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Part III

Department of the Treasury

26 CFR Part 1

**Transfers by Domestic Corporations That
Are Subject to Section 367(a)(5);
Distributions by Domestic Corporations
That Are Subject to Section 1248(f);
Proposed Rule**

DEPARTMENT OF THE TREASURY**Internal Revenue Service****26 CFR Part 1****[REG-209006-89]****RIN 1545-AM97****Transfers by Domestic Corporations That Are Subject to Section 367(a)(5); Distributions by Domestic Corporations That Are Subject to Section 1248(f)****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under sections 367(a), 367(a)(5), 367(b), 1248(a), 1248(e), 1248(f), and 6038B of the Internal Revenue Code (Code). The proposed regulations under sections 367(a)(5) and 367(b) apply when a domestic corporation transfers certain property to a foreign corporation in an exchange described in section 361(a) or (b). The proposed regulations under section 1248(e) suspend the application of section 1248(e) when capital gains are taxed at a rate equal to or greater than the rate at which ordinary income is taxed. The proposed regulations under section 1248(f) apply when a domestic corporation distributes stock of certain foreign corporations in a distribution to which section 337, 355, or 361 applies. The proposed regulations under section 1248(f) include regulations described in Notice 87-64 (1987-2 CB 375). The proposed regulations under section 6038B establish reporting requirements for certain transfers of property by a domestic corporation to a foreign corporation in certain exchanges described in section 361(a) or (b). Finally, the proposed regulations under section 367(a) include the regulations described in Notice 2008-10 (2008-3 IRB 277).

The proposed regulations included in this document affect domestic corporations that transfer property to foreign corporations in certain transactions, or that distribute the stock of certain foreign corporations, and certain shareholders of such domestic corporations. The proposed regulations are necessary, in part, to provide guidance on changes to the law made by the Technical and Miscellaneous Revenue Act of 1988 (Pub. L. 100-647, 102 Stat. 3342).

DATES: Written or electronic comments and requests for a public hearing must be received by November 18, 2008.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-209006-89), 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-209006-89), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or sent electronically, via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-209006-89).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Daniel McCall, (202) 622-3860; concerning submissions of comments, requests for a public hearing, and/or to be placed on the building access list to attend a hearing, Richard Hurst (Richard.A.Hurst@irs.counsel.treas.gov), or (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:**Paperwork Reduction Act**

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by October 20, 2008.

Comments are requested concerning: Whether the proposed collections of information are 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 collections 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 collections of information may be minimized, including through the application or 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 collections of information in these proposed regulations are in §§ 1.367(a)-7(c)(4) and (5); 1.1248(f)-2(b)(1) and (c)(1); and 1.6038B-1(c)(6). The collections of information are mandatory. The likely respondents are domestic corporations.

Estimated total annual reporting burden: 3260.

Estimated average annual burden hours per respondent: 10.69.

Estimated number of respondents: 305.

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

Books and 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 26 U.S.C. 6103.

Background

This document contains proposed amendments to 26 CFR part 1 under sections 367(a), 367(a)(5), 367(b), 1248(a), 1248(e), 1248(f), and 6038B of the Code.

Section 367(a)(1) generally provides that if a United States person transfers property to foreign corporation in connection with an exchange described in section 332, 351, 354, 356, or 361, then the foreign corporation shall not be considered a corporation for purposes of determining the extent to which the United States person recognizes gain on the transfer. Sections 367(a)(2) and 367(a)(3), respectively, provide exceptions to the general rule of section 367(a)(1) for transfers of stock or securities of a foreign corporation that is a party to the exchange or a party to the reorganization, and for certain property used in an active foreign trade or business. However, section 367(a)(5) provides that, except to the extent provided in regulations, the exceptions to the general rule of section 367(a)(1) provided by section 367(a)(2) and (a)(3) do not apply to a transfer of property by a domestic corporation to a foreign corporation in an exchange described in section 361(a) or (b).

Section 367(b)(1) provides that in the case of any exchange described in section 332, 351, 354, 355, 356, or 361 in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation shall be considered to be a corporation except to

the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes. A fundamental policy of section 367(b) is to preserve the potential application of section 1248 following the acquisition of the stock or assets of a foreign corporation by another foreign corporation. H.R. Rep. No. 94-658, at 242 (1975).

Section 367(c)(1) provides that for purposes of section 367, any distribution described in section 355 (or so much of section 356 as relates to section 355) shall be treated as an exchange whether or not it is an exchange.

Section 1248(a) provides that a United States person shall include in gross income as a dividend any gain recognized on the sale or exchange of stock of a foreign corporation that was a controlled foreign corporation (CFC) (as defined in section 957(a)) at any time during the five-year period ending on the date of the sale or exchange but only if the United States person owned (or is considered to have owned, within the meaning of section 958) 10 percent or more of the total combined voting power of the foreign corporation at any time during that five-year period (a section 1248 shareholder). The amount of the gain recognized by the United States person on the sale or exchange that is recharacterized as a dividend is limited to the earnings and profits of the foreign corporation, and of certain foreign subsidiaries of such corporation, attributable to the stock sold or exchanged that were accumulated in taxable years of the foreign corporation beginning after December 31, 1962, and during the period or periods the stock was held by the United States person while the foreign corporation was a CFC.

Section 1248(e) provides that, except as provided in regulations, if a United States person sells or exchanges stock of a domestic corporation that was formed or availed of principally for the holding, directly or indirectly, of stock of one or more foreign corporations, such sale or exchange shall be treated for purposes of section 1248 as a sale or exchange of the stock of the foreign corporations held by the domestic corporation.

Section 1248(f)(1) provides that, except as provided in regulations, a domestic corporation that distributes stock of a foreign corporation in a distribution to which section 311(a), 337, 355(c)(1), or 361(c)(1) applies, shall include in gross income as a dividend an amount equal to the excess of the fair market value of such stock over its adjusted basis, but only to the extent of

the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock was held by the domestic corporation while the foreign corporation was a CFC.

