Unionbancal Corp. v. Commissioner, 113 T. C. 309 (1999)

Temporary regulations can validly disallow deferred losses from intercompany sales when the selling member leaves the controlled group before the property is disposed of outside the group.

Summary

Unionbancal Corp. sold a loan portfolio to its UK parent at a loss in 1984. Under IRC section 267(f), the loss was deferred as both parties were part of the same controlled group. When Unionbancal left the group in 1988, the IRS denied its claim for the deferred loss under a temporary regulation, shifting the loss benefit to the purchasing member's basis. The Tax Court upheld this regulation, ruling that it reasonably interpreted the statute by deferring the loss until the property left the controlled group. This decision clarified that deferred losses under section 267(f) do not have to be restored to the seller when it exits the group, and highlighted the IRS's authority to limit retroactive application of new regulations.

Facts

In 1984, Unionbancal Corp. sold a loan portfolio to its indirect UK parent, Standard Chartered-U. K. , for $422,985,520, realizing a loss of $87. 9 million. The IRS allowed a deduction of $2. 3 million for 1984, deferring the remaining loss under IRC section 267(f). In 1988, Unionbancal left the controlled group, which still held the loan portfolio. Unionbancal sought to deduct the deferred loss in 1988, but the IRS disallowed it under a temporary regulation that shifted the loss benefit to the purchasing member's basis when the seller exited the group. The loan portfolio was sold outside the group in 1989.

Procedural History

The IRS issued a notice of deficiency for Unionbancal's 1988 tax year, disallowing the $85. 6 million deferred loss. Unionbancal petitioned the Tax Court, challenging the validity of the temporary regulation and the IRS's refusal to allow retroactive application of a new regulation. The Tax Court upheld the temporary regulation and the IRS's decision not to apply the new regulation retroactively.

Issue(s)

1. Whether the temporary regulation under IRC section 267(f) validly disallows the deferred loss to the selling member when it leaves the controlled group before the property is disposed of outside the group.
2. Whether the temporary regulation violates the U. S. -U. K. income tax treaty.
3. Whether the IRS's refusal to allow Unionbancal to elect retroactive application of the final regulation was authorized under IRC section 7805(b).

Holding

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1. Yes, because the temporary regulation reasonably interprets IRC section 267(f) by deferring the loss until the property leaves the controlled group, even if the selling member exits the group first.
2. No, because the temporary regulation does not discriminate based on the country of incorporation of the taxpayer's parent.
3. Yes, because IRC section 7805(b) authorizes the IRS to limit the retroactive application of regulations without any requirement to allow beneficial retroactivity.

Court's Reasoning

The court applied the Chevron standard, finding the temporary regulation a reasonable interpretation of IRC section 267(f). The regulation generally defers the loss until the property leaves the controlled group, consistent with the statute's purpose to prevent premature loss recognition among related parties. The court rejected Unionbancal's argument that the deferred loss must be restored to the seller, noting that the statute does not mandate this and that the temporary regulation effectively identifies the loss with the property through a basis adjustment. The court also found no treaty violation, as the regulation applies equally to all taxpayers regardless of their parent's country of incorporation. Finally, the court upheld the IRS's refusal to apply the final regulation retroactively, stating that IRC section 7805(b) gives the IRS discretion to limit retroactivity without considering taxpayer benefit.

Practical Implications

This decision clarifies that deferred losses under IRC section 267(f) do not have to be restored to the seller upon exiting the controlled group, potentially affecting how taxpayers structure intercompany sales. It reinforces the IRS's authority to issue prospective regulations and limit their retroactive application, which may impact taxpayers' expectations regarding regulatory changes. The decision also highlights the importance of considering the tax treatment of deferred losses in different jurisdictions, as the inability of the purchasing member to recognize the loss in its home country did not affect the validity of the U. S. regulation. Subsequent cases, such as Turner Broadcasting System, Inc. v. Commissioner, have applied similar principles to the treatment of deferred losses in controlled group transactions.

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