INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

January 31, 2003

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Index (UIL) No.: 1502.50-00
CASE MIS No.: TAM-154173-02/CC:CORP:B2

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Parent =

Year X =

a =

b =

ISSUE: Whether the taxpayer properly computed its charitable contribution deduction limitations in accordance with the provisions of Treas. Reg. § 1.1502-47.

CONCLUSION: The taxpayer's calculation of the limitation on the charitable contributions deduction is inappropriate for a life-nonlife consolidated group. In general, a consolidated group must determine the limitation on its charitable contributions deduction based on adjusted consolidated taxable income pursuant to § 1.1502-24. A life-nonlife consolidated group, however, must

determine its consolidated taxable income on a subgroup basis in accordance with § 1.1502-47(a)(2). Section 1.1502-47(r) provides that the subgroup approach preempts any other consolidated return regulation. Thus, a life-nonlife subgroup must use the subgroup approach for all purposes, including the determination of the limitation on the charitable contributions deduction.

FACTS:

The pertinent information submitted indicates that Parent, a nonlife company, is the common parent of a consolidated group that files a life-nonlife consolidated return pursuant to an election under I.R.C. § 1504(c)(2). The Parent group files its life-nonlife consolidated return using a calendar year tax year. An election under § 1504(c)(2) requires that members of the Parent group comply with all of the consolidated return regulations, including the subgroup requirements set forth in § 1.1502-47 of the Income Tax Regulations.

For purposes of this technical advice memorandum, the parties focus on Year X. In Year X, members of the nonlife subgroup made charitable contributions of approximately $ a and members of the life subgroup made charitable contributions of approximately $ b. The taxpayer computed the consolidated charitable contribution deduction limitation of Treas. Reg. § 1.1502-24(c) by first aggregating the consolidated taxable incomes of each subgroup, after modifying each subgroup's consolidated taxable incomes as provided by § 1.1502-24(c). The taxpayer determined that 10% of this "consolidated modified taxable income" is the aggregate amount of charitable deductions that the group is entitled to under I.R.C. § 170 and § 1.1502-24. The taxpayer then allocated to each subgroup a portion of the total amount of charitable deductions allowed based on the proportion of charitable contributions each subgroup made to the total charitable contributions by all members of the group.

The agent's position is that each life-nonlife subgroup computes its own charitable contribution deduction limitation based on that subgroup's consolidated taxable income (or "CTI"). See §§ 1.1502-47 and 1.1502-24. Under § 1.1502-47, each subgroup is required to determine its own CTI.

LAW AND ANALYSIS:

Section 170(a) of the Internal Revenue Code allows taxpayers a deduction for charitable contributions made within the taxable year. However, § 170(d) provides that in case of a corporation, the total deductions under subsection (a) for any taxable year shall not exceed 10 percent of the taxpayer's taxable income computed without regard to (A) this section, (B) part VIII (except section 248), (C) any net operating loss

carryback to the taxable year under section 172, and (D) any capital loss carryback to the taxable year under section 1212(a)(1).

For a consolidated group not filing a life-nonlife consolidated return, the charitable contribution deduction and the limitation thereon are calculated on a consolidated group basis. Treas. Reg. § 1.1502-11(a) provides:

> The consolidated taxable income for a consolidated return year shall be determined by taking into account–
>
> (1) The separate taxable income of each member of the group (see § 1.1502-12 for the computation of separate taxable income);
> . . .
>
> (5) Any consolidated charitable contributions deduction (see § 1.1502-24 for the computation of the consolidated charitable contributions deduction); . . . .

Treas. Reg. § 1.1502-24(a) provides that the deduction allowed by § 170 for the taxable year shall be the lesser of (1) the aggregate deduction of the members of the group allowable under § 170 (determined without regard to § 170(b)(2)), plus the consolidated charitable contribution carryovers to such year, or (2) five percent of the adjusted consolidated taxable income as determined under paragraph (c) of § 1.1502-24.

It should be noted that Treas. Reg. § 1.1502-24(a) has not been updated to take into account the amendment to § 170(b)(2), increasing the limitation to 10 percent. The Service does not question the application of the 10 percent limitation to consolidated groups and will not apply the regulations to restrict the limitation on a consolidated charitable contribution to a lesser percentage than allowed under the Code for the applicable year(s).

Treas. Reg. § 1.1502-24(c) provides that for purposes of this section, the adjusted consolidated taxable income of the group for any consolidated return year shall be the consolidated taxable income computed without regard to this section, section 242, 243(a)(2) and (3), § 1.1502-25, § 1.1502-26, and § 1.1502-27, and without regard to any consolidated net operating or net capital loss carrybacks to such year.