Explanation of Provisions

A. Section 367(a)(5)

1. Overview

As noted in the Background part of this preamble, section 367(a)(2) and (3) provide exceptions to the general rule of section 367(a)(1). Section 367(a)(2) provides that, except to the extent provided in regulations, section 367(a)(1) shall not apply to the transfer of stock or securities of a foreign corporation that is a party to the exchange or a party to the reorganization. Section 367(a)(3) provides that, except to the extent provided in regulations, section 367(a)(1) shall not apply to the transfer of property used in an active foreign trade or business. Sections 1.367(a)-2T and § 1.367(a)-3, along with other related provisions, implement the exceptions in section 367(a)(2) and (a)(3). In addition, section 367(a)(6) grants the Secretary authority to promulgate regulations providing additional exceptions to the general rule of section 367(a)(1).

Section 367(a)(5) provides that the exceptions to the general rule of section 367(a)(1) provided under section 367(a)(2) and (3) shall not apply in the case of a transfer of property by a domestic corporation (U.S. transferor) to a foreign corporation (foreign acquiring corporation) in an exchange described in section 361(a) or (b) (section 361 exchange). The general rule under section 367(a)(5), therefore, is that a transfer of property by a U.S. transferor to a foreign acquiring corporation in a section 361 exchange is subject to the general rule of section 367(a)(1). In that case, the U.S. transferor recognizes gain with respect to the transfer of appreciated property in the section 361 exchange. See section 367(a)(1) and the regulations under that section.

Section 367(a)(5), however, further provides that subject to such basis adjustments and such other conditions as shall be provided in regulations the general rule of section 367(a)(5) shall not apply (and therefore the exceptions to the general rule of section 367(a)(1) may be available) if the U.S. transferor is controlled (within the meaning of section 368(c)), by five or fewer

domestic corporations. For purposes of the control requirement, members of the same affiliated group (within the meaning of section 1504) are treated as a single corporation. The legislative history to section 367(a)(5) explains that regulations are expected to provide relief from the general rule only if the "U.S. corporate shareholders in the transferor agree to take a basis in the stock they receive in a foreign corporation that is a party to the reorganization equal to the lesser of (a) the U.S. corporate shareholders' basis in such stock received pursuant to section 358, or (b) their proportionate share of the basis in the assets of the transferor corporation transferred to the foreign corporation." S. Rep. No. 100-445, at 62 (1988).

The legislative history explains that "the requirement that five or fewer domestic corporations own at least 80 percent of the U.S. transferor's stock assures that the bulk of the built-in gain [in the transferred property] remains subject to U.S. taxing jurisdiction." The legislative history further states that "it is expected that regulations [issued under section 367(a)(5)] will require the U.S. corporate transferor to recognize immediately any built-in gain that does not remain subject to U.S. taxing jurisdiction by virtue of a substituted stock basis." For example, the U.S. transferor would recognize gain "where 20 percent or less of the U.S. corporate transferor is owned by foreign shareholders who receive substituted basis stock in the transferee corporation, which stock would not be subject to U.S. taxing jurisdiction on disposition." The U.S. transferor would also recognize gain to the extent each controlling domestic corporate shareholder does not receive an amount of stock of the issuing corporation in the reorganization sufficient to preserve its share of the built-in gain in the property transferred by the U.S. transferor in the section 361 exchange.

2. Explanation of Proposed Regulations

The proposed regulations confirm the general rule of section 367(a)(5), but provide an elective exception to the general rule pursuant to which the exceptions provided by section 367(a) and the regulations under that section may be available.

(a) General Rule of Section 367(a)(5)

Consistent with section 367(a)(5), the proposed regulations confirm that the exceptions to the general rule of section 367(a)(1) provided in section 367(a) generally are not available to a transfer of property by a U.S. transferor to a foreign acquiring corporation in a

section 361 exchange. As noted, under the general rule of section 367(a)(5), section 367(a)(1) would require the U.S. transferor to recognize gain on the transfer of appreciated property to the foreign acquiring corporation in the section 361 exchange. This general rule applies even if the conditions and requirements for the application of such exceptions would otherwise be met. The proposed regulations clarify that the general rule of section 367(a)(5) applies to a transfer of property pursuant to an exchange described in section 351 (section 351 exchange) that qualifies as both a section 351 exchange and a section 361 exchange. See Notice 2008-10, 2008-3 IRB 277.

(b) Elective Exception to the General Rule

The proposed regulations provide an elective exception to the general rule of section 367(a)(5) if certain conditions and requirements are satisfied (discussed in parts A.2.b.i through v of this preamble). If the exception applies, then the exceptions to the general rule of section 367(a)(1) provided in section 367(a) and the regulations under that section are available to the transfer of property by the U.S. transferor to the foreign acquiring corporation in the section 361 exchange, subject to any conditions and requirements for the application of such exceptions. In addition, even if the exception provided by the proposed regulations applies, the U.S. transferor may still recognize gain on the section 361 exchange in certain circumstances (discussed in part A.2.b.ii of this preamble), including any gain otherwise required to be recognized under section 367(a). See, for example, section 367(a)(3)(B) and (C).

The conditions and requirements of the elective exception carry out the policy of section 367(a)(5) by ensuring that the exceptions to the general rule of section 367(a)(1) are available only to the extent the net built-in gain in certain property transferred by the U.S. transferor in the section 361 exchange remains subject to corporate-level taxation in the hands of the controlling domestic corporate shareholders of the U.S. transferor through their ownership of stock received in the transaction. References to "stock received" in this preamble include stock deemed received in the transaction.

The proposed regulations apply to all property transferred by the U.S. transferor in the section 361 exchange, other than property to which section 367(d) applies (section 367(d) property). But see part D.2 of this preamble regarding proposed regulations under section 367(a) that require section

367(d) property to be treated as property to which section 367(a) applies (section 367(a) property) in transactions that may be eligible for the exception to the coordination rule of § 1.367(a)-3(d)(2)(vi)(A) provided by § 1.367(a)-3(d)(2)(vi)(B)(1). For purposes of these proposed regulations, section 367(a) property includes any property transferred by the U.S. transferor in the section 361 exchange (other than section 367(d) property), whether the property is appreciated (built-in gain property) or depreciated (built-in loss property) at the time of the section 361 exchange. The proposed regulations preserve (or require the recognition of) the net built-in gain in the section 367(a) property transferred in the section 361 exchange (generally defined as "inside gain" by the proposed regulations). In this regard, a transfer of section 367(a) property pursuant to a section 361 exchange to which the elective exception applies is treated differently than a transfer of built-in gain property and built-in loss property by a U.S. person to a foreign corporation in a section 351 exchange that is not also a section 361 exchange. In the latter transaction, only the built-in gain property would be subject to section 367(a)(1), and the U.S. transferor would be required to recognize gain with respect to such property without offsetting the gain with losses related to the built-in loss property.

