INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE-MIS No.: TAM-105188-04, CC:CORP:BO4

Taxpayer's Name:
Taxpayer's Address:

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

LEGEND:

Distributing =

Controlled =

Business B =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

a =

b =

c =

d =

e =

f =

ISSUE:

Does Controlled's separate return limitation year ("SRLY") cumulative register under § 1.1502-21T(c)(1) include only the items of income, gain, deduction, and loss generated by Controlled and any applicable subgroup members (as defined in § 1.1502-21T(c)(2)) or does it also include Distributing's items of income, gain, deduction, and loss?

CONCLUSION:

Controlled's SRLY cumulative register includes only the items of income, gain, deduction, and loss generated by Controlled and any applicable subgroup members because the context does not require that Distributing be treated as an extension of Controlled for purposes of § 1.1502-21T(c)(1). See § 1.1502-21T(f)(1).

FACTS:

Distributing is a publicly-traded company and the common parent of an affiliated group that files consolidated tax returns on a calendar-year basis ("Distributing Group"). Distributing was engaged in several different businesses, both directly and through its subsidiaries. In Year 1 (a year after 1991 but before 1997), Distributing entered into a plan of reorganization under which it would spin off Business B. On Date 1 (a date during Year 1), Distributing formed Controlled but did not transfer to it significant assets. Distributing included Controlled in its Year 1 consolidated tax return.

On Date 2 (a date during Year 2, after 1991 but before 1997), Distributing transferred to Controlled the assets (including stock of wholly-owned subsidiaries) related to Business B. The Business B assets constituted approximately a percent of the operating assets of Distributing based on financial statement book value. On Date

5, Controlled's market capitalization was b percent of the cumulative market capitalization of Distributing and Controlled. The fair market value of the assets received by Controlled from Distributing exceeded the basis of the assets by a material amount.

As part of a reorganization that qualified for tax-free treatment under §§ 368(a)(1)(D) and 355 of the Internal Revenue Code (the "Code"), Distributing distributed all the stock of Controlled to its shareholders on Date 4 (a date during Year 2). On Date 3 (a date during Year 2), in anticipation of the spin-off of Controlled, an initial public offering of Controlled stock was consummated. Following the distribution, Distributing continued to conduct other lines of business, both directly and through its remaining subsidiaries.

Following the distribution of Controlled stock to the shareholders of Distributing, Controlled was the publicly-traded common parent of an affiliated group that files consolidated tax returns on a fiscal-year basis ("Controlled Group"). The Controlled Group included the subsidiaries that Distributing transferred to Controlled on Date 2.

In Year 3, the Controlled Group reported a consolidated net operating loss ("CNOL") of $c. Of that amount, approximately $d was attributable to Controlled, $e was attributable to other former Distributing Group members, and the remainder was attributable to members of the Controlled Group that were not former Distributing Group members. The Distributing Group filed an amended tax return for Year 2 and claimed a refund due to a CNOL carryback of approximately $f of the Controlled Group's CNOL.

TAXPAYER'S POSITION:

The taxpayer argues that, by application of § 1.1502-21T(f)(1), Distributing should be treated as the "alter ego" of Controlled,[1] and, therefore, that the cumulative register of Controlled should include the income history of Distributing dating back to Distributing's 1991 taxable year.[2] The taxpayer argues that, with regard to carrybacks of SRLY attributes, the cumulative register rule is built on a matching principle. Because Controlled's losses were generated by Business B, which was transferred to Controlled by Distributing, the taxpayer argues that § 1.1502-21T(f)(1) must be interpreted at least broadly enough to allow for inclusion of Distributing's income history in the cumulative register of Controlled, to match Controlled's losses with the income history of Distributing. In addition, taxpayer asserts that an interpretation of § 1.1502-21T(f)(1), as applied to the transaction at issue, that is based on the principles of

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[1] The taxpayer has not specified whether the period of inclusion of Distributing's items should end as of the transfer of Business B, or as of the date of the distribution of the Controlled stock.

