

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-161948-05

RIN 1545-BF43

Limitations on the Importation of Net Built-in Losses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under sections 334(b)(1)(B) and 362(e)(1) of the Internal Revenue Code of 1986 (Code). The proposed regulations apply to certain nonrecognition transfers of loss property to corporations that are subject to Federal income tax. The proposed regulations affect the corporations receiving the loss property.

DATES: Written or electronic comments must be received by **[INSERT DATE 90 DAYS AFTER THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG 161948-05), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-161948-05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the Federal eRulemaking Portal at www.regulations.gov (IRS-REG-161948-05).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, John P. Stemwedel (202) 622-7790 or Theresa A. Abell (202) 622-7000, and, concerning submissions of comments and requests for a public hearing, Oluwafunmilayo (Funmi) Taylor at (202) 622-7180 (not toll free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking revises a collection of information approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2019. Comments on the revised collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, D.C. 20224. Comments on the collection of information should be received by **[INSERT DATE 60 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. Comments are specifically requested concerning:

Whether the proposed revised collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The revised collection of information in these proposed regulations is in §§1.332-6, 1.351-3, and 1.368-3. By requiring that taxpayers separately report the fair market value and basis of property (including stock) described in section 362(e)(1)(B) and in 362(e)(2)(A) that is transferred in a tax-free transaction, this revised collection of information aides in identifying transactions within the scope of sections 334(b)(1)(B), 362(e)(1), and 362(e)(2) and thereby facilitates the IRS' verification that taxpayers are complying with sections 334(b)(1)(B), 362(e)(1), and 362(e)(2). The respondents will be corporations and their shareholders.

Revised eEstimated total annual reporting burden: 281,250375,000 hours.

Revised eEstimated average annual burden hours per respondent: 1.25-1.25 hours.

Estimated number of respondents: 225,000 (of the originally estimated 350,000; original 0.75 hour estimate unchanged for the remaining 125,000 respondents).

Estimated frequency of responses: once.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103.

Background

Sections 334(b)(1)(B) and 362(e)(1) (the anti-loss importation provisions) were enacted in the American Jobs Creation Act of 2004 (Public Law 108-357, 188 Stat. 1418) to prevent erosion of the corporate tax base through the importation of loss in nonrecognition transfers. This Notice of Proposed Rulemaking proposes regulations under both of these anti-loss importation provisions.

Explanation of provisions

1. The Anti-loss Importation Provisions: Sections 334(b)(1)(B) and 362(e)(1)

Section 334(b)(1)(B) applies to corporate acquisitions of loss property in liquidations described in section 332 (complete liquidation of subsidiary). Section 362(e)(1) applies to corporate acquisitions of loss property in transactions described in section 362(a) (transactions to which section 351 applies and acquisitions of property as paid-in surplus or contributions to capital, each a section 362(a) transaction) and in transactions described in section 362(b) (reorganizations). The application and effect of the anti-loss importation provisions are materially identical, and so the proposed

regulations use the same nomenclature and operating rules for both anti-loss importation provisions.

The anti-loss importation provisions apply when a corporation acquires property that is described in section 362(e)(1)(B) in a transaction described in section 332, 362(a), or 362(b), and, under the generally applicable basis rules (other than the anti-loss duplication rule in section 362(e)(2)), the acquiring corporation (Acquiring) would take the property with an aggregate basis in excess of “value” (generally equal to fair market value under the proposed regulations; see paragraph 1.b.ii. of this preamble). When an anti-loss importation rule applies, Acquiring’s basis in each such property is equal to the property’s value. To the extent Acquiring receives property in the transaction that is not subject to the anti-loss importation rules, Acquiring’s basis in the property is determined under generally applicable basis rules, including section 362(e)(2).

Property is described in section 362(e)(1)(B) (designated “importation property” in the proposed regulations) if two conditions are satisfied. First, any gain or loss recognized on a disposition of the property would not be subject to Federal income tax in the hands of the transferor immediately before the transfer. Section 362(e)(1)(B)(i). Second, any gain or loss recognized on a disposition of the property would be subject to Federal income tax in the hands of the transferee immediately after the transfer. Section 362(e)(1)(B)(ii).

Since the enactment of the anti-loss importation provisions, a number of questions have arisen concerning their application. The principal concern has been the determination of whether property is importation property, but various other questions

(discussed subsequently in this preamble) have also been raised regarding the application of the anti-loss importation provisions and their interaction with other rules of law. To address these issues, the proposed regulations provide a framework for identifying importation property and determining whether the transfer of the property is a transaction subject to the anti-loss importation provisions (designated a “loss importation transaction” under the proposed regulations).

a. Importation property

The proposed regulations use a hypothetical sale analysis to identify importation property. Under this approach, the actual tax treatment of any gain or loss that would be recognized on a sale of the property, first by the transferor immediately before, and then by Acquiring immediately after, the transfer, determines whether an individual property is importation property. If any gain or loss that would be recognized on a hypothetical sale of the property by the transferor immediately before the transfer would not be subject to Federal income tax in the hands of the transferor, the first condition for classification as importation property is satisfied. If any gain or loss that would be recognized on a hypothetical sale of the property by Acquiring immediately after the transfer would be subject to Federal income tax in the hands of Acquiring, the second condition for classification as importation property is satisfied. Property is importation property only if both conditions are satisfied.

In general, the determination is made by reference to the tax treatment of the hypothetical seller of the transferred or acquired property, that is, whether the hypothetical seller would take the gain or loss into account in determining its Federal income tax liability. This determination must take into account all relevant facts and

circumstances. The proposed regulations include a number of examples illustrating this approach. Thus, in one example, a tax-exempt entity transfers property to a taxable domestic corporation, and the determination takes into account whether the transferor, though generally tax-exempt, would nevertheless be required to include the amount of the gain or loss in unrelated business taxable income under sections 511 through 514 of the Code. In other examples, a foreign corporation transfers property to a taxable domestic corporation and the determination takes into account whether the foreign corporation would be required to include the amount of gain or loss under section 864 or 897 as income effectively connected with, or treated as effectively connected with, the conduct of a U.S. trade or business. Although the examples assume there is no applicable income tax treaty, in the case of an applicable income tax treaty, the determination of whether property is importation property would take into account whether the transferor would be taxable under the business profits article or gains article of the income tax treaty.

i. Partnerships, S corporations, grantor trusts as hypothetical seller.

Although the general rule in the proposed regulations looks solely to the tax treatment of the hypothetical seller, a modified rule applies if a hypothetical seller is a partnership, a small business corporation that has elected under section 1362(a) to be an S corporation, or a grantor trust. In these cases, the determination is made by reference to the tax treatment of the gain or loss as taken into account by the partners, shareholders, or owners of the entities. The modified rule recognizes that, in these cases, the Code provides that the gain or loss on the hypothetical sale would be included by the partner, shareholder, or owner, and would not be taxable to the

hypothetical seller, irrespective of whether any amount is actually distributed to such other person. See section 701 (partnership not subject to tax), flush language in section 362(e)(1)(B) (partners treated as owning partnership property); sections 1363 and 1366 (S corporation's income generally taxable to shareholders, not S corporation); section 671 (grantor or other person treated as owning trust property).

If an organizing instrument assigns gain and loss to partners or beneficiaries in different amounts, including by reason of a special allocation under a partnership agreement, the proposed regulations make clear that the hypothetical sale model makes the determination of whether gain or loss is subject to Federal income tax by reference to the person to **whichwhom**, under the terms of the instrument, the hypothetical gain or loss would actually be allocated, taking into account the entity's net gain or loss actually recognized in the tax period in which the transaction occurs.

ii. Other pass-through entities: anti-avoidance rule.

In certain circumstances, the Code permits distributions to effect a similar shifting of tax consequences. For example, under sections 651 and 652, and sections 661 and 662, distributions made by a trust are deducted from the trust's income and included in the beneficiary's (or beneficiaries') income. Certain domestic corporations are also able to shift tax consequences by distributing income or gain from a property sale. These corporations include regulated investment companies (RICs, as defined in section 851(a)), real estate investment trusts (REITs, as defined in section 856(a)), and domestic corporations taxable as cooperatives (see section 1381).

The IRS and Treasury are concerned that disregarding the effects of this shifting of tax liability would in certain circumstances undermine the anti-importation provisions.

However, the IRS and Treasury are also concerned that applying a look-through rule in all such cases would present a significant administrative burden.

Accordingly, the proposed regulations contain an anti-avoidance rule that applies to domestic trusts, estates, RICs, REITs, and cooperatives that directly or indirectly transfer property ~~(, including through other such entities),~~ in a section 362 transaction, if the property had been directly or indirectly transferred to or acquired by the entity as part of a plan to avoid the application of the anti-importation provisions. For purposes of this rule, it is immaterial who had the plan to avoid the anti-importation provisions. When the anti-avoidance rule applies, the domestic entity, which, absent application of the anti-avoidance rule, would be treated under these regulations as subject to Federal income tax, is treated as subject to a look-through rule. Under the look-through rule, the entity is presumed to distribute the proceeds of the hypothetical sale (which, for this purpose, are presumed to be an amount greater than zero), and, to the fullest extent permitted by the terms of its organizing instrument, it is presumed to make the distributions to persons that would not take distributions from the entity into account in determining a Federal income tax liability. If an interest in such an entity is held indirectly through one or more other such entities, the principles of this rule apply to look to the ultimate owners of the interest. The determination of whether the property is importation property is then made by reference to the deemed distributees or, in the case of tiered entities, to the ultimate deemed distributees.

To illustrate, assume 90 percent of a REIT's shares are owned by persons that would not take into account any gain or loss in determining a Federal income tax liability and that each share has an equal right to any distribution by the REIT. The REIT holds

property that was transferred to the REIT as part of a plan to avoid the application of the anti-importation rule to a section 362 transaction. At a time when the acquired property has a built-in loss, the REIT transfers the property to a domestic corporation in a section 362 transaction. In this case, the anti-avoidance rule would apply. Thus, the REIT is presumed to distribute all the proceeds of the hypothetical sale of the property transferred in the section 362 transaction, and the determination of whether any gain or loss on that hypothetical sale would be taken into account in determining a Federal income tax liability is made by reference to the distributee REIT shareholders. Thus, 90 percent of the property transferred in the section 362 transaction would be importation property. Alternatively, assume that the property was originally acquired (as part of a plan to avoid the application of the anti-importation rule to a section 362 transaction) by a trust whose trustee has discretion to distribute all or a portion of the trust's gain or loss to a person that would not take any amount of such distribution into account in determining a Federal income tax liability and, when the property has a built-in loss, the trust transfers the property to a domestic corporation in a section 362 transaction. In this case, all of the property transferred in the section 362 transaction would be importation property because the trustee could distribute all of the proceeds from the hypothetical sale to a person that would not take the distribution into account in determining a Federal income tax liability.