The proposed regulations contain an anti-stuffing rule pursuant to which any property that would otherwise constitute section 367(a) property shall not be considered section 367(a) property for purposes of any determination under the proposed regulations for which the amount of section 367(a) property is relevant, if the U.S. transferor acquires such property in connection with the section 361 exchange with a principle purpose of affecting any such determination (for example, inside gain and inside basis). This rule may apply, for example, if the U.S. transferor acquires built-in loss property or cash proceeds from indebtedness incurred in connection with the transaction.

The conditions and requirements for the application of the exception provided by the proposed regulations ensure that, in the aggregate, the inside gain is recognized currently by the U.S. transferor or preserved for future taxation in the stock received in the transaction by the controlling domestic corporate shareholders of the U.S. transferor. If the entire inside gain is preserved in the stock received by the controlling domestic corporate shareholders, the basis adjustment required by the exception (discussed in

part A.2.b.iii of this preamble) effectively results in the section 361 exchange being treated similarly to a transfer of the section 367(a) property in a section 351 exchange insofar as, in the aggregate, the controlling domestic corporate shareholders' adjusted basis in the stock received in the transaction generally would reflect the aggregate bases of the section 367(a) property and the net built-in gain in such property on the date of the section 361 exchange.

The inside gain equals the amount by which the aggregate gross fair market value of the section 367(a) property transferred by the U.S. transferor in the section 361 exchange exceeds the sum of the aggregate bases of such property and a proportionate amount of any liabilities of the U.S. transferor assumed in the section 361 exchange or satisfied in the reorganization pursuant to section 361(c)(3), but only to the extent the payment of any such liability would give rise to a deduction (deductible liabilities). For this purpose, gross fair market value means fair market value determined without regard to mortgages, liens, pledges, or other liabilities.

However, the fair market value of any property subject to nonrecourse indebtedness shall not be less than the amount of such indebtedness. In addition, the aggregate bases of the section 367(a) property is determined after taking into account any gain otherwise required to be recognized by the U.S. transferor under section 367(a). See, for example, section 367(a)(3)(B) and (C). The proposed regulations provide rules for determining the proportionate amount of any deductible liabilities taken into account in determining the inside gain. The IRS and Treasury Department believe that taking deductible liabilities into account in determining inside gain comports with the policy of section 367(a)(5) to protect the corporate tax base following the repeal of the "General Utilities" doctrine, insofar as the U.S. transferor would have received the benefit of any deductible liabilities if it had disposed of its assets in a taxable transaction in which the deductible liabilities were assumed by the acquirer.

In determining the inside gain, the IRS and Treasury Department declined to consider attributes (for example, net operating losses and foreign tax credits) of the U.S. transferor other than the tax bases of the section 367(a) property and deductible liabilities allocable to section 367(a) property. These attributes are not considered for this purpose because of concerns regarding the complexity for determining how any limitations on the use of such attributes should be taken into account and the potential for

duplicating the benefit of such attributes. Comments are requested regarding whether and how other attributes of the U.S. transferor should be taken into account for determining inside gain.

If the section 361 exchange is part of a divisive reorganization described in section 368(a)(1)(D) in which the U.S. transferor distributes the stock of the foreign acquiring corporation in a distribution to which section 355 applies (section 355 distribution) and, as part of a plan or series of related transactions, such stock is subsequently distributed in one or more section 355 distributions, in addition to the conditions discussed in parts A.2.b.i through v of this preamble, two additional conditions must be satisfied. First, each section 355 distribution must be to a member of the affiliated group (within the meaning of section 1504) that includes the U.S. transferor at the time of the 361 exchange. Second, each affiliated group member that receives stock of the foreign acquiring corporation in the final section 355 distribution must adjust the basis of the stock received (as determined under section 358 and the regulations under that section) as required by the proposed regulations (discussed in part A.2.b.iii of this preamble). These two additional conditions ensure that the amount of inside gain attributable to the U.S. transferor's controlling domestic corporate shareholders remains subject to corporate-level taxation following the final section 355 distribution and permit section 355 distributions of the stock of the foreign acquiring corporation within an affiliated group.

(i) Control Requirement

At the time of the section 361 exchange, the U.S. transferor must be controlled (within the meaning of section 368(c)) by five or fewer, but at least one, domestic corporations (the control group). For this purpose, members of the same affiliated group (within the meaning of section 1504) are treated as one corporation. If the U.S. transferor is controlled (within the meaning of section 368(c)) by more than five domestic corporations, but some combination of five or fewer domestic corporations control the U.S. transferor within the meaning of section 368(c), the U.S. transferor must designate the five or fewer domestic corporations that comprise the control group on Form 926, "Return by a U.S. Transferor of Property to a Foreign Corporation."

Although a regulated investment company (as defined in section 851(a)) (RIC), a real estate investment trust (as defined in section 856(a)) (REIT), and a

subchapter S corporation (as defined in section 1361(a)) is each generally treated as a domestic corporation for purposes of the Code, such entities are not generally subject to corporate-level taxation. Therefore, the proposed regulations provide that these entities cannot be members of the control group.

The proposed regulations confirm that because the stock ownership threshold for the control requirement is determined by reference to section 368(c), only direct ownership of the stock of the U.S. transferor is taken into account. The IRS and Treasury Department declined to exercise the authority under section 367(a)(6) to permit indirect ownership (through a partnership or other entity) to be taken into account for this purpose, in part, because of the complexity and administrative difficulties that would arise from the basis adjustments (discussed in part A.2.b.iii of this preamble) that would be needed to account for the intervening partnership or other entity. For example, in the case of indirect ownership through a partnership, basis adjustments would need to account for differences between a partner's basis in its partnership interest and the partnership's basis in the stock of the U.S. transferor. Comments are requested regarding the manner in which indirect ownership could be taken into account for this purpose without undue complexity.

(ii) Gain Recognition by U.S. Transferor

Even if the exception provided by the proposed regulations applies, in two instances the U.S. transferor must recognize gain on the transfer of section 367(a) property in the section 361 exchange. This is the case even if an exception to the general rule of section 367(a)(1) would otherwise apply to such transfer.

