and B. Under section 334(b), S has a \$60 basis in the assets received from X and B has a \$40 basis in the assets received from X.

(b) *Intercompany items from the liquidation.* Under the matching rule, X's \$100 intercompany gain from its liquidating distributions to S and B is not taken into account under this section as a result of the liquidation (and therefore is not yet reflected under §§ 1.1502-32 and 1.1502-33). Under the successor person rule of paragraph (j)(2)(i) of this section, S and B are both successors to X. Under paragraph (j)(2)(ii) of this section, to be consistent with the purposes of this section, S succeeds to X's \$40 intercompany gain with respect to the assets distributed to B, and B succeeds to X's \$60 intercompany gain with respect to the assets distributed to S. The gain will be taken into account by S and B under the matching and acceleration rules of this section based on subsequent events. (The allocation of the intercompany gain does not govern the allocation of any other attributes.)

(k) *Cross references—(1) Section 108.* See § 1.108-3 for the treatment of intercompany deductions and losses as subject to attribute reduction under section 108(b).

(2) *Section 263A(f).* See section 263A(f) and § 1.263A-9(g)(5) for special rules regarding interest from intercompany transactions.

(3) *Section 267(f).* See section 267(f) and § 1.267(f)-1 for special rules applicable to certain losses and deductions from transactions between members of a controlled group.

(4) *Section 460.* See § 1.460-4(j) for special rules regarding the application of section 460 to intercompany transactions.

(5) *Section 469.* See § 1.469-1(h) for special rules regarding the application of section 469 to intercompany transactions.

(6) *§ 1.1502-80.* See § 1.1502-80 for the non-application of certain Internal Revenue Code rules.

(l) *Effective dates—(1) In general.* This section applies with respect to transactions occurring in years beginning on or after July 12, 1995. If both this section and prior law apply to a transaction, or neither applies, with the result that items may be duplicated, omitted, or eliminated in determining taxable income (or tax liability), or items may be treated inconsistently, prior law

(and not this section) applies to the transaction. For example, S's and B's items from S's sale of property to B which occurs before July 12, 1995 are taken into account under prior law, even though B may dispose of the property after July 12, 1995. Similarly, an intercompany distribution to which a shareholder becomes entitled before July 12, 1995 but which is distributed after that date is taken into account under prior law (generally when distributed), because this section generally takes dividends into account when the shareholder becomes entitled to them but this section does not apply at that time. If application of prior law to S's deferred gain or loss from a deferred intercompany transaction (as defined under prior law) occurring prior to July 12, 1995 would be affected by an intercompany transaction (as defined under this section) occurring after July 12, 1995, S's deferred gain or loss continues to be taken into account as provided under prior law, and the items from the subsequent intercompany transaction are taken into account under this section. Appropriate adjustments must be made to prevent items from being duplicated, omitted, or eliminated in determining taxable income as a result of the application of both this section and prior law to the successive transactions, and to ensure the proper application of prior law.

(2) *Avoidance transactions.* This paragraph (l)(2) applies if a transaction is engaged in or structured on or after April 8, 1994, with a principal purpose to avoid the rules of this section (and instead to apply prior law). If this paragraph (l)(2) applies, appropriate adjustments must be made in years beginning on or after July 12, 1995, to prevent the avoidance, duplication, omission, or elimination of any item (or tax liability), or any other inconsistency with the rules of this section. For example, if S is a dealer in real property and sells land to B on March 16, 1995 with a principal purpose of converting any future appreciation in the land to capital gain, B's gain from the sale of the land on May 11, 1997 might be characterized as ordinary income under this paragraph (l)(2).

(3) *Election for certain stock elimination transactions—(i) In general.* A group may elect pursuant to this paragraph (l)(3) to apply this section (including the elections available under paragraph (f)(5)(ii) of this section) to stock elimination transactions to which prior law would otherwise apply. If an election is made, this section, and not prior law, applies to determine the timing and attributes of S's and B's gain