The IRS and the Treasury Department continue to study whether a look-through approach should be generally applied to trusts -and request comments on the need for, and potential scope of, such a rule.

iii. Gain or loss affecting certain income inclusions

Practitioners have raised numerous questions regarding the treatment of property held by or transferred to controlled foreign corporations, as defined in section 957 (taking into account section 953(c)) (CFC). Because the general rule looks to the tax treatment of the hypothetical seller, and no exception applies for CFCs, the general operation of the proposed regulations would not treat such amounts as subject to Federal income tax. Nevertheless, because the characterization of gain or loss that would be taken into account in determining a potential income inclusion under section 951(a) has generated some concern among practitioners, the proposed regulations include an express provision stating that gain or loss recognized by a CFC is not considered subject to Federal income tax solely by reason of an income inclusion under section 951(a). The proposed regulations include a similar provision to clarify that gain or loss recognized by a passive foreign investment company, as defined in section 1297(a), is also considered not subject to Federal income tax notwithstanding that it could affect an inclusion under section 1293(a). Comments are specifically requested on this approach.

iv. Gain or loss taxed to more than one person

If any gain or loss realized on a hypothetical sale would be includible in income by more than one person, the proposed regulations treat such property as tentatively divided into separate portions in proportion to the allocation of gain or loss to each person. Tentatively divided portions are treated and analyzed in the same manner as any other property for purposes of applying the anti-importation provisions. (See paragraph c. of this preamble for an illustration of the application of this rule.) Thus, the generally applicable rules determine whether a portion of tentatively divided property is

importation property, and, if the tentatively divided portion is importation property, it is taken into account (as described subsequently in this preamble) with all other importation property to determine whether the transaction is a loss importation transaction.

b. Loss importation transaction

Once the importation property has been identified, Acquiring determines the aggregate basis that it would have in all importation property acquired in the transaction (including the tentatively divided portions of transferred property), without regard to the anti-loss importation provisions or section 362(e)(2). If the aggregate basis of the importation property exceeds such property's aggregate value, the transaction is a loss importation transaction and subject to the anti-loss importation provisions. If the aggregate basis of importation property does not exceed such property's value, the anti-loss importation provisions have no further application.

i. Aggregate, not transferor-by-transferor, approach

Under section 362(e)(1) and the proposed regulations, the determination of whether a section 362 transaction is a loss importation transaction is made by reference to the net amount of built-in gain and built-in loss in all importation property acquired from all transferors in the transaction. This approach differs from the transferor-by-transferor approach of section 362(e)(2), which expressly focusses on the net built-in loss transferred by a particular transferor in a section 362(a) transaction.

ii. Valuing partnership interests

In general, the anti-loss importation rules do not take liabilities into account in determining the value of transferred property and, thus, whether the transfer of such property is a transfer of loss property.

However, in both informal inquiries and written comments, practitioners have raised concerns about the effect of this rule when the property transferred is an interest in a partnership with liabilities. In particular, practitioners are concerned that the inclusion of a partner's share of partnership liabilities in outside basis may create the appearance of a built-in loss because partnership liabilities do not correspondingly increase the value of the interest. The amount of cash at which the partnership interest would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts, should reflect the appropriate measure of fair market value. When a partnership interest is sold, the amount realized may include a share of partnership liabilities from which the transferor is discharged, which is generally equal to the amount of liabilities included in the transferor's outside basis. As such, the sale of a partnership interest properly accounts for the transferee partner's share of partnership liabilities and therefore, reflects the value of that partnership interest.

To address this issue, the proposed regulations generally adopt the approach proposed by commentators and modify the definition of "value" (generally, fair market value) to take liabilities into account when determining whether a partnership interest is a loss asset. However, because there can be differences between Transferor's share of partnership liabilities and Acquiring's share of partnership liabilities, the proposed regulations provide that the value of a partnership interest is the sum of cash that

Acquiring would receive for such interest, increased by any §1.752-1 liabilities (as defined in §1.752-1(a)(4)) of the partnership that are allocated to Acquiring with regard to such transferred interest under section 752. The proposed regulations include an example that illustrates the application and effect of this rule. The proposed regulations also clarify that any section 743(b) adjustment to be made as a result of the transaction is made after any section 362(e) basis adjustment.

c. Acquiring's basis in acquired property

If a transaction is a loss importation transaction, Acquiring's basis in each importation property received (including the tentatively divided portions of property determined to be importation property) is an amount equal to value, notwithstanding the general rules in sections 334(b)(1)(B), 362(a), and 362(b). This rule applies to all importation property, regardless of whether the property's value is greater or less than its basis prior to the loss importation transaction.

Immediately following the application of the anti-loss importation provisions (and prior to any application of section 362(e)(2)), any property that was treated as tentatively divided for purposes of applying these provisions ceases to be treated as divided and is treated as one undivided property (re-constituted property) with a basis equal to the sum of the bases of the portions determined under the anti-importation provision and the bases of all other portions determined under generally applicable provisions (other than section 362(e)(2)). For example, assume that property is transferred in a section 362(a) transaction and the property is treated as tentatively divided for purposes of applying section 362(e)(1) (see paragraph a.iv. of this preamble). Further assume that one tentatively divided portion (basis \$125, value \$100) is determined to be importation

property and the other (basis \$125, value \$100) is not. Finally, assume that, the aggregate basis of all importation property transferred in the transaction (including the \$125 basis of the tentatively divided portion) is \$900 and the aggregate value of all importation property (including the \$100 value of the tentatively divided portion) is only \$800. Thus, the importation property has a net loss, the transaction is a loss importation transaction, and the basis of each importation property is equal to its value. Accordingly, immediately after the application of section 362(e)(1), the tentatively divided property is treated as one single property with a basis of \$225 (\$100 basis in the importation portion plus \$125 basis in the non-importation portion).

If the transaction is described in section 362(a), the transferred property (including the re-constituted property that was tentatively divided for purposes of applying section 362(e)(1)) is then aggregated on a transferor-by-transferor basis to determine whether further adjustment will be required to the bases of loss property under section 362(e)(2). Therefore in the example in the preceding paragraph, after the application of section 362(e)(1), the provisions of section 362(e)(2) may apply to adjust the basis of the property further because the transfer is a section 362(a) transaction. The proposed regulations include a cross-reference to section 362(e)(2) as well as examples illustrating the application of both sections 362(e)(1) and section 362(e)(2) to situations involving multiple transferors and multiple properties that are not all importation properties. Because section 362(e)(2) only applies to transactions described in section 362(a), section 362(e)(2) has no application to liquidations or to reorganizations that do not include a transaction described in section 362(a). The proposed regulations include examples illustrating the interaction of these provisions.

2. Filing Requirements

To facilitate the administration of both the anti-loss importation provisions and the anti-duplication provisions in section 362(e)(2), the proposed regulations modify the reporting requirements applicable in all affected transactions (section 332 liquidations and transactions described in section 362(a) or section 362(b)) to require taxpayers to identify the basis and value of property subject to those sections.

3. Modifications to Liquidation Regulations

The proposed regulations also include several modifications to the regulations applicable to corporate liquidations. These modifications are not changes to current substantive law; they are intended solely to update the regulations to reflect certain statutory changes. The statutory changes reflected in these modifications include the repeal of the General Utilities doctrine (reflected in the modification of sections 334(a) and 337(a), and the repeal of sections 333 and 334(c)), the removal of former section 334(b)(2) (replaced by section 338), and the relocation of former section 332(c) (subsidiary indebtedness) to current section 337(b). In response to certain regulatory changes, the proposed regulations also add several cross-references to regulations under section 367 and 897 to highlight the treatment of certain transfers between foreign corporations.

The proposed regulations do not address the regulations under section 346 and no inference should be drawn from the omission of a proposal under that section.

Effective/applicability date

These regulations are generally proposed to apply to transactions occurring on or after the date the regulations are published as final regulations in the **Federal Register**,

unless completed pursuant to a binding agreement that was in effect immediately before the date such final regulations are published and all times afterwards. It is also proposed that taxpayers would be permitted to apply the final regulations (when published) to transactions occurring after October 22, 2004.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Further, it is hereby certified that these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information requirement in these regulations modifies an existing collection of information by requiring that certain information be reported separately instead of in the aggregate. Although there may be an ~~incremental~~ increase in reporting burden, ~~this~~ increased burden is expected to be minimal because taxpayers should have ready access to the requested information ~~and~~ the proposed regulations ~~would~~ not require taxpayers to report, or maintain records on, information that is not, in the aggregate, already required to be reported ~~and~~ maintained under the current regulations. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are timely submitted to the IRS. Alternatively, taxpayers may submit comments electronically via the Federal e-Rulemaking Portal at www.regulations.gov (IRS and REG-161948-05). The IRS and Treasury Department request comments on all aspects of the proposed regulations. Comments are specifically requested on the appropriate treatment of transactions subject to both section 367(b) and either section 334(b)(1)(B) or 362(e)(1). Comments are also specifically requested on what effect a basis reduction required under section 334(b)(1)(B) or section 362(e)(1) may have on earnings and profits and any inclusion required under §1.367(b)-3. All comments will be available at www.regulations.gov or upon request for public inspection and copying. A public hearing may be scheduled if requested in writing by any person who timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is [John P. Stemwedele](#) and [R. Broderick](#) of the Office of Associate Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.332-6 is amended by revising paragraph (a)(3) and adding a new sentence at the end of paragraph (e) to read as follows:

§1.332-6 Records to be kept and information to be filed with return.

(a) * * *

(3) The fair market value and basis of assets of the liquidating corporation that have been or will be transferred to any recipient corporation, aggregated as follows:

(i) Importation property distributed in a loss importation transaction, as defined in §1.362-3(c)(2) and (c)(3) (except that “section 332 liquidation” is substituted for “section 362 transaction”), respectively;

(ii) Property with respect to which gain or loss was recognized on the distribution;

(iii) Property not described in paragraph (a)(3)(i) or paragraph (a)(3)(ii) of this section;

* * * * *

(e) Effective/applicability date. * * * Paragraph (a)(3) of this section applies to any taxable year beginning on or after these regulations are published as final regulations in the **Federal Register**, unless effected pursuant to a binding agreement that was in effect prior to that date and at all times thereafter.

Par. 3. Section 1.332-7 is amended by adding a new sentence after the first sentence of the section to read as follows:

§1.332-7 Indebtedness of subsidiary to parent.

* * * See section 337(b)(1). * * *

Par. 4. Section 1.334-1 is amended to read as follows:

§1.334-1 Basis of property received in liquidations.

