Treasury Decision 7991, 26 CFR, IRC Sec(s). 42

November 30, 1984

AGENCY:

Internal Revenue Service, Treasury.

ACTION:

Temporary regulations.

SUMMARY:

This document contains temporary regulations relating to deductions, timing of deductions, and losses in certain transactions between related taxpayers. The temporary regulations provide guidance to taxpayers subject to the provisions of section 267 of the Internal Revenue Code. This action is necessary because of changes to the applicable tax law made by the Tax Reform Act of 1984. The text of a portion of the temporary regulations set forth in this document also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in the Proposed Rules section of this issue of the Federal Register.

DATES:

Effective after December 31, 1983, these temporary regulations are generally applicable to amounts otherwise allowable as deductions for taxable years beginning after 1983 and to losses on transactions after 1983.

FOR FURTHER INFORMATION CONTACT:

Keith E. Stanley (for rules under section 267(f)) and John G. Schmalz or Robert H. Ginsburgh (for other rules) of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224 (Attention: CC:LR:T) (Telephone: 202-566-3458 for Keith E. Stanley or 202-566-3297 for John G. Schmalz and Robert H. Ginsburgh; not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 174 of the Tax Reform Act of 1984 (Pub. L. No. 98-369; 98 Stat. 494) amends section 267 of the Internal Revenue Code of 1954 (relating to losses, expenses, and interest with respect to transactions between related taxpayers). This document adds temporary regulations to Part 1 of Title 26 of the Code of Federal Regulations to reflect the amendments to section 267. More specifically, temporary regulations are added in question and answer form under section 267 (a), (b), and (e) and section 706, dealing with deferral of certain deductions generally and application of that deferral and the disallowance of certain losses to partnerships.

See §§1.267 (a)-2T and 1.706-2T, added by this document. The temporary regulations are added in standard format under section 267(f), dealing with losses between members of a controlled group of corporations. See §§1.267(f)-1T and 1.267(f)-2T added by this document.

The temporary regulation added by this document will stay in effect until superseded by later temporary or final regulations relating to these matters.

Cross Reference Notice

The text of the temporary regulations at §§1.267(a)-2T, 1.267(f)-1T, 1.267(f)-2T, and 1.1502-13T also serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in the Proposed Rules section of this issue of the Federal Register.

Limited Scope of Temporary Regulations

These temporary regulations are not intended to address comprehensively all the issues raised by the amendments to section 267. Taxpayers may rely for guidance on the temporary regulations in this document, which the Internal Revenue Service will follow in resolving issues arising under section 267. No inference, however, should be drawn regarding questions not expressly raised and answered.

Topics

This preamble is divided into two topics. Topic I deals with the temporary regulations under section 267 (a), (b), and (e) and section 706. Topic II deals with the temporary regulations under section 267(f).

Topic I

Sections 267 (a), (b), and (e) and 706

Before the enactment of the Tax Reform Act of 1984, section 267(a)(2) of the Code denied a deduction for certain expenses and for interest owed by a taxpayer to a related taxpayer if payment was not made within 21/2 months after the close of the taxable year of the payor in which the amount otherwise would have been deductible and if, by reason of the accounting method of the person to whom the payment was to be made, the amount was not included in the income of that person unless paid. Also, section 267(a)(2) did not apply to transactions between a partner and a partnership because they were not related persons under section 267(b). The Act revised section 267(a)(2) by providing that a deduction for an otherwise deductible amount may not be taken by the payor until the day the amount is includible in the gross income of the person to whom payment of the amount is made if that person and the payor are persons described in section 267(b) on the last day of the taxable year of the payor in which such amount otherwise would have been deductible. In addition, the Act extends this deferral to transactions between a partner and a partnership (excluding certain expenses and interest of partnerships owning low-income housing).

Explanation of section 267 (a), (b), and (e). The regulations under section 267(a) deal with issues that are of general application as well as issues that arise with respect to the application of section 267 to partnerships. The rules of general application concern transactions in which the person to whom the payment is owed uses the completed contract method of accounting and transactions in which the original issue discount rules under sections 1271 through 1275 or the imputed interest rules under section 483 apply. The rules of general application also deal with the situation in which the persons involved are related persons under section 267(b) at the end of the taxable year but cease to be so related in a subsequent year that ends before payment is made. The rules of general application also distinguish between amounts owed for the purchase of property versus amounts owed for the performance of services. See S. Rep. No. 98-169, 98th Cong., 2d Sess. 495 (1984).

With respect to the regulations under section 267(a) that deal with the application of section 267 to partnerships, the regulations make clear that section 267(a) applies to the partnership, rather than to the partners individually. In addition, the regulations provide that the disallowance rule of section 267(a)(1) and the deferral rule of section 267(a)(2) apply (subject to a de minimis exception) to property exchanged and amounts owed between partnerships that are not related persons for purposes of section 267 if the partnerships have one or more common partners or if any of the partners in either partnership is related to one or more partners in the other partnership. In such cases, the regulations require disallowance under section 267(a)(1) and deferral under section 267(a)(2) to the extent that they would have been required had the transaction occurred between the payor partnership and the partners of the payee partnership or, if the amount disallowed or deferred would be greater, between the payee partnership and the partners of the payor partnership. This rule ensures that section 267 will not be avoided by use of a partnership as an intermediary in related party transactions, and is thus consistent with the general approach suggested in the legislative history, see S. Rep. No. 98-169, 98th Cong., 2d Sess. 496, n.17 (1984), as well as with the rule of the regulations under section 267 prior to amendment. Consideration was given to extending this rule to transactions between other pass-through entities (for example, S corporations) and between such an entity and a partnership, and comments are invited concerning the appropriateness of such an extension.

Explanation of section 706. The regulations also address the interrelationship of section 706(d)(2) with section 267(a)(2). The regulations provide that a deduction for any expense that is deferred under section 267 constitutes an allocable cash basis item under section 706(d)(2)(B)(iv).

Topic II

Section 267(f)

A new section 267(f) was enacted by the Tax Reform Act of 1984. Section 267(f)(2) relates to the deferral and restoration of loss on the sale or exchange of property between two members of a controlled group. These temporary regulations provide guidance under new section 267(f).

Explanation of section 267(f). Under new section 267(f)(2), a loss of the sale or exchange of property from one member of a controlled group of corporations (a 50-percent-common-control test) to another member "shall be deferred until the property is transferred outside such controlled group and there would be recognition of loss under consolidated return principles or until such other time as may be prescribed in regulations."