[2] Section 1.1502-21T(c)(1)(i) and (g)(1) provides that the cumulative register of a member begins as of its first taxable year in the group beginning on or after January 1, 1997. However, under § 1.1502-21T(g)(3), subject to certain requirements that have been met in this case, a consolidated group may apply the cumulative register rules for all consolidated return years ending on or after January 29**,** 1991.

separate return filing disregards the impact of the significant changes to the SRLY regulations that occurred in 1991. Finally, the taxpayer argues that an interpretation that resolves the issue at hand based on separate return principles also disregards the contextual analysis required by § 1.1502-21T(f)(1) and reduces that provision to an anti-abuse rule.

LAW AND ANALYSIS:

Section 1.1502-21T(c)(1)(i) provides that the aggregate of the net operating loss carryovers and carrybacks of a member arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group under § 1.1502-21T(a) may not exceed the aggregate consolidated taxable income ("CTI") for all consolidated return years of the group determined by reference to only the member's items of income, gain, deduction, and loss. This is commonly referred to as the cumulative register rule.

Section 1.1502-21T(c)(2) provides that in the case of a net operating loss carryover or carryback for which there is a SRLY subgroup, the principles of § 1.1502-21T(c)(1) apply to the SRLY subgroup, and not separately to its members.

Section 1.1502-21T(c)(2)(ii) provides that, in the case of a carryback, the SRLY subgroup is composed of the member carrying back the loss (the loss member) and each other member of the group from which the loss is carried back that has been continuously affiliated with the loss member from the year to which the loss is carried through the year in which the loss arises.

For the years at issue, § 1.1502-1(f)(4) provided that the term predecessor means a transferor or distributor of assets to a member (the successor) in a transaction (i) to which § 381(a) applies; or (ii) that occurs on or after January 29, 1991, in which the successor's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the assets of the transferor or distributor, but only if the amount by which basis differs from value, in the aggregate, is material.

Section 1.1502-21T(f)(1) provides that, for purposes of § 1.1502-21T, any reference to a corporation, member, common parent, or subsidiary, includes, as the context may require, a reference to a successor or predecessor, as defined in § 1.1502-1(f)(4).

Section 1.1502-21T(f)(2) provides that, except as the Commissioner may otherwise determine, any increase in the CTI of a SRLY subgroup that is attributable to a successor is disregarded unless the successor acquires substantially all the assets and liabilities of its predecessor and the predecessor ceases to exist.

The § 1.1502-21T regulations apply to all consolidated return years beginning on or after January 1, 1997. See § 1.1502-21T(g)(1). However, § 1.1502-21T(g)(3)

provides that a consolidated group may apply the rules of § 1.1502-21T to all consolidated return years ending on or after January 29, 1991 and beginning before January 1, 1997, but the rules of § 1.1502-21T(c) are applied only with respect to the losses and deductions of those corporations that became members of the group (including members of a subgroup) and to acquisitions occurring on or after January 29, 1991 (and only with respect to such losses and deductions).

The issue addressed by this technical advice memorandum is whether Controlled's SRLY cumulative register under § 1.1502-21T(c)(1) includes only its items of income, gain, loss, and deduction (and those items of the members of any applicable SRLY subgroup[3]) or whether it also includes Distributing's items of income, gain, loss, and deduction beginning in 1991. Based on the type of transaction undertaken, and in light of the text of the regulations at issue (the "1991 regulations"[4]), the well-established purpose of the SRLY rules, and the indications of intent provided in the preamble to those regulations, this memorandum concludes that Controlled's cumulative register does not include items of Distributing.

Section 1.1502-21T(f)(1) provides that, for purposes of § 1.1502-21T, "any reference to a corporation, member, common parent, or subsidiary, includes, as the context may require, a reference to a successor or predecessor, as defined in § 1.1502-1(f)(4)." Section 1.1502-1(f)(4) provides general definitions of predecessor and successor for purposes of the consolidated return regulations. For the period at issue, § 1.1502-1(f)(4) provided that "predecessor" means a transferor or distributor of assets to a member (the successor) in a transaction (i) to which § 381(a) applies; or (ii) that occurs on or after January 29, 1991, in which the successor's basis for the assets is determined, directly or indirectly, in whole or in part, by reference to the basis of the assets of the transferor or distributor, but only if the amount by which basis differs from value, in the aggregate, is material.

