From:
Sent: Wednesday, February 24, 2010 5:05:05 PM
To:
Cc:
Subject: Your question about 1.337(d)-2

Hi,   -- as discussed, here is a brief (and necessarily general) summary of the application of 1.337(d)-2 to a hypothetical set of facts:

Basic facts:
M, a member of a consolidated group, holds all the stock of S with an aggregate basis of $10. M sells the S stock to an unrelated party for $8 (recognizing a loss of $2). The stock loss is subject to 1.337(d)-2 and M will use the disconformity method in Notice 2004-58 to determine its allowable loss.

Under Notice 2004-58, subsidiary stock loss is disallowed to the extent of the smallest of the following three factors:
1. the gain amount (total gains recognized by S on the disposition of assets while in the group)
2. the disconformity amount (the excess, if any, of M's basis in S stock over S's net asset basis -- basically S's net built-in gain), and

3. the net positive adjustment (the greater of: the total investment adjustments applied to M's basis in S under 1.1502-32, excluding any adjustments for distributions, and zero -- basically the net amount M's basis was increased by -32 adjustments excluding the effect of any distributions).

M first computed its Notice 2004-58 factors as:
1. Gain amount = $2
2. Disconformity amount = $4, and
3. Net positive adjustment = $0. (The total adjustments under 1.1502-32 actually totaled a negative $1, so the disconformity amount is zero, the greater of $0 and negative $1).

Using these factors, M's disallowance amount would be $0 (the smallest of the three factors) and M would be allowed to claim its entire $2 stock loss.

However, if it is determined that, prior to the stock sale, S distributed an asset with a basis of $0 and a value of $3, S would recognize a $3 gain under section 311(b) and M's Notice 2004-58 computations would be revised as follows:

Stock basis: $10 + $3 gain recognized - $3 distribution (the value of the property distributed) = $10

Stock loss: $2 (note: the parties would have no reason to change the purchase price b/c the original $8 purchase price/value already reflected the fact that S no longer held the distributed property)

Revised Notice 2004-58 factors:
1. Gain amount: original $2 + $3 gain recognized on distribution of property = $5
2. Disconformity amount: $4 (there would be no change because the gain realized and amount distributed would move the inside and outside bases in tandem), and

3. Net positive adjustment: $2 (the greater of zero and $2, the total investment adjustments under 1.1502-32, exclusive of distributions: the sum of the original negative $1 and the positive $3 from the 311(b) gain on the distribution)

Using these factors, M's disallowance amount is $2 (the smallest of the three factors) and M is entitled to claim none of its $2 stock loss.

Please let me know if you have any further questions on the application of 1.337(d)-2 or Notice 2004-58. Thanks.