The primary rationale for deferring loss on transfers between members of the same group is to prevent the premature recognition of loss merely because the property is transferred to a related person. Although the temporary regulations provide that the principles of section 482 and the regulations thereunder are to be applied before section 267(f)(2) is applied, an ancillary rationale for deferring loss is to prevent artifically increasing the amount of a loss taken by a member on the sale or exchange of property at less than fair market value to another member in cases where section 482 is not easy to apply. Section 267(f)(2) provides for deferral of loss on such transfers until such time as the property is transferred outside the group (presumably at its fair market value), at which time that loss will be recognized in conjunction with the gain or loss recognized by the member transferring the property outside the group. At that time the sales price of property to an independent party can be used as a bench mark in applying section 482 to an intercompany sale of the same goods.

1. Rules for Groups Not Filing Consolidated Returns

If loss is deferred on a sale of property from one member of a controlled group not included in a consolidated return to another member, these temporary regulations generally apply the principles for restoring losses that are set forth in §1.1502-13 for members that join in filing a consolidated return.

a. Selling Member Ceases To Be a Member

Section 1.1502-13(f)(1)(iii) provides for loss restoration when either the selling member or the owning member ceases to be a member. In certain cases such a restoration rule could provide a way of easily thwarting the intent of section 267(f)(2). Accordingly, the temporary regulations provide that if a member (M1) sells property to another member (M2), and thereafter, while M2 still holds the property, M1 ceases to be a member of the group, then M1's unrestored deferred loss for property at the time M1 ceases to be a member will never be restored to M1. Instead, M2's basis in the property will be increased by the amount of M1's unrestored deferred loss at the time M1 leaves the group. However, a special rule is provided to prevent the resourcing of deferred loss in the hands of the owning member through either increased depreciation deductions or reduced gain (or increased loss) upon resale of the property. See §1.267(f)-1T (c) (6) and (7). Thus, the loss is preserved in the group because no member of a group should under section 267(f) be able to recognize a loss while the group continues to hold property it purchased from itself.

If, after the application of this rule, M2 keeps the property and is subsequently liquidated, the loss is forever lost. This is the normal consequence of the operation of sections 336 and 337.

b. Depreciable Property

For purposes of determining when a deferred loss on the sale of depreciable property is restored, §1.267(f)-1T(d) replaces the rule of §1.1502-13(d) of the consolidated returns regulations. The purpose of this rule is to prevent rapid restoration of the deferred loss in cases where the purchasing member depreciates the property more rapidly than did the selling member.

Loss will not be periodically restored under §1.267(f)-1T(d) to the extent the selling member's (M1's) selling price is less than the salvage value that was assumed by M1. Mechanically this is accomplished by limiting the restoration amount to the lesser of the amount of M1's deferred loss for the property on the date of its sale or the total amount of depreciation that would have been allowable to M1 for the property after the date of its sale had it not been sold. Restoration of the portion of the loss that is not periodically restored can occur under other provisions of §1.267(f)-1T. Such a restoration will occur, for example, upon the purchasing member's subsequent sale of the property outside the group.

c. Transfer of a Receivable

The temporary regulations at §1.267(f)-1T (e) provide an exception to section 267(f)(2) for a member (M1) selling a receivable at "fair market value" at a loss to another member. The amount of that loss, not in excess of M1's gain on the sale to a nonmember of the property that generated the receivable, is excepted from the section 267(f)(2) loss deferral rules on the rationale that the group has recognized offsetting income. This treatment is in response to language in the Conference Committee Report for the Tax Reform Act of 1984, H.R. Rep. No. 98-861, 98th Cong., 2d Sess. 1033 (1984).

Section 44(b)(2) of the Tax Reform Act of 1984 mandates a regulations project under section 482. The Service may study the issue of the appropriate "fair market value" of a receivable in connection with this regulations project.

d. Inventory Sales

As is the case with sales of other kinds of property, the temporary regulations generally provide for the deferral and restoration of loss on the sale of inventory from one member (M1) to another member (M2) in accordance with the rules for deferred intercompany transactions in §1.1502-13 of the consolidated returns regulations. It is uncertain whether §1.1502-13 of the consolidated returns regulations properly determines the amount of deferred gain or loss on intercompany inventory sales and the timing of the restoration of that gain or loss. The Service and the Treasury have the problem under study and invite comments on this problem.

Under section 267(f)(3)(B), except to the extent provided in regulations, section 267(f)(2) does not apply to the sale of inventory in the ordinary course of the transferor's trade or business if either the transferor or the transferee is a foreign corporation. Under §1.267(f)-1T(g)(3), evidence of a sale of inventory outside the ordinary course of business includes a sale made for the purpose of accelerating losses and an abnormally large volume of sales near the end of the taxable year. Use of these items of evidence responds to language in the Conference Committee Report for the Tax Reform Act of 1984, H.R. Rep. No. 98-861, 98th Cong., 2d Sess. 1033 (1984).

The temporary regulations at §1.267-1T(g)(2) specifically provide for two cases in which section 267(f)(2) is applicable to the sale of inventory at a loss from one member (M1) to another member (M2) even though M1 or M2 is a foreign corporation. In the first case, M1 is a domestic corporation and M2 is a foreign corporation whose income from the resale of the inventory is taxable under section 882 (relating to effectively connected income). In the second case, M1 is a foreign corporation whose income from the sale of the inventory is taxable under section 882, and M2 either is a domestic corporation or is a foreign corporation whose income from the resale of the inventory is also taxable under section 882. This rule prevents a group's use of a foreign corporation for purposes of selling inventory in the domestic market while avoiding the application of section 267(f)(2). Furthermore, this rule preserves the fairness of competition between groups that include such foreign corporations and similar groups including only domestic corporations.

e. Earnings and Profits Adjustments

The temporary regulations at §1.267 (f)-1T(c)(3) provide that if a member (M1), that does not join in filing a consolidated return with another member (M2), has deferred a loss on the sale of property to M2, M1's earnings and profits are not reduced until its deferred loss is restored. If this rule in the temporary regulations issued by this document is issued in final regulations, §§1.312-6 and 1.312-7 will be amended to reflect this earnings and profits treatment.

2. Rules Applicable if Consolidated Returns Are Filed

The temporary regulations provide that section 267(f)(2) generally does not apply to a loss on the sale of property between two members of a controlled group that join in filing a consolidated return. The consolidated returns regulations under §1.1502-13 provide for the deferral and restoration of such losses.

a. Exceptions to General Consolidated Return Rule

Notwithstanding the fact that the selling member (M1) of loss property and the purchasing member (M2) join in filing a consolidated return at the time of the sale, problems arise in certain cases with permitting a restoration of deferred loss under §1.1502-13. The temporary regulations ensure that a member not be permitted to escape the loss deferral provisions of section 267(f)(2) merely because it joins or has joined with another member in filing a consolidated return. Thus, for example, even though M1's deferred loss would ordinarily be restored under §1.1502-13(f)(1)(iii) upon M2 leaving the affiliated group but still remaining a member of the same controlled group, the temporary regulations provide the deferred loss is not restored in that case.