Distributing transferred to Controlled the assets of Business B in a carryover basis transaction meeting the requirements of § 1.1502-1(f)(4)(ii). Therefore, Distributing qualifies as a predecessor of Controlled under the general definition contained in § 1.1502-1(f)(4). However, § 1.1502-21T(f)(1) puts forth a higher threshold for treatment of a predecessor as an extension of a member that is subject to the SRLY regulations. Under § 1.1502-21T(f)(1), any reference to a member of a group includes, "as the context may require, a reference to a successor or predecessor, as defined in § 1.1502-1(f)(4)." (Emphasis added.) If Distributing is found to be a predecessor that is treated as an extension of Controlled for purposes of the cumulative register

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[3] The taxpayer has not argued that Distributing should be treated as a subgroup member for purposes of the carryback of Controlled's Year 3 loss.

[4] On February 4, 1991, the IRS and the Treasury Department issued proposed regulations regarding the SRLY limitation. See CO-78-90, 1991-1 C.B. 757. On June 27, 1996, the IRS and the Treasury Department issued temporary regulations that were substantially identical. See T.D. 8677, 1996-2 C.B. 119. These 1996 temporary regulations are electively applicable by taxpayers for years ending on or after January 29, 1991. See § 1.1502-21T(g)(3).

computation under the "context" standard of § 1.1502-21T(f)(1), the income history of Distributing will be included in the cumulative register of Controlled.

Thus, the controversy in this case concerns the meaning of the phrase, "as the context may require." Controlled generated a loss in Year 3 from its operation of Business B. In Year 2, Distributing had transferred to Controlled all of the assets of Business B, but continued to operate other businesses. The taxpayer contends that, because of the "compelling" relationship between Distributing and Controlled, the "context" requires that Distributing be treated as an extension of Controlled. Taxpayer bases its argument, at least in part, on application of the matching principles that it asserts led to the introduction of the cumulative register in the 1991 regulations.

Neither the 1991 regulations, nor the final 1999 version of the SRLY regulations, expounds on the meaning of the phrase "as the context may require." However, an examination of the pertinent sections of the 1991 regulations, the accompanying preamble, as well as the well-developed history and purpose of the SRLY regulations, provides a strong basis for interpretation of this language.

A. HISTORY AND PURPOSE OF THE SRLY RULES:

The SRLY rules have historically served to police the line between consolidated return years and separate return years. One of the most valuable features of consolidated filing is the right of a group to freely offset the losses of one member against the income and gain of other members. See section 1501; § 1.1502-11(a). However, it was established very early in the history of consolidated filing that the right to such unlimited offset extends only to losses incurred during years of affiliation. See Woolford Realty Co. v. Rose, 286 U.S. 319 , 330 (1932) (affirming the opinion of the 5th Circuit and stating that deduction of a separate year loss of one member against consolidated taxable income attributable to a different member "is unreasonable and cannot have been intended by the framers of the statute.") With regard to whether such a limitation impeded the proper functioning of the precursors to §§ 172 and 1502, the circuit court of appeals had stated:

> The view we take gives full effect to them both. It does not permit affiliation to deprive the taxpayer of his net loss privilege or in any manner diminish it. It does not permit affiliation to enlarge or in any manner change it. [53 F.2d 821, 825 (5th Cir. 1931).]