(a) In general. Section 334 sets forth rules for determining a distributee's basis in property received in a distribution in complete liquidation of a corporation. The general rule is set forth in section 334(a) and provides that, if property is received in a distribution in complete liquidation of a corporation and if gain or loss is recognized on the receipt of the property, then the distributee's basis in the property is the fair market value of the property at the time of the distribution. However, if property is received in a complete liquidation to which section 332 applies, including property received in satisfaction of an indebtedness described in section 337(b)(1), see section 334(b)(1) and paragraph (b) of this section.

(b) Liquidations under section 332--(1) General rule. Except as otherwise provided in paragraph (b)(2) or (b)(3) of this section, if a corporation (P) meeting the ownership requirements of section 332(b)(1) receives property from a subsidiary (S) in a complete liquidation to which section 332 applies (section 332 liquidation), including property received in a transfer in satisfaction of indebtedness that satisfies the requirements of section 337(b)(1), P's basis in the property received is the same as S's basis in the property immediately before the property was distributed. However, see §1.460-4(k)(3)(iv)(B)(2) for rules relating to adjustments to the basis of certain contracts accounted for using a long-term contract method of accounting that are acquired in a section 332 liquidation.

(2) Basis in property with respect to which gain or loss was recognized. Except as otherwise provided in the Internal Revenue Code and regulations, if S recognizes gain or loss on the distribution of property to P in a section 332 liquidation, P's basis in that property is the fair market value of the property at the time of the distribution. Section 334(b)(1)(A) (certain tax-exempt distributions under section 337(b)(2)); see also, for example, §1.367(e)-2(b)(3)(i).

(3) Basis in importation property received in loss importation transaction--(i) Purpose. The purpose of section 334(b)(1)(B) and this paragraph (b)(3) is to prevent P from importing a net built-in loss in a transaction described in section 332. See paragraph (b)(3)(iii)(A) of this section for definitions of terms used in this paragraph (b)(3).

(ii) Determination of basis. Notwithstanding paragraph (b)(1) of this section, if a section 332 liquidation is a loss importation transaction, P's basis in each importation property received from S in the liquidation is an amount that is equal to the value of the property. The basis of property received in a section 332 liquidation that is not importation property received in a loss importation transaction is determined under generally applicable basis rules without regard to whether the liquidation also involves the receipt of importation property in a loss importation transaction.

(iii) Operating rules--(A) In general. For purposes of section 334(b)(1)(B) and this paragraph (b)(3), the provisions of §1.362-3 (basis of importation property received in a loss importation transaction) apply, adjusted as appropriate to apply to section 332 liquidations. Thus, when used in this paragraph (b)(3), the terms "importation property," "loss importation transaction," and "value" have the same meaning as in § 1.362-3(c)(2),

1.362-3(c)(3), and 1.362-3(c)(4), respectively, except that “section 332 liquidation” is substituted for “section 362 transaction.” Similarly, when gain or loss on property would be owned or treated as owned by multiple persons, the provisions of §1.362-3(d)(2) apply to tentatively divide the property in applying this section, substituting “section 332 liquidation” for “section 362 transaction” and making such other adjustments as necessary.

(B) Time for making determinations. For purposes of section 334(b)(1)(B) and this paragraph (b)(3)--

(1) P’s basis in distributed property. P’s basis in each property S distributes to P in the section 332 liquidation is determined immediately after S distributes each such property;

(2) Value of distributed property. The value of each property S distributes to P in the section 332 liquidation is determined immediately after S distributes the property;

(3) Importation property. The determination of whether each property distributed by S is importation property is made as of the time S distributes each such property;

(4) Loss importation transaction. The determination of whether a section 332 liquidation is a loss importation transaction is made immediately after S makes the final liquidating distribution to P.

(iv) Examples. The examples in this paragraph (b)(3)(iv) illustrate the application of section 334(b)(1)(B) and the provisions of this paragraph (b)(3). Unless the facts indicate otherwise, the examples use the following nomenclature and assumptions: USP is a domestic corporation that has not elected to be an S corporation within the meaning of section 1361(a)(1); FC, CFC1, and CFC2 are controlled foreign corporations

within the meaning of section 957(a), which are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause their property to be subject to Federal income taxation; there is no applicable income tax treaty; and all persons and transactions are unrelated. All other relevant facts are set forth in the examples:

Example 1. Basic application of this paragraph (b)(3). (i) Distribution of importation property in a loss importation transaction. (A) Facts. USP owns the sole outstanding share of FC stock. FC owns three assets, A1 (basis \$40, value \$50), A2 (basis \$120, value \$30), and A3 (basis \$140, value \$20). On Date 1, FC distributes A1, A2, and A3 to USP in a complete liquidation that qualifies under section 332.

(B) Importation property. Under §1.362-3(d)(2), the fact that any gain or loss recognized by a CFC may affect an income inclusion under section 951(a) does not alone cause gain or loss recognized by the CFC to be treated as taken into account in determining a Federal income tax liability for purposes of this section. Thus, if FC had sold either A1, A2, or A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Further, if USP had sold A1, A2, or A3 immediately after the transaction, USP would take into account any gain or loss recognized on the sale in determining its Federal income tax liability. Therefore, A1, A2, and A3 are all importation properties. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(2).

(C) Loss importation transaction. Immediately after the distribution, USP's aggregate basis in the importation properties, A1, A2, and A3, would, but for section 334(b)(1)(B) and this section, be \$300 (\$40 + \$120 + \$140) and the properties' aggregate value would be \$100 (\$50 + \$30 + \$20). Therefore, the importation properties' aggregate basis would exceed their aggregate value and the distribution is a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(3).

(D) Basis of importation property distributed in loss importation transaction. Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, the basis in each of the importation properties received is equal to its value immediately after FC distributes the property. Accordingly, USP's basis in A1 is \$50; USP's basis in A2 is \$30; and USP's basis in A3 is \$20.

(ii) Distribution of both importation and non-importation property in a loss importation transaction. (A) Facts. The facts are the same as in paragraph (i)(A) of this Example 1 except that FC is engaged in a U.S. trade or business and A3 is used in that U.S. trade or business.

(B) Importation property. A1 and A2 are importation properties for the reasons set forth in paragraph (i)(B) of this Example 1. However, if FC had sold A3 immediately before the transaction, FC would take into account any gain or loss recognized on the sale in determining its Federal income tax liability. Therefore, A3 is not importation property. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(2).

(C) Loss importation transaction. Immediately after the distribution, USP's aggregate basis in the importation properties, A1 and A2, would, but for section 334(b)(1)(B) and this section, be \$160 (\$40 + \$120). Further, the properties' aggregate value would be \$80 (\$50 + \$30). Therefore, the importation properties' aggregate basis would exceed their aggregate value and the distribution is a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(3).

(D) Basis of importation property distributed in loss importation transaction. Because the importation properties, A1 and A2, were transferred in a loss importation transaction, the basis in each of the importation properties received is equal to its value immediately after FC distributes the property. Accordingly, USP's basis in A1 is \$50 and USP's basis in A2 is \$30.

(E) Basis of other property. Because A3 is not importation property distributed in a loss importation transaction, USP's basis in A3 is determined under generally applicable basis rules. Accordingly, USP's basis in A3 is \$140, the adjusted basis that FC had in the property immediately before the distribution. See section 334(b)(1).

(iii) FC not wholly owned. The facts are the same as in paragraph (i)(A) of this Example 1 except that USP owns only 80% of the sole outstanding class of FC stock and the remaining 20% is owned by individual X. Further, on Date 1 and pursuant to the plan of liquidation, FC distributes A1 and A2 to USP and A3 to X. A1 and A2 are importation properties, the distribution to USP is a loss importation transaction, and USP's bases in A1 and A2 are equal to their value (\$50 and \$30, respectively) for the reasons set forth in paragraphs (ii)(C) and (ii)(D) of this Example 1. Under section 334(a), X's basis in A3 is \$20.

(iv) Importation property, no net built in loss. (A) Facts. The facts are the same as in paragraph (i)(A) of this Example 1 except that the value of A2 is \$230.

(B) Importation property. A1, A2, and A3, are importation properties for the reasons set forth in (i)(B) of this Example 1.

(C) Loss importation transaction. Immediately after the distribution, USP's aggregate basis in the importation properties, A1, A2, and A3, would, but for section 334(b)(1)(B) and this section, be \$300 (\$40 + \$120 + \$140). However, the properties' aggregate value would also be \$300 (\$50 + \$230 + \$20). Therefore, the importation properties' aggregate basis would not exceed their aggregate value and the distribution is not a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(3).

(D) Basis of importation property not distributed in loss importation transaction. Because the importation properties, A1, A2, and A3, were not distributed in a loss importation transaction, the basis of each of the importation properties is determined under the generally applicable basis rules. Accordingly, immediately after the distribution, USP's basis in A1 is \$40, USP's basis in A2 is \$120, and USP's basis in A3 is \$140, the adjusted bases that FC had in the properties immediately before the distribution. See section 334(b)(1).

(v) CFC stock as importation property distributed in loss importation transaction.
(A) Facts. USP owns the sole outstanding share of FC stock. FC owns the sole outstanding share of CFC1 stock (basis \$80, value \$100) and the sole outstanding share of CFC2 stock (basis \$100, value \$5). On Date 1, FC distributes its shares of CFC1 and CFC2 stock to USP in a complete liquidation that qualifies under section 332.

(B) Importation property. No special rule applies to the treatment of property that is the stock of a CFC. Thus, if FC had sold either the CFC1 share or the CFC2 share immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Further, if USP had sold either the CFC1 share or the CFC2 share immediately after the transaction, USP would take into account any gain or loss recognized on the sale in determining its Federal income tax liability. Thus, the CFC1 share and the CFC2 share are importation property. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(2).

(C) Loss importation transaction. Immediately after the distribution, USP's aggregate basis in importation property (the CFC1 share and the CFC2 share) would, but for section 334(b)(1)(B) and this section, be \$180 (\$80 + \$100) and the shares' aggregate value is \$105 (\$100 + \$5). Therefore, the importation property's aggregate basis would exceed their aggregate value and the distribution is a loss importation transaction. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(3).

(D) Basis of importation property distributed in loss importation transaction. Because the importation property (the CFC1 share and the CFC2 share) was transferred in a loss importation transaction, USP's basis in each of the shares received is equal to its value immediately after FC distributes the shares. Accordingly, USP's basis in the CFC1 share is \$100 and USP's basis in the CFC2 share is \$5.

Example 2. Multiple step liquidation. (i) Facts. USP owns the sole outstanding share of FC stock. On January 1 of year 1, FC adopts a plan of liquidation. FC makes the following distributions to USP in a transaction that qualifies as a complete liquidation under section 332. In year 1, FC distributes A1 and, immediately before the distribution, FC's basis in A1 is \$100 and A1's value is \$120. In Year 2, FC distributes A2, and, immediately before the distribution, FC's basis in A2 is \$100 and A2's value is \$120. In year 3, in its final liquidating distribution, FC distributes A3 and, immediately before the distribution, FC's basis in A3 is \$100 and A3's value is \$120. As of the time of the final distribution, USP had depreciated the bases of A1 and A2 to \$90 and \$95, respectively; the value of A1 had appreciated to \$160; and, the value of A2 has declined to \$0.