First, the U.S. transferor must recognize gain equal to the aggregate amount of inside gain allocable to non-control group members. The inside gain is allocated among control group members and non-control group members based on each shareholder's ownership interest (by value) in the U.S. transferor at the time of the section 361 exchange. The U.S. transferor must recognize gain with respect to non-control group members even if the entire inside gain could be preserved in the stock received by the control group members as a group.

Second, the U.S. transferor must recognize gain to the extent any control group member cannot preserve its share of inside gain in the stock received that is allocable to the section 367(a) property transferred in the section 361

exchange. The amount of a control group member's share of inside gain that cannot be preserved in the stock received is the amount by which the control group member's share of inside gain exceeds the fair market value of the stock received by the control group member that is allocable to section 367(a) property. Gain is required to be recognized in such a case because the fair market value of the stock equals the maximum amount of the control group member's share of inside gain that can be preserved in such stock (if the basis of such stock were zero). Under this rule, stock received that is allocable to property other than section 367(a) property is not available to preserve any portion of the control group member's share of inside gain. The U.S. transferor may be required to recognize gain under this rule when, for example, non-qualifying property (property other than stock or securities permitted to be received under section 361(a)) is received or when the foreign acquiring corporation assumes certain liabilities of the U.S. transferor in the section 361 exchange.

The proposed regulations provide rules for determining the portion of the stock received by a control group member that is attributable to section 367(a) property that are consistent with general tax principles, including Rev. Rul. 68-55, 1968-1 CB 140, and the authorities cited therein. Under these rules, stock received by a control group member is allocated between the aggregate section 367(a) property and all other property transferred in the section 361 exchange based on relative gross fair market value.

The U.S. transferor must recognize gain with respect to any control group member that cannot preserve its entire share of inside gain in the stock received in the transaction even if the control group members' aggregate share of inside gain can be preserved in the stock received by the control group members as a group. For example, assume that the U.S. transferor is wholly owned by two domestic corporations (US1 and US2) and that each control group member's share of inside gain is \$40x. If in the transaction US1 received stock with a value of \$30x and \$20x of non-qualifying property, the U.S. transferor would recognize \$10x gain with respect to US1, even if US2 received sufficient stock to preserve \$50x gain (the sum of US2's \$40x share of inside gain and the portion of US1's share of inside gain (\$10x) that cannot be preserved in the stock received by US1).

(iii) Adjustments To Basis of Stock Received by Control Group Members

Under the proposed regulations, each control group member's basis in the stock received in the transaction as determined under section 358 and the regulations under that section (section 358 basis) that is allocable to the section 367(a) property transferred by the U.S. transferor in the section 361 exchange is reduced to the extent necessary to preserve the control group member's share of inside gain. As a general matter, if the U.S. transferor must recognize gain with respect to a control group member because the control group member's entire share of inside gain cannot be preserved in the stock received by the control group member in the transaction (see part A.2.b.ii of this preamble), the control group member's section 358 basis in the stock received that is attributable to section 367(a) property is reduced to zero.

Only the basis of stock received by the control group member that is attributable to section 367(a) property transferred in the section 361 exchange is reduced (for example, the basis of stock attributable to section 367(d) property is not reduced). The reduction to a control group member's section 358 basis in the stock received that is attributable to section 367(a) property equals the amount, if any, by which the control group member's share of inside gain (reduced by the amount of any gain recognized by the U.S. transferor with respect to the control group member (discussed in part A.2.b.ii of this preamble)) exceeds the built-in gain in such stock (outside gain). The outside gain is the amount by which the fair market value of such stock exceeds the section 358 basis of the stock (as determined before any required adjustment to such basis under the proposed regulations). The proposed regulations provide special rules that apply if the control group member holds more than one block of stock received in the transaction.

If the section 361 exchange is part of a divisive reorganization described in section 368(a)(1)(D) that is eligible for the exception (see part A.2.b of this preamble for additional conditions that must be satisfied in such a case), each affiliated group member that receives stock of the foreign acquiring corporation in the final section 355 distribution must reduce the section 358 basis of such stock to the same extent that the control group member that initially received the stock from the U.S. transferor would have reduced its section 358 basis in such stock. In such a case, the control group member that

received the stock of the foreign acquiring corporation from the U.S. transferor is not required to reduce the section 358 basis of such stock.

A section 361 exchange that is subject to section 367(a)(5) may be part of a triangular reorganization in which the control group members receive stock of the corporation that controls the foreign acquiring corporation (the controlling corporation). In such a case, the proposed regulations require the control group members to adjust (if necessary) the section 358 basis of the stock of the controlling corporation (whether foreign or domestic) received in the transaction. The IRS and Treasury Department believe adjusting the basis of such stock to be appropriate even if the controlling corporation is domestic because the control group members' aggregate share of inside gain may not be preserved in the stock of the foreign acquiring corporation held by the controlling corporation in all cases. For example, liabilities assumed or incurred by the foreign acquiring corporation in connection with the transaction could reduce the amount of inside gain preserved in such stock. Moreover, even if the control group members' aggregate share of inside gain could be preserved in such stock, such an approach would shift the inside gain to the domestic controlling corporation, rather than to the control group members as intended by section 367(a)(5).

(iv) Agreement To Recognize Gain and File Amended Tax Return

The proposed regulations require the U.S. transferor to include a statement with its U.S. income tax return for the year of the section 361 exchange certifying that if the foreign acquiring corporation disposes of a significant amount of the section 367(a) property transferred in the section 361 exchange in one or more related transactions entered into with a principal purpose of avoiding the U.S. tax that would have been imposed on a sale of such property by the U.S. transferor at the time of the section 361 exchange, then the U.S. transferor (or the foreign acquiring corporation on behalf of the U.S. transferor) shall file a U.S. income tax return (or amended U.S. income tax return, as the case may be) for the year of the section 361 exchange reporting the gain realized but not recognized on the section 361 exchange. This requirement is intended to prevent the potential use of reorganizations subject to section 367(a)(5) to avoid the repeal of the "General Utilities" doctrine. Interest must be paid (determined under section 6621) on the amount of any additional tax due on such return. For

this purpose, a disposition of a significant amount of the section 367(a) property occurs if the foreign acquiring corporation disposes of an amount of the section 367(a) property transferred in the section 361 exchange that is greater than forty percent of the fair market value of the section 367(a) property at the time of the section 361 exchange. Comments are requested regarding whether an exception from this rule should be provided for dispositions of section 367(a) property occurring in the ordinary course of business.

