Closing-of-Books Election Sparks Interest

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Proposed regulations have been issued under Section 382 dealing with the allocation of income and loss to periods before and after a loss corporation's ownership change date (CO-049-88). The new rules allow a loss corporation to allocate a NOL or taxable income, and net capital loss or gain for the ownership change year, between the pre-change and post-change periods, either by ratably allocating an equal portion to each day in the change year, or by electing to close its books on the change date.

A closing-of-the-books election applies only for purposes of this allocation and does not terminate the loss corporation's taxable year as of the change date. If the election is made, the amounts allocated to the pre-change and post-change periods cannot exceed the NOL or taxable income and net capital loss or gain for the change year.

This irrevocable election is made on the information statement required by Temp. Reg. 1.382-2T(a)(2)(ii) for the change year and must be made by the due date (including extensions) of the loss corporation's return for that year.

Consolidated Groups

If the election is made with respect to an ownership change of a group (or subgroup) of consolidated

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corporations, it will apply to every member. Any allocation of items under these rules is determined after applying the consolidated return rules (Reg. 1.1502-76); there are coordination provisions.

Proposed Regulation 1.382-6(d) coordinates with Reg. 1.1502-76, which provides that a consolidated return must include each subsidiary's items of income, gain, deduction, loss, and credit for the portion of the year for which it is a member. If a subsidiary joins or leaves the group during a consolidated return year, its items for the portion of its year for which it is not a member must be included in a separate return. Regulation 1.1502-76 provides rules for allocating the subsidiary's items between the returns. Any period of less than 12 months for which a separate or consolidated return is required under Reg. 1.1502-76 is deemed a separate taxable year.

On the other hand, if the corporation has a change date on a day other than the last day of the short taxable year, Reg. 1.1502-76 first applies to allocate a portion of the corporation's items to the short taxable year that includes the change date. The proposed regulations then apply to allocate items within the short taxable year for purposes of Section 382.

Operating Rules

Capital items are allocated separately from ordinary items and are not included in determining a NOL or taxable income. In determining a NOL or taxable income and net capital loss or gain, pre-change and post-change items recognized during the change year generally can be offset against one another without regard to the Section 382 limitation. Plus, a NOL is generally reduced by the amount of capital gain remaining after offset by capital loss carryovers, without regard to the Section 382 limitation.

Under Section 382(h), if a loss corporation has a net unrealized built-in loss, built-in loss recognized during the post-change period is allocated entirely to the post-change period and is subject to the Section 382 limitation. To the extent the loss corporation has a net unrealized built-in gain, built-in gain recognized during the post-change period is allocated entirely to the post-change period and increases the Section 382 limitation. For purposes of the allocation rules, these built-in losses or gains are not taken into account in determining the loss corporation's NOL or taxable income and net capital loss or gain.

The proposed regulations also exclude income or gain recognized on the disposition of assets transferred to the loss corporation during the post-change period if a principal purpose of the transfer was to ameliorate the impact of the Section 382 limitation. Such income or gain is allocated entirely to the post-change period. Absent this rule, a loss corporation could plan to ratably allocate some of this income or gain to the pre-change period, thereby allowing the amount so allocated to be offset by pre-change losses without limitation, even though the income or gain is not a pre-change item.

Other Implications

If the closing-of-the-books election is made, it will not only control regular corporate tax computations, but will also be effective for alternative minimum tax purposes. Finally, while letter rulings have allowed taxpayers an increase in the Section 382 limitation to the extent that net pre-change income was offset by net post-change loss, this favorable rule was eliminated in the proposed regulations.

Effective Dates

The new rules are proposed to be effective when finalized. Nevertheless, the Service's letter ruling policy will reflect the principles contained in the proposed regulations for all such rulings issued after 11/19/92. ■