(ii) Importation property. If FC had sold either A1, A2, or A3 immediately before it was distributed, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Further, if USP had sold either A1, A2, or A3 immediately after it was distributed, USP would take into account any gain or loss recognized on the sale in determining its Federal income tax liability. Therefore, A1, A2, and A3 are all importation properties. See paragraph (b)(3)(iii)(A) of this section and §1.362-3(c)(2).

(iii) Loss importation transaction. Immediately after it was distributed, USP's basis in each of the importation properties, A1, A2, and A3, would, but for section 334(b)(1)(B) and this section, have been \$100. Further, immediately after each such property was distributed, its value was \$120. Thus, the properties' aggregate basis, \$300, would not have exceeded the properties' aggregate value, \$360. Accordingly, the distribution is not a loss importation transaction irrespective of the fact that, when the liquidation was completed, the properties' aggregate basis was \$285 and the properties' aggregate value was \$280. See paragraph (b)(3)(iii)(B) of this section and §1.362-3(c)(3).

(iv) Basis of importation property not distributed in loss importation transaction. Because the importation properties, A1, A2, and A3, were not distributed in a loss importation transaction, the basis of each of the importation properties is determined under the generally applicable basis rules. Accordingly, USP takes each of the properties with a basis of \$100 and, immediately after the final distribution, has an adjusted basis of \$90 in A1 (USP's \$100 basis less the \$10 depreciation), \$95 in A2 (USP's \$100 basis less the \$5 depreciation), and \$100 in A3. See section 334(b).

(c) Effective/applicability date. This section applies to any taxable year beginning on or after these regulations are published as final regulations in the **Federal Register**, unless effected pursuant to a binding agreement that was in effect prior to that date and at all times thereafter. However, taxpayers may apply this section to transactions occurring after October 22, 2004.

Par. 5. Section 1.337-1 is added to read as follows:

§1.337-1 Nonrecognition for property distributed to parent in complete liquidation of subsidiary. If section 332(a) is applicable to the receipt of a subsidiary's property in complete liquidation, no gain or loss is recognized to the liquidating subsidiary with respect to such property (including property distributed with respect to indebtedness,

see section 337(b)(1) and §1.332-7), except as provided in section 337(b)(2) (distributions to certain tax-exempt distributees), section 367(e)(2) (distributions to foreign corporations), and section 897(d) (distributions of U.S. real property interests by foreign corporations).

Par. 6. Section 1.351-3 is amended by revising paragraph (a)(3), (b)(3), and (f) to read as follows:

§1.351-3 Records to be kept and information to be filed.

(a) * * *

(3) The fair market value and basis of the property transferred by such transferor in the exchange, determined immediately before the transfer and aggregated as follows:

(i) Importation property transferred in a loss importation transaction, as defined in §1.362-3(c)(2) and §1.362-3(c)(3), respectively;

(ii) Loss duplication property as defined in §1.362-4(c)(1);

(iii) Property with respect to which any gain or loss was recognized on the transfer (without regard to whether such property is also identified in paragraph (a)(3)(i) or (ii) of this section); and

(iv) Property not described in paragraph (a)(3)(i), (a)(3)(ii), or (a)(3)(iii) of this section.

* * * * *

(b) * * *

(3) The fair market value and basis of property received in the exchange, determined immediately before the transfer and aggregated as follows:

(i) Importation property transferred in a loss importation transaction, as defined in §1.362-3(c)(2) and §1.362-3(3), respectively;

(ii) Loss duplication property as defined in §1.362-4(c)(1);

(iii) Property with respect to which any gain or loss was recognized on the transfer (without regard to whether such property is also identified in paragraph (b)(3)(ii) of this section);

(iv) Property not described in paragraph (b)(3)(i), (b)(3)(ii), or (b)(3)(iii) of this section; and

* * * * *

(f) Effective/applicability date. * * * Paragraphs (a)(3) and (b)(3) of this section apply to any taxable year beginning on or after these regulations are published as final regulations in the **Federal Register**, unless effected pursuant to a binding agreement that was in effect prior to that date and at all times thereafter.

Par. 7. Section 1.358-6 is amended by revising paragraphs (c)(1)(A), (c)(1)(B), (c)(2)(ii)(B), (c)(3)(i), (c)(3)(ii), (c)(4), (e), and (f)(3), and adding new paragraph (f)(4) to read as follows.

§1.358-6 Stock basis in certain triangular reorganizations.

* * * * *

(c) * * *

(1) Forward triangular merger or triangular C reorganization. * * *

(i) * * *

(A) P acquired the T assets acquired by S in the reorganization (and P assumed any liabilities which S assumed or to which the T assets acquired by S were subject) directly from T in a transaction in which P's basis in the T assets was determined under section 362(b) (taking into account the provisions of section 362(e)(1)); and

* * * * *

(2) * * *

(ii) Reverse triangular merger that qualifies as a section 351 transfer or section 368(a)(1)(B) reorganization. * * *

(B) Determine the basis in the T stock acquired as if P acquired such stock from the former T shareholders in a transaction in which P's basis in the T stock was determined under section 362(b) (taking into account the provisions of section 362(e)(1) and, to the extent the transfer is a transaction described in section 362(a), the provisions of section 362(e)(2)).

(3) Triangular B reorganization. * * *

(i) P acquired the T stock acquired by S in the reorganization directly from the T shareholders in a transaction in which P's basis in the T stock was determined under section 362(b) (taking into account the provisions of section 362(e)(1)); and

(ii) P transferred the T stock to S in a transaction in which P's basis in its S stock was determined under section 358 (taking into account the provisions of section 362(e)(2) to the extent the transfer is a transaction described in section 362(a)).

(4) Examples. The rules of this paragraph (c) are illustrated by the following examples. For purposes of these examples, P, S, and T are domestic corporations, the property transferred is not importation property within the meaning of §1.362-3(c)(2) or loss duplication property within the meaning of §1.362-4(c)(2), P and S do not file consolidated returns, P owns all of the shares of the only class of S stock, the P stock exchanged in the transaction satisfies the requirements of the applicable triangular reorganization provisions, and the facts set forth the only corporate activity.

* * * * *

(e) Cross-references--(1) Triangular reorganizations involving members of a consolidated group. For rules relating to stock basis adjustments made as a result of a triangular reorganization in which P and S, or P and T, as applicable, are, or become, members of a consolidated group, see §1.1502-30. However, if a transaction is a group structure change, stock basis adjustments are determined under §1.1502-31 and not under §1.1502-30, even if the transaction also qualifies as a reorganization otherwise subject to §1.1502-30.

(2) Transfers of importation property in loss importation transaction and transfers of loss duplication property. For rules relating to stock basis adjustments made as a result of a triangular reorganization in which the property treated as acquired by P would be importation property received in a loss importation transaction, see §1.362-3. For rules relating to adjustments made as a result of a triangular reorganization that also qualifies under section 362(a), see §1.362-4.

(3) Triangular reorganizations involving certain foreign corporations. For rules relating to stock basis adjustments made as a result of triangular reorganizations involving certain foreign corporations, see §§1.367(b)-4(b), 1.367(b)-10, and 1.367(b)-13.

(f) Effective/applicability dates.--(1) General rule. In general, this section applies to triangular reorganizations occurring on or after December 23, 1994. However, paragraphs (c)(1)(i)(A), (c)(2)(ii)(B), (c)(3)(i), and (c)(3)(ii) of this section apply to triangular reorganizations occurring on or after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

(3) Triangular G reorganizations and special rule for triangular reorganizations involving members of a consolidated group. Paragraphs (b)(2)(v) and (e)(1) of this section shall apply to triangular reorganizations occurring on or after September 17, 2008. * * *

(4) Triangular reorganizations involving importation property acquired in loss importation transaction or loss duplication transaction; triangular reorganizations involving certain foreign corporations. Paragraphs (e)(2) and (e)(3) of this section shall apply to triangular reorganizations occurring on or after the date these regulations are published as final regulations in the **Federal Register**.

Par. 8. Section 1.362-3 is added to read as follows:

§1.362-3 Basis of importation property acquired in loss importation transaction.

(a) Purpose. The purpose of section 362(e)(1) and this section is to prevent a corporation (Acquiring) from importing a net built-in loss in a transaction described in either section 362(a) (section 351 transfers, contributions to capital, or paid-in surplus) or section 362(b) (reorganizations). See paragraph (c) of this section for definitions of terms used in this section.

(b) Basis determinations under this section--(1) Basis of importation property received in loss importation transaction. Notwithstanding any other provision of law, Acquiring's basis in importation property (as defined in paragraph (c)(2) of this section) acquired in a loss importation transaction (as defined in paragraph (c)(3) of this section) is equal to the value of the property immediately after the transaction.

(2) Adjustment to basis of subsidiary stock in triangular reorganizations. If a corporation (P) computes its basis in stock of a subsidiary (whether S or T) under §1.358-6 (stock basis in certain triangular reorganizations), P's basis in property treated as acquired by P in §1.358-6(c) is determined under section 362(e)(1) and this section to the extent such property, if actually acquired by P, would be importation property acquired in a loss importation transaction. See §1.358-6(c)(1)(i)(A), 1.358-6(c)(2)(ii)(B), and 1.358-6(c)(3)(i). The subsidiary's basis in the property actually acquired in the transaction is determined under applicable law (including this section), without regard to the amount of any adjustment to P's basis in the subsidiary's stock. Thus, the basis of the property in S's or T's hands may differ from the amount of the adjustment to P's basis in its stock of S or T.

(3) Acquiring's basis in other property transferred. In general, Acquiring's basis in property received in a section 362 transaction (as defined in paragraph (c)(1) of this

section) that is not determined under section 362(e)(1) and this section is determined under section 362(a) or section 362(b). However, if the transaction is described in section 362(a) (without regard to whether it is also described in any other section), further adjustment may be required under section 362(e)(2). See §1.362-4.

(c) Definitions. For purposes of this section, the following definitions apply:

(1) Section 362 transaction. The term section 362 transaction means any transaction described in section 362(a) or in section 362(b).

