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Consolidated Returns

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The new vitality of section 269 clearly cannot be ignored. It should occupy a prominent position in the mind of all tax practitioners dealing with corporate acquisitions, combinations, or rearrangements of any sort when past or prospective losses appear in the picture. It can no longer be shrugged off with implausible or flimsy business purposes.

VII

CONSOLIDATED RETURNS

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An affiliated group of corporations with a common parent is permitted to file a consolidated return in lieu of each corporation filing a separate return.[1] At least eighty per cent of the voting stock and eighty per cent of the non-voting common stock in each subsidiary must be owned by one or more other affiliated corporations, and the parent must own the same percentages of stock in at least one of the other affiliated corporations.[2] This article does not purport to cover the determination of what constitutes an affiliated group nor the computation of the consolidated taxable income or consolidated net operating loss,[3] but is limited to the carryover and carryback of such losses and the effect upon such carryover and carryback when a corporation is added to or deleted from the consolidated group.

CARRYOVER TO AN AFFILIATED GROUP OF A PRIOR NET OPERATING LOSS

The net operating loss of an affiliated group can be carried forward to offset income of the group in future years just as a single corporation's net operating loss can be carried over.[4] If a corporation was not a member of the affiliated group when it incurred a net operating loss, but then joins the affiliated group, the net operating loss carryover can be used to offset post-affiliation income of that corporation.[5] However, if that corporation does not have sufficient income to use up the net

1. INT. REV. CODE OF 1954, § 1501 [hereinafter cited as CODE §].

2. CODE § 1504.

3. See Treas. Reg. §§ 1.1502-31(a)(1), (2), (5) (1955), as amended, T.D. 6412, 1959-2 CUM. BULL. 199 [hereinafter cited as Reg. §].

4. Reg. § 1.1502-31(a)(3) (1955).

5. Reg. §§ 1.1502-31(a)(3), (b)(3) (1955), as amended, T.D. 6412, 1959-2 CUM. BULL. 199.

operating loss carryover, the carryover may *not* be used to offset income of the other members of the affiliated group.[6] If the affiliated group has a net operating loss carryover from a year in which one subsidiary was not a member of the group, it is unclear whether the carryover loss may be used to offset income of the subsidiary in a year in which the group's income, excluding the income of the subsidiary, is insufficient to utilize fully the net operating loss carryover.[7] The preaffiliation loss of a subsidiary cannot be used to offset income of that subsidiary in a year in which it is a member of an affiliated group if the affiliated group has a consolidated loss in that year.[8] If the rule were otherwise, the preaffiliation loss of the subsidiary would reduce the income of the subsidiary, thus increasing the group's loss and its current year net operating loss. The result would be a shifting of the net operating loss from the subsidiary to the group and from an old year to the current year, thus affecting both the income which can be offset and the years in which it can be used.

CARRYBACK OF A NET OPERATING LOSS

The net operating loss of an affiliated group can be carried back to offset income of the group in prior years in the same manner as the loss is carried back by a single corporation.[9] However, the portion of the loss which results from operations of an affiliated corporation which was not a member of the group in prior years cannot be carried back to offset income of the group in years in which the affiliate was not a member of the group.[10] This is particularly significant in the case of a newly formed subsidiary. The loss cannot be carried back if the affiliate was not in existence in prior years.[11] The loss of the previously nonaffiliated corporation can be carried back to offset its income in years in which it filed separate returns.[12]

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6. Reg. § 1.1502-31(b)(3) (1955), as amended, T.D. 6412, 1959-2 CUM. BULL. 199; Capital Service, Inc., 18 P-H Tax Ct. Mem. 112 (1949), *aff'd*, 180 F.2d 579 (9th Cir. 1950).

7. Oliver Co. v. Patterson, 151 F. Supp. 709 (D. Ala. 1957), *aff'd*, 249 F.2d 894 (5th Cir. 1958), is often cited for the proposition that the loss of the group cannot be used to offset future income of the previously nonaffiliated subsidiary. However, in that case both the parent and the subsidiary filed separate returns, and in the year in which the parent suffered the loss. The limited holding was to the effect that the pre-affiliation loss of a parent could not be used to offset post-affiliation profits of a subsidiary.

8. Phinney v. Houston Oil Field Material Co., 252 F.2d 357 (5th Cir. 1958).

9. Reg. § 1.1502-31(a)(4) (1955), as amended, T.D. 6412, 1959-2 CUM. BULL. 199.

10. Reg. § 1.1502-31(b)(3) (1955), as amended, T.D. 6412, 1959-2 CUM. BULL. 199; Trinco Industries, 22 T.C. 959 (1954).

11. Phinney v. Houston Oil Field Material Co., 252 F.2d 357 (5th Cir. 1958); American Trans-Ocean Nav. Corp., 229 F.2d 97 (2d Cir. 1956); Midland Management Co., 38 T.C. No. 24 (May 7, 1962).

12. Reg. §§ 1.1502-31(a)(4), (b)(3) (1955), as amended, T.D. 6412, 1959-2 CUM. BULL. 199.

EFFECT OF SECTIONS 381 AND 382

In addition to all the restrictive rules outlined above, the Regulations provide that the net operating losses of newly acquired subsidiaries may not be available to the group unless the acquisition satisfies the requirements of sections 381 and 382.[13] Thus, although the availability of a net operating loss carryover or carryback on a consolidated return is often readily determinable, the rules are so stringent that it is difficult to obtain the benefit of the carryover or carryback for a corporation or group which suffered the loss, and in certain situations the loss will be unavailable to the group or corporation although it would have been available if a consolidated return had not been filed.[14]

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13. Reg. § 1.1502-31(b)(21) (1955). See at 262-67 for the requirements of § 381, at 267 71 for the requirements of § 382(b), and at 254-59 for the requirements of § 382(a).

14. See text accompanying note 8 *supra*.