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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR
Attn:

FROM: Acting Associate Chief Counsel (Corporate) CC:CORP

SUBJECT:

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[1]All references herein to the Internal Revenue Code (I.R.C.) are to the Code of 1986, as amended and in force for the years at issue herein.

with respect to the case and the issues discussed in the document require inspection or disclosure of the Field Service Advice.

LEGEND

Parent =

Shareholder A =

Sub 1 =

Sub 2 =

AA Shareholder =

Shareholder B =

Shareholder C =

Country D =

Country E =

$a =

$b =

#q =

#r =

#s =

%d =

%e =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Year 2 =

Introduction:

Sub 1 joined Parent's consolidated group during the last #q days of the consolidated group's calendar tax year and became a subsidiary in Parent's consolidated group. Parent made a dividend distribution to Shareholder C, a foreign corporation, which is not a member of the consolidated group, #r-day before Sub 1 had joined the consolidated group. Sub 1 purportedly incurred a loss during the last #q days of Parent's consolidated group's calendar tax year, and, thus, Sub 1 had a deficit in its current earnings and profits, ensuring that Parent also had a deficit in its current earnings and profits. Parent's accumulated earnings and profits available for the dividend distribution on Date 1 will be substantially reduced if Sub 1's loss is prorated over Parent's 12-month Year 2 calendar tax year. Dividends that are paid to Shareholder C are subject to a 5 percent withholding tax reportable on Form 1042. Thus, if Parent's accumulated earnings and profits available for distribution on Date 1 is substantially reduced, then the amount of dividends subject to the withholding tax is reduced as well. This memorandum will examine the following three issues.

Issues:

(1) A. In determining the amount of accumulated earnings and profits to the date of a distribution, is a taxpayer required to show, where it is possible, the actual interim earnings and profits to the date of a distribution, instead of using the daily proration method? More specifically, does the "cannot be shown" language of Treas. Reg. § 1.316-2(b) require the taxpayer to prove, to the extent that it is possible, the amount of interim earnings and profits available as of the distribution date?

B. Whether allowing the taxpayer to use the daily proration method provided in § 1.316-2(b) is consistent with the treatment afforded to the third and fourth situations described in Rev. Rul. 74-164?

(2) Whether the daily proration method employed in § 1.316-2(b) for determining the amount of accumulated earnings and profits to the date of a distribution allows any part of a loss incurred by a subsidiary after it becomes part of a consolidated group to be allocated to the earlier part of the parent's tax year, before the subsidiary became a member of the group and, thus, before the parent's distribution?

(3) Whether the $a expense that a corporation purportedly incurred after it had joined the consolidated group constitutes a recognized built-in loss under § 382(h)(2)(B)?

Conclusions:

(1) A. Treas. Reg. § 1.316-2(b) permits the taxpayer to adopt the daily proration method and does not require the taxpayer to show, even

where it is possible, the actual amount of interim earnings and profits to the date of the distribution.

B. Treas. Reg. § 1.316-2(b) is consistent with the treatment afforded to the third and fourth situations addressed in Rev. Rul. 74-164.

(2) The loss that Sub 1 supposedly incurred during the last #q days of Parent's consolidated group's tax year should not be prorated over Parent's 12-month calendar tax year, i.e., this loss should not be prorated to the date of the distribution. Therefore, this loss should not affect the amount of accumulated earnings and profits that was available when Parent paid a $b dividend to Shareholder C on Date 1.

(3) Based on the facts provided and assumed, the $a expense does not appear to constitute a recognized built-in loss.

Facts:

In Year 1, Sub 1 was acquired by Parent, a domestic corporation, and by Shareholder A.[2] Parent received an option to acquire, or have Sub 1 acquire, the Sub 1 common stock held by Shareholder A.

Well before Date 1, the following ownership structure had existed: (a) Sub 2 was a wholly owned subsidiary of Parent; (b) AA Shareholder, a Country D corporation, held %d of the voting stock and %e of the other classes of stock of Parent; and (c) AA Shareholder was an indirect wholly owned subsidiary of Shareholder B, a Country E corporation.