Provisions of the temporary regulations that could prevent the restoration of deferred loss that otherwise would occur under §1.1502-13 include §1.267(f)-1T(c)(4) (which provides that two members of the same group are not, with respect to each other, considered to cease to be members of the group as long as they are both members of any one group), §1.267(f)-1T(c)(5) (which prevents restoration when a member that is both the selling member and the owning member ceases to be a member), §1.267(f)-1T(c) (6) and (7) (which prevents restoration when the selling member ceases to be a member), §1.267(f)-1T(c)(8) (which prevents restoration upon the purchasing member's disposition of the property to a person having a section 267(b) relationship with the selling member), and §1.267-2T(e) (which prevents restoration when property upon which loss has been deferred is disposed of outside the affiliated group to a member of the controlled group).

When depreciable property that was subject to the restoration rule of the consolidated returns regulations becomes subject to the restoration rule of these temporary regulations, §1.267(f)-2T (g) and (h) provides special rules for determining the amount and the timing of the restoration that occurs. Similarly, the temporary regulations provide a special rule for determining the amount of deferred loss for a receivable that is restored at the time the deferred loss would otherwise have been fully restored under the consolidated returns regulations. See §1.267(f)-2T(j).

b. Section 267(f)(2) Overrides Election Not To Defer

The selling member must defer under section 267(f)(2) loss realized on the sale or exchange of property to the purchasing member, notwithstanding the fact that the group with which these members join in filing a consolidated return has made an election under §1.1502-13(c)(3) not to defer gain or loss on intercompany transactions. See §1.267(f)-2T(c). To eliminate hardship that otherwise could possibly occur as a result of this exception, it is anticipated that a group will have the Commissioner's consent to revoke that election beginning during its taxable year ending in 1984. However, any revocation must be in such form and subject to such terms and conditions as the Commissioner may prescribe by revenue procedure or ruling.

c. Consolidated Return Regulations Cross-Reference

In some cases, the rules of section 267(f) and the regulations implementing section 267(f) apply to affiliated groups filing consolidated returns. Accordingly, a temporary regulations section is added to the consolidated returns regulations at §1.1502-13T to cross-reference to §1.267(f)-2T. If the temporary regulation §1.267(f)-2T becomes final, then §1.1502-13T(k) will also become final.

Executive Order 12291, Regulatory Flexibility Act, and Paperwork Reduction Act

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. A general notice of proposed rulemaking is not required by 5 U.S.C. 553 for temporary regulations. Accordingly, the temporary regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The collection of information contained in this regulation has been submitted to the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB under control number 1545-0885.

Drafting Information

The principal authors of these temporary regulations are Keith E. Stanley (for rules under section 267(f)) and John G. Schmalz and Robert H. Ginsburgh (for other rules) of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue

Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

List of Subjects

26 CFR 1.61-1-1.281-4

Income taxes, Taxable income, Deductions, Exemptions.

26 CFR 1.701-1-1.771-1

Income taxes, Partnerships.

26 CFR 1.1501-1-1.1564-1

Income taxes, Controlled group of corporations, Consolidated returns.

Adoption of Amendments to the Regulations

Accordingly, the following amendments are made to Part 1 of Title 26.

Paragraph 1. Immediately after §1.267(a)-1, there is added a new §1.267(a)-2T. The new section reads as follows:

§1.267(a)-2T Temporary regulations; questions and answers arising under the Tax Reform Act of 1984.

(a) Introduction-(1) Scope. This section prescribes temporary question and answer regulations under section 267(a) and related provisions as amended by section 174 of the Tax Reform Act of 1984, Pub. L. No. 98-369.

(2) Effective date. Except as otherwise provided by Answer 2 or Answer 3 in paragraph (c) of this section, the effective date set forth in section 174(c) of the Tax Reform Act of 1984 applies to this section.

(b) Questions applying section 267(a)(2) and (b) generally. The following questions and answers deal with the application of section 267(a)(2) and (b) generally:

Question 1: Does section 267(a)(2) ever apply to defer the deduction of an otherwise deductible amount if the person to whom the payment is to be made properly uses the completed contract method of accounting with respect to such amount?

Answer 1: No. Section 267(a)(2) applies only if an otherwise deductible amount is owed to a related person under whose method of accounting such amount is not ncludible in income unless paid to such person. Regardless of when payment is made, an amount owed to a contractor using the completed contract method of accounting is includible in the income of the contractor in accordance with §1.451-3(d) in the year in which the contract is completed or in which certain disputes are resolved.

Question 2: Does section 267(a)(2) ever apply to defer the deduction of otherwise deductible original issue discount as defined in sections 163(e) and 1271 through 1275 ("the OID rules")?

Answer 2. No. Regardless of when payment is made, an amount owed to a lender that constitutes original issue discount is included in the income of the lender periodically in accordance with the OID rules. Similarly, section 267(a)(2) does not apply to defer an otherwise deductible amount to the extent section 467 or section 7872 requires periodic inclusion of such amount in the income of the person to whom payment is to be made, even though payment has not been made.

Question 3: Does section 267(a)(2) ever apply to defer the deduction of otherwise deductible unstated interest determined to exist under section 483?

Answer 3: Yes. If section 483 recharacterizes any amount as unstated interest and the other requirements of section 267(a)(2) are met, a deduction for such unstated interest will be deferred under section 267.

Question 4: Does section 267(a)(2) ever apply to defer the deduction of otherwise deductible cost recovery, depreciation, or amortization?

Answer 4: Yes, in certain cases. In general, section 267(a)(2) does not apply to defer the deduction of otherwise deductible cost recovery, depreciation, or amortization. Notwithstanding this general rule, if the other requirements of section 267(a)(2) are met, section 267(a)(2) does apply to defer deductions for cost recovery, depreciation, or amortization of an amount owed to a related person for interest or rent or for the performance or nonperformance of services, which amount the taxpayer payor capitalized or treated as a deferred expense (unless the taxpayer payor elected to capitalize or defer the amount and section 267(a)(2) would not have deferred the deduction of such amount if the taxpayer payor had not so elected). Amounts owed for services that may be subject to this provision include, for example, amounts owed for acquisition, development, or organizational services or for covenants not to compete. In applying this rule, payments made between persons described in any of the paragraphs of section 267(b) (as modified by section 267(3)) will be closely scrutinized to determine whether they are made in respect of capitalized costs (or costs treated as deferred expenses) that are subject to deferral under section 267(a)(2), or in respect of other capitalized costs not so subject.