(2) Importation property.--(i) General rule. The term importation property means any property (including separate portions of property tentatively divided under paragraph (e)(2) of this section) with respect to which--

(A) Any gain or loss that would be recognized on its sale by the transferor immediately before the transaction (the transferor's hypothetical sale) would not be subject to tax imposed under any provision of subtitle A of the Internal Revenue Code (Federal income tax) (taking into account the provisions of paragraph (d) of this section); and

(B) Any gain or loss that would be recognized on its sale by Acquiring immediately after the transaction (Acquiring's hypothetical sale) would be subject to Federal income tax (taking into account the provisions of paragraph (d) of this section)

(ii) Special rules for applying this paragraph (c)(2). See paragraph (d) of this section for rules for determining whether gain or loss on a hypothetical sale would be taken into account in determining a Federal income tax liability and paragraph (e) of this section for rules applicable when more than one person would take such gain or loss into account.

(3) Loss importation transaction. The term loss importation transaction means any section 362 transaction in which Acquiring's aggregate basis in all importation property received from all transferors in the transaction would exceed the aggregate value of such property immediately after the transaction. For this purpose, Acquiring's basis in property received is determined without regard to this section or section 362(e) (2).

(4) Value.--(i) General rule. The term value means fair market value.

(ii) Special rule for transfers of partnership interests. Notwithstanding the general rule in paragraph (c)(4)(i) of this section, when referring to a partnership interest, for purposes of this section, the term value means the sum of the cash that Acquiring would receive for the interest, assuming an exchange between a willing buyer and a willing seller (neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts), increased by any §1.752-1 liabilities (as defined in §1.752-1(a)(4)) of the partnership allocated to Acquiring with regard to such transferred interest under section 752 immediately after the transfer to Acquiring. See §1.743-1 regarding the application of section 743(b) following a section 362(e) basis reduction.

(d) Rules for determining whether gain or loss would be taken into account in determining a Federal income tax liability--(1) General rule. In general, any gain or loss that would be recognized on a hypothetical sale described in either paragraph (c)(2)(i) or paragraph (c)(2)(ii) of this section is considered to be subject to Federal income tax if, taking into account all relevant facts and circumstances, such gain or loss would affect or be taken into account in determining the Federal income tax liability of the transferor or Acquiring, respectively. This determination is made without regard to whether such

person has or would have any actual Federal income tax liability for the taxable year of the transaction.

(2) Look-through rule in the case of certain pass-through entities.

Notwithstanding the general rule in paragraph (d)(1) of this section, the determination of whether any gain or loss on a hypothetical sale would be treated as subject to Federal income tax is made by reference to the person that would be required to include such gain or loss in its taxable income if the hypothetical seller is--

- (i) A trust treated as owned by its grantors or others (see section 671);
- (ii) A partnership (see section 701); or
- (iii) An S corporation (see sections 1363 and 1366).

(3) Controlled foreign corporations (CFC), passive foreign investment companies (PFIC). For purposes of this section, gain or loss that would be recognized by a CFC (as defined in section 957(a)) or a PFIC (as defined in section 1297(a)) is not deemed taken into account in determining a Federal income tax liability solely because it could affect an inclusion under section 951(a) or section 1293(a).

(4) Look-through treatment in the case of certain avoidance transactions. (i)

Application of section. This paragraph (d)(4) applies if--

(A) The transferor is a domestic entity that is a trust, estate, regulated investment company (RIC) (as defined in section 851(a)), a real estate investment trust (REIT) (as defined in section 856(a)), or a cooperative (see section 1381); and

(B) The transferor transfers, directly or indirectly, property that was transferred to or acquired by it as part of a plan (whether of transferor, Acquiring, or any other person)

to avoid the application of section 362(e)(1) and this section to a section 362 transaction.

(ii) Effect of application of section. Notwithstanding paragraph (d)(1) of this section, if a transferor is described in both paragraph (d)(4)(ii)(A) and (B) of this section

—

(A) The transferor is treated as though it distributes the proceeds of the hypothetical sale (which, for this purpose, are presumed to be an amount greater than zero);

(B) To the fullest extent possible under the transferor's organizing instrument, taking into account the beneficiaries or owners of interests (as applicable) in the transferor, the deemed distribution is treated as made to a distributee or distributees that would not take distributions from the transferor into account in determining a Federal income tax liability; and

(C) The determination of whether the gain or loss on the hypothetical sale is treated as subject to Federal income tax is made by reference to the deemed distributee or distributees.

(iii) Tiered entities. If a deemed distributee is an entity described in paragraph (d)(4)(i)(A) of this section, the determination of whether gain or loss on the hypothetical sale is taken into account in determining a Federal income tax liability is made by treating the deemed distributee, and any successive such deemed distributees, as a transferor and applying the rules in paragraphs (d)(4)(i) and (ii) of this section to its deemed distribution (and to all successive deemed distributions), until no deemed

distributee or successive deemed distributee is an entity described in paragraph (d)(4)(i) (A) of this section.

(e) Special rules for gain or loss that would be taken into account by multiple persons--(1) In general. If gain or loss from a disposition of property would be includible in income by more than one person, the property is treated as tentatively divided into separate portions in proportion to the amount of gain or loss recognized with respect to the property that would be allocated to each such person. If an entity's organizing instrument specially allocates gain and loss, the tentative division of property under this paragraph (e) must reflect the manner in which gain or loss on the disposition of such property would be allocated under the terms of the organizing instrument, taking into account the net gain or loss actually recognized by the entity in that tax year.

(2) Application of section. The rules of this section apply independently to each tentatively divided portion to determine if the portion is importation property. Each tentatively divided portion that is determined to be importation property is included with all other importation property in the determination of whether the transaction is a loss importation transaction.

(3) Acquiring's basis in property tentatively divided into separate portions. Immediately after the application of section 362(e)(1) and this section and before the application of section 362(e)(2), each property treated as tentatively divided into separate portions for purposes of applying section 362(e)(1) and this section ceases to be treated as tentatively divided and Acquiring has a single, undivided basis in such property that is equal to the sum of --

(A) The value of each tentatively divided portion that is importation property, if the transaction is a loss importation transaction; and

(B) Acquiring's basis in each tentatively divided portion that is not importation property received in a loss importation transaction, as determined under section 362(a) or 362(b), as applicable, and without regard to any potential application of section 362(e)(2).

(f) Examples. The examples in this paragraph (f) illustrate the application of section 362(e)(1) and the provisions of this section. Unless otherwise indicated, the examples use the following nomenclature and assumptions: A and B are U.S. citizens. DC, DC1, and P are domestic corporations that have not elected to be S corporations within the meaning of section 1361(a)(1) and that are not members of a consolidated group. F is a foreign individual. FP is a foreign partnership. FC, FC1, and FC2 are foreign corporations. Unless the facts indicate otherwise, the foreign individuals, corporations, and partnerships are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause them, their shareholders, their partners, or their property to be subject to Federal income taxation. There is no applicable income tax treaty, and all persons and transactions are unrelated unless the facts indicate otherwise.

Example 1. Basic application of section. (i) Section 351 transfer of importation property in a loss importation transaction. (A) Facts. FC owns three assets, A1 (basis \$40, value \$150), A2 (basis \$120, value \$30), and A3 (basis \$140, value \$20). On Date 1, FC transfers A1, A2, and A3 to DC in a transaction to which section 351 applies.

(B) Importation property. If FC had sold A1, A2, or A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Further, if DC had sold A1, A2, or A3 immediately after the transaction, DC would take into account any gain or loss

recognized on the sale in determining its Federal income tax liability. Therefore, A1, A2, and A3 are all importation properties. See paragraph (c)(2) of this section.

(C) Loss importation transaction. FC's transfer of A1, A2, and A3 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation properties, A1, A2, and A3, would be \$300 (\$40 + \$120 + \$140) under section 362(a) and the properties' aggregate value would be \$200 (\$150 + \$30 + \$20). Therefore, the importation properties' aggregate basis would exceed their aggregate value and the transaction is a loss importation transaction. See paragraph (c)(3) of this section.

(D) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1, A2, and A3 will each be equal to the property's value (\$150, \$30, and \$20, respectively) immediately after the transfer.

(E) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the transferred properties would not exceed their aggregate value immediately after the transfer. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to this transaction. DC's bases in A1, A2, and A3, as determined under paragraph (i)(D) of this Example 1, are \$150, \$30, and \$20, respectively. Under section 358(a), FC receives the DC stock with a basis of \$300 (the sum of FC's bases in A1, A2, and A3 immediately before the exchange).

(ii) Reorganization. The facts are the same as in paragraph (i)(A) of this Example 1 except that, instead of transferring property to DC in a section 351 exchange, FC merges with and into DC in a transaction described in section 368(a)(1) (A). The analysis and results are the same as set forth in paragraphs (i)(B), (i)(C), (i)(D), and (i)(E) of this Example 1, except that, under section 358(a), FC's shareholders will take the DC stock with a basis determined by reference to their FC stock basis.

(iii) FC's property used in U.S. trade or business. (A) Facts. The facts are the same as in paragraph (i)(A) of this Example 1, except that FC is engaged in a U.S. trade or business and uses all the properties in that U.S. trade or business. In this case, none of the properties would be importation property because FC would take any gain or loss on the disposition of the properties into account in determining its Federal income tax liability. Accordingly, this section does not apply to the transaction.

(B) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in the transferred properties

would be \$300 (\$40 + \$120 + \$140) under section 362(a) and the properties' aggregate value immediately after the transfer would be \$200 (\$150 + \$30 + \$20). Therefore, FC has a net built-in loss and FC's transfer of A1, A2, and A3 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's \$100 net built-in loss (\$300 aggregate basis over \$200 aggregate value) would be allocated proportionately (by the amount of built-in loss in each property) to reduce DC's basis in the loss properties, A2 and A3. See §1.362-4. As a result, DC's basis in A2 would be \$77.14 (\$120 basis under section 362(a) reduced by \$42.86, A2's proportionate share of FC's net built-in loss, computed as $\$90/\$210 \times \$100$) and DC's basis in A3 would be \$82.86 (\$140 basis under section 362(a) reduced by \$57.14, A3's proportionate share of FC's net built-in loss, computed as $\$120/\$210 \times \$100$). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the \$100 basis reduction to FC's basis in the DC stock received in the transaction, DC's bases in A2 and A3 would remain their section 362(a) bases of \$120 and \$140, respectively. Under section 362(a), DC's basis in A1 is \$40 (irrespective of whether the section 362(e)(2)(C) election is made). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be \$300; if FC and DC do make the election, FC's basis in the DC stock will be \$200 (\$300 - \$100 net built-in loss). See §1.362-4(b).

Example 2. Multiple transferors. (i) Facts. The facts are the same as in paragraph (i)(A) of Example 1, except that FC only owns A1 (basis \$40, value \$150) and A2 (basis \$120, value \$30) and F owns A3 (basis \$140, value \$20). On Date 1, FC transfers A1 and A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) Importation property. A1 and A2 are importation properties for the reasons set forth in paragraph (i)(B) of Example 1. A3 is also an importation property because, if F had sold A3 immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability, and, further, if DC had sold A3 immediately after the transaction, DC would take into account any gain or loss recognized on the sale in determining its Federal income tax liability.

