Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **20251401F**
Release Date: 4/4/2025

CC:LA:6:DEN:4:MMPOLLOCK:
POSTF-106767-24

UILC: 1502.21-00

date: December 11, 2024

to:

Revenue Agent
(Large Business & International)

from: Michael Pollock
Senior Attorney
(Litigation & Advisory)

---

subject: Consolidated NOL Carryback After Spin-Off

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Distributing =

A =

Corporation A =

LLC =

Sub =

Business X =

Business Y =

Shareholder =

Assets =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

p =

q =

r =

s =

t =

u =

v =

w =

x =

y =

z =

aa =

Date1 =

Date2 =

Year0 =

Year1 =

Year2 =

Year3 =

Year4 =

Year5 =

ISSUES

Whether, after a spin-off transaction, the Taxpayer (*i.e.*, Distributing) should be allowed to allocate the cumulative income from certain subsidiaries (which were not distributed, but a portion of the assets of which were distributed pursuant to the spin-off transaction) to the transferee corporation when the subsidiaries remained owned by the Taxpayer

CONCLUSION

The Taxpayer should not be allowed to allocate the cumulative income from Corporation A and Sub to a successor entity after a spin-off transaction, as those entities remained owned by the Taxpayer. This is because the spin-off transaction involved the separation of some members that left the Distributing Group (defined below), but Corporation A and Sub remained with Distributing post spin. Therefore, no portion of the cumulative income from Corporation A and Sub should be allocated to A. Granting the Taxpayer's request would be an inappropriate expansion of the SRLY limitation.

FACTS

a. The Spin-Off Transaction.

For the relevant taxable years, Distributing was the parent of an affiliated group of corporations that filed a consolidated return (the "Distributing Group") engaged in Business X and Business Y. On Date1, Distributing completed a tax-free distribution of Business Y (including Assets) into a separate company, A (the "Spin-off"). After the Spin-off, Distributing and A operate as separate companies, and neither entity has any ownership interest in the other. However, a substantial majority of the voting power of the shares of both companies is owned beneficially by Shareholder, who is also of both companies.

b. Prior Examination, Closing Agreements, and Informal Claim for Regular NOL and AMT NOL Carryback/Deductions.

An unagreed issue arose from the examination of Distributing's Year1, Year2, and Year4 tax returns regarding the proper tax treatment of Assets. A's Year4 tax return was also examined. Both Distributing and A elected Fast Track mediation to resolve the unagreed issue and Closing Agreements (Forms 906) were entered into by Distributing and A. Distributing's Closing Agreement includes an allowance for Distributing "to carry back a net operating loss from Year5 as if it had made the election to carry back the loss on its original return" and A's Closing Agreement includes an allowance for A "to carry back a net operating loss from Year5 as if it had made the election to carry back the loss on its original return."

Neither Closing Agreement specifically stated to which tax return the loss can be carried. Nevertheless, the Taxpayer interpreted the Closing Agreement to allow the Taxpayer to carryback A's losses in tax year Year5 to Distributing's Year4 tax return. This assumption led Distributing to file an informal claim requesting $b carryback/deduction of regular net operating losses and $a carryback/deduction of Alternative Minimum Tax net operating losses from A's Year5 tax return to Distributing's Year4 tax return.

c. Service's Disallowance of Informal Claim for NOL Deductions (30-Day Letter) and the Taxpayer's Protest.

Exam disallowed the informal claim and concluded that the Taxpayer should not be allowed to deduct the net operating losses from A's Year5 tax year on its Year4 tax return, as the Closing Agreement did not specifically state that A's Year5 losses can be carried back to Distributing's Year4 tax return. In addition, Exam also concluded that, even if A's Year5 losses can be carried back, the losses must be first carried back to Distributing's Year3 consolidated tax return, and then to A's Year4 tax return. However, Distributing incurred net losses in Year3, and A was not a member of the Distributing consolidated return in Year4 after the spin-off.