The SRLY rules implement the principle established by Woolford Realty and limit a group's ability to offset separate return year losses of one member against the income of other members. The regulations in effect for the years prior to the issuance of the regulations currently at issue ("pre-1991 regulations") provided for a clear separate entity-based rule regarding the use of SRLY losses. A consolidated group could use such losses to offset only the income generated by the member carrying over such losses. See § 1.1502-21A(c)(2). Unfortunately, these regulations created certain

anomalous results, as discussed in the preamble to the 1991 regulations at issue. For example, if the member carrying over the SRLY loss produced income in a consolidated return year, but the group had no positive CTI for that year, the member's SRLY losses could not be absorbed in that year. Because the pre-1991 regulations contained no mechanism to carry over the member's contribution to CTI to other years, the SRLY losses could not be absorbed in a different consolidated return year unless the member also contributed to CTI in that other year. See CO-78-90, 1991-1 C.B. 757, 758.

Another anomaly was caused by the fact that the SRLY limitation of the pre-1991 regulations operated on a member-by-member (fragmentation) basis. Therefore, if multiple group members moved together between consolidated groups, a strange outcome could result. Assume, for example, that two members of the same group joined another group, and one member carried over a portion of its net operating losses arising in the old group. Although, in the first group, the carryovers could have offset the income of both members, the new group generally could absorb the carryovers only to the extent that the specific member carrying over the loss contributed to the new group's CTI. See id. at 759. In describing the troubling nature of this outcome, the preamble to the 1991 regulations states:

> [T]he tax laws should be neutral with respect to changes in ownership so that losses arising among members of a group are able to be used among the members following an ownership change, subject only to the restrictions imposed on a single entity in similar circumstances. [Id.]

In an attempt to address the problems that resulted from application of the pre-1991 regulations, in 1991, the IRS and Treasury Department proposed the regulations now at issue.

B. 1991 REGULATIONS AND PREAMBLE:

1. Subgrouping and Cumulative Register

The 1991 regulations introduced to the SRLY regime two significant structural changes in order to address the anomalies described above. First, the 1991 regulations introduced subgrouping rules. Under these rules, if a subgroup exists with regard to a particular SRLY tax attribute,[5] the SRLY limitation is based on the aggregate contribution to CTI by the members included in the SRLY subgroup, rather than being computed on a member-by-member basis. See § 1.1502-21T(c)(2). This change

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[5] Section 1.1502-21T(c)(2)(i) provides that in the case of a carryover, the SRLY subgroup is composed of the member carrying over the loss (the loss member) and each other member that was a member of the former group that becomes a member of the group at the same time as the loss member.

Section 1.1502-21T(c)(2)(ii) provides that in the case of a carryback, the SRLY subgroup is composed of the member carrying back the loss (the loss member) and each other member of the group from which the loss is carried back that has been continuously affiliated with the loss member from the year to which the loss is carried through the year in which the loss arises.

preserves the members' pre-existing right to freely offset income of one member against loss of another. The addition of the subgrouping rules moves away from strict separate entity treatment, in certain respects. Clearly, calculating the aggregate contribution of a subgroup will produce a different total than calculating the contribution solely of the member that carries the SRLY attribute. Indeed, the purpose of the subgrouping rule is to treat the various members of the subgroup as if they were divisions of a single corporation, and to apply the carryover and carryback rules to that single entity.[6] The application of this rule does not result in free use of the SRLY attributes by the consolidated group. Rather, implementation of the single entity concept results in the continued free use of the SRLY attributes only among those members that had such free use within the group in which the loss was incurred. Thus, application of the subgrouping rule departs from separate return outcomes only to the extent necessary to address the lack of neutrality that had resulted from the application of the pre-1991 regulations, when multiple members moved together between consolidated groups.

The 1991 regulations also introduced the concept of the cumulative register found at § 1.1502-21T(c)(1). Under this provision, a member's contribution to CTI is measured cumulatively over the period during which the corporation is a member of the group.[7] As a result, a member's SRLY losses may be absorbed in a consolidated return year in which the member does not contribute to CTI to the extent of the member's cumulative net positive contribution to CTI over a course of years. Introduction of the cumulative register concept moves away from strict separate-entity treatment, in certain respects. For example, under § 172, losses may be carried back only a limited number of years, and then must be carried forward. Because the cumulative register rule of § 1.1502-21T(c)(1) constructs a running total beginning as early as 1991, it is possible for a taxpayer to have a much larger (or much smaller) usable carryback under the 1991 regulations than under the separate return application of § 172.[8]

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[6] See CO-78-90, 1991-1 C.B. at 759 ("[L]osses arising among members of a group are able to be used among the members following an ownership change, subject only to the restrictions imposed on a single entity in similar circumstances.")

