Joint Committee on Taxation
June 12, 2002
JCX-63-02

DESCRIPTION OF CHAIRMAN'S MODIFICATION TO THE PROVISIONS OF THE "TAX SHELTER TRANSPARENCY ACT" SCHEDULED FOR A MARKUP BY THE SENATE COMMITTEE ON FINANCE ON JUNE 13, 2002[1]

The Chairman's modification would add the following provision to the Tax Shelter Transparency Act:[2]

A. Modification with Respect to Rite Aid Case

Present Law

An affiliated group of corporations may elect to file a consolidated return in lieu of separate returns. A condition of electing to file a consolidated return is that all corporations that are members of the consolidated group must consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for filing such return.[3]

Section 1502 states:

> The Secretary shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent the avoidance of such tax liability.[4]

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Modification to the Provisions of the "Tax Shelter Transparency Act" Scheduled for a Markup By the Senate Committee on Finance on June 13, 2002* (JCX-63-02), June 12, 2002.

[2] A description of the provisions of the Tax Shelter Transparency Act can be found at: Joint Committee on Taxation, *Description of Proposals in S. 2498, the "Tax Shelter Transparency Act"* (JCX-53-02), June 11, 2002.

[3] Section 1501.

[4] Section 1502.

Under this authority, the Treasury Department has issued extensive consolidated return regulations.[5]

In the recent case of *Rite Aid Corp. v. United States*,[6] the Federal Circuit Court of Appeals addressed the application of a particular provision of certain consolidated return loss disallowance regulations, and concluded that the provision was invalid. The particular provision, known as the "duplicated loss" provision,[7] would have denied a loss on the sale of stock of a subsidiary by a parent corporation that had filed a consolidated return with the subsidiary, to the extent the subsidiary corporation had assets that had a built-in loss, or had a net operating loss, that could be recognized or used later.

The Federal Circuit Court opinion contained language discussing the fact that the regulation produced a result different than the result that would have obtained if the corporations had filed separate returns rather than consolidated returns.[8]

The Treasury Department has announced that it will not continue to litigate the validity of the duplicated loss provision of the regulations, and has issued interim regulations that permit taxpayers for all years not to apply that provision.[9]

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[5] Regulations issued under the authority of section 1502 are considered to be "legislative" regulations rather than "interpretative" regulations, and as such are usually given greater deference by courts in case of a taxpayer challenge to such a regulation. The Supreme Court has stated that ". . . legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).

[6] 255 F.3d 1357 (Fed. Cir. 2001).

[7] Treas. Reg. Sec. 1.1502-20(c)(1)(iii).

[8] For example, the court stated: "The loss realized on the sale of a former subsidiary's assets after the consolidated group sells the subsidiary's stock is not a problem resulting from the filing of consolidated income tax returns. The scenario also arises where a corporate shareholder sells the stock of a non-consolidated subsidiary. The corporate shareholder could realize a loss under I.R.C. sec. 1001, and deduct the loss under I.R.C. sec. 165. The subsidiary could then deduct any losses from a later sale of assets. The duplicated loss factor, therefore, addresses a situation that arises from the sale of stock regardless of whether corporations file separate or consolidated returns. With I.R.C. secs. 382 and 383, Congress has addressed this situation by limiting the subsidiary's potential future deduction, not the parent's loss on the sale of stock under I.R.C. sec. 165." 255 F.3d 1357, 1360 (Fed. Cir. 2001).

[9] The Treasury Department has also indicated its intention to continue to study all the issues that the original loss disallowance regulations addressed (including issues of furthering single entity principles) and possibly issue different regulations (not including the particular approach of Treas. Reg. Sec. 1.1502-20(c)(1)(iii)) on the issues in the future. *See* Notice 2002-11, 2002-7 I.R.B. 526 (Feb. 19, 2002); T.D. 8984, 67 F.R. 11034 (March 12, 2002); REG-

There is a concern that some taxpayers might attempt to take a position that under the language and reasoning of the Federal Circuit Court decision in the *Rite Aid* case, other consolidated return regulations not involved in that case (*i.e*., to the extent they provide a different result than if corporations had filed separate returns) might now be considered subject to challenge. This might create uncertainty or lead to protracted litigation.

Description of Proposal

The proposal would provide that the regulatory authority provided in section 1502 shall be construed without regard to the interpretation of that authority in the decision of the Federal Circuit Court in *Rite Aid Corp. v. United States.* [10] That is, the proposal would overrule the court's reasoning that there was not a problem resulting from the filing of consolidated returns because a corporate taxpayer could deduct a loss on the sale of stock of a nonconsolidated subsidiary. The proposal would thus deny the case any precedential effect with respect to other consolidated return regulations.

The proposal would nevertheless allow the result of the case to stand, with respect to the specific regulatory provision that was invalidated in the case (Treas. Reg. Sec. 1.1502-20(c)(1)(iii)).

The proposal would confirm that consolidated return regulations may provide rules treating corporations filing consolidated returns differently from corporations filing separate returns.

The proposal would thus confirm that Treasury is authorized to issue consolidated return regulations utilizing either a single entity or separate entity approach or a combination of the two approaches, as Treasury deems necessary, in order that the tax liability of any affiliated group of corporations making a consolidated return, and of each corporation in the group, both during and after the period of affiliation, may be determined and adjusted in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such liability.

Effective Date

The proposal would be effective for all taxable years, whether beginning before, with, or after the date of enactment of the proposal.

No inference is intended that the results following from this proposal are not the same as the results under present law.

102740-02, 67 F.R. 11070 (March 12, 2002); *see also*, Notice 2002-18, 2002-12 I.R.B. 644 (March 25, 2002).

[10] 255 F.3d 1357 (2001).