Question 5: If a deduction in respect of an otherwise deductible amount is deferred by section 267(a)(2) and, prior to the time the amount is includible in the gross income of the person to whom payment is to be made, such person and the payor taxpayer cease to be persons specified in any of the paragraphs of section 267(b) (as modified by section 267(e)), is the deduction allowable as of the day on which the relationship ceases?

Answer 5: No. The deduction is not allowable until the day as of which the amount is includible in the gross income of the person to whom payment of the amount is made, even though the relationship ceases to exist at an earlier time.

Question 6: Do references in other sections to persons described in section 267(b) incorporate changes made to section 267(b) by section 174 of the Tax Reform Act of 1984?

Answer 6: Yes. References in other sections to persons described in section 267(b) take into account changes made to section 267(b) by section 174 of the Tax Reform Act of 1984 (without modification by section 267(e)(1)). For example, a transfer after December 31, 1983 (the effective date of the new section 267(b)(3) relationship added by the Tax Reform Act of 1984) of section 1245 class property placed in service before January 1, 1981, from one corporation to another corporation, 11 percent of the stock of which is owned by the first corporation, will not constitute recovery property (as defined in section 168) in the hands of the second corporation by reason of section 168(e)(4) (A)(i) and (D).

(c) Questions applying section 267(a) to partnerships. The following questions and answers deal with the application of section 267(a) to partnerships:

Question 1: Does section 267(a) disallow losses and defer otherwise deductible amounts at the partnership (entity) level?

Answer 1: Yes. If a loss realized by a partnership from a sale or exchange of property is disallowed under section 267(a)(1), that loss shall not enter into the computation of the partnership's taxable income. If an amount that otherwise would be deductible by a partnership is deferred by section 267(a)(2), that amount shall not enter into the computation of the partnership's taxable income until the taxable year of the partnership in which falls the day on which the amount is includible in the gross income of the person to whom payment of the amount is made.

Question 2: Does section 267(a)(1) ever apply to disallow a loss if the sale or exchange giving rise to the loss is between two partnerships even though the two partnerships are not persons specified in any of the paragraphs of section 267(b)?

Answer 2: Yes. If the other requirements of section 267(a)(1) are met, section 267(a)(1) applies to such losses arising as a result of transactions entered into after December 31, 1984 between partnerships not described in any of the paragraphs of section 267(b) as follows, and §1.267(b)-1(b) does not apply. If the two partnerships have one or more common partners (i.e., if any person owns directly, indirectly, or constructively any capital or profits interest in each of such partnerships), or if any partner in either partnership and one or more partners in the other partnership are persons specified in any of the paragraphs of section 267(b) (without modification by section 267(e)), a portion of the selling partnership's loss will be disallowed under section 267(a)(1). The amount disallowed under this rule is the greater of: (1) The amount that would be disallowed if the transaction giving rise to the loss had occurred between the selling partnership and the separate partners of the purchasing partnership (in proportion to their respective interests in the purchasing partnership); or (2) the amount that would be disallowed if such transaction had occurred between the separate partners of the selling partnership (in proportion to their respective interests in the selling partnership) and the purchasing partnership. Notwithstanding the general rule of this paragraph (c) Answer 2, no disallowance shall occur if the amount that would be disallowed pursuant to the immediately preceding sentence is less than 5 percent of the loss arising from the sale or exchange.

Question 3: Does section 267(a)(2) ever apply to defer an otherwise deductible amount if the taxpayer payor is a partnership and the person to whom payment of such amount is to be made is a partnership even though the two partnerships are not persons specified in any of the paragraphs of section 267(b) (as modified by section 267(e))?

Answer 3: Yes. If the other requirements of section 267(a)(2) are met, section 267(a)(2) applies to such amounts arising as a result of transactions entered into after December 31, 1984 between partnerships not described in any of the paragraphs of section 267(b) (as modified by section 267(e)) as follows, and §1.267(b)-1(b) does not apply. If the two partnerships have one or more common partners (i.e., if any person owns directly, indirectly, or constructively any capital or profits interest in each of such partnerships), or if any partner in either partnership and one or more partners in the other partnership are persons specified in any of the paragraphs of section 267(b) (without modification by section 267(e)), a portion of the payor partnership's otherwise allowable deduction will be deferred under section 267(a)(2). The amount deferred under this rule is the greater of: (1) The amount that would be deferred if the transaction giving rise to the otherwise allowable deduction had occurred between the payor partnership and the separate partners of the payee partnership (in proportion to their respective interests in the payee partnership); or (2) the amount that would be deferred if such transaction had occurred between the separate partners of the payor partnership (in proportion to their respective interests in the payor partnership) and the payee partnership. Notwithstanding the general rule of this paragraph (c) Answer 3, no deferral shall occur if the amount that would be deferred pursuant to the immediately preceding sentence is less than 5 percent of the otherwise allowable deduction.

Example. On May 1, 1985, partnership AB enters into a transaction whereby it accrues an otherwise deductible amount to partnership AC. AC is on the cash receipts and disbursements method of accounting. A holds a 5 percent capital and profits interest in AB and a 49 percent capital and profits interest in AC, and A's interest in each item of the income, gain, loss, deduction, and credit of each partnership is 5 percent and 49 percent, respectively. B and C are not related. Notwithstanding that AB and AC are not persons specified in section 267(b), 49 percent of the deduction in respect of such amount will be deferred under section 267(a)(2). The result would be the same if A held a 49 percent interest in AB and a 5 percent interest in AC. However, if A held more than 50 percent of the capital or profits interest of either AB or AC, the entire deduction in respect of such amount would be deferred under section 267(a)(2).

Question 4: What does the phrase "incurred at an annual rate not in excess of 12 percent" mean as used in section 267(e)(5)(C)(ii)?

Answer 4: The phrase refers to interest that accrues but is not includible in the income of the person to whom payment is to be made during the taxable year of the payor. Thus, in determining whether the requirements of section 267(e)(5) (providing an exception to certain provisions of section 267 for certain expenses and interest of partnerships owning low income housing) are met with respect to a transaction, the requirement of section 267(e)(5)(C)(ii) will be satisfied, even though the total interest (both stated and unstated) paid or accrued in any taxable year of the payor taxpayer exceeds 12 percent, if the interest in excess of 12 percent per annum, compounded semi-annually, on the outstanding loan balance (principal and accrued but unpaid interest) is includible in the income of the person to whom payment is to be made no later than the last day of such taxable year of the payor taxpayer.

Par. 2. Immediately after §1.267(d)-1, there are added new §§1.267(f)-1T and 1.267(f)-2T. These new sections read as follows:

§1.267(f)-1T Temporary regulations for deferring certain losses of controlled groups.