[7] Section 1.1502-21T(c)(1)(i) provides:

> The aggregate of the net operating loss carryovers and carrybacks of a member arising (or treated as arising) in SRLYs that are included in the CNOL deductions for all consolidated return years of the group . . . may not exceed the aggregate consolidated taxable income for all consolidated return years of the group determined by reference to only the member's items of income, gain, deduction, and loss.

[8] For example, assume that in Years 1 through 5, S1 joined in the filing of a consolidated return with Group X. S1 had large amounts of income in each of Years 1 through 3, but, in each of Years 4 and 5, S1 had no income or loss. At the end of Year 5, S1 left the group. In Year 6, S1 incurred a loss. Assuming a 2-year carryback period under § 172, S1 is eligible to carry back its Year 6 loss to Years 4 and 5. However, applying § 172 on a separate return basis, S is unable to use any of the Year 6 loss in the carryback years because S1 generated no taxable income in those years. In contrast, under the 1991 regulations, Group X can use the S1 Year 6 loss to the extent of S1's positive cumulative register for years during Years 1 through 5 (limited by CTI).

Because a consolidated group offsets consolidated year items of all members before applying § 172, it is impossible to replicate a perfect separate entity outcome regarding the use of SRLY attributes by a consolidated group.[9] Despite this inability to reach a perfect resolution, it is notable that the cumulative register tracks only the items of the member that carries over or back a SRLY attribute (or the items of the members of the subgroup that exists with respect to the tax attribute). See § 1.1502-21T(c)(1) and (2). Further, the preamble to the 1991 regulations indicates that, to the extent that a subgroup exists, the drafters intended that the cumulative register would generally track only the subgroup that is initially established:

> Once a group becomes a subgroup within another group, it is generally not permitted to increase its membership. Permitting increases in the membership of subgroups would effectively eliminate the SRLY limitation. [CO-78-90, 1991-1 C.B. at 759.]

Thus, the cumulative register rule respects separate entity principles, enhanced by the subgrouping rules, and departs from separate return outcomes only to the extent necessary to correct, to the extent possible, the anomalous outcome produced under the pre-1991 regulations, which effectively disregarded economic contributions of members to the group in years in which a group did not produce positive CTI.

2. Predecessors and Successors

The 1991 regulations incorporated into the SRLY rules the predecessor and successor concepts here at issue. Section 1.1502-21T(f)(1) provides:

> Predecessors and successors—(1) In general. For purposes of this section, any reference to a corporation, member, common parent, or subsidiary, includes, as the context may require, a reference to a successor or predecessor, as defined in § 1.1502-1(f)(4).

As noted above, the 1991 regulations do not expound upon the meaning of the phrase "as the context may require" with regard to claims for treatment of predecessors and successors as extensions of one another. However, the preamble provides insight into the intended application of this rule to inclusion of predecessor items that would enlarge the cumulative register of a successor:

> In order to prevent one member's inappropriate use of the historic contribution to consolidated taxable income by another member, predecessors will be taken into account only as the context may require. In addition, a SRLY limitation may not be increased by a member transferring a portion of its assets in order to divide its

[9] If a corporation has taxable income for one year, the corporation can carry to that year tax attributes from its other years, by application of § 172. However, if that corporation is a member of a consolidated group for the year at issue, § 172 is applied only after the taxable income of the member has been combined with (and possibly offset by) items of other members of the group. See § 1.1502-11(a).

> contribution to consolidated taxable income between itself and other members of the group. [CO-78-90, 1991-1 C.B. at 759 (emphasis added).]