(v) Election and Reporting Requirements

To elect to apply the exception, the proposed regulations require the U.S. transferor and the control group members to enter into a written agreement to make such election on or before the due date for the U.S. transferor's timely-filed return for the taxable year in which the section 361 exchange occurs. Each party to the written agreement must also include a statement with its timely-filed return for the year of the section 361 exchange reporting the election and other specified information. If the section 361 exchange is part of a divisive reorganization described in section 368(a)(1)(D) that is eligible for the exception (see part A.2.b of this preamble for additional conditions that must be satisfied in such a case), each affiliated group member that receives stock of the foreign acquiring corporation in the final section 355 distribution must enter into the written agreement and include the reporting statement with its timely-filed return (instead of the control group member that initially received the stock of the foreign acquiring corporation from the U.S. transferor.) Relief for reasonable cause may be available for the failure to comply with the election and reporting requirements.

3. Special Entities

The proposed regulations apply to property transfers by U.S. transferors, including RICs, REITs, and subchapter S corporations. Comments are requested regarding whether and the extent to which the IRS and Treasury Department should exercise the authority under section 367(a)(6) to provide an exception from the general rule of section 367(a)(5) for a transfer of property by a RIC, a REIT, or a subchapter S corporation to a foreign corporation pursuant to a section 361 exchange.

B. Section 367(b)

1. Overview

Section 367(b)(1) provides that in the case of any exchange described in section 332, 351, 354, 355, 356, or 361 in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation shall be considered to be a corporation except to the extent provided in regulations prescribed by the Secretary which are necessary or appropriate to prevent the avoidance of Federal income taxes.

A fundamental policy of section 367(b) is to preserve the potential application of section 1248 following certain section 367(b) exchanges. H.R. Rep. No. 94-658, at 242 (1975). Thus, if the potential application of section 1248 cannot be preserved immediately following the acquisition of the stock or assets of a foreign acquired corporation by a foreign acquiring corporation in a section 367(b) exchange, the final regulations (TD 8862) under section 367(b) issued on January 24, 2000 (2000 final regulations) require certain shareholders of the foreign acquired corporation to include in income as a dividend the section 1248 amount attributable to the stock of the foreign acquired corporation. See § 1.367(b)-4(b). For example, the inclusion in income of the section 1248 amount is required if the section 367(b) exchange results in the loss of section 1248 shareholder status or if the foreign acquired corporation or foreign acquiring corporation is not a CFC immediately after the section 367(b) exchange. See § 1.367(b)-4(b)(1)(i).

2. Outbound Asset Reorganizations—In General

The 2000 final regulations require a U.S. transferor that is a section 1248 shareholder of a foreign acquired corporation and that transfers the stock of such corporation to a foreign acquiring corporation in a section 361 exchange to include in income the section 1248 amount attributable to the stock of the foreign acquired corporation. The U.S. transferor must include the section 1248 amount in income even if the foreign acquiring corporation and the foreign acquired corporation are CFCs with respect to which the U.S. transferor is a section 1248 shareholder immediately after the section 361 exchange. See § 1.367(b)-4(b)(1)(iii), *Example 4*. Moreover, under section 1248(f)(1) the U.S. transferor generally would be required to include in income the section 1248 amount attributable to the stock of the foreign acquiring corporation distributed under section 361(c)(1). The section 1248

amount attributable to the stock of the foreign acquiring corporation would generally include the section 1248 amount attributable to the stock of the foreign acquired corporation. See generally § 1.1248-8.

The final regulations (TD 9243) under section 367(b) issued on January 26, 2006 (2006 final regulations) provided an exception to the general rule of § 1.367(b)-4(b)(1)(i) that applies in certain triangular reorganizations where the exchanging shareholder receives stock of a domestic corporation that controls the foreign acquiring corporation. This exception only applies, however, to a shareholder that exchanges stock of the foreign acquired corporation for stock of the domestic corporation in an exchange described under section 354 or 356. Thus, the exception provided by the 2006 final regulations does not apply where the U.S. transferor receives stock of a domestic controlling corporation for stock of a foreign acquired corporation in a section 361 exchange.

After studying the issue further and in response to comments received, the IRS and Treasury Department have determined that requiring the U.S. transferor to include the section 1248 amount in income may not be necessary in cases where the section 1248 amount attributable to the stock of the foreign acquired corporation can be preserved. Accordingly, the proposed regulations under section 367(b) included in this document provide an additional exception to the general rule of the 2000 final regulations that applies to certain transfers of stock of a foreign acquired corporation by a U.S. transferor to a foreign acquiring corporation in a section 361 exchange.

In such a case, the proposed regulations provide that the U.S. transferor must include in income the section 1248 amount attributable to the stock of the foreign acquired corporation only if immediately after the section 361 exchange the foreign acquiring corporation or the foreign acquired corporation is not a CFC with respect to which the U.S. transferor is a section 1248 shareholder. *Example 4* in § 1.367(b)-4(b)(1)(iii) is modified accordingly. The proposed regulations under section 1248(f) included in this document supplement this exception to ensure that the section 1248 amount can be preserved in the hands of a corporate section 1248 shareholder following the distribution of the stock of the foreign acquiring corporation by the U.S. transferor. See part C of this preamble for discussion of the proposed regulations under section 1248(f).

3. Special Rules for Outbound Triangular Asset Reorganizations

As noted, the 2000 final regulations also require the U.S. transferor to include in income the section 1248 amount attributable to stock of a foreign acquired corporation transferred to a foreign acquiring corporation in a section 361 exchange that is part of triangular asset reorganization, even if the corporation that controls the foreign acquiring corporation is domestic. The provisions of § 1.367(b)-13 (TD 9243) do not apply to preserve the section 1248 amount attributable to the stock of the foreign acquired corporation in such a case. The proposed regulations under section 367(b) included in this document, however, would provide an exception to the general rule of the final 2000 regulations in such triangular asset reorganizations.

