

35. When an affiliated group exists, Federal income tax treatment often changes for the group members.

Item	If Consolidated Return Is Filed	If Separate Returns Are Filed
a.	The dividend payment is eliminated in computing consolidated taxable income, so no tax.	Giant reports \$1 million in income, and then claims a \$1 million dividends received deduction.
b.	Only one 15% tax bracket is allowed to the <i>affiliated</i> group, so total Federal income tax is \$22,250. An allocation method is used to determine the payment of each member.	Only one 15% tax bracket is allowed to the <i>controlled</i> group, so total Federal income tax is \$22,250.
c.	Both corporations are fully liable for the \$140,000 income tax liability. An allocation method is used to determine the payment of each member.	Giant is liable only for its \$65,000 liability, and PebbleCo for its \$75,000.
d.	Only one \$250,000 floor is allowed to the <i>affiliated</i> group in computing the accumulated earnings credit. The parties are not allowed two such floors.	Only one \$250,000 floor is allowed to the <i>controlled</i> group in computing the accumulated earnings credit. The parties are not allowed two such floors.

Table 8.1

36. When an affiliated group exists, Federal income tax treatment often changes for the group members.

Situation	If Consolidated Return is Filed	If Separate Returns are Filed
a. Giant and PebbleCo both produce taxable profits from manufacturing activities.	The § 199 DPAD is computed on a group basis and deducted on the consolidated return.	The § 199 DPAD is computed separately for both Giant and PebbleCo.
b. PebbleCo pays Giant an annual royalty for use of the Giant trademarks.	The deduction and income items both are reported in the year of Giant's income recognition. On the consolidated return, they net to zero.	The deduction and income items both are reported in the year of Giant's income recognition.
c. Giant uses a calendar tax year, while PebbleCo's tax year-end is March 31.	PebbleCo must convert to a calendar tax year, immediately upon joining the Giant consolidated group.	Pebble can retain its fiscal tax year.

Situation	If Consolidated Return is Filed	If Separate Returns are Filed
d. Giant uses dollar-value LIFO for its inventory tax accounting, while PebbleCo uses FIFO.	The affiliates can continue to use different inventory tax accounting methods.	The affiliates can continue to use different inventory tax accounting methods.

Table 8.1

37. The 80% test is failed in a. In b., stock attribution rules apply in identifying a controlled group, but not an affiliated group. In c., the affiliated group test must be met on every day of the tax year, while the controlled group test must be met only on the last day of the year.

Situation	Facts	Parent-Subsidiary Controlled Group? (Y/N)	Affiliated Group? (Y/N)
a.	Throughout the year, P owns 65% of the stock of S.	N	N
b.	Parent owns 70% of SubCo. The other 30% of SubCo stock is owned by Senior, a wholly owned subsidiary of Parent.	Y	N
c.	For 11 months, P owns 75% of the stock of S. For the last month of the tax year, P owns 100% of the S stock.	Y	N

pp. 8-9, 8-10, and 8-12

Note: It may depend on how you interpret the question. If you look at only Parent & SubCo then there is no affiliated group (the author's solution). However, if you consider Senior then there is an "identifiable" parent (Senior is a wholly owned subsidiary of Parent)

40. Consolidated tax liabilities are shared in the following manner.

	Separate Taxable Income	Allocation Ratio	Allocated Tax Due
Parent	\$ 850	850/1,200	\$241
SubOne	300	300/1,200	85
SubTwo	50	50/1,200	14
SubThree	<u>-0-</u>	0	<u>-0-</u>
Totals	<u>\$1,200</u>		<u>\$340</u>

Example 16

41. Consolidated tax liabilities are shared in the following manner.

	<b>Separate Taxable Income</b>	<b>Separate Tax Liability</b>	<b>Allocation Ratio</b>	<b>Allocated Tax Due</b>
Parent	\$ 850	\$297.5	297.5/380	\$266
SubOne	300	65, after applying energy tax credit	65/380	58
SubTwo	50	17.5	17.5/380	16
SubThree	<u>-0-</u>	<u>-0-</u>	0	<u>-0-</u>
Totals	<u>\$1,200</u>	<u>\$380.00</u>		<u>\$340</u>

Example 16

43.