(a) Scope-(1) In general. This section and §1.267(f)-2T prescribe temporary regulations under section 267(f) as added by section 174(b)(2) of the Tax Reform Act of 1984, Pub. L. No. 98-369.

(2) Effective date. Section 267(f) is effective for the sale of property after 1983 except that section 267(f) does not apply to a sale of property to a foreign corporation on or before March 1, 1984.

(3) Effect of consolidated return. This section applies to loss on the sale of property between two members of a controlled group that do not join in filing a consolidated return for the taxable year the loss is incurred. Section 1.267(f)-2T applies to such a loss if the members join in filing a consolidated return for that year.

(4) Coordination with section 482. The principles of section 482 and the regulations thereunder apply before section 267(f) and the regulations thereunder apply.

(b) Definitions. For purposes of this section and §1.267(f)-2T:

(1) Group. The term "group" means "controlled group." The term "controlled group" is defined in section 267(f)(1). Thus, excluded members referred to in section 1563(b), such as foreign corporations and exempt corporations, are not excluded from a group.

(2) Member. The term "member" means a corporation included in a controlled group.

(3) M1 and M2. The terms "M1" and "M2" refer, respectively, to the selling member and the purchasing member of property sold from one to the other. Unless otherwise specified, M1 and M2 are members of the same group at all relevant times.

(4) Sale. The term "sale" includes "exchange."

(5) Depreciation and depreciable property. The term "depreciation" means the deduction under section 167 or 168 or the deduction for amortization or depletion. The term "depreciable property" means any property subject to depreciation as so defined.

(6) Inventory. "Inventory" is property described in section 1221 (1).

(7) Separate return year. The term "separate return year" is defined in §1.1502-1 (e).

(c) Deferral and restoration of loss under consolidated returns principles-(1) General rule. Except as otherwise provided in this section, the rules for deferred intercompany transactions in §1.1502-13 of the consolidated return regulations apply under section 267(f)(2) to the deferral and restoration of loss on the sale of property directly or indirectly between M1 and M2 as if-

(i) the taxable year in which the sale occurred were a consolidated return year (as defined in §1.1502-1(d)) and

(ii) all references to a "group" or an "affiliated group" were to a controlled group.

(2) Elections not to deter loss not applicable. Section 1.1502-13(c)(13) (relating to an election not to defer gain or loss) does not apply for purposes of this section.

(3) Earnings and profits. If, under this section, a loss is deferred by M1 on the sale of property to M2, then such loss shall not be reflected in earnings and profits until that amount is restored. See §1.312-6(a).

(4) General rule for continuation of membership. Two corporations that are members of the same group are not, with respect to each other, considered to cease to be members of the group as long as they are both members of any one group. Thus, for examp le, if P owns all the stock of M1 and M1 owns all the stock of M2, and if loss on the sale of property from M1 to M2 has been deferred under this section, P's transfer of all the stock to M1 to a nonmember will not result in a restoration of the deferred loss under section 267(f)(2) and §1.1502-13(f)(1)(iii) because M1 and M2 remain members of one group. The result is the same whether the stock transfer is taxable or nontaxable and whether the transferee is an individual or a corporation.

(5) Exception to restoration rule for selling member that is also owning member. Section 1.1502-13(f)(2)(ii)(b) generally provides an exception to the restoration rule of §1.1502-13(f)(1)(iii) (relating to a member ceasing to be a member) when the common parent of an affiliated group is both the selling and the owning member. For purposes of this section, the principles of §1.1502-13(f)(2)(ii)(b) are extended to any member of a controlled group that is, at the time it ceases to be a member of the group, both the selling member and the owning member of property for which loss has been deferred. Thus, for example, if M1 defers a loss on its sale of property to M2 and M2 subsequently sells the property back to M1, then even M1 ceases to be a a member of the group, M1's loss will continue to be deferred. If M2 had deferred a loss as a result of its resale of the property to M1, that loss will be restored under section 267(f)(2) and §1.1502-13(f)(1)(iii) when M1 ceases to be a member. If the property is depreciable property, see paragraph (d) of this section.

(6) Exception to restoration rule for selling member that ceases to be a member. If a selling member of property for which loss has been deferred ceases to be a member when the property is still owned by another member, then, for purposes of this section, §1.1502-13(f)(1)(iii) shall not apply to restore that deferred loss and that loss shall never be restored to the selling member.

(7) Basis adjustment and holding period. If paragraph (c)(6) of this section precludes a restoration for property, then the following rules apply:

(i) On the date the selling member ceases to be a member, the owning member's basis in the property shall be increased by the amount of the selling member's unrestored deferred loss at the time it ceased to be a member ("increase amount").

(ii) If the property is depreciable property, then the amount of the owning member's depreciation for a taxable year attributable to the increase amount shall be equal to the amount of deferred loss for the property which the selling member would have restored under paragraph (d) of this section for its taxable year ending with or within the owning member's taxable year had the selling member not ceased to be a member.

(iii) The owning member's holding period for the property shall be increased by the selling member's holding period.

(iv) Annual depreciation attributable to the increase amount shall be deemed to have the same source (as within or without the United States) as the selling member had for its deferred loss. If gain or loss upon sale of the property by the owning member would have a different source than the selling member had for its deferred loss, then the owning member shall recognize a loss equal to the increase amount (as reduced by any depreciation attributable thereto) having the same source that the selling member had for its deferred loss, and the owning member shall adjust its gain or loss attributable to the other source by that amount.

(8) No restoration on sale to a section 267(b) related person. If property for which loss was deferred by M1 is sold by M2 to any person having a relationship to M1 specified in any paragraph of section 267(b) (other than a member of the same group), the remaining balance of the deferred loss, to the extent it is in excess of the amount of the gain (if any) recognized on the sale, shall never be restored and shall be treated as a loss referred to in section 267(d)(1).

(9) Deconsolidation provisions not applicable. The restoration rules under §1.1502-13(f)(1)(iv) (relating to deferred loss on inventory) and §1.1502-13(f)(1)(vii) (relating generally to filing consolidated returns for fewer than 3 years) are not applicable for purposes of this section.

(10) Deleted examples. For purposes of this section, the examples of §1.1502-13(h) are not applicable.

(d) Restoring deferred loss on depreciable property-(1) General rule. Solely for purposes of this section, this paragraph (d) replaces §1.1502-13(d) (relating to the restoration of gain or loss deferred on the sale of depreciable property from M1 to M2). Under this paragraph (d), for each of its taxable years ending after depreciable property was sold to M2, M1 shall restore a portion of the loss it deferred on that sale. The portion so restored is equal to the "restoration amount" multiplied by a fraction. The numerator of the fraction is the amount of the depreciation that would have been allowable to M1 that year (or for the portion of the year after the sale) had M1 not sold the property. The denominator equals the total amount of depreciation for all taxable years that would have been allowable to M1 after the date of the property's sale had the property not been sold. The "restoration amount" equals the lesser of-

(i) the amount of M1's deferred loss on the date of the sale or

(ii) the amount of the denominator.