In the Taxpayer's Protest to the 30-Day Letter, the Taxpayer raised the "end of the day" concept under Treas. Reg. § 1.1502-76(b)(1)(ii)(A)(1), which provides that "If a corporation … becomes or ceases to be a member during a consolidated return year, it becomes or ceases to be a member at the end of the day on which its status as a member changes, and its tax year ends for all Federal income tax purposes at the end of that day …" Consequently, the Taxpayer asserted that A's Year5 losses should be carried back to 1) Distributing's Year4 return for the period before the spin (Date1, the spin-off day), then 2) the short Year4 taxable year for which A filed its own consolidated tax return.

Both of these issues were addressed in prior examination and are currently under consideration by Appeals. The issue at hand is whether the "old" A entities (prior to spin-off) had sufficient income to offset the NOL carryback from "new" A's Year5 losses (this is assuming that A's Year5 losses can be carried back to Distributing's Year4 tax return).

d. Appeals Consideration.

To support that "new" A's entities had cumulative taxable income in Year4, the Taxpayer provided the SRLY Register to Appeals Officer. Without formally ruling on either of the issues described above, the Appeals Officer sent the case back to Exam to verify that the government agrees with the Taxpayer's computation included in the SRLY Register.

The SRLY Register shows, from tax years Year0 through Year3, the Taxpayer accumulated net losses of $c. Of this amount, the Taxpayer determined that the entities that were distributed to A during the spin-off had net cumulative income of $aa from tax years Year0 through Year3. As a result, the Taxpayer claimed that A's Year5 losses of $aa can be carried back to Distributing's Year4 tax return. During Appeals, the question of whether the Taxpayer has substantiation for the amounts and allocations made in SRLY Register arose.

In response, the Taxpayer discovered that none of the personnel at the Taxpayer or at the accounting firm that prepared the SRLY Register were still employed by either company. For this reason, the Taxpayer re-created the SRLY Register using two methodologies that are referred to as the "Market Approach" and the "Asset Approach".

- *d% Allocation on SRLY Register*

The original SRLY Register showed the entities that were distributed to A in the spin-off transaction. These entities were listed under the column "[A] Corporation", and the cumulative income and losses were allocated to these entities. There are three-line items in the SRLY Register that stand out, because the Taxpayer attributed d% of the total (in Distributing) column to A. They are shown in the table below.

	Tax Years Year0 – Year3	Attributed to
	Total Net Income	[A]
Corporation A	$ e	$ f
Sub	$ g	$ h
Eliminations	$ i	$ j

The Taxpayer had no explanation or support for how or why d% was used on the original SRLY Register. Because the Taxpayer had no support for the d% allocation, the Taxpayer attempted to re-create the amounts that were listed on the A column above.

- *Corporation A and Sub*

In reviewing , it was determined that both Corporation A and Sub remained with the Distributing Group and were not distributed to A as part of the spin-off transaction.

The Taxpayer stated that a portion of the assets included in these two entities were contributed to A in the spin-off transaction; and accordingly, per the Taxpayer, the cumulative income should also be allocated to A based on the percentage of assets distributed.

- *Market Approach*

The first analysis recreated the SRLY Register using a market cap approach. Under this approach, the cumulative income and losses were allocated based on stock market price of each company on the spin-off date. Per Capital IQ, the following are the "Market Capitalization" on Date2.

Distributing	k	n%
A	l	o%
	m	

Market Capitalization = number of shares outstanding * closing price per share

Per the Taxpayer, the market cap computation resulted in a p% figure, a percentage that was not materially different from the d% reflected on the SRLY Register.

- *Asset Approach*

Per the Taxpayer, the analysis using the asset approach was a more substantive review that recreated A's cumulative SRLY register itself using a reasonable alternative methodology. The Taxpayer further stated that the asset approach analysis was intended to "double-check" the reasonableness of the SRLY Register.

- *Corporation A*

Corporation A owned LLC on the date of the spin-off. LLC had assets totaling $u. Of this amount, the Taxpayer stated that $v (or g%) of assets were transferred to A.

Under this new calculation, A was attributed $t of Distributing's cumulative net income as computed below.

