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U.S. Tax Court: Consolidated group's use of predecessor's NOLs disallowed under SRLY rules

The U.S. Tax Court today held that a consolidated group was not entitled to consolidated net operating loss (CNOL) deductions based on pre-liquidation net operating loss (NOL) carryovers of a predecessor entity under the consolidated separate return limitation years (SRLY) rules.

The case is: *HBM Holdings Company v. Commissioner*, 167 T.C. No. 6. Read the Tax Court's opinion.

Summary

The taxpayer was the parent of a consolidated group formed on July 1, 2018. The taxpayer succeeded under section 381(a), in a deemed liquidation under section 332 occurring on June 30, 2018, to $108 million of NOL carryovers of an entity now disregarded as separate from the taxpayer (referred to as "DRE").

On the returns for its short tax year ending December 31, 2018, and the 2020 and 2021 tax years, the consolidated group claimed CNOL deductions on the basis of the DRE NOL carryovers. However, the taxpayer had no separate taxable income for those years, and the IRS disallowed the deductions on the grounds that the SRLY rules under Treas. Reg. § 1.1502-1 barred using DRE's losses to offset the income of other group members.

The Tax Court granted summary judgment for the IRS, concluding that:

- DRE was a predecessor to the taxpayer within the meaning of Treas. Reg. § 1.1502-1(f)(4) because it transferred assets to the taxpayer in a transaction to which section 381(a) applied, notwithstanding that the consolidated group did not exist at the time of DRE's deemed liquidation.
- The "lonely parent rule" under Treas. Reg. § 1.1502-1(f)(2)(i), which allows a common parent to apply carryovers from its separate return years (SRYs) without SRLY limitations, does not apply to the SRYs of a predecessor of the common parent.
- The taxpayer and the other founding members of the group did not constitute a SRLY subgroup under Treas. Reg. § 1.1502-21(c)(2)(i). Because the taxpayer was an S corporation and the other members were qualified subchapter S subsidiaries (QSSSs) immediately before the group was formed, they could not have been members of a prior affiliated group together.

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