If the controlling corporation is foreign, the exception applies if, immediately after the section 361 exchange, the foreign controlling corporation, the foreign acquiring corporation, and the foreign acquired corporation are CFCs with respect to which the U.S. transferor is a section 1248 shareholder. If the controlling corporation is domestic, the exception applies if, immediately after the section 361 exchange, the foreign acquired corporation is a CFC with respect to which the domestic controlling corporation is a section 1248 shareholder. In addition, in either case, the controlling corporation (foreign or domestic) must apply the principles of § 1.367(b)-13 to determine the adjustment to the basis of the stock of the foreign acquiring corporation (instead of the over-the-top basis adjustment rules of § 1.358-6) to ensure that the section 1248 amount attributable to the stock of the foreign acquired corporation at the time of the section 361 exchange is preserved in the stock of the foreign acquiring corporation immediately after the section 361 exchange. Under these principles, each share of stock of the foreign acquiring corporation would generally be divided into the portions necessary to preserve the pre-exchange section 1248 amounts attributable to the stock of the foreign acquired corporation and the foreign acquiring corporation, respectively. If the controlling corporation is foreign, the proposed regulations under section 1248(f) included in this document supplement this exception to ensure that the section 1248 amount can be preserved following the distribution of the stock of the foreign controlling corporation by the U.S. transferor to its shareholders.

C. Section 1248(f)

1. Overview

Section 1248(f)(1) provides that, except as provided in regulations, if a domestic corporation (domestic distributing corporation) that is a section 1248 shareholder with respect to a foreign corporation distributes the stock of such foreign corporation in a distribution described in section 311(a), 337, 355(c)(1), or 361(c)(1), then notwithstanding any other provisions of the Code, the domestic distributing corporation must include in income as a dividend the section 1248 amount attributable to such stock. Section 1248(f)(1) requires the inclusion of the section 1248 amount because the section 1248 amount attributable to the stock distributed may not be preserved in the hands of the distributee shareholders following the distribution. Section 1248(f)(1) does not apply to the extent the domestic distributing corporation otherwise recognizes gain on the distribution, in which case the gain recognized would be recharacterized as a dividend under section 1248(a), as appropriate.

Section 1248(f)(2), however, provides that section 1248(f)(1) shall not apply to a domestic distributing corporation's distribution of stock of a foreign corporation to a domestic corporation that is treated as holding the stock for the period during which the stock was held by the domestic distributing corporation and that, immediately after the distribution, is a section 1248 shareholder with respect to the foreign corporation. The legislative history explains that where "the corporate distribute[e] does not receive a stepped up basis as a result of the distribution and* * *the potential for the future application of section 1248 still exists, it is not necessary to [apply section 1248(f)(1) to] override the nonrecognition provisions which otherwise apply to a corporate distribution." S. Rep. No. 94-938, at 270 (1976).

The legislative history provides that the Treasury Department may exercise the regulatory authority granted under section 1248(f)(1) to provide that, where section 1248(f)(2) does not otherwise apply, "the recipient corporation may be required to take a carryover basis in the stock received (rather than a substituted basis under section 358, for example, in the case of a section 355 or 361 distribution) and section 1248(f)(1) will not apply to such distribution." S. Rep. No. 100-445, at 64 (1988).

In Notice 87-64 (1987-2 CB 375), the IRS and Treasury Department announced that, in the case of section

355 distributions of CFC stock, regulations under section 1248(f) may limit the application of section 1248(f)(1) to distributions in which the CFC is no longer a CFC after the distribution or in which one or more of the distributees are not United States shareholders (within the meaning of section 951(b)) of the CFC after the distribution. The notice further states that the regulations would ensure that, subsequent to a section 355 distribution of CFC stock that would not be subject to section 1248(f)(1) under the regulations, the amount of gain recognized from a disposition of the CFC stock that would be recharacterized as a dividend under section 1248(a) would include the earnings and profits attributable to the CFC stock under section 1248 as of the date of the section 355 distribution. To achieve this result, the notice provides that the regulations may require appropriate adjustments to the basis and holding period of the CFC stock received by one or more of the distributees.

2. General Rules

The proposed regulations under section 1248(f) included in this document provide that a domestic distributing corporation that is a section 1248 shareholder of a foreign corporation and that distributes stock of such foreign corporation in a distribution to which section 337 applies (section 337 distribution), shall generally include in income as a dividend the section 1248 amount attributable to the stock distributed.

The proposed regulations further provide that a domestic distributing corporation that is a section 1248 shareholder of a foreign corporation and that distributes stock of such foreign corporation in a section 355 distribution, other than stock received by the domestic distributing corporation in a section 361 exchange, shall generally include in income as a dividend the section 1248 amount attributable to the stock distributed. This rule applies, however, only to the extent the domestic distributing corporation does not otherwise recognize gain on the section 355 distribution, in which case the gain recognized would be recharacterized as a dividend under section 1248(a), as appropriate.

Finally, the proposed regulations provide that a domestic distributing corporation that is a section 1248 shareholder of a foreign distributed corporation and that distributes stock of such corporation received in a section 361 exchange, in a section 355 distribution or a distribution to which

section 361 applies (section 361 distribution), shall, notwithstanding any other provision of the Code, include in income as a dividend the "section 1248(f) amount" attributable to the stock distributed. The section 1248(f) amount equals the aggregate amount that would be included in income as a dividend by the foreign distributed corporation under section 964(e) if, immediately after the section 361 exchange that preceded the section 355 distribution or section 361 distribution, the foreign distributed corporation sold the stock of each foreign corporation received in the section 361 exchange. This rule supplements the proposed regulations under section 367(b) which provide an exception to the general rule of § 1.367(b)-4(b)(1)(i) in certain cases where stock of a foreign acquired corporation is transferred by a U.S. transferor in a section 361 exchange.

3. Exceptions to the General Rules

The proposed regulations incorporate the statutory exception provided by section 1248(f)(2) for distributions that meet certain conditions. The proposed regulations also provide elective exceptions for section 355 distributions and section 361 distributions. The exceptions for such distributions are elective because applying the exceptions may reduce a corporate distributee's section 358 basis in the stock received in the distribution. The conditions of the exceptions carry out the policy of section 1248(f) by limiting the exceptions to distributions where the potential application of section 1248 and the relevant section 1248 amounts can be preserved following the distribution.