On or about Date 1, the following events occurred: (a) AA Shareholder sold its Parent stock to Shareholder C, a foreign corporation, that was formed by AA Shareholder and Shareholder A to acquire Parent's stock; (b) Shareholder C issued to AA Shareholder a #r-day promissory note for $b in consideration for Parent's stock; (c) Parent paid a $b dividend to Shareholder C;[3] and (d) Shareholder C gave to AA Shareholder the $b dividend payment to satisfy the #r-day promissory note.

On or about Date 2, Sub 1 redeemed its stock from Shareholder A, and became a wholly owned subsidiary of Sub 2, which is a wholly owned subsidiary of Parent. Because Sub 1 was an indirect subsidiary of Parent, Sub 1 was included in the Parent Year 2 consolidated group return. Sub 1 purportedly incurred a loss for the period from

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[2]We assume that Shareholder A's interest in Sub 1 exceeded 20 percent.

[3]Through our discussions with you, we have learned that: (a) Parent did not have any current earnings and profits for Year 2; (b) Parent did have accumulated earnings and profits at the beginning of Year 2; and (c) Parent incurred an operating deficit during Year 2.

Date 2 through Date 3. This loss was largely attributed to bonus payments that were scheduled to be paid during the last #s weeks of Year 2.

Because Sub 1 was a member of the consolidated group purportedly when it incurred this loss, Sub 1 contends that it should be permitted to prorate this loss on a daily basis over the Parent's entire Year 2 tax year. If this approach is adopted, the amount of accumulated earnings and profits that was available to Parent for the dividend that it paid on Date 1 would be substantially reduced.

Issue 1:

A. In determining the amount of accumulated earnings and profits to the date of a distribution, is a taxpayer required to show, where it is possible, the actual interim earnings and profits to the date of a distribution, instead of using the daily proration method? More specifically, does the "cannot be shown" language of Treas. Reg. § 1.316-2(b) require the taxpayer to prove, to the extent that it is possible, the amount of interim earnings and profits available as of the distribution date?

B. Whether allowing the taxpayer to use the daily proration method provided in § 1.316-2(b) is consistent with the treatment afforded to the third and fourth situations described in Rev. Rul. 74-164?[4]

You have advised us that the Service can demonstrate a greater amount of interim earnings and profits available on the date of the distribution than the daily proration method would provide. The analysis that follows will consider whether the Service can require a taxpayer to "show" the amount of accumulated earnings and profits available on the date of the distribution if it is possible to do so. That is, does the "cannot be shown" language of § 1.316-2(b) require the taxpayer to prove the amount of interim current earnings and profits available on the distribution date to the extent that it is possible? If that is not so, we will consider whether the regulation is consistent with respect to how the Service treated the third and fourth situations set forth in Rev. Rul. 74-164.

Conclusion:

A. The regulation permits the taxpayer to adopt the daily proration method and does not require the taxpayer to show, even where possible, the actual amount of interim earnings and profits to the date of the distribution.

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[4]The consolidated return regulations will not be considered with respect to the first issue, but will be discussed during the analysis of the second issue. Moreover, because the Year 2 tax year is at issue, only the consolidated regulations in effect during Year 2 will be referred to in this Field Service Advice Memorandum, unless otherwise noted.

B. The regulation is consistent with the treatment afforded to the third and fourth situations addressed in the revenue ruling.

Law and Analysis:

A.

The last sentence of § 1.316-2(b) provides that:

> [i]n any case in which it is necessary to determine the amount of earnings and profits accumulated since February 28, 1913, and the actual earnings and profits to the date of a distribution within any taxable year (whether beginning before January 1, 1936, or, in the case of an operating deficit, on or after that date) cannot be shown, the earnings and profits for the year (or accounting period, if less than a year) in which the distribution was made shall be prorated to the date of the distribution not counting the date on which the distribution was made.

(Emphasis added.)

The following example illustrates an application of the above regulation:

Company Z has accumulated earnings and profits of $20,000 on January 1 of year 2. The company incurs an operating loss of $16,000 during the year, and distributes $20,000 to its shareholder on July 1 of year 2. If the taxpayer demonstrates the exact date when the operating deficit was incurred, the taxpayer can allocate the entire deficit to the period when the deficit was incurred. Here, if Company Z can demonstrate (i.e., show) that its operating deficit for year 2 was incurred during the first six months of year two, then the entire $16,000 operating loss will reduce the amount of accumulated earnings and profits available for distribution. Accordingly, in this scenario, only $4,000 of accumulated earnings and profits would be available on July 1, to be taxed as a dividend when the distribution was made. *See* Bittker & Eustice, Federal Income Taxation of Corporations & Shareholders § 8.02[6], ex. 4 (7th ed. 2000).