In a life-nonlife group, the regulations adopt a subgroup rather than a group method to determine CTI. Treas. Reg. § 1.1502-47(a). The regulations provide specific rules on how each subgroup determines its own CTI.

Specifically, Treas. Reg. § 1.1502-47(g) provides that the life-nonlife group's CTI is the sum of three amounts:

(1) Nonlife consolidated taxable income. The nonlife consolidated taxable income [(NLCTI)] (as defined in paragraph (h) of this section) of the nonlife subgroup, as set off by the life subgroup losses as provided in paragraph (n) of this section. The amount in this paragraph (g)(1) may not be less than zero.

(2) Consolidated partial LICTI. The consolidated partial LICTI [life insurance company taxable income] (as defined in paragraph (j) of this section) of the life subgroup, as set off by the nonlife subgroup losses as provided in paragraph (m) of this section. The amount in this paragraph (g)(2) may not be less than zero.

(3) Surplus accounts. The sum of the amounts subtracted under section 815 from the policyholders' surplus accounts of the life members.

Treas. Reg. § 1.1502-47(h) provides that NLCTI "is the consolidated taxable income of the nonlife subgroup, computed under § 1.1502-11 as modified by this paragraph (h)." Paragraph (h) does not specifically modify the calculation of the charitable contribution deduction or the limitation thereon. The definition of the life subgroup CTI, consolidated partial LICTI, is reserved. Treas. Reg. § 1.1502-47(j).

The taxpayer acknowledges that the life-nonlife regulations require that the charitable contribution deduction must be taken into account on a subgroup basis. However, the taxpayer argues that the consolidated return regulations, and in particular, Treas. Reg. §§ 1.1502-24 and -47, do not specifically address how the charitable contribution deduction taxable income limitation in § 1.1502-24(c) is to be calculated. Therefore, the taxpayer argues that although the charitable contribution deduction is taken into account on a subgroup basis pursuant to § 1.1502-47(h), § 1.1502-47(h) does not preempt the definition of the adjusted consolidated taxable income limitation of § 1.1502-24(c).

In calculating the charitable contribution deduction, the taxpayer computed a "modified taxable income" amount for each subgroup, calculating each subgroup's income by treating each subgroup as a group under Treas. Reg. § 1.1502-11 and making the adjustments required by § 1.1502-24(c) to each subgroup's income. The taxpayer then aggregated the "modified taxable incomes" of each subgroup (both positive with the modifications) to determine what the taxpayer characterizes as "consolidated modified taxable income." The taxpayer determined that 10 percent of this "consolidated modified taxable income" is the aggregate amount of charitable deductions the group is entitled to pursuant to § 170 and § 1.1502-24.

The taxpayer then allocated to each subgroup a portion of the total amount of charitable deductions allowed based on the proportion of charitable contributions each subgroup made to the total charitable contributions by all members of the group. The

taxpayer argues that this is the subgroup's charitable contribution limitation. The taxpayer claims the subgroups are entitled to a subgroup charitable contribution deduction up to the lesser of the sum of the charitable contributions made by the members of the subgroup for the year or the subgroup's allocable portion of the limitation.

The Service certainly agrees with the taxpayer that the charitable contribution deduction must be calculated on a subgroup basis. However, the taxpayer's approach was not calculated on a subgroup basis. It was calculated on a group basis and then allocated to each subgroup. There is no authority for this allocation approach. The effect of this allocation approach is to ignore the requirement that each subgroup determines a subgroup CTI.

We do not agree with the taxpayer in the manner in which it calculated the charitable contribution deduction limitation. We do not agree with the taxpayer's proposition that Treas. Reg. § 1.1502-47(h) intended to treat the subgroup as the group for purposes of taking into account the charitable contribution deduction but § 1.1502-47(h) did not intend to treat the subgroup as the group for purposes of determining the taxable income limitation under § 1.1502-24(c).

Treas. Reg. § 1.1502-47(h) modifies the entire § 1.1502-24 calculation and not just a portion of the calculation. The life-nonlife regulations provide that the § 1.1502-11 calculations, normally made on a entire group basis, must be made on a subgroup basis for life-nonlife groups. The regulations do not exclude the charitable contribution deduction computation, § 1.1502-11(a)(5), from the subgroup computation of subgroup CTI. Treas. Reg. § 1.1502-47(h).

Furthermore, Treas. Reg. § 1.1502-47(n)(2)(vi) provides that the setoff of life subgroup losses against nonlife consolidated taxable income does not affect nonlife member deductions that depend in whole or in part on taxable income. The implication of § 1.1502-47(n)(2)(vi) is that deductions that are limited by the taxpayer's taxable income are limited to the subgroup's taxable income and not the entire group's income. Treas. Reg. § 1.1502-47(m)(3)(v) is a similar provision for the life subgroup.

