



TaxNewsFlash

United States

No. 2024-007
January 8, 2024

KPMG report: Observations on amendments to section 52 regulations as part of amendments to consolidated return regulations

The U.S. Treasury Department and IRS on December 27, 2024, released [final regulations](#) (36 pages) under sections 1502, 1503, 1552, 1563, 52, and 414, which were published in the Federal Register on December 30, 2024.

The final regulations follow [proposed regulations](#) (26 pages) issued in August 2023 ([read TaxNewsFlash](#)), which modify the consolidated return regulations and the controlled group rules under sections 1502, 1503, 1552, and 1563, as well as [corrections](#) (2 pages) to the proposed regulations issued in December 2023, which make parallel modifications to the regulations under sections 52(b) and 414(c)(1) (the “modified regulations”).

The modified regulations amend the common control rules under sections 52(b) and 414(c)(1) through an expansion of the constructive ownership rules that apply to determine the existence of parent-subsidary groups.

Background – Trades or businesses that are under common control

An entity can be a member of a section 52 group through the application of either section 52(a) or (b). Section 52(a) describes controlled groups of corporations, whereas section 52(b) describes trades or businesses (whether or not incorporated) under common control. Section 52(a) and (b) each have separate rules for parent-subsidary, brother-sister, and combined common control groups. Prior to the new final regulations, the constructive ownership rules for a parent-subsidary control group under section 52(a) differed from those under section 52(b) for trades or businesses under common control. In particular, while section 52(a) relies on the broader rules under section 1563(d) and (e) (which attribute ownership from options, partnerships, estates and trusts), the prior regulations addressing the application of section 52(b)'s constructive ownership rules incorporate a single constructive ownership rule in section 414 (which attributes ownership only from options). Attribution from partnerships, estates, or trusts was not previously contemplated in the context of section 52(b)'s constructive ownership rules.

Changes to the constructive ownership rules

The final regulations change the constructive ownership rules that apply for purposes of determining whether there exists a section 52(b) controlled group of trades or businesses by incorporating a number of constructive ownership rules in section 414 (rather than solely the specific constructive ownership rule in section 414 which attributes ownership only from options). Specifically, taxpayers must apply Treas. Reg. § 1.414(c)-4(b)(1), (2), and (3) to determine whether the more than 50% controlling interest threshold is reached. Notably, Treas. Reg. § 1.414(c)-4(b)(2) generally requires proportionate attribution from partnerships if the partner owns an interest of 5% or more in either the profits or capital of the partnership.

The preamble to the final regulations explains that the modifications to the section 52(b) constructive ownership rules for parent-subsidiary groups under common control is necessary to mirror prior changes to the constructive ownership rules for parent-subsidiary groups for controlled groups of corporations under sections 52(a) and 1563. Section 1563 (which applies to controlled groups of corporations under 52(a)) was previously amended by the Technical and Miscellaneous Revenue Act of 1988¹ to provide for attribution from partnerships, estates, and trusts when taking into account the constructive ownership rules for parent-subsidiary controlled groups of corporations.

The amendments to the regulations under section 52(b) (and section 414(c)(1)) are effective for tax years (plan years) beginning on or after January 1, 2025.

KPMG observations

The changes to the section 52 regulations have the potential to expand the members of a group under common control under section 52(b) and further complicate the analysis taxpayers must engage in to determine the membership of their section 52 single employer group (for multiple purposes of the Code). Most significantly, the final regulations change the contours of section 52(b) controlled groups to include trades or businesses indirectly owned through non-trade or business entities. The expansion would appear to largely impact certain partnership-parented structures.

The scope of the change can be illustrated through the following examples:

- **Example 1:** X is a corporation that owns 80% of the capital and profits interest in PRS, a partnership. PRS owns 80% of the total combined voting power of all classes of stock entitled to vote of Y, a corporation. Both under the prior regulations and the modified regulations, there exists a section 52(a) group that includes X and Y.
- **Example 2:** UTP is a partnership engaged in a trade or business that owns 80% of the capital and profits interest in LTP, a partnership not engaged in a trade or business. LTP owns 80% of the total combined voting power of all classes of stock entitled to vote of X, a corporation. Although not entirely clear under the prior final regulations, under the modified regulations, there clearly exists a section 52(b) group that includes UTP and X.

The change is noteworthy due to the number of Code sections that rely on the aggregation rules under section 52(b), including the gross receipts test under section 448(c) (which is used to determine whether a taxpayer meets the exception to the requirement to use the accrual method), the small business exception to the capitalization requirements under section 263A, and the small business exception to interest expense deduction limitations under section 163(j), among other threshold tests in the Code. Additionally, the determination of whether a corporation is an applicable corporation for purposes of the corporate alternative minimum tax (CAMT) is based upon the adjusted financial statement income of all persons treated as a single employer under section 52(a) or (b).² Therefore, this change in the aggregation rules for controlled groups under section 52(b) has the potential to make it more likely that a corporate member of a structure that includes partnerships, estates, or trusts becomes an applicable corporation for CAMT purposes.

¹ Pub. L. No. 100-647, Nov. 10, 1988.

² See section 59(k)(1)(D), Prop. Treas. Reg. § 1.59-2(e), and the preamble to REG-112129-23.

The effective date of the change is also worth highlighting. As noted above, the amendments to the regulations under section 52 are effective for tax years beginning on or after January 1, 2025. Thus, calendar year taxpayers do not need to apply the modified regulations to 2024 returns. However, given the complex nature of the section 52 analysis, taxpayers are well-advised to study and determine the impacts of the modified regulations as soon as practicable.

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