On the other hand, if Company Z cannot determine (i.e., show) the amount of accumulated earnings and profits available on the date of the distribution, Company Z must prorate the operating deficit on a daily basis for the year. Here, if the operating deficit is prorated on a daily basis, then $8,000 of the loss is allocated to the first six months of year 2, and the remaining $8,000 of the loss is allocated to the last six months of the year. Thus, the computed amount of accumulated earnings and profits available on the date of the distribution for dividend treatment is $12,000. That amount is based on the $20,000 of accumulated earnings and profits on January 1 of year 2 less the $8,000 of year 2 loss allocated to the July 1 distribution date. *Id.*

In the instant case, the taxpayer had accumulated earnings and profits at the beginning of the taxable year. It had no current earnings and profits for the taxable year because it had an operating loss. It had made a distribution to one or more of its shareholders during the taxable year. In this situation, we conclude that the regulation

contemplates using a proration method unless the taxpayer chooses to and can demonstrate (i.e., show) the amount of interim earnings and profits to the date of the distribution. In other words, we conclude that the regulation allows the taxpayer to use the daily proration method as the default instead of choosing to prove the amount of earnings and profits as of the date of the distribution.

This approach is consistent with the tenor of a footnote in General Counsel Memorandum ("GCM") 35307 (1973). The second footnote of the GCM provides that

> [w]e [the Service] question whether corporations ordinarily close their books prior to year end so that an accurate computation of interim earnings can actually be made. Furthermore, even if an accurate interim earnings can be computed, the administrative burden to the Service in confirming that computation could be overwhelming.

The first sentence of the quoted language presumes that the taxpayer should not be required to close its books in order to show the amount of its interim earnings and profits. The writer of the GCM criticizes in the second sentence the notion of allowing a taxpayer to show the amount of interim earnings and profits. Although the writer may have considered it desirable to mandate that all taxpayers prorate their operating losses, the regulation expressly permits the taxpayer to show the amount of interim earnings and profits as of the date of the distribution. Presumably, any taxpayer by closing its books could show the amount of earnings and profits available for distribution as of any interim date. If this regulation were thus construed as requiring a taxpayer to close his books, where necessary, in order to show the amount of earnings and profits, the proration method would never be required.

On the other hand, if this regulation were construed as requiring a taxpayer to show the amount of earnings and profits available as of the date of distribution, but without requiring the taxpayer to close its books to do so, a taxpayer could easily thwart such a requirement by simply demonstrating that the amount of just one item of income or expense to the date of distribution was incapable of being shown. Accordingly, we conclude that this regulation should be construed as permitting a taxpayer the choice of demonstrating the amount of earnings and profits available as of the date of distribution. As such, the regulation should be construed as meaning that in the absence of making a choice, the taxpayer is then required to use the daily proration method. Thus, a preferred construction of the "cannot be shown" language of § 1.316-2(b) is "cannot be shown by the taxpayer, if he chooses to do so."

In sum, under § 1.316-2(b) the taxpayer is permitted, but is not required, to show the amount of interim earnings and profits available at the date of the distribution, even if it arguably could be done. Accordingly, the Service should not challenge the taxpayer's use of the proration method (i.e., the default method) if the operating loss was properly allocated under this method, but the following discussion shows that it was not properly allocated.

B.

You have asked us whether § 1.316-2(b) is inconsistent with Rev. Rul. 74-164. The revenue ruling contains four situations that discuss how earnings and profits may be prorated. Here, only the third and fourth situations are relevant. The third and fourth situations are calculations. In each calculation, the corporation has: (a) positive accumulated earnings and profits at the beginning of the year; (b) no current earnings and profits for the year because it incurs an operating deficit by the end of the year; and (c) makes a distribution to its shareholder in the middle of the year. In situations three and four, the operating loss was prorated on a daily basis to the date of the distribution. If the calculations are examined in isolation, one might conclude that the revenue ruling mandates that a taxpayer must prorate its operating losses on a daily basis. Without regard to whether the taxpayer can show the actual amount of interim earnings and profits, such an approach would indeed be inconsistent with the regulation that indicates that the taxpayer must prorate if it cannot show the amount of interim earnings and profits available to the date of the distribution.