Corporation A Cumulative Net Income	$ e	g%	$ r
Plus [Intercompany] Eliminations			$ s
Total			$ t

- *Sub*

Sub had total assets of $w, and of this amount, $x (or y%) were transferred to A.

Under this new calculation, A was attributed $z of Distributing's cumulative net income as computed below.

Distributing	$ g	y%	$ z
Plus [Intercompany] Eliminations			$ -
Total			$ z

LAW AND ANALYSIS

1. General overview: Separate return year; Separate Return Limitation Year (SRLY)

The taxable income of a consolidated group generally is determined by aggregating (and offsetting) the income and losses of each member of the group. *See* § 1.1502-11. This approach reflects the single-entity model of the consolidated group (*i.e.,* treating the group as a single taxable entity). However, an exception to the single-entity approach may apply in the case of losses incurred by members in taxable years in which they did not join in the filing of a consolidated return with the instant group, if those losses are carried either forward or backward to consolidated return years of the instant group. In these situations, the separate return limitation year (SRLY) rules of § 1.1502-21(c) may limit the use of the losses by the group. The general purpose of the SRLY rules is to preclude taxpayers from trafficking in losses and other attributes.

The definition of "separate return year" relates to any return of a member (or predecessor), other than a consolidated return of the instant group. See § 1.1502-1(f)(1). It is a term of art, embracing either an actual *separate* return of a member or a member's inclusion in another group's *consolidated* return. Section 1.1502-1(f) defines SRLY as "any separate return year of a member or a predecessor of a member," with certain exceptions not relevant to this discussion.

Section 1.1502-21(e) defines the consolidated net operating loss deduction ("CNOL") as any excess of deductions over gross income (without regard to any CNOL deduction), as determined under § 1.1502-11(a). The CNOL deduction for any consolidated return year is the aggregate of the net operating loss carryovers and carrybacks to the year. § 1.1502-21(a). The net operating loss carryovers and carrybacks consist of any CNOLs of the consolidated group and any net operating losses of members arising in SRLYs. The net operating loss carryovers and carrybacks to a taxable year are determined under the principles of § 172 and § 1.1502-21. § 1.1502-21(b).

Section 1.1502-21(c)(1) provides a limitation on net operating loss carryovers and carrybacks from SRLYs. Specifically, the aggregate of the net operating loss carryovers and carrybacks of a member arising in SRLYs that are included in the CNOL deductions for all consolidated return years of the group may not exceed that 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 ("cumulative register"). § 1.1502-21(c)(1).

SRLY subgroup rules in § 1.1502-21(c)(2) provide that the rules of § 1.1502-21(c)(1) apply to a SRLY subgroup, if there is one, and not separately to its members. For a carryback, the SRLY subgroup is composed of the member carrying back the loss ("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. § 1.1502-21(c)(2)(ii).

2. Predecessors and Successors.

Section 1.1502-21(f)(1) provides that any reference to a corporation, member, common parent, or subsidiary in § 1.1502-21 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. A "predecessor" is a transferor or distributor of assets to a member in a transaction to which § 381(a) applies. § 1.1502-1(f)(4)(i). Under § 1.1502-1(f)(4)(ii), the term "predecessor" also applies to a transaction occurring after January 1, 1997, in which the successor's basis in the assets is determined, in whole or in part, by reference to the basis of the assets in the hands of the transferor or distributor.[1]

Here, in the Spin-Off, each of Corporation A and Sub contributed assets to A prior to the Spin-Off in transactions that resulted in a carryover basis. However, as discussed further in detail below, there is no authority that allows the cumulative income of the two companies to be allocated in this case under the predecessor and successor rules because A's cumulative register does not include items of entities that remain in the Distributing Group after the Spin-Off.

3. Responses to the Taxpayer's argument.

The Taxpayer argues that, since "[t]here is no direct authority with respect to determining what amount of income, deduction, gain, or loss can be attributed to non-member stock assets contributed to a Controlled Corporation for purposes of determining the cumulative SRLY register for the SRLY subgroup. . . . any method reasonable under the circumstances may be used to determine the amount of the predecessor's income included in the SRLY subgroup of 'new' [A]." (The Taxpayer proposes, in the SRLY register it provided, two approaches, the "asset" approach and the "market cap" approach, as the "reasonable methods" that it contends should be used to determine the amount of allocable income.)