(a) Section 337 Distributions

The general rule will not apply to a section 337 distribution of the stock of a foreign corporation if immediately after the distribution the 80-percent distributee (described in section 337(c)) is a section 1248 shareholder with respect to the foreign corporation, the 80-percent distributee's holding period in the stock received in the distribution is the same as the domestic distributing corporation's holding period in such stock at the time of the distribution, and the 80-percent distributee's basis in the stock received in the distribution is not greater than the domestic distributing corporation's basis in such stock at the time of the distribution.

The IRS and Treasury Department believe the conditions should be satisfied in most section 337 distributions because of the application of sections 334 and 1223. However, comments are requested regarding any

cases where these conditions may not be met and whether the 80-percent distributee should be permitted to adjust the basis or holding period of the stock received so that the conditions can be met.

(b) Certain Section 355 Distributions

The proposed regulations provide an elective exception to the general rule for a section 355 distribution of stock of a foreign corporation not received by the domestic distributing corporation in a section 361 exchange to a domestic corporation that is a section 1248 shareholder with respect to the foreign corporation immediately after the distribution. The election to apply the exception is irrevocable and must be made by the domestic distributing corporation and all such section 1248 shareholders. If the election is made, adjustments may be made to each section 1248 shareholder's section 358 basis and holding period in the stock received to preserve the section 1248 amount attributable to such stock at the time of the distribution.

To apply the exception, the proposed regulations require the domestic distributing corporation and the section 1248 shareholders to enter into a written agreement on or before the due date (including extensions) of the domestic distributing corporation's tax return for the taxable year during which the section 355 distribution occurs. The proposed regulations also require the domestic distributing corporation and each section 1248 shareholder to include a statement with its tax return for the taxable year during which the distribution occurs reporting that the election to apply the exception has been made and any required adjustments to stock basis or holding period. Each party to the agreement must retain the original or a copy of the agreement as part of its records. The proposed regulations provide relief for reasonable cause for the failure to comply with the election and reporting requirement.

If the exception applies, two adjustments may be required with respect to each section 1248 shareholder. First, solely for purposes of section 1248, immediately following the distribution the section 1248 shareholder's holding period in the stock received in the distribution shall equal the domestic distributing corporation's holding period in such stock at the time of the distribution. Second, if the section 1248 amount attributable to the stock of the foreign corporation at the time of the distribution exceeds the section 1248 shareholder's postdistribution amount attributable to such stock (excess

amount), the section 1248 shareholder's section 358 basis in such stock is reduced by the excess amount. The postdistribution amount is the section 1248 shareholder's section 1248 amount attributable to the stock received in the distribution, computed immediately after the distribution and taking into account the adjustment to the shareholder's holding period in such stock.

(c) Distributions Pursuant to a Plan of Reorganization

The proposed regulations provide an elective exception to the general rule for a section 355 distribution or section 361 distribution of stock of a foreign corporation received by the domestic distributing corporation in the section 361 exchange that precedes such distribution to a domestic corporation that is a section 1248 shareholder with respect to the foreign corporation immediately after the distribution. The election to apply the exception is irrevocable and must be made by the domestic distributing corporation and all such section 1248 shareholders. If the exception applies, adjustments may be made to each section 1248 shareholder's section 358 basis (as adjusted under the proposed regulations under section 367(a)(5)) and the amount of earnings and profits attributable to the stock received for purposes of section 1248 to preserve the section 1248(f) amount attributable to such stock at the time of the distribution.

To apply the exception, the proposed regulations require the domestic distributing corporation and the section 1248 shareholders to enter into a written agreement on or before the due date (including extensions) of the domestic distributing corporation's tax return for the taxable year during which the distribution occurs. The proposed regulations also require the domestic distributing corporation and each section 1248 shareholder to include a statement with its tax return for the taxable year during which the distribution occurs reporting that the election to apply the exception has been made and any required adjustments to stock basis or the amount of earnings and profits attributable to the stock received for purposes of section 1248. Each party to the agreement must include the original or a copy of the agreement as part of its records. The proposed regulations provide relief for reasonable cause for the failure to comply with the election and reporting requirements.

If the exception applies, two adjustments may be required with respect to each section 1248

shareholder. First, each share of stock of the foreign corporation received by the section 1248 shareholder is divided into portions attributable to each block of stock of a foreign acquired corporation transferred by the domestic distributing corporation in the section 361 exchange with respect to which the domestic distributing corporation was a section 1248 shareholder at the time of the section 361 exchange, and to all other property transferred by the domestic distributing corporation in the section 361 exchange. For example, if in the section 361 exchange the domestic distributing corporation transfers a block of stock in each of three foreign corporations with respect to which it is a section 1248 shareholder, then each share of stock of the foreign distributed corporation received by the section 1248 shareholder must be divided into three portions. Alternatively, if multiple blocks of stock in each of the three foreign corporations were transferred in the section 361 exchange, then each share of the stock of the foreign distributed corporation would be divided into additional portions to account for the additional blocks of stock transferred. The proposed regulations further provide that, for purposes of section 1248, the earnings and profits attributable to each block of stock of a foreign acquired corporation transferred in the section 361 exchange that results in a divided portion of a share of stock of the foreign acquiring corporation (or whole share, if no division is required) are attributable to such portion (or whole share, if no division is required) based on the section 1248 shareholder's ownership interest (by value) in the domestic distributing corporation at the time of the section 361 exchange.

Second, if the section 1248(f) amount attributable to a portion of a share (or whole share, if no division is required) of stock of the foreign distributed corporation received in the distribution exceeds the section 1248 shareholder's postdistribution amount attributable to such portion (or whole share) (excess amount), then the section 1248 shareholder's section 358 basis in such portion (or whole share, if no division is required), as adjusted under the proposed regulations under section 367(a)(5) (discussed in part A.2.b.iii of this preamble), is reduced by such excess amount. This adjustment ensures that the section 1248 shareholder's share of the section 1248 amount attributable to the stock of each foreign acquired corporation transferred in the section 361 exchange is preserved in the stock of the foreign distributed

corporation received by such shareholder in the distribution.