Thus, the preamble clarifies that predecessor items will be allowed to expand successor cumulative registers in very limited cases, i.e., "only as the context may require." (Emphasis added.) The preamble expresses no such intent with regard to inclusion of successor items.

Beyond the explanation contained in the preamble, the regulations do provide one illustration of the application of the "context" requirement in the case of carryovers (but not carrybacks). Section 1.1502-21T(f)(2) contains the following specific rule regarding the inclusion of items of successors in the cumulative registers of predecessors:[10]

> Limitation on SRLY subgroups. Except as the Commissioner may otherwise determine, any increase in the consolidated taxable income of a SRLY subgroup that is attributable to a successor is disregarded unless the successor acquires substantially all the assets and liabilities of the predecessor and the predecessor ceases to exist.

Section 1.1502-21T(f)(2) was intended to address tax avoidance situations in which a taxpayer may try to increase its cumulative register by segregating poorly performing assets in a subsidiary.[11] Another matter of concern was the possibility of taxpayers transferring assets to other group members in order to qualify those members as "successors" and thus bring additional positive income history into the transferor's cumulative register.[12]

The 1991 regulations address these concerns by instituting a relatively harsh rule, which results in the inclusion of negative contributions to a cumulative register by successors, but the exclusion of positive contributions, except to the extent that the successor acquires substantially all the assets and liabilities of the predecessor and the predecessor ceases to exist. Therefore, the regulations do not allow for positive expansion of the cumulative register, except in the case of entity-combining transactions. This result is consonant with the application of separate return principles to the carryback and carryover of SRLY attributes into a consolidated group.

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[10] Although § 1.1502-21T(f)(2), by its terms, appears to apply solely to successors of members of a subgroup, the provision is widely interpreted as applicable to successors outside of the subgroup context. See, e.g., Andrew J. Dubroff, et al., Federal Income Taxation of Corporations Filing Consolidated Returns, § 42.02(3)(a) (2d ed. 2004).

[11] See CO-78-90, 1991-1 C.B. at 759 ("[A] SRLY limitation may not be increased by a member transferring a portion of its assets in order to divide its contribution to consolidated taxable income between itself and other members of the group.) .

[12] See CO-78-90, 1991-1 C.B. at 759 ("Once a group becomes a subgroup within another group, it is generally not permitted to increase its membership. Permitting increases in the membership of subgroups would effectively eliminate the SRLY limitation.").

By its terms, the rule of § 1.1502-21T(f)(2) is inapplicable to carryback situations. However, this sole illustration of "context" requirement under § 1.1502-21T(f) provides an indication that the cumulative register was intended to remain faithful to the separate entity principles of the earlier SRLY rules.

C. RESPONSES TO THE TAXPAYER'S ARGUMENTS:

The taxpayer has argued that an interpretation of § 1.1502-21T(f)(1) that is guided by the principles of separate return filing, as applied to the facts presented, disregards the impact of the significant changes to the SRLY regulations which occurred in 1991. In particular, the taxpayer argues that, with regard to carrybacks of SRLY attributes, the cumulative register rule is based on a matching principle. Because Controlled's losses were generated by Business B, which was transferred to Controlled by Distributing, the taxpayer argues that Distributing constituted the "alter ego" of Controlled. Thus, the taxpayer asserts that the § 1.1502-21T(f)(1) "context" requirement must be interpreted to allow for inclusion of Distributing's income history in the cumulative register of Controlled, to match Controlled's losses with the income history of Distributing.

The taxpayer urges an interpretation of the SRLY rules that breaks from their historic function of ensuring that the usage of tax attributes is not enlarged by reason of members carrying such tax attributes into a consolidated group. This result is not grounded in the structural changes that appeared in the 1991 regulations. The taxpayer's desired result would match the losses from Business B with the income generated by that business in prior years, but Controlled's cumulative register would also include the income history of other businesses that remained with Distributing, which have no connection with Controlled. The context of the transaction undertaken by the taxpayer provides no persuasive reason for a result that diverges so dramatically from the result that would have been reached in a non-consolidated setting.