(2) Reduction for deferred loss. The amount of M1's deferred loss for an item of depreciable property shall be reduced each taxable year by the amount restored relating to that item under paragraph (d)(1) of this section.

(3) Examples. This paragraph (d) is illustrated by the following examples:

Example (1). M1 and M2 use the calendar year. On January 1, 1980, M1 purchases depreciable property from a third party for $1,200 and begins depreciating it on the straight-line method (with $200 salvage value) over 10 years. On January 1, 1985, when its adjusted basis in the property is $700, M1 sells the property to M2 for $500 and realizes a deferred loss of $200. M2 owns the property until 1990. The portion of M1's $200 deferred loss that is restored in 1985 equals the amount of that loss ($200) multiplied by a fraction. Its numerator equals the depreciation that would have been allowable to M1 in 1985 had it not sold the property ($100). Its denominator equals the total amount of depreciation for all taxable years that would have been allowable to M1 after the date of the property's sale had the property not been sold ($500). Thus, the amount restored in 1985 equals $40 (i.e., $200 x $100/$500). M1 will also restore $40 in 1986, 1987, 1988, and 1989. Thus, if M2 owns the property through the end of 1989, M1 will restore the entire deferred loss of $200, i.e., $40 x 5. (Note that in this example the restoration amount equals the amount of M1's deferred loss ($200) since this amount is less than the amount of the denominator ($500).)

Example (2). Assume the same facts as in example (1) except that on January 1, 1987, when M1's unrestored deferred loss equals $120, M2 sells the property outside the group. Under section 267(f)(2) and §1.1502-13(f)(1)(i), M1 will restore the $120 deferred loss on its 1987 return.

Example (3). Assume the same facts as in example (1) except that M1's sale of the property to M2 is for $150 rather than for $500. Thus, M1's deferred loss realized on the sale is $550. The numerator and the denominator of the fraction remain at $100 and $500 respectively. The restoration amount is $500 (i.e., the lesser of the amount of the deferred loss ($550) or the amount of the denominator ($500)). The amount of M1's deferred loss restored in 1985 equals $100 (i.e., $500 x $100/$500). M1 will also restore $100 in 1986, 1987, 1988, and 1989.

Example (4). (i) Assume the same facts as in example (3) except that on January 1, 1987, when M1's unrestored deferred loss equals $350, M2 sells the property outside the group. Under section 267(f)(2) and §1.1502-13(f)(1)(i), M1 will restore the $350 deferred loss on its 1987 return.

(ii) If M2 instead abandons the property after 1989, when M1's unrestored deferred loss would equal $50, M1 would restore that $50 deferred loss under section 267(f)(2) and §1.1502-13(f)(1)(i) on its return for the taxable year during which M2 abandoned the property.

(e) Receivables-(1) Transfer of receivable. If M1 owns a receivable which it had acquired as a result of its sale at a gain of goods or services to any person other than a member, and if M1 transfers that receivable in a sale at fair market value at a loss to M2, then notwithstanding any other provisions in this section, so much of the loss as does not exceed the gain from the sale of the underlying goods or services shall not be deferred.

(2) Example. This paragraph (e) is illustrated by the following example:

Example. A member (M1), a calendar year taxpayer, uses the accrual method. In 1985, M1 sells to a nonmember property having a basis of $60 for a receivable of $100. M1 reports the gain of $40 on its tax return for 1985. In 1986, M1 sells the receivable for its fair market value of $90 to another member for a $10 loss. M1 reports the $10 loss on the sale of the receivable on its 1986 tax return. If the sale is not at fair market value, this paragraph (e) does not apply and the $10 loss is deferred. See also paragraph (a)(4) of this section (relating to coordination with section 482).

(f) Loss deferral rules not to apply to DISC. Under section 267(f)(3)(A), a group does not include a DISC. However, a group does include a FSC. "DISC" and "FSC" are defined in sections 992 and 922, respectively.

(g) Sales of inventory involving foreign corporations-(1) General rule. Under section 267(f)(3)(B), except to the extent provided in regulations, section 267 (a)(1) and (f)(2) does not apply to the sale by M1 to M2 of property which is inventory in the hands of both M1 and M2 if the sale is in the ordinary course of M1's trade or business and if either M1 or M2 is a foreign corporation.

(2) Exception. Section 267(f)(2) is applicable to the sale of inventory at a loss from M1 to M2 in the following cases:

(i) M1 is a domestic corporation, M2 is a foreign corporation, and M2's income from the resale of the inventory is taxable under section 882 (relating to effectively connected income).

(ii) M1 is a foreign corporation, M1's income from the sale of the inventory is taxable under section 882, and M2 either is a domestic corporation or is a foreign corporation whose income from the resale of the inventory is taxable under section 882.

(3) Sales outside ordinary course. For purposes of paragraph (g)(1) of this section, whether a sale is outside the ordinary course of business is to be determined under the facts and circumstances. Evidence of a sale of inventory by M1 to M2 outside the ordinary course of business includes-

(i) A sale made for the purpose of accelerating losses,

(ii) An abnormally large volume of sales near the end of the taxable year, and

(iii) A sale by M1 at a loss of inventory to M2 if, had that inventory not been sold, a write-down to a value equal to the price for which it was sold would not have been proper (for example under §1.471-2(c) and §1.471-4(b), as affirmed by Thor Power Tool Co. v. Commissioner, 439 U.S. 522 (1979)).

(h) Certain foreign currency losses. Under section 267(f)(3)(C), section 267 (a)(1) and (f)(2) does not apply to a loss on the repayment of a loan if all of the following conditions are met:

(1) The loss is sustained by a member on the repayment to it of a loan made to another member,

(2) The loan is payable or denominated solely in a foreign currency, and

(3) The loss is attributable to a reduction in value of the foreign currency in which the loan is payable or denominated.

(Approved by the Office of Management and Budget under control number 1545-0885.)

§1.267(f)-2T Temporary regulations for deferring certain losses of members that join in filing consolidated returns.

(a) Scope. This section applies to loss on the sale of property between two members of a controlled group that join in filing a consolidated return for the year the loss is incurred. For effective dates, see §1.267(f)-1T(a). For definitions, see §1.267(f)-1T(b).

(b) General rule. If a loss is incurred on a sale by M1 to M2 in a taxable year during which they join in filing a consolidated return, §1.1502-13 applies, except as provided in this section.