The methodology used in calculating the taxable income limitation on a subgroup basis is consistent with consolidated return principles. Treas. Reg. § 1.1502-24(c) defines adjusted consolidated taxable income as the consolidated taxable income computed without regard to the consolidated charitable contribution deduction (as determined under § 1.1502-24), § 242, § 243(a)(2) and (3), § 1.1502-25, § 1.1502-26, and § 1.1502-27, and without regard to any net operating loss ("NOL") or capital loss carryovers. The exclusions are items that are generally taken into account under § 1.1502-11 in determining each subgroup's consolidated taxable income for a life-nonlife return. Because these items are included or excluded at the subgroup level, it is

consistent with § 1.1502-24(c) that the measure of taxable income for purposes of the charitable contribution deduction limitation also be at the subgroup level.

The taxpayer cites United Dominion Industries, Inc. v. Commissioner, 532 U.S. 822 (2001) as support for its position. In United Dominion, the issue was whether there should be a product liability loss carryback by a consolidated group in which a member of the group has a product liability expense but still has separate taxable income under § 1.1502-12. The consolidated return regulations do not determine separate NOLs for members of the group and refer only to the group's loss, the consolidated net operating loss ("CNOL"). Because the provision for product liability loss carrybacks under I.R.C. § 172 provides a 10-year carryback to a "taxpayer" having a product liability loss, the Court determined that, absent a regulation providing otherwise, an allocable portion of the group's CNOL must be treated as a product liability loss for purposes of the 10-year carryback.

United Dominion is distinguishable because in this case the consolidated return regulations are not silent. The consolidated charitable contributions deduction is generally determined under § 1.1502-24 and is based on CTI. In a life-nonlife consolidated return, Treas. Reg. § 1.1502-47 provides that each subgroup determines its own subgroup CTI. Therefore, as discussed above, a life-nonlife group should calculate the consolidated charitable contributions deduction on a subgroup basis. The subgroup approach is required for life-nonlife consolidated returns.

Furthermore, unlike United Dominion, the subgroup approach provides a straightforward calculation, whereas the taxpayer's approach requires several additional calculations that have no basis in the Code or regulations. For example, the taxpayer determines "modified taxable income" of each subgroup and then aggregates the two "modified taxable incomes" before determining the charitable contribution deduction. The taxpayer's method does not address whether, when a subgroup's "modified taxable income" is a loss, the subgroup's loss is first carried back to offset subgroup income in a prior year before determining "adjusted consolidated taxable income." See § 1.1502-47(h)(2)(iii). In contrast, by determining the charitable contributions deduction limitation on a subgroup basis, the limitation is determined before the application of NOLs and capital loss carrybacks, which is consistent with the normal § 170 calculation and the normal § 1.1502-24 calculation. Additionally, the taxpayer's method requires an allocation of the taxable income limitation to each subgroup without any guidance as to how this allocation should be made. In contrast, no allocation is necessary when the limitation is made on a subgroup basis.

This case is also distinguishable from the recent decision in State Farm Mutual Automobile Insurance Co. v. Commissioner, 119 T.C. No. 21 (2002). The issue in State Farm was the appropriate manner of making the book income adjustment for alternative minimum tax purposes for a life-nonlife consolidated group. The court determined that the book income adjustment must be made on a consolidated group

basis, not a subgroup basis, because Treas. Reg. § 1.56-1 provided the adjustment should be made on a group basis. Treas. Reg. § 1.1502-47(r) preempts other consolidated return regulations. Without an explicit preemption, the court determined that § 1.56-1 applied. Treas. Reg. § 1.56-1 did not address life-nonlife consolidated groups.

In this case, the life-nonlife regulations specifically provide that the other consolidated return regulations are preempted. Treas. Reg. § 1.1502-47(r). Therefore, application of § 1.1502-24, the calculation of the consolidated charitable contributions deduction, is preempted under § 1.1502-47(r) to the extent that the calculation is based on each subgroup's CTI rather than the group's CTI. In particular, § 1.1502-47(h) provides that the nonlife subgroup's income is the subgroup's income computed under § 1.1502-11. Because §§ 1.1502-47(h) and -11(a)(5) provide that the charitable contributions deduction calculation is made on a subgroup basis, it follows that the charitable contributions deduction limitation should also be made on a subgroup basis.

In summary, without an express indication that the subgroup method is not to be used for all purposes of determining the charitable contributions deduction, the Service concludes that Treas. Reg. § 1.1502-47(h) provides a straightforward method for determining the charitable contributions limitation on a subgroup basis. Thus, in a life-nonlife consolidated group, each subgroup determines the subgroup's consolidated charitable contributions deduction limitation based upon the subgroup's adjusted consolidated taxable income.

CAVEATS

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.