As discussed above, the well-established purpose of the SRLY rules is to prevent the offsetting of separate return year attributes of one member against income of different members. Taxpayer's interpretation of § 1.1502-21T(f)(1) would change the function of the SRLY rules in a fundamental manner. Taxpayer's proposed result allows the functional equivalent of the carryback of losses generated by a new subsidiary to a taxable year of its non-consolidated corporate parent. There is no indication in either the regulatory language or the associated preamble that such a substantial change was intended. In contrast, the two major structural changes in the SRLY rules that were introduced in the 1991 regulations were carefully outlined in the regulatory text, see § 1.1502-21T(c)(1) and (2), and extensively explained in the preamble. See CO-78-90, 1991-1 C.B. at 758-760. The taxpayer argues that the matching principles that support at least the introduction of the cumulative register militate in favor of inclusion of predecessor income history under the facts presented. However, the preamble to the 1991 regulations explains the specific anomalies that subgrouping and the cumulative register were intended to address; that preamble provides no link between the

cumulative register matching principles and application of the predecessor and successor rules. In fact, the only reference in the preamble to the application of the predecessor concept to cumulative registers in a carryback concept indicates an intention generally to disallow the addition of predecessor income histories into successor cumulative registers.[13]

The cumulative register is indeed based on a matching principle. As discussed above, the pre-1991 regulations included no mechanism to provide a taxpayer with a SRLY "credit" for its economic contribution to the group in a particular year if the group did not have positive CTI in that year. As a result, the pre-1991 regulations could produce the anomalous result of allowing no use of a SRLY attribute, in spite of positive contribution to CTI by the SRLY member. The cumulative register rule allows the consolidated group to use the separate return year attributes, but only to the extent of the cumulative contribution by the SRLY member to the group. Thus, the rule allows for matching of income and losses of a particular corporation across taxable years, and harmonizes the operations of the § 172 carryback and carryover rules with the rules for computing CTI under § 1.1502-11(a). In contrast, the lack of matching that the taxpayer seeks to address is inherent in the system of corporate taxation. That is, except to the extent that a loss is generated during a consolidated return year, the Code and regulations do not provide for use of that loss by any other corporation, unless specific requirements are satisfied. See § 381(a).

The taxpayer further argues that the existence of the rule of § 1.1502-21T(f)(2) is evidence that the "context" language of § 1.1502-21T(f)(1) is intended to be expansive, and thus, its existence cuts in favor of broader inclusion of predecessor items in cumulative registers. Section 1.1502-21T(f)(2) states that a predecessor's cumulative register may be increased by inclusion of items of the successor only if the successor acquires substantially all the assets and liabilities of the predecessor and the predecessor ceases to exist. Because § 1.1502-21T(f)(2) does not specifically provide a rule for inclusion of successor's income history in the cumulative register of the predecessor, the taxpayer argues that such inclusion is implicit in § 1.1502-21T(f)(1), and that only the existence of § 1.1502-21T(f)(2) prevents positive income history of successors from being included. Further, because no provision comparable to § 1.1502-21T(f)(2) applies in the carryback context, the taxpayer argues that the predecessor rules should be applied in a more expansive manner than the successor rules.

The taxpayer draws inferences from the somewhat opaque language of § 1.1502-21T(f)(2) that contravene the history and purpose of the SRLY rules. Further, the preamble to the 1991 regulations clearly indicates that, in carryback situations, predecessor income was intended to be added to cumulative registers of successors in

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[13] See CO-78-90, 1991-1 C.B. at 759 ("In order to prevent one member's inappropriate use of the historic contribution to consolidated taxable income by another member, predecessors will be taken into account only as the context may require." [Emphasis added]).

very limited circumstances ("only as the context may require"). The preamble also indicates specific concerns with manipulation of cumulative registers in the carryover context, and that the somewhat punitive rule of § 1.1502-21T(f)(2) was intended to combat those concerns. Based on these factors, the existence of § 1.1502-21T(f)(2) should be interpreted not to cut in favor of an expansive reading of the "context" requirement of § 1.1502-21T(f)(1).