(iii) Loss importation transaction. The transfers by FC and F are a section 362 transaction. The transaction is a loss importation transaction for the reasons set forth in paragraph (i)(C) of Example 1 (notwithstanding that one of the transferors, FC, did not transfer a net built-in loss). See paragraph (c)(3) of this section.

(iv) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation properties, A1, A2, and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1, A2, and A3 will each be equal to the property's value (\$150, \$30, and \$20, respectively) immediately after the transfer.

(v) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into

account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See §1.362-4(b). Taking into account the application of section 362(e)(1) and this section, neither DC's aggregate basis in FC's properties nor DC's basis in F's property would exceed the properties' respective values immediately after the transaction. Therefore neither FC nor F has a net built-in loss, neither transfer is a loss duplication transaction, and section 362(e)(2) does not apply to either transfer. DC's bases in A1, A2, and A3, as determined under paragraph (iv) of this Example 2, are \$150, \$30, and \$20, respectively. Under section 358(a), FC's basis in the DC stock received is \$160 (\$40 + \$120) and F's basis in the DC stock received in the exchange is \$140.

Example 3. Transfer of importation and non-importation property. (i) Facts. As in paragraph (i) of Example 2, FC owns A1 (basis \$40, value \$150) and A2 (basis \$120, value \$30), and F owns A3 (basis \$140, value \$20). In addition, A2 is a U.S. real property interest as defined in section 897(c)(1). On Date 1, FC transfers A1 and A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) Importation property. A1 and A3 are importation properties for the reasons set forth in paragraph (i)(B) of Example 1 and paragraph (i) of Example 2, respectively. However, A2 is not importation property because, if FC had sold A2 immediately before the transaction, FC would take into account any gain or loss recognized on the sale in determining its Federal income tax liability.

(iii) Loss importation transaction. FC's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's aggregate basis in the importation properties, A1 and A3, would be \$180 (\$40 + \$140) and the properties' aggregate value would be \$170 (\$150 + \$20) immediately after the transaction. Therefore, the importation properties' aggregate basis would exceed their aggregate value immediately after the transaction, and the transfer is a loss importation transaction.

(iv) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation properties, A1 and A3, were transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A1 and in A3 will each be equal to the property's value (\$150 and \$20, respectively) immediately after the transfer.

(v) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See §1.362-4(b).

(A) FC's transfer. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have an aggregate basis of \$270 in the transferred properties (\$150 in A1, as determined under paragraph (iv) of this Example 3, plus \$120 in A2, determined under

section 362(a)), and the properties would have an aggregate value of \$180 (\$150 + \$30) immediately after the transfer. Therefore, FC has a net built-in loss and FC's transfer of A1 and A2 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's \$90 net built-in loss (\$270 aggregate basis to DC over \$180 aggregate value) would be allocated proportionately to reduce DC's basis in the loss property transferred by FC. As a result, FC's entire net built-in loss would be allocated to A2, the only loss property transferred by FC, and DC's basis in A2 would be \$30 (\$120 basis under section 362(a) reduced by \$90 net built-in loss). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the \$90 basis reduction to FC's basis in the DC stock received in the transaction, DC's basis in A2 would remain its section 362(a) basis of \$120. DC's basis in A1 is \$150 as determined under paragraph (iv) of this Example 3 (irrespective of whether the section 362(e)(2)(C) election is made). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be \$270; if FC and DC do make the election, FC's basis in the DC stock will be \$180 (\$270 - \$90 net built-in loss). See §1.362-4.

(B) F's transfer of A3. Taking into account the application of section 362(e)(1) and this section, DC's basis in A3, the property transferred by F, would not exceed its value immediately after the transfer. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's basis in A3, as determined under paragraph (iv) of this Example 3, is \$20. Under section 358(a), F receives the DC stock with a basis of \$140.

Example 4. Multiple transferors of non-importation properties. (i) Facts. DC1 owns A1 (basis \$40, value \$150). In addition, as in Example 3, FC owns A2 (basis \$120, value \$30), a U.S. real property interest as defined in section 897(c)(1), and F owns A3 (basis \$140, value \$20). On Date 1, DC1 transfers A1, FC transfers A2, and F transfers A3, to DC in a single transaction described in section 351.

(ii) Importation property. A2 is not importation property and A3 is importation property for the reasons set forth in paragraph (ii) of Example 3 and paragraph (i)(B) of Example 1, respectively. A1 is not importation property because, if DC1 had sold A2 immediately before the transaction, DC1 would take into account any gain or loss recognized on the sale in determining its Federal income tax liability.

(iii) Loss importation transaction. The transfer of A1, A2, and A3 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in importation property, A3, would be \$140 and the value of the property would be \$20 immediately after the transaction. Therefore, the importation property's basis would exceed value and the transfer is a loss importation transaction.

(iv) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation property, A3, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of

this section applies and DC's basis in A3 will be equal to A3's \$20 value immediately after the transfer.

(v) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See §1.362-4.

(A) DC1's transfer. Taking into account the application of section 362(e)(1) and this section, DC's basis in A1 (\$40 under section 362(a)) would not exceed its value immediately after the transfer. Therefore, DC1 does not have a net built-in loss, DC1's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to DC1's transfer. DC's basis in A1, determined under section 362(a), is \$40. Under section 358(a), DC1 receives the DC stock with a basis of \$40.

(B) FC's transfer. Taking into account the application of section 362(e)(1) and this section, but without taking into account the provisions of section 362(e)(2), DC would have a section 362(a) basis of \$120 in A2, which would exceed A2's \$30 value immediately after the transfer. Therefore, FC has a net built-in loss and FC's transfer of A2 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FC's \$90 net built-in loss (DC's \$120 basis in A2 over A2's \$30 value) would be applied to reduce DC's basis in A2, the only loss property transferred by FC. As a result, DC's basis in A2 would be \$30 (\$120 basis under section 362(a), reduced by the \$90 net built-in loss). However, if FC and DC were to elect under section 362(e)(2)(C) to apply the \$90 basis reduction to FC's basis in the DC stock received in the transaction, DC's basis in A2 would be its \$120 basis determined under section 362(a). If FC and DC do not make a section 362(e)(2)(C) election, FC's basis in the DC stock received in the exchange will be \$120; if FC and DC do make the election, FC's basis in the DC stock will be \$30 (\$120 - \$90). See §1.362-4.

(C) F's transfer. F's transfer of A3 is a transaction described in section 362(a). However, taking into account the application of section 362(e)(1) and this section, DC's basis in A3 (\$20) would not exceed its value immediately after the transfer. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's basis in A3, as determined under paragraph (iv) of this Example 4, is \$20. Under section 358(a), FC receives the DC stock with a basis of \$140.

Example 5. Partnership transactions. (i) Transfer by foreign partnership, foreign and domestic partners. (A) Facts. A and F are equal partners in FP. FP owns A1 (basis \$100, value \$70). Under the terms of the FP partnership agreement, FP's items of income, gain, deduction, and loss are allocated equally between A and F. FP transfers A1 to DC in a transfer to which section 351 applies. No election is made under section 362(e)(2)(C).

(B) Importation property. If FP had sold A1 immediately before the transaction, any gain or loss recognized on the sale would be allocated to and includible by A and F

equally under the partnership agreement. Thus, A1 is treated as tentatively divided into two equal portions, one treated as owned by A and one treated as owned by F. If FP had sold A1 immediately before the transaction, any gain or loss recognized on the portion treated as owned by A would have been taken into account in determining a Federal income tax liability (A's); thus A's tentatively divided portion of A1 is not importation property. However, no gain or loss recognized on the tentatively divided portion treated as owned by F would have been taken into account in determining a Federal income tax liability. Further, if DC had sold A1 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability (DC's); thus, F's tentatively divided portion of A1 is importation property.

(C) Loss importation transaction. FP's transfer of A1 is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, F's portion of A1, would be \$50 under section 362(a) and the property's value would be \$35 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation property, F's tentatively divided portion of A1, was transferred in a loss importation transaction, section 362(e)(1) and paragraph (b)(1) of this section applies and DC's basis in F's portion of A1 will be equal to its \$35 value.

(E) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC's aggregate basis in A1 would be \$85 (the sum of the \$35 basis in F's tentatively divided portion of A1, as determined under paragraph (i)(D) of this Example 5, and the \$50 basis in A's tentatively divided portion of A1, determined under section 362(a), see paragraph (d)(2) of this section) and A1's value immediately after the transfer would be \$70. Therefore, FP has a net built-in loss and FP's transfer of A1 is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), FP's \$15 net built-in loss (\$85 basis over \$70 value) would be allocated to reduce DC's basis in the loss asset, A1, the only loss property transferred by FP. As a result, DC's basis in A1 would be \$70 (\$85 basis under section 362(a) and this section, reduced by the \$15 net built-in loss). Under section 358, FP's basis in the DC stock received in the exchange will be \$100. See §1.362-4.

(ii) Transfer with election to apply section 362(e)(2)(C). The facts are the same as in paragraph (i)(A) of this Example 5, except that FP and DC elect to apply section 362(e)(2)(C) to reduce FP's basis in the DC stock received in the exchange. The analysis and results are the same as in paragraphs (i)(B), (i)(C), (i)(D), and (i)(E) of this Example 5, except that the \$15 reduction to DC's basis in A1 is not made and, as a

result, DC's basis in A1 remains \$85, and FP's basis in the DC stock received in the exchange is reduced from \$100 to \$85. The \$15 reduction to FP's basis in DC stock reduces A's basis in its FP interest under section 705(a)(2)(B). See §1.362-4(f)(1).

(iii) Transfer by domestic partnership. The facts are the same as in paragraph (i) (A) of this Example 5 except that FP is a domestic partnership. The analysis and results are the same as in paragraphs (i)(B), (i)(C), (i)(D), and (i)(E) of this Example 5.

(iv) Transfer of interest in partnership with liability. (A) Facts. F and two other individuals are equal partners in FP. F's basis in its partnership interest is \$247. F's share of FP's §1.752-1 liabilities (as defined in §1.752-1(a)(4)) is \$150. F transfers his partnership interest to DC in a transaction to which section 351 applies. FP has no section 754 election in effect. If DC were to sell the FP interest immediately after the transfer, DC would receive \$100 in cash or other property. In addition, taking into account the rules under §1.752-4, DC's share of FP's §1.152-1 liabilities (as defined in §1.752-1(a)(4)) is \$145 immediately after the transfer.

(B) Importation property. If F had sold his partnership interest immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Further, if DC had sold the partnership interest immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Therefore, F's partnership interest is importation property.

