



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: DEBORAH A. BUTLER
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CC:DOM:FS

SUBJECT: Reduction of Tax Attributes under Code Section 108(b)

This Field Service Advice responds to your memorandum dated September 17, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

P =
B =
C =
d% =
Jurisdiction Y =
Year X =
\$r =
\$s =
\$t =

ISSUE:

Whether a consolidated group that excludes cancellation of indebtedness ("COD") income under section 108(a) must, pursuant to section 108(b), reduce the group's consolidated net operating loss ("CNOL") as a tax attribute, even if no portion of the CNOL is attributable to the member having the excluded income.

CONCLUSION:

A consolidated group that excludes cancellation of indebtedness (“COD”) income under section 108(a) must, pursuant to section 108(b), reduce the group’s consolidated net operating loss (“CNOL”) as a tax attribute, even if no portion of the CNOL is attributable to the member having the excluded income.

FACTS:

P is the parent of B. B owned d% of C. P filed consolidated returns that included B and C, as well as other group members. Several years before the years at issue, a number of substantial loans were made from P to B and, to a lesser extent, from B to C.

Thereafter, P, B and C were among the debtors in a Chapter 11 bankruptcy petition filed in Jurisdiction Y. Late in year X, a plan of reorganization was filed on behalf of the debtors and approved by the Court. Under the plan, B and C merged into P. Additionally, the members’ substantial intercompany debts were canceled.

At issue is taxpayer's treatment of the cancellation of indebtedness effected by the plan of reorganization. The treatment was as follows. Since B and C were insolvent, B and C excluded approximately \$r of COD income under section 108(a).¹ Second, P reduced the tax attributes of B by approximately \$s in accordance with section 108(b). Finally, P and B (*i.e.*, the creditor members) claimed bad debt deductions of approximately \$t, which ultimately increased the group’s CNOL carryforward by a like amount.

LAW AND ANALYSIS

Gross income includes income from the discharge of indebtedness. I.R.C. §61(a)(12). Gross income does not include discharge of indebtedness income where the taxpayer is insolvent. I.R.C. § 108(a)(1)(B). The amount of indebtedness excluded from gross income is applied to reduce the taxpayer’s tax attributes as follows:

- (A) NOL - Any net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year

¹The facts are unclear concerning why B and C had \$r amount of COD income, rather than \$t amount of COD income. However, because the difference between \$t and \$r is minimal, we will assume for purposes of our discussion that B and C had \$t amount of COD income (rather than \$r amount of COD income).

(B) General Business Credit - Any carryover to or from the taxable year of a discharge of an amount for purposes for determining the amount allowable as a credit under section 38 (relating to general business credit),

(C) Minimum Tax Credit - The amount of the minimum tax credit available under section 53(b) as of the beginning of the taxable year immediately following the taxable year of the discharge,

(D) Capital Loss Carryovers - Any net capital loss for the taxable year of the discharge, and any capital loss carryover to such taxable year under section 1212,

(E) Basis Reduction -

(i) In general - The basis of the property of the taxpayer. . . .

I.R.C. §108(b)(2).

P apparently contends that the CNOL, which is attributable to P and B (i.e., the creditor members of the group), is not a tax attribute of B and C, respectively (i.e., the debtor members of the group), and is not subject to section 108(b) attribute reduction.

Based on the items listed in section 108(b)(2) and (b)(5) (e.g., NOL, general business credit, minimum tax credit, capital loss carryovers, basis reduction, etc.), the definition of a tax attribute is an item that could serve to reduce the tax liability of a taxpayer. Each member of a consolidated group has separate "taxpayer" status. See Insilco Corp. v. Commissioner, 73 T.C. 589 (1979), aff'd, 659 F.2d 059 (2d Cir. 1981). Moreover, Treas. Reg. § 1.1502-6 expressly provides that each member of the group is severally liable for the tax of the entire group. Additionally, pursuant to Treas. Reg. §§ 1.1502-11(a)(2) and 1.1502-21, the only NOL that any group member has that can reduce the consolidated tax liability of the group for a carryback or carryover year is the CNOL. Since each member is liable for the consolidated tax, a CNOL deduction reduces the tax liability of every member of the group, regardless of to which group member the CNOL was attributable. The group's CNOL, regardless of which member's deductions generated that CNOL, is available as a carryover to offset the consolidated taxable income of the entire group, regardless of which member's income generated that consolidated taxable income. Furthermore, the part of a CNOL attributable to a member is not apportioned to the member for the carryback year unless a specific rule, such as Treas. Reg. § 1.1502-79 (relating to carryover and carryback of CNOLs to separate return years), provides for that apportionment; and, in the instant case, no rule provides for that apportionment. In short, a CNOL is a tax attribute potentially usable by every member of a consolidated group. Therefore, a CNOL attributable to P and B is an available tax attribute of B and C, as well as P, which should be subject to section 108(b) attribute reduction.

From a broader perspective, the bad debt deductions of P and B and the excluded corresponding COD income benefitted all group members. The \$t amount of bad debt deductions, which were not offset by \$t amount of COD income inclusion, reduced the tax liability of the entire group. However, even though the group (i.e., all members) benefitted by these bad debt deductions, P apparently asserts that the group should look only to the tax attributes of B and C, the specific group members that had the COD income excluded from income. Since B and C apparently had only \$s of tax attributes to reduce, the petitioners in essence assert that the group should reap the significant tax benefits associated with claiming \$t amount of bad debt deductions, as well as excluding \$t amount of COD income from gross income, but then bear a significantly lesser amount of increased tax burden associated with reducing tax attributes.

Furthermore, Treas. Reg. § 1.1502-11 (which provides that the CNOL deduction is a consolidated item) supports treating the CNOL as a tax attribute of each member of the group, at least to the extent the loss carryover is not being carried (as it is not in the instant case) to a separate return year. Additionally, the fact that the group's CNOL was generated by bad debt deductions taken by creditor members on the same debt on which debtor members had the excluded COD income (as are the facts in the instant case) further supports treating the CNOL as a tax attribute subject to reduction under section 108(b).

Concerning Priv. Ltr. Rul. ("PLR") 9121017, we believe PLR 9121017 is incorrect to the extent it indicates that, in section 108(b), Congress used the term "taxpayer" to limit tax attribute reduction for a consolidated group just to the amount of tax attributes of the particular member that generated the cancellation of indebtedness income. As already indicated, although each member of a consolidated group has separate "taxpayer" status, each member of the group is severally liable for the tax of the group. Under the approach of the consolidated return regulations, a CNOL carryover attributable to one group member is available to offset the income of the other group members in the consolidated carryover year. Since the CNOL attributable to one member is available to reduce the tax liability of all members, it is inappropriate to limit section 108 attribute reduction within a consolidated group to the amount of tax attributes of just the particular group member having the COD income. As you are aware, PLR 9121017 may not be cited as precedent. See I.R.C. § 6110(j)(3). Moreover, even if PLR 9121017 could be cited as precedent, the PLR could be distinguished from the instant case in various ways not addressed in this memorandum.

If you have any questions, please call (202) 622-7930.

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