<b>Stock Basis at End of Year</b>	<b>Alternative A</b>	<b>Alternative B</b>	<b>Alternative C</b>
2009	\$34 million	\$34 million	\$34 million
2010	\$41 million	\$19 million	\$15 million Excess Loss Account
2011	\$51 million	\$29 million	\$5 million Excess Loss Account

If a subsidiary is sold while its parent holds an Excess Loss Account in it, capital gain income is created to the extent of the account balance.

Examples 18 and 19

44. The stock basis in a subsidiary is adjusted at the end of every tax year in a manner similar to that of the financial accounting "equity" method. Stock basis cannot go below zero, so an excess loss account is created when negative adjustments exceed the beginning-of-year stock basis.

<b>Tax Year</b>	<b>Operating Gain/(Loss)</b>	<b>Stock Basis</b>
1	\$100,000	\$500,000 + \$100,000 = \$600,000
2	(\$400,000)	\$600,000 - \$400,000 = \$200,000
3	(\$300,000)	\$0 with a \$100,000 excess loss account (\$200,000 - \$300,000)

Examples 18 and 19

45. If subsidiary stock is sold while its parent holds an excess loss account in it, capital gain income is created equal to the extent of the account balance.

Amount realized from stock sale	\$250,000
- WhaleCo basis in MinnowCo stock	(-0-)
+ Excess loss account	<u>100,000</u>
Capital gain income	<u>\$350,000</u>

pp. 8-17, 8-18, and Example 19

46. Consolidated taxable income is computed as follows.

<b>2009</b>	\$200,000
<b>2010</b>	170,000
<b>2011</b>	50,000
<b>2012</b>	340,000

The Orange losses offset the Teal income dollar for dollar, but they never become large enough to produce a consolidated loss. Because both corporations produce ordinary income, there are no adjustments to make using the format of Figure 8.2. There are no consolidated NOL carryovers in any of the specified years.

#### Example 21

47. It is assumed that the group does not elect to forgo the carryback of the 2011 consolidated net operating loss.

#### Consolidated taxable income

2009	\$300,000	
2010	90,000	
2011	0	(\$350,000) NOL carryback. This first generates a full refund of the 2009 group tax liability. The remaining \$50,000 NOL carryback then generates a partial refund of the 2010 group income tax liability. The 2011 NOL now is fully used.
2012	325,000	

#### Example 23

50. Under the SRLY rules, the group cannot carry back the losses that Child brings into the group. Subsequent deductions are limited to the cumulative positive contributions toward group taxable income that are traceable to Child. Child's NOL can be deducted by the Thrust group as follows.

2009	\$0
2010	\$500,000
2011	\$400,000 (exhausted)

Figure 8.3

51. a. This intercompany transaction is subject to the matching rule. Realized gain is deferred, through an elimination in the computation of consolidated taxable income. The \$80,000 gain is recognized when SubCo later sells the land to Outsider.

	Separate Taxable Income	Adjustments	Post- Adjustment Amounts
ParentCo \$210,000 Information	\$210,000		
SubCo Information Group-Basis Transactions	(\$ 20,000)		(\$ 20,000)
Intercompany Events		– \$80,000 Gain on intercompany sale to SubCo †	(\$ 80,000)
Consolidated Taxable Income			\$110,000

NOTES  
† Matching Rule

- b. The solution includes the \$10,000 post-acquisition gain realized and recognized by SubCo on the land.

	Separate Taxable Income	Adjustments	Post-Adjustment Amounts
ParentCo Information	\$90,000		\$ 90,000
SubCo Information Group-Basis Transactions	\$40,000		\$ 40,000
Intercompany Events		+ \$80,000 Restore gain on ParentCo's Sale to SubCo †	+ \$ 80,000
Consolidated Taxable Income			\$210,000

NOTES  
† Matching Rule

Example 34