(C) Loss importation transaction. F's transfer is a section 362 transaction. However, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, the partnership interest, determined under section 362(a) and taking into account the rules under section 752, would be \$242 (F's \$247 basis reduced by F's \$150 share of PRS liabilities and increased by DC's \$145 share of PRS liabilities) and, under §1.362-4(c)(12)(ii), the value of the PRS interest would be \$245 (the sum of \$100, the cash DC would receive if DC immediately sold the partnership interest, and \$145, DC's share of the §1.752-1 liabilities (as defined in §1.752-1(a)(4)) under section 752 immediately after the transfer to DC). Therefore, the importation property's basis (\$242) would not exceed its value (\$245), and the transfer is not a loss importation transaction.

(D) Basis in property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. As described in paragraph (iv)(C) of this Example 5, taking into account the application of section 362(e)(1) and this section, DC's basis in the partnership interest would not exceed its value. Therefore, under §1.362-4, F does not have a net built-in loss, the transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transfer. DC's basis in F's partnership interest is \$242, determined under sections 362(a) and 752. Under section 358, taking into account the rules under section 752, F's basis in the DC stock received in the exchange is \$97 (\$247 reduced by F's \$150 share of FP liabilities).

Example 6. Transactions involving tax-exempt entities. (i) Exempt transferor. (A) Facts. InsCo is a benevolent life insurance association of a purely local character exempt from Federal income tax under section 501(a) because it is described in section 501(c)(12). InsCo owns shares of stock of DC1 (basis \$100, value \$70) for investment purposes, which are not debt-financed property (as defined in section 514). On December 31, Year 1, InsCo transfers the DC1 stock to DC in a transaction to which section 351 applies. No election is made under section 362(e)(2)(C).

(B) Importation property. If InsCo had sold the DC1 stock immediately before the transaction, any gain or loss realized would be excluded from unrelated business taxable income (UBTI) under section 512(b)(5), and thus no gain or loss recognized on the sale would have been taken into account in determining Federal income tax liability. Further, if DC had sold the DC1 stock immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining Federal income tax liability. Therefore, the DC1 stock is importation property.

(C) Loss importation transaction. InsCo's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in importation property, the DC1 stock, would be \$100, and the stock's value would be \$70 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation property, the DC1 stock, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in the stock will be equal to its \$70 value.

(E) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's basis in the DC1 stock would not exceed its value immediately after the transaction. Therefore, InsCo does not have a net built-in loss, InsCo's transfer is not a loss duplication transaction, and section 362(e)(2) has no application to the transaction. DC's basis in the DC1 stock, as determined under paragraph (i)(D) of this Example 6, is \$70. Under section 358, InsCo's basis in the DC stock received in the exchange will be \$100.

(ii) Transferor loses tax-exempt status. (A) Facts. The facts are the same as in paragraph (i)(A) of this Example 6 except that InsCo fails to be described in section 501(c)(12) in Year 1.

(B) Importation property. If InsCo had sold the DC1 stock immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Therefore, the DC1 stock is not importation property and this section does not apply to the transaction.

(C) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have a section 362(a) basis of \$100 in the stock, which would exceed its value of \$70 immediately after the transfer. Therefore, InsCo has a net built-in loss and InsCo's transfer of the DC1 stock is a loss duplication transaction. Accordingly, under the general rule of section 362(e)(2), InsCo's \$30 net built-in loss (\$100 basis over \$70 value) would be allocated to reduce DC's basis in the loss asset, the DC1 stock, the only loss property transferred by InsCo. As a result, DC's basis in the DC1 stock would be \$70 (\$100 basis under section 362(a), reduced by the \$30 net built-in loss). Under section 358, InsCo's basis in the DC stock received in the exchange will be \$100.

(iii) Transfer of property that is subject to unrelated business tax. (A) Facts. The facts are the same as in paragraph (i)(A) of this Example 6 except that, on December 31, Year 1, instead of the DC1 stock, InsCo transfers A1 (basis \$200, value \$150) to DC. A1 is an office building that InsCo owned from January 1 to December 31 of Year 1. During the entirety of this period, A1 constitutes debt-financed property (as defined in section 514). Pursuant to sections 512 and 514, InsCo would be required to include in UBTI a portion of the gains or losses from a sale of A1 at the end of Year 1. DC does not take the property subject to the debt.

(B) Importation property. If InsCo had sold A1 immediately before the transaction, the gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability, even though at a lesser rate of inclusion. Therefore, A1 is not importation property and this section does not apply to the transaction.

(C) Basis of property received in transaction. The analysis and results are the same as in paragraph (ii)(C) of this Example 6.

Example 7. Transactions involving CFCs. (i) Transfer by CFC. (A) Facts. FC is a CFC with 100 shares of stock outstanding. A owns 60 of the shares and F owns the remaining 40 shares. FC owns two assets, A1 (basis \$70, value \$100), which is used in the conduct of a U.S. trade or business, and A2 (basis \$100, value \$75), which is not used in the conduct of a U.S. trade or business. FC transfers both assets to DC in a transaction to which section 351 applies.

(B) Importation property. If FC had sold A1 immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability (FC's). See section 882(a). Therefore, A1 is not importation property. If FC had sold A2 immediately before the transaction, FC would not take the gain or loss recognized into account in determining its Federal income tax liability, but the gain or loss could be taken into account in determining a section 951 inclusion to FC's U.S. shareholders. However, under paragraph (d)(3) of this section, gain or loss is not deemed taken into account in determining a Federal

income tax liability solely because it could affect an inclusion under section 951(a). Further, if DC had sold A2 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Therefore, A2 is importation property.

(C) Loss importation transaction. FC's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's basis in the importation property, A2, would be \$100 and the property's value would be \$75 immediately after the transaction. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction.

(D) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation property, A2, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in A2 will be equal to A2's \$75 value immediately after the transfer.

(E) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section but without taking into account the provisions of section 362(e)(2), DC would have an aggregate basis of \$145 in the transferred properties (\$70 in A1, determined under section 362(a), plus \$75 in A2, determined under this section) and the properties would have an aggregate value of \$175 (\$100 + \$75) immediately after the transfer. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transaction. DC's basis in A1 will be \$70, determined under section 362(a), and DC's basis in A2 will be \$75, as determined under paragraph (i)(D) of this Example 7. Under the general rule in section 358(a), FC receives the DC stock with a basis of \$170 (\$70 attributable to A1 plus \$100 attributable to A2).

(ii) Transfer of CFC stock. (A) Facts. The facts are the same as in paragraph (i) (A) of this Example 7, except that A transfers its 60 shares of FC stock (basis \$80, value \$105) and F transfers its 40 shares of FC stock (basis \$100, value \$70) to DC in an exchange that qualifies under section 351.

(B) Importation property. If A had sold its FC shares immediately before the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability (A's). Therefore, A's FC shares are not importation property. However, if F had sold its FC shares immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Further, if DC had sold F's FC shares immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. Therefore, F's FC shares are importation property.

(C) Loss importation transaction. The transfer of the FC shares is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)

(2), DC's aggregate basis in the importation property, F's shares of FC stock, would be \$100 under section 362(a) and the shares' aggregate value would be \$70. Therefore, the importation property's aggregate basis would exceed its aggregate value, and the transfer is a loss importation transaction.

(D) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation property, F's shares of FC stock, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's aggregate basis in the shares will be equal to their \$70 aggregate value immediately after the transfer.

(E) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. The application of section 362(e)(2) is determined separately for each transferor. See §1.362-4(b).

(1) A's transfer. Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the shares (\$80 under section 362(a)) would not exceed the shares' value (\$105) immediately after the transaction. Therefore A does not have a built-in loss, A's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to A's transfer. DC's aggregate basis in A's shares, determined under section 362(a), is \$80. Under section 358(a), A receives the DC stock with a basis of \$80.

(2) F's transfer. Taking into account the application of section 362(e)(1) and this section, DC's aggregate basis in the shares would not exceed their value immediately after the transaction. Therefore, F does not have a built-in loss, F's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to F's transfer. DC's aggregate basis in F's shares, as determined under paragraph (ii)(D) of this Example 7, is \$70. Under section 358(a), F receives the DC stock with a basis of \$100.

Example 8. Property subject to withholding tax. (i) Facts. FC owns a share of DC1 stock (basis \$100, value \$70) as an investment. FC receives dividends on the share that are subject to Federal withholding tax of 30 percent of the amount received under section 881(a); under section 1442(a), DC1 must withhold tax on the dividends paid. FC transfers the DC1 share to DC in a transaction to which section 351 applies.

(ii) Importation property. Although any dividends received with respect to the DC1 stock were subject to withholding tax, if FC had sold the share of stock of DC1, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. See section 865(a)(2). Further, if DC had sold the share of DC1 stock immediately after the transaction, any gain or loss recognized on the sale would be taken into account in determining Federal income tax liability. Therefore, the share of DC1 stock is importation property.

(iii) Loss importation transaction. FC's transfer is a section 362 transaction. Furthermore, but for section 362(e)(1) and this section and section 362(e)(2), DC's

basis in the importation property, the share of DC1 stock, would be \$100 and the share's value would be \$70 immediately after the transaction. Therefore, the share's basis would exceed its value and the transfer is a loss importation transaction.

(iv) Application of section 362(e)(1) and this section to importation property received in loss importation transaction. Because the importation property, the DC1 share, was transferred in a loss importation transaction, paragraph (b)(1) of this section applies and DC's basis in the share will be equal to the share's \$70 value.

(v) Basis of property received in transaction. Following the application of section 362(e)(1) and this section, the provisions of section 362(e)(2) must be taken into account because the transfer is a section 362(a) transaction. Taking into account the application of section 362(e)(1) and this section, DC's basis in the DC1 share would not exceed the share's value immediately after the transaction. Therefore, FC does not have a net built-in loss, FC's transfer is not a loss duplication transaction, and section 362(e)(2) does not apply to the transaction. DC's basis in the DC1 share, as determined under paragraph (iv) of this Example 8, is \$70. Under section 358, FC's basis in the DC stock received in the exchange will be \$100.

Example 9. Property transferred in triangular reorganization. (i) Foreign subsidiary. (A) Facts. P owns the sole outstanding share of stock of FC (basis \$1), FC1 owns the sole outstanding share of FC2 (basis \$100), and FC2 owns one asset, A1 (basis \$100, value \$20). In a forward triangular merger described in §1.358-6(b)(2)(i), FC2 merges with and into FC, and FC1 receives shares of P stock in exchange for its FC2 stock. The forward triangular merger is a transaction described in section 368(a)(2)(D) and, therefore, in section 362(b).

(B) Determining P's basis in its FC share. Pursuant to §1.358-6, for purposes of determining the adjustment to P's basis in its FC shares, P is treated as though it first received A1 in a transaction in which its basis in A1 would be determined under section 362(b) and then it transferred A1 to FC in a transaction in which P's basis in its FC stock would be determined under section 358.