Finally, the taxpayer argues that an interpretation of the 1991 regulations that resolves the issue at hand based on separate return principles disregards the "context" requirement of § 1.1502-21T(f)(1) and reduces that provision to an anti-abuse rule. Taxpayer points to the extensive history of the IRS and the Treasury Department in drafting anti-abuse rules, and notes that § 1.1502-21T(f)(1) bears little resemblance to such anti-abuse rules.[14]

It is clear from the preamble to the 1991 regulations that § 1.1502-21T(f)(1) was intended, at least in part, to serve an anti-abuse purpose.[15] Nevertheless, § 1.1502-21T(f)(1) constitutes more than an anti-abuse rule. For example, in the course of finalizing the SRLY regulations, the IRS and Treasury Department further considered the application of the predecessor and successor rules with regard to cumulative registers in the carryover context. Those final regulations went one step further in interpreting "as the context may require," beyond strict separate entity treatment, allowing expansion of the cumulative register to include the income of successors in the cumulative registers of predecessors, but only in the context of wholly-owned successors. See §1.1502-21(f)(2)(ii)(C).[16] The preamble to the 1999 regulations indicates that, in the course of finalizing those regulations, the IRS and the Treasury Department took into account the context surrounding such transactions and determined that strict separate entity treatment should not be followed because, in such cases, application of §1.1502-21T(f)(2) produced "unduly harsh results." T.D. 8823, 1999-2 C.B. 34, 39.[17]

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[14] There has been no suggestion that the transaction at issue constituted tax avoidance.

[15] See CO-78-90, 1991-1 C.B. at 759 ("In order to prevent one member's inappropriate use of the historic contribution to consolidated taxable income by another member, predecessors will be taken into account only as the context may require. In addition, a SRLY limitation may not be increased by a member transferring a portion of its assets in order to divide its contribution to consolidated taxable income between itself and other members of the group.").

[16] In many, if not most, of such transactions, inclusion of such wholly-owned successors will be an extension of the single entity theory of subgrouping, and a successor can be viewed as part of the pre-transfer whole. Concerns regarding administrability appear to have led the drafters to not differentiate between transfers to subsidiaries that result in an expansion of the pool of assets and those transfers that do not.

[17] The preamble to the final regulations expresses particular sympathy with regard to divisive § 351 transactions:

> [I]f T, a member of a SRLY subgroup, formed T1, by contributing to it one of its businesses, and T1 produced net operating losses, those losses would be included in determining the taxable income of the subgroup. On the other hand, if T1 produced taxable income, that income would not be included in the subgroup's taxable income. If no transfer to T1 had occurred, and the

CONCLUSION:

If the Distributing Group were not filing a consolidated return for the carryback year at issue, the Year 3 NOL carryback of Controlled could not be used to offset the income of Distributing. The well-established purpose of the SRLY rules is to prevent the offsetting of separate return year attributes of one member against income of other members, and thus to promote neutrality with regard to the use of separate return year attributes carried into consolidated groups versus those carried into separate return years. The major structural changes introduced in the 1991 regulations further promote neutrality. There is no indication in the text of the 1991 regulations nor in their preamble that the new rules were intended to fundamentally change the application of the principles of § 172, § 381, or the pre-existing SRLY rules, by enabling separate return year attributes to be used against taxable income of other entities, with the exception of SRLY subgroup members. Thus, on the facts presented, we conclude that, under § 1.1502-21T(f)(1), the context does not require that Distributing be treated as an extension of Controlled for purposes of computing Controlled's cumulative register. Consequently, Controlled's SRLY cumulative register includes only the items of income, gain, loss, and deduction generated by Controlled and any applicable subgroup members (as defined in § 1.1502-21T(c)(1)).

CAVEAT(S):

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

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business had remained in T, all of its income or loss, as the case may be, would be included in determining the subgroup's taxable income. T.D. 8823, 1999-2 C.B. at 39.