The regulation and revenue ruling are not inconsistent, however. In situations three and four of the revenue ruling, the ruling does not indicate whether the accumulated earnings and profits were capable of being shown or that the taxpayer has attempted or elected to do so. Thus, for both situations, the absence of any facts indicating that the taxpayer chose or tried to demonstrate the actual amount of earnings and profits available for distribution as of the date of the distribution requires use of the daily proration method as the default method. This is consistent with the analysis, set forth above, concluding that the daily proration method should be employed, unless the taxpayer actually demonstrates the amount of interim earnings and profits to the date of the distribution.

Issue 2:

Whether the daily proration method, employed in § 1.316-2(b) for determining the amount of accumulated earnings and profits to the date of a distribution, allows any part of a loss incurred by a subsidiary after it becomes part of a consolidated group to be allocated to the earlier part of the parent's tax year, before the subsidiary became a member of the group and, thus, before the parent's distribution?

The last sentence of § 1.316-2(b) provides, in relevant part, that "the earnings and profits for the year . . . in which the distribution was made shall be prorated to the date of a distribution . . . " (Emphasis added). In the case at issue, we are considering a distribution made by the parent of a consolidated return group to its shareholder, which is not a member of the consolidated group. After the distribution and during the last #q days of Parent's consolidated group's tax year, a corporation (i.e., Sub 1) joined the consolidated group. Sub 1 had a deficit in its earnings and profits from a loss that supposedly was generated after Sub 1 had joined the consolidated group. Parent's earnings and profits includes the tiered up earnings and profits of Sub 1. Hence, if all of Parent's earnings and profits are to be prorated over Parent's 12-month tax year, this will effectively allocate most of Sub 1's loss to a period before Sub 1 was a member of

Parent's consolidated group. This serves to reduce Parent's accumulated earnings and profits as of the date of the distribution, thus reducing the amount of the distribution to be taxed as a dividend.

Conclusion:

The loss that Sub 1 supposedly incurred during the last #q days of the consolidated group's tax year should not be prorated to the date of the distribution. Therefore, this loss should not affect the amount of Parent's accumulated earnings and profits that was available when Parent paid a $b dividend to Shareholder C on Date 1.

Law and Analysis:

A construction of a consolidated return regulation, a legislative regulation, that produces an unreasonable result should be ignored in favor of one producing a reasonable result.[5] In computing Parent's accumulated earnings and profits to the date of the distribution, it is unreasonable to prorate Sub 1's loss to a period in Parent's tax year before Sub 1 became a member of the group. A proration of earnings (and losses) formula presumes that such loss could have been incurred by the consolidated group over the period of the allocation. Where a subsidiary incurs a loss after it becomes a member of the consolidated group, it is not possible that any part of the loss could have been incurred before the subsidiary became a member of the group. In fact, to the extent that any such loss was allocated to a period before the subsidiary became a member of the consolidated group, the consolidated group could not deduct that loss. Rather, the subsidiary would deduct the loss in its short separate return year ending on the date that the subsidiary became a member of the consolidated group. Accordingly, it is inconsistent for the consolidated group to deduct the loss and then to assert that any part of this loss affects Parent's accumulated earnings and profits to the date of the distribution (i.e., a period before Sub 1 became a member of the consolidated group).

The last sentence of § 1.316-2(b) can be construed in either of two reasonable ways. Both of these constructions will generate the same result. Under either construction, Sub 1's loss will have no effect on the amount of Parent's accumulated earnings and profits available as of the date of the distribution.

First Construction:

Section 1.316-2(b) directs that a parent of a consolidated group must prorate all of its earnings and profits, including the tiered up earnings and profits. Nevertheless,

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[5]The last sentence of § 1.316-2(b) provides, in relevant part, that "the earnings and profits for the year . . . in which the distribution was made shall be prorated to the date of a distribution. . . . " (Emphasis added).