(1) P's deemed acquisition and transfer of A1. If FC2 had sold A1 for its value immediately before the deemed transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. If P had sold A1 immediately after the deemed transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability (P's). Therefore, with respect to P's deemed acquisition, A1 is importation property. Furthermore, immediately after the deemed transaction, P's basis in A1, but for section 362(e)(1) and this section and section 362(e)(2), would be \$100 and A1's value is \$20. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction. Accordingly, P's deemed basis in A1 will be equal to A1's \$20 value.

(2) P's FC stock basis. As a result of P's deemed transfer of A1 to FC (and applying the principles of §1.367(b)-13), P's basis in its FC stock is increased by its \$20 deemed basis in A1. Accordingly, following the transaction, P's basis in its share of FC stock will be \$21 (the sum of its original \$1 basis and the \$20 adjustment for the deemed transfer of A1).

(C) FC's basis in A1. FC's basis in A1 is determined under the rules of this section without regard to the determination of P's adjustment to its basis in FC stock. If FC2 had sold A1 for its value immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. However, if FC had sold A1 immediately after the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability, so A1 is not importation property. Accordingly, this section will not apply to the transaction. Although there is a net built-in loss in A1, the transaction is not described in section 362(a), and so section 362(e)(2) and §1.362-4 will not apply to the transaction. Thus, under section 362(b), FC's basis in A1 will be \$100.

(D) FC1's basis in P stock. Under section 358, FC1's basis in the P stock it receives in the exchange will be \$100.

(ii) Property transferred to U.S. subsidiary in triangular reorganization. (A) Facts. The facts are the same as in paragraph (i)(A) of this Example 9, except that P also owns the sole outstanding share of DC (basis \$1) and, instead of merging into FC, FC2 merged into DC.

(B) Determining P's basis in its DC share. As determined under paragraph (i)(B) (2) of this Example 9, P's basis in its DC share is \$21, the sum of its original \$1 basis plus the \$20 adjustment for the deemed transfer of A1.

(C) DC's basis in A1. If FC2 had sold A1 for its value immediately before the transaction, no gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability. However, if DC had sold A1 immediately after the transaction, any gain or loss recognized on the sale would have been taken into account in determining a Federal income tax liability, so A1 is importation property with respect to DC. Furthermore, immediately after the transaction, DC's basis in A1, but for section 362(e)(1) and this section and section 362(e)(2), would be \$100 and A1's value is \$20. Therefore, the importation property's basis would exceed its value and the transfer is a loss importation transaction. Accordingly, DC's basis in A1 will be \$20, A1's value immediately after the transaction.

(D) FC1's basis in P stock. Under section 358, FC1's basis in the P stock it receives in the exchange is \$100.

(g) Effective/applicability date. This section applies to any transaction occurring on or after the date these regulations are published as final regulations in the **Federal**

Register, unless effected pursuant to a binding agreement that was in effect prior to that date and at all times thereafter. However, taxpayers may apply this section to transactions occurring after October 22, 2004.

Par. 9. Section 1.362-4 is amended by:

1. Revising the introductory paragraph in paragraph (h).
2. Revising Example 11 in paragraph (h).
3. Adding a new sentence to the end of paragraph (j).

The revisions and additions read as follows:

§1.362-4 Limitations on Duplication of Net Built-in Losses.

* * * * *

(h) Examples. The examples in this paragraph (h) illustrate the application of section 362(e)(2) and the provisions of this section. Unless the facts otherwise indicate, the examples use the following nomenclature and assumptions: X, Y, P, S, S1, and S2 are domestic corporations; A and B are U.S. individuals; FC1 and FC2 are foreign corporations and are not engaged in a U.S. trade or business, have no U.S. real property interests, and have no other relationships, activities, or interests that would cause them, their shareholders, or their property to be subject to Federal income taxation; there is no applicable income tax treaty; PRS is a domestic partnership; no election is made under section 362(e)(2)(C); and the transferred property is not importation property (as defined in §1.362-3(c)(2)) and the transfers are not loss importation transactions (as defined in §1.362-3(c)(3)), so that the basis of no property is determined under section 362(e)(1). All persons and transactions are unrelated unless the facts indicate otherwise, and all other relevant facts are set forth in the

examples. See §1.362-3(f) for additional examples illustrating the application of section 362(e)(2) and this section, including to transactions that are subject to section 362(e)(2), and section 362(e)(1).

* * * * *

Example 11. Transfers of importation property with non-importation property. (i) Single transferor, loss importation transaction. (A) Facts. FC1 transfers Asset 1 (basis \$80, value \$50) and Asset 2 (basis \$120, value \$110) to DC in a transaction to which section 351 applies. Asset 1 is not importation property within the meaning of §1.362-3(c)(2). Asset 2 is importation property within the meaning of §1.362-3(c)(2).

(B) Application of section 362(e)(1). Immediately after the transfer, and without regard to section 362(e)(1) or section 362(e)(2) and this section, DC's aggregate basis in importation property (Asset 2) would be \$120. The aggregate value of the importation property immediately after the transfer is \$110. Accordingly, the transaction is a loss importation transaction within the meaning of §1.362-3(c)(3) and, under section 362(e)(1), DC's basis in Asset 2 would equal its value, \$110.

(C) Application of section 362(e)(2) and this section. (1) Analysis. (i) Loss duplication transaction. FC1's transfer of Asset 1 and Asset 2 is a transaction described in section 362(a). But for section 362(e)(2) and this section, DC's aggregate basis in those assets would be \$190 (\$80 under section 362(a) + \$110 under section 362(e)(1)), which would exceed the aggregate value of the assets \$160 (\$50 + \$110) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and FC1 has a net built-in loss of \$30 (\$190 - \$160).

(ii) Identifying loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 1 would be \$80, which would exceed Asset 1's \$50 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 2 would be \$110, which would not exceed Asset 2's \$110 value immediately after the transaction. Accordingly, Asset 2 is not loss duplication property.

(C) Basis in loss duplication property. DC's basis in Asset 1 is \$50, computed as its \$80 basis under section 362(a) reduced by FC1's \$30 net built-in loss.

(D) Basis in other property. Under section 362(e)(1), DC's basis in Asset 2 is \$110. Under section 358(a), FC1 has an exchanged basis of \$200 in the DC stock it receives in the transaction.

(ii) Multiple transferors, no importation of loss. (A) Facts. The facts are the same as paragraph (i)(A) of this Example 11, except that, in addition, FC2 transfers Asset 3

(basis \$100, value \$150) to DC as part of the same transaction. Asset 3 is importation property within the meaning of §1.362-3(c)(2).

(B) Application of section 362(e)(1). Immediately after the transfer, and without regard to section 362(e)(1) or section 362(e)(2) and this section, DC's aggregate basis in importation property (Asset 2 and Asset 3) would be \$220 (\$120 + \$100). The aggregate value of the importation property immediately after the transfer is \$260 (\$110 + \$150). Accordingly, the transaction is not a loss importation transaction within the meaning of §1.362-3(c)(3) and DC's bases in the importation property is not determined under section 362(e)(1).

(C) Application of section 362(e)(2) and this section: FC1. Notwithstanding that the transfers by FC1 and FC2 are pursuant to a single plan forming one transaction, section 362(e)(2) and this section apply to each transferor separately.

(1) Analysis. (i) Loss duplication transaction. FC1's transfer of Asset 1 and Asset 2 is a transaction described in section 362(a). But for section 362(e)(2) and this section, DC's aggregate basis in those assets would be \$200 (\$80 + \$120), which would exceed the aggregate value of the assets \$160 (\$50 + \$110) immediately after the transaction. Accordingly, the transfer is a loss duplication transaction and FC1 has a net built-in loss of \$40 (\$200 - \$160).

(ii) Identifying loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 1 would be \$80, which would exceed Asset 1's \$50 value immediately after the transaction. Accordingly, Asset 1 is loss duplication property. But for section 362(e)(2) and this section, DC's basis in Asset 2 would be \$120, which would exceed Asset 2's \$110 value immediately after the transaction. Accordingly, Asset 2 is also loss duplication property.

(2) Basis in loss duplication property. DC's basis in Asset 1 is \$50, computed as its \$80 basis under section 362(a) reduced by \$30, its allocable portion of FC1's \$40 net built-in loss ($\$80/\$200 \times \40). DC's basis in Asset 2 is \$110, computed as its \$120 basis under section 362(a) reduced by \$10, its allocable portion of FC1's \$40 net built-in loss ($\$120/\$200 \times \40).

(3) Basis in other property. Under section 358(a), FC1 has an exchanged basis of \$200 in the DC stock it receives in the transaction.

(D) Application of section: FC2. FC2's transfer of Asset 3 is not a loss duplication transaction because Asset 3's value exceeds its basis immediately after the transaction. Accordingly, under section 362(a), DC's basis in Asset 3 is \$100.

* * * * *

(j) Effective/applicability date. * * * The introductory paragraph and Example 11 of paragraph (h) of this section apply to transactions on or after the date these

regulations are published as final regulations in the **Federal Register** unless effected pursuant to a binding agreement that was in effect prior to that date and at all times thereafter; however, taxpayers may apply such provisions to transactions occurring after October 22, 2004.

Par. 10. Section 1.368-3 is amended by revising paragraphs (a)(3), (b)(3) and (e) to read as follows:

§1.368-3 Records to be kept and information to be filed with returns.

(a) * * *

(3) The value and basis of the assets, stock or securities of the target corporation transferred in the transaction, determined immediately before the transfer and aggregated as follows--

(i) Importation property transferred in a loss importation transaction, as defined in §1.362-3(c)(2) and §1.362-3(c)(3), respectively;

(ii) Loss duplication property as defined in §1.362-4(c)(1);

(iii) Property with respect to which any gain or loss was recognized on the transfer (without regard to whether such property is also identified in paragraph (a)(3)(i) or (a)(3)(ii) of this section);

(iv) Property not described in paragraph (a)(3)(i), (a)(3)(ii) or (a)(3)(iii) of this section; and

* * * * *

(b) * * *

(3) The value and basis of all the stock or securities of the target corporation held by the significant holder that is transferred in the transaction and such holder's basis in

that stock or securities, determined immediately before the transfer and aggregated as follows--

(i) Stock and securities with respect to which an election is made under section 362(e)(2)(C); and

(ii) Stock and securities not described in paragraph (b)(3)(i) of this section.

* * * * *

(e) Effective/applicability date. * * * Paragraphs (a)(3) and (b)(3) of this section apply to any taxable year beginning on or after these regulations are published as final regulations in the **Federal Register**, unless effected pursuant to a binding agreement that was in effect prior to that date and at all times thereafter.

Deputy Commissioner for Services and Enforcement.