As mentioned above, the purpose of the SRLY rules is to prevent the offsetting of separate return year attributes of one member against income of different members. This situation is similar to the one in TAM 200514019, which involved a post-spinoff carryback of losses by the controlled corporation. There, the taxpayer argued that under § 1.1502-21T(f)(1) the distributing company should be treated as the "alter ego" of the controlled corporation for purposes of determining the cumulative register of the controlled corporation's subgroup. The TAM extensively discussed the purpose of the

[1] For such transactions occurring before June 25, 1999, this definition applies only if the amount by which the aggregate basis of the assets exceeds their value is material. In addition, for a transaction that occurs before June 25, 1999, only one member may be considered a predecessor to or a successor of one other member.

SRLY regulations, as well as the relevant preambles, and noted that the cumulative register rule allows the consolidated group to use the separate return year attributes only to the extent of the cumulative contribution by the SRLY member to the group. Addressing the taxpayer's argument for treating the distributing company as the alter ego of the controlled subgroup, the TAM stated:

> [T]he [cumulative register] 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 [consolidated taxable income] 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).

TAM 200514019. Accordingly, the TAM concluded that under § 1.1502-21T(f)(1), the context does not require that the distributing corporation be treated as an extension of the controlled corporation for purposes of computing the controlled corporation's cumulative register.

The Taxpayer is correct that there is no guidance regarding the attribution of income to non-member stock assets contributed to a controlled corporation in a spin-off for purposes of determining the accumulated register of the controlled corporation's subgroup. The reason for the absence of guidance is because no such attribution is contemplated by the regulations. The Taxpayer's interpretation of § 1.1502-21 would change the fundamental operation of the SRLY rules since the Taxpayer's proposed result would allow the carryback of losses generated by spun-off corporations to a taxable year of other corporations that are not affiliated with the spun-off corporations. *See* I.R.C. § 1504.[2]

The Taxpayer argues "[a]s predecessors under the definition in Treas. Reg. § 1.1502-1(f)(4)(ii), both [Corporation A] and [Sub] are included in the SRLY subgroup with their successor, 'new' [A]." Form 886-A, at 6.

We disagree with the Taxpayer's interpretation of the regulation. The preamble to the 1991 notice of proposed rulemaking to amend the consolidated return regulations explains the anomalous results produced by the determination of the SRLY limitation (by contribution to consolidated taxable income) and that subgrouping and the cumulative register are intended to address such anomalies. 56 FR 4228-01. However, nothing in that preamble links the cumulative register principles to the application of the predecessor and successor rules. Rather, the only reference to use of cumulative registers in the context of the predecessor rules in the preamble is that the regulations are purposed to generally disallow such use:

---

[2] Although Distributing and A are arguably related because they are both commonly controlled by the same shareholder, these entities technically are not "affiliated" under the Code unless there is at least 80% corporate ownership of vote and value. *See* I.R.C. § 1504.

> 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). 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.

Id. Thus, we adopt the analysis set forth in the TAM and conclude that, under § 1.1502-21(f)(1), the context does not require that A be treated as an extension of the Distributing Group entities for purposes of computing the cumulative register. Consequently, the SRLY cumulative register for A includes only the items of income, gain, loss, and deduction generated by A and any applicable subgroup members (as defined in § 1.1502-21(c)(2)) in the carryback year.

For the above reasons, the Taxpayer's position should be rejected, and the IRS's position as described in this advice should be adopted.

CAVEAT

I.R.C. § 6110(k)(3) dictates that this memorandum may not be used or cited as precedent.

This memorandum was coordinated with Associate Chief Counsel (Corporate). Please contact Michael Pollock via email at Michael.M.Pollock@irscounsel.treas.gov or by phone at with any questions.

WILLIAM PECK
Associate Area Counsel
(Litigation & Advisory)

By: _____
MICHAEL POLLOCK
Senior Attorney
(Litigation & Advisory)