§ 1.316-2(b) does not actually indicate over what tax year the earnings and profits will be prorated. It is reasonable to conclude, however, that the earnings and profits should be prorated over the tax year in which the earnings and profits were incurred. For a stand alone corporation, the tax year for which earnings were incurred will also be the tax year of the entity that is making the distribution. Yet, in the context of a consolidated return where we are examining tiered up earnings and profits, those years can differ. However, the proration should be done with regard to the year in which the earnings and profits were incurred. This means that two prorations are necessary to determine the amount of Parent's earnings and profits to the date of the distribution. The first proration is for the earnings and profits tiered up to Parent from Sub 1. These earnings and profits were incurred over Sub 1's short tax year and, thus, should be prorated over that period. Accordingly, under that proration, zero earnings and profits are allocated to any period before Sub 1 became a member of Parent's group. The second proration is for Parent's actual earnings and profits incurred over Parent's full calendar year. Thus, no amount of Sub 1's negative earnings and profits will be allocated to the period of the consolidated group ending on the date of the distribution. Therefore, Sub 1's loss is irrelevant for determining the accumulated earnings and profits of Parent available on the date of the distribution.

Second Construction:

A second reasonable construction of the language of § 1.316-(2)(b) requires, for determining Parent's earnings and profits as of the distribution date, that an initial, separate proration of Sub 1's earnings and profits be made with regard to its short tax year. After this proration, the taxpayer will then prorate Parent's earnings and profits over Parent's 12-month tax period, but will exclude the tiered up earnings and profits of Sub 1 which has been independently prorated. Adding these two prorated amounts provides the total amount of Parent's earnings and profits as of the date of Parent's distribution.

The literal language of § 1.316-2(b) supports this interpretation. That regulation provides that

> [i]n any case in which it is necessary to determine the amount of earnings and profits accumulated . . . and the actual earnings and profits to the date of a distribution within any taxable year . . . cannot be shown, the earnings and profits for the year . . . in which the distribution was made shall be prorated to the date of the distribution . . .

Parent's earnings and profits include the amount of Sub 1's earnings and profits that is tiered up to Parent. Hence, in determining the amount of Parent's earnings and profits to the date of Parent's distribution, it is "necessary to determine the amount" of Sub 1's earnings and profits to that date. Thus, the literal language of § 1.316-2(b) requires an independent proration of Sub 1's earnings and profits to the date of Parent's distribution. This in turn means that Sub 1's earnings and profits should be prorated over Sub 1's short tax year, instead of over Parent's calendar year. Of course, Sub 1's short tax year begins after the date of Parent's distribution. Because the

amount of Sub 1's loss prorated to the date of the distribution is zero, no portion of the loss is taken into account at the date of Parent's distribution.

Section 1.1502-80 provides that when the consolidated regulations are silent with respect to the resolution of an issue, the general provisions of the Internal Revenue Code govern.[6] Therefore, the result mandated under § 1.316-2(b) controls.

Issue 3:

Whether the $a expense that a corporation purportedly incurred after it had joined the consolidated group constitutes a recognized built-in loss under § 382(h)(2)(B)?

Sub 1 paid bonuses during the short period (i.e., the last #s weeks of the consolidated group's tax year). These bonus payments caused Sub 1 to incur an $a expense. If the $a expense does not constitute a recognized built-in loss, then § 382 will not prevent the taxpayer (i.e., the Parent of the consolidated group) from deducting the $a expense.

Conclusion:

Based on the facts provided, the $a expense does not constitute a recognized built-in loss.

Law and Analysis:

Section 382(h)(2)(B) provides that a recognized built-in loss "means any loss recognized during the recognition period[7] on the disposition of any asset . . ."

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[6]Section 1.1502-80 during the relevant year provided that the "Code, or other law, shall be applicable to the group to the extent the regulations do not exclude its application. Thus, for example, in a transaction to which section 381(a) applies, the acquiring corporation will succeed to the tax attributes described in Section 381(c). Furthermore, sections 269, 304, and 482 apply for any consolidated return year."

[7]The "recognition period" is the five-year period that begins on the date when there is an ownership change of the loss corporation. *See* section 382(h)(7)(A). Section 382(k)(1) provides that a "loss corporation" "means a corporation entitled to use a net operating loss carryover or having a net operating loss for the taxable year in which the ownership change occurs. Except to the extent provided in regulations, such term includes any corporation with a net unrealized built-in loss." An ownership change occurs when: "(A) the percentage of stock of the loss corporation owned by 1 or more 5 percent shareholders has increased by more than 50 percentage points, over (B) the lowest percentage of stock of the loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period." *See* section 382(g)(1)(A)-(B). We assume that an ownership change occurred here.