(c) Election not to defer loss not applicable. For purposes of section 267(f), an election under §1.1502-13(c)(3) has no effect. Thus, even though M1 and M2 join in filing a consolidated return with a group for which an election under §1.1502-13(c)(3) is in effect, M1's loss on a sale of property to M2 will be deferred as if that election had not been made.

(d) Unrestored deferred loss adjustments if separate return year-(1) Occurrence of a separate return year. If M1 joins in filing a consolidated return with M2 for a taxable year during which M1 sells property (after the effective date of section 267(f)) to M2 at a loss, and if either M1 or M2 (or both) later has a separate return year, then the event that results in that separate return year does not alone result in restoration of M1's deferred loss under §1.1502-13(f) except to the extent either of the following provisions is applicable:

(i) That event alone would have resulted in restoration under §1.267(f)-1T had M1 and M2 not joined in filing a consolidated return. See, for example, §1.267(f)-1T(c)(4), (5), (6), and (7).

(ii) That event would have resulted in a one-time restoration under either paragraph (g) (2), (5), or (6) of this section (for depreciable property) or paragraph (j)(2) of this section (for receivables).

(2) Subsequent restorations-(i) Any amount that was not restored after applying paragraph (d)(1) of this section shall be restored under §1.267(f)-1T (applied without paragraph (a)(3) thereof) and, if applicable, under paragraph (g) (3), (5), or (6) of this section.

(ii) If paragraph (g)(3) of this section applies and if M1 subsequently ceases to be a member, §1.267 (f)-1T(c)(7) applies by deeming the increase amount to be equal to M1's unrestored deferred loss on the date M1 ceases to be a member.

(e) Unrestored deferred loss adjustments if property disposed of outside consolidated group but not outside controlled group-(1) Occurrence of disposition. If M1 and M2 join in filing a consolidated return for a taxable year during which M1 sells property (after the effective date of section 267(f)) to M2 at a loss, then M2's later disposition of that property to a member (M3) that does not join in filing a consolidated return with M1 and M2 will not result in restoration of M1's deferred loss under §1.1502-13 unless paragraph (h) of this section (relating to depreciable property) or paragraph (j)(2) of this section (relating to certain receivables) applies. Thus, for example, that loss will not be restored on the disposition to M3, notwithstanding §1.1502-13(e)(2) and (f)(1)(i) and (ii).

(2) Subsequent restorations-(i) Restoration of M1's deferred loss for the property subsequent to M2 disposing of the property to M3 shall be made under §1.267(f)-1T (applied without paragraph (a)(3) thereof) and, if applicable, under paragraph (h) of this section.

(ii) If paragraph (h) of this section applies and if M1 subsequently ceases to be a member, §1.267(f)-1T(c)(7) applies by deeming the increase amount to be equal to M1's unrestored deferred loss on the date M1 ceases to be a member.

(f) No restoration on sale to a section 267(b) related person. Section 1.267(f)-1T(c)(8) applies whether or not M1 and M2 join or have ever joined in filing a consolidated return.

(g) Restoring deferred loss on depreciable property after deconsolidation-(1) Conditions of application. Except as otherwise provided, this paragraph (g) applies only if all the following conditions are met:

(i) M1 defers a loss on the sale of depreciable property to M2 that occurs after the effective date of section 267(f) during a taxable year in which M1 and M2 join in filing a consolidated return.

(ii) Either M1 or M2 (or both) has a later separate return year that would result in restoring M1's deferred loss if this section were not applicable.

(iii) For that separate return year, both M1 and M2 remain members of the same controlled group under §1.267(f)-1T(c)(4).

(2) One-time restoration. If this paragraph (g) applies and the amount of the loss restored by M1 under §1.1502-13(d) prior to the date either M1 or M2 began its first separate return year is less than the amount of the loss that would have been restored to M1 had M1 and M2 never joined in filing a consolidated return, then M1 shall restore an amount equal to the difference between those two amounts. This amount shall be restored by M1 when restoration would have occurred under §1.1502-13(f)(1), were it applicable.

(3) Annual adjustments. If this paragraph (g) applies, then for each M1 taxable year during which M1 and M2 remain members of the same controlled group and which ends after the beginning of the first M1 or first M2 separate return year (whichever occurs first), M1 shall restore an amount equal to the amount of M1's "adjusted deferred loss" (as defined in paragraph (g)(4) of this section) multiplied by a fraction. The numerator of the fraction is the amount M1 would have restored under §1.267(f)-1T(d) for that M1 taxable year (or, if M2 has the first separate return year, for the portion of the M1 taxable year after the first M2 separate return year) had M1 and M2 never joined in filing consolidated returns. The denominator is the total amount M1 would have restored beginning with the first such separate return year had M1 and M2 never joined in filing consolidated returns.

(4) Adjusted deferred loss. The "adjusted deferred loss" is an amount equal to-

(i) the amount of M1's deferred loss immediately prior to the one-time restoration of this paragraph (g), reduced by

(ii) the amount (if any) of that one-time restoration.

(5) M1 leaves group while owning property. If M1 is the owning member of the property for which M1 has deferred loss, and if the conditions of paragraph (g)(1) of this section are met except that the separate return year occurs as a result of M1 leaving the group, then the principles of paragraph (g) (2) and (3) of this section are applied as if M1 and M2 remain members of the same controlled group.

(6) M1 leaves group while property still in group. If the conditions of paragraph (g)(1) of this section are met except that M1 leaves the group when the property is still owned by a member, then-

(i) A one-time restoration is made under the principles of paragraph (g)(2) of this section (if applicable),

(ii) The adjusted deferred loss is determined under paragraph (g)(4) of this section, and

(iii) Section 1.267(f)-1T(c)(7) applies by deeming the increased amount to be equal to the adjusted deferred loss.

(7) Example. This paragraph (g) is illustrated by the following examples:

Example (1). (i) M1 and M2 join in filing a consolidated return for the calendar year. On January 1, 1980, M1 purchases depreciable property from a third party for $1,400 and begins depreciating it on the straight line method (with $200 salvage value) over 12 years. On January 1, 1985, when its adjusted basis in the property is $900, M1 sells the property to M2 for $800 for a loss of $100. Under §1.1502-13(c)(1) the $100 loss is deferred. M2 depreciates the property on the straight line method (with zero salvage value) over 4 years. On January 1, 1987, all of the stock of M2 is transferred to M1's sole individual shareholder. Thus, M2 has a separate return year beginning January 1, 1987, and M2 remains a member of the same controlled group in which M1 is a member.