Furthermore, amounts that are allowable as deductions during the recognition period and that are attributable to periods before the change date[8] will be treated as a recognized built-in loss for the tax year for which they are allowable as deductions. (Emphasis added). *See* section 382(h)(6)(B). Section 382 limits the use of such built-in losses for tax purposes.

Neither § 382(h)(2)(B) nor the regulations promulgated under § 382 define the word "attributable". Because § 1374 considers the built-in gain consequences for a subchapter C corporation that converts to a subchapter S corporation, we examine the regulations promulgated under that section to determine the meaning of the word "attributable".

Section 1.1374-4(b)(2) provides, in relevant part, that "any item of deduction properly taken into account during the recognition period is [a] recognized built-in loss if the item would have been properly allowed as a deduction against gross income before the beginning of the recognition period to an accrual method taxpayer."[9] Because the regulation treats all taxpayers as accrual method taxpayers, the word "attributable" in § 382(h)(2)(B) ostensibly refers to deductions that an accrual method taxpayer was allowed to claim in its separate tax year (i.e, before Sub 1 had joined the consolidated group).

Here, Sub 1 is deemed to be an accrual method taxpayer for purposes of applying § 382. *See* section 461(a).[10] Section 461(h) indicates when an accrual method taxpayer may take a deduction. Under § 461(h)(1), an accrual method taxpayer is allowed to take a deduction when the "all events test" and "economic performance test" are satisfied. Section 461(h)(4) provides that a deduction meets the "all events test" for an accrual method taxpayer if all events occur that determine the taxpayer's liability and the amount of the liability can be determined with reasonable accuracy. The "all events test" "shall not be treated as met any earlier than when economic performance with respect to such item occurs." *See* section 461(h)(1). Section 461(h)(2)(A)(i) provides that if the liability of the taxpayer "arises out of the providing of services to the taxpayer by another person, economic performance occurs as such person provides such services."

The testing period is the "3-year period ending on the day of any owner shift involving a 5-percent shareholder . . . " *See* section 382(i)(1).

[8]A "change date" is the date of an ownership shift involving a five percent shareholder. *See* section 382(j)(1).

[9]Even though § 1.1374-4 was finalized on or about December 23, 1994, the language contained in that regulation is relevant to this case because we are examining that language only for guidance.

[10]Section 461(a) provides that the "amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income."

In the instant case, “economic performance” arguably occurred when the employees, who received the bonus payments, provided the services to which their bonuses related. Thus, if the relevant employees were deemed to have provided services on each work day during the Year 2 calendar tax year, then economic performance occurred throughout that period. Nevertheless, the facts that were provided suggest that the “all events test” was satisfied only when the bonuses were paid (during the last #q days of the Year 2 calendar year). (You did not advise us when each bonus payment was declared.) Accordingly, the bonus-payment amount was determined with reasonable accuracy and certainty only once the payments were made, and, therefore, Sub 1 was only eligible to deduct these amounts in the last month of the Year 2 calendar tax year. Because Sub 1 was a member of the consolidated group at that time, the $a expense was not “attributable” to a period before Sub 1 became a member of the Parent group. Consequently, the expense does not constitute a recognized built-in loss that was subject to the § 382 limitation because it was attributable to Sub 1's short tax year ending on Date 3 of Year 2.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

With respect to the second issue, there is some risk that a court could conclude that neither § 1.316-2(b) nor the consolidated return regulations squarely address the issue and, therefore, the court could allow the taxpayer to use any reasonable method. *See Gottesman & Co. v. Comm’r*, 77 T.C. 1149 (1981). The Tax Court held in *Gottesman* that if the Service fails to provide rules under the consolidated return regulations on a specific issue that is not addressed by a code section, then the taxpayer is entitled to use any reasonable method. Despite this holding, *Gottesman* involved a penalty issue, and, thus, the holding in that case is narrow and arguably applies only to penalty cases. Furthermore, in the instant case, allocating Sub 1's loss to the date of the distribution is unreasonable. Accordingly, we believe that if properly construed, § 1.316-2(b) by itself does address the issue, and the rationale advanced in *Gottesman* should not permit the taxpayer to use an allocation method in which Sub 1's loss is prorated to a portion of Parent’s tax period before Sub 1 became a member of Parent’s consolidated group.

Please call if you have any further questions.