(ii) While M1 and M2 continue to join in filing a consolidated return, M1's $100 deferred loss is restored under §1.1502-13(d)(1) as shown in the following table:

	1985	1986
1. Consolidated return fraction under sec. 1.1502-13 (d) (1) (ii) (b):		
a. Numerator (M2's depreciation)	$200	$200
b. Denominator (M2's depreciable basis)	800	800
c. Fraction	200/800	200/800
2. M1's deferred loss at time of deferred intercompany transaction	100	100
3. Amount of M1's loss restored	25	25

Thus, as of January 1, 1987, M1 has restored $50 (i.e., $25+$25) of its loss and $50 (i.e., $100-$50) of its loss remains deferred.

(iii) If §1.267(f)-1T(d) were applicable when M1 sold the property to M2, M1 would have restored $14.29 of its $100 deferred loss for each of its taxable years 1985-1991. That is, for each of those years, M1's restoration amount ($100) would have been multiplied by a fraction having a numerator of $100 (the amount of depreciation that would have been allowable to M1 that year had M1 not sold the property) and a denominator of $700 (the total depreciation that would have been allowable to M1 for all taxable years after 1984 had M1 not sold the property). Thus, M1 could have restored $28.58 (i.e., $14.29 × 2 years) as of the end of 1986. Since the amount ($50) M1 restored in 1985 and 1986 under §1.1502-13(d) is not less than the amount ($28.58) M1 would have restored under $1.267(f)-1T(d), there is no "one-time restoration" under paragraph (g)(2) of this section.

(iv) In 1987, M1 will restore $10 of the $50 unrestored deferred loss. This 1987 restoration is determined by multiplying M1's adjusted deferred loss ($50) by a fraction. The numerator is $14.29 (the amount M1 would have restored under §1.267-1T(d) for that year had M1 and M2 never joined in filing a consolidated return). The denominator is $71.45 (the total amount M1 would have restored for its taxable years 1987-1991 had M1 and M2 never joined in filing a consolidated return, i.e., $14.29×5 years). Similarly, M1 will restore $10 in 1988, 1989, 1990, and 1991.

Example (2). (i) The facts are the same as in example (1) except that M2 depreciates the property on the straight line method (with zero salvage value) over 8 Years.

(ii) While M1 and M2 continue to join in filing a consolidated return, M1's $100 deferred loss is restored under §1.1502-13(d)(1) as shown in the following table:

	1985	1986
1. Consolidated return fraction under sec. 1.1502-13(d)(1)(ii)(b):		
a. Numerator (M2's depreciation)	$100	$100
b. Denominator (M2's depreciable basis)	800	800
c. Fraction	100/800	100/800

2. M1's deferred loss at time of deferred intercompany transaction.. 100 100

3. Amount of M1's loss restored .... 12.50 12.50 --

Thus, as of Janaury 1, 1987, M1 has restored $25 (i.e., $12.50+$12.50 of its loss and $75 (i.e., $100-$25) of its loss remains deferred.

(iii) As in example (1), if §1.267(f)-1T(d) were applicable when M1 sold the property to M2, M1 would restore $14.29 of its deferred loss for each of its taxable years 1985-1991. Thus, M1 would have restored $28.58 (i.e., $14.29×2 years) as of the end of 1986. Because the amount restored by M1 under §1.1502-13(d) for 1985 and 1986 ($25) is less than the total amount M1 would have restored for these years had M1 never filed a consolidated return with M2 ($28.58), M1 restores as a "one-time restoration" under paragraph (g)(2) of this section the $3.58 difference (i.e., $28.58-$25) on December 31, 1986 (i.e., immediately before M2's separate return year begins).

(iv) In 1987, M1 will restore $14.284 of the deferred loss. This restoration is determined by multiplying M1's adjusted deferred loss of $71.42 (i.e., $75-$3.58) by a fraction. As in example (1), the numerator of this fraction is $14.29 and the denominator is $71.45. Similarly, M1 will restore $14.284 in 1988, 1989, 1990, 1991. Thus, by the end of 1991, M1 will have restored the entire amount of the loss that remained deferred ($75) as of the time immediately prior to M2's separate return year (i.e., $3.58+($14.284×5 years)).

(h) Depreciable property disposed of outside consolidated group but not outside controlled group. If, after the effective date of section 267(f); M1 defers a loss on a sale of depreciable property to M2 during a taxable year for which M1 and M2 join in filing a consolidated return, then M2's disposition of that property to a member that does not join in filing the consolidated return will result in restoring M1's deferred loss under the principles of paragraph (g) (2) and (3) of this section.

(i) [Reserved]

(j) Restoring deferred loss for a receivable after deconsolidation-(1) Conditions of application. This paragraph (j) applies only if all of the following conditions are met:

(i) M1 defers a loss on the sale of a receivable to M2 that occurs after the effective date of section 267(f) and during a taxable year in which M1 and M2 join in filing a consolidated return.

(ii) If M1 and M2 had not joined in filing a consolidated return that year, all or a portion of the loss would not have been deferred under §1.267(f)-1T(e).

(iii) An event occurs ("restoration event") which in the absence of applying this section would result in restoring all or a portion of M1's deferred loss under §1.1502-13 but which, as a result of applying this section (as if this paragraph (j) did not apply), would not result in restoring that deferred loss.

(2) One-time restoration. If this paragraph (j) applies, then at the time M1 would have restored its deferred loss under §1.1502-13 were this section not applicable, M1 shall restore an amount equal to the lesser of-

(i) The amount of the loss that would not have been deferred under §1.267(f)-1T(e) had M1 and M2 not joined in filing a consolidated return for the taxable year in which M1 sold the receivable to M2 or

(ii) The amount of the loss that would have been restored under §1.1502-13 as a result of the restoration event were it not for this section.

Par. 3. Immediately after §1.706-1, there is added a new §1.706-2T. The new section reads as follows:

§1.706-2T Temporary regulations; question and answer under the Tax Reform Act of 1984.

Question 1: For purposes of section 706(d), how is an otherwise deductible amount that is deferred under section 267(a)(2) treated?

Answer 1: In the year the deduction is allowed, the deduction will constitute an allocable cash basis item under section 706(d)(2)(B)(iv).

Par. 4. Immediately after §1.1502-13, there is added a new §1.1502-13T. The new section reads as follows:

§1.1502-13T Temporary regulations for certain intercompany transactions.

(a)-(j) [Reserved]

(k) Priority of sections 267(f). For application of section 267(f) when a consolidated return is filed, see §1.267(f)-2T.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 267 (f)(2)(B), 706(d)(2)(B)(iv), 1502, and 7805 of the Internal Revenue Code of 1954 (98 Stat. 704, 26 U.S.C. 267; 98 Stat. 589, 26 U.S.C. 706; 68A Stat. 367, 26 U.S.C. 1502; 68A Stat. 917, 26 U.S.C. 7805, respectively).

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

Approved: November 14, 1984.

Ronald A. Pearlman,

Acting Assistant Secretary of the Treasury.