The IRS and Treasury Department declined to adopt rules that would not require the division of shares to preserve section 1248 amounts because such rules could inappropriately increase or decrease the section 1248 amount attributable to the stock of the foreign distributed corporation received by a section 1248 shareholder in the distribution. For example, if in the section 361 exchange the domestic distributing corporation transferred appreciated tangible property and stock of a CFC with earnings and profits for purposes of section 1248(a) in excess of the built-in gain in such stock, then the appreciation in the tangible property could inappropriately increase the section 1248 amount attributable to the stock of the foreign distributed corporation received by a section 1248 shareholder in the distribution (to the extent the CFC's earnings and profits exceed the section 1248 amount attributable to the CFC stock at the time of the section 361 exchange). A similar inappropriate increase would result if the domestic distributing corporation transferred appreciated stock of two CFCs in the section 361 exchange, one CFC without a section 1248 amount and the other CFC with a section 1248 amount but with earnings and profits for purposes of section 1248 in excess of such section 1248 amount.

The IRS and Treasury Department also declined to adopt rules that would preserve any reduction to a section 1248 shareholder's section 358 basis in a portion of a share (or whole share, if no division is required) of stock of the foreign distributed corporation received in the distribution by increasing the basis of other portions of the share (or other whole shares, if no division is required) of stock or by establishing a suspended basis account equal to the basis reduction. Those rules were not adopted because a capital loss would be created that could economically offset the section 1248 amount, which would not be consistent with the policy underlying section 1248(f) and the regulations described in Notice 87-64. S. Rep. No. 94-938, at 270 (1976).

Comments are requested on how the rules of the proposed regulations can be simplified and how the rules should apply to different classes of stock.

4. Section 964(e) and Inclusions Under Section 367(b)

Comments are requested regarding whether the IRS and Treasury Department should exercise the authority under section 367(b) to apply the principles of section 1248(f)(1) to

section 355 distributions or section 361 distributions of stock of a foreign corporation by a CFC, to the extent the transaction does not otherwise result in an income inclusion to the exchanging shareholders of the CFC under section 367(b) and the regulations under that section. Comments should consider the appropriate balance between the policy of sections 1248(a) and 964(e) and the associated complexity and compliance burdens.

D. Changes to Exception to Coordination Rule of § 1.367(a)-3(d)(2)(vi)(A)

1. Overview

Section 1.367(a)-3(d)(2)(vi)(A) (the coordination rule) provides that if, in connection with an indirect stock transfer, a U.S. person transfers assets to a foreign corporation (direct asset transfer) in an exchange described in section 351 or section 361, the rules of section 367 and the regulations under that section shall first apply to the direct asset transfer and then to the indirect stock transfer. However, an exception to the coordination rule (coordination rule exception) provides that section 367(a) and (d) shall not apply to a direct asset transfer otherwise subject to the coordination rule to the extent that assets transferred by a domestic acquired corporation to a foreign acquiring corporation in an asset reorganization are re-transferred to a domestic corporation controlled by the foreign acquiring corporation (domestic controlled corporation), but only if the domestic controlled corporation's basis in the retransferred assets is not greater than the domestic acquired corporation's basis in such assets and other conditions are satisfied. See § 1.367(a)-3(d)(2)(vi)(B)(1).

The 2006 final regulations established the conditions for the application of the coordination rule exception. The preamble to the notice of proposed rulemaking that preceded the 2006 final regulations explained that the conditions were adopted to limit the use of asset reorganizations subject to the coordination rule that might facilitate inversion transactions and certain divisive transactions. See REG-125628-01 (issued January 5, 2005).

2. Clarification of Conditions for Application of the Coordination Rule Exception

In response to transactions intended to use the coordination rule exception inappropriately to repatriate earnings and profits of foreign corporations without the recognition of gain or a dividend inclusion, the IRS and

Treasury Department issued Notice 2008-10 (2008-3 IRB 277). The notice announced that the conditions for the application of the coordination rule exception would be revised to clarify that any adjustment to basis required under section 367(a)(5) must be made to the basis of stock of the foreign acquiring corporation received by the control group members in the asset reorganization such that the appropriate amount of built-in gain in the property transferred by the domestic acquired corporation to the foreign acquiring corporation is reflected in such stock. The notice clarifies that the control group members cannot satisfy the basis adjustment requirement by adjusting the basis of stock of the foreign acquiring corporation held before the reorganization. The notice further states that the revised regulations would confirm that to the extent the appropriate amount of built-in gain in the property transferred by the domestic acquired corporation cannot be preserved in the stock received by the control group members in the reorganization, then the domestic acquired corporation's transfer of property to the foreign acquiring corporation shall be subject to section 367(a) and (d).

The proposed regulations included in this document incorporate, with modifications, the clarifications to the conditions for the application of the coordination rule exception announced in the notice. The proposed regulations also provide that to the extent any of the re-transferred assets constitutes section 367(d) property, the coordination rule exception shall apply only if the section 367(d) property is treated as section 367(a) property for purposes of satisfying the conditions and requirements of section 367(a)(5) and the regulations under that section. Thus, for example, any gain that the U.S. transferor must recognize on the direct asset transfer or any adjustment required to a control group member's section 358 basis in stock received in the transaction must take into account any inside gain attributable to section 367(d) property (treated as section 367(a) property for purposes of determining such inside gain) that is part of the re-transferred assets.

The IRS and Treasury Department continue to study transactions that have the effect of repatriating earnings and profits of foreign corporations without the recognition of gain or a dividend inclusion. Temporary regulations were recently issued (TD 9400 and TD 9402) under sections 367(b) and 956(e) to address the inappropriate use of certain cross-border triangular reorganizations

and other nonrecognition transactions to repatriate earnings and profits of a foreign corporation without the recognition of gain or a dividend inclusion. The IRS and Treasury Department are evaluating other transactions that have a similar effect to determine whether guidance is appropriate. In particular, the IRS and Treasury Department are analyzing whether it is appropriate for the gain limitation rule of section 356(a)(1) to apply in an acquisitive asset reorganization involving a foreign acquiring corporation, considering that a policy of section 367(b) is "to protect against tax avoidance in transfers to foreign corporations and upon the repatriation of previously untaxed foreign earnings." H.R. Rep. No. 94-658 (1975). Comments are requested in this regard, including whether the application of any such guidance should be limited to cases where section 356(a)(2) would otherwise apply to the shareholder's receipt of non-qualifying property.

The IRS and Treasury Department also continue to study whether appropriate modifications should be made to the "all earnings and profits" inclusion requirement of § 1.367(b)-3(b) when a domestic corporation acquires the assets of a foreign corporation pursuant to an acquisitive asset reorganization under section 368(a)(1) and then transfers all or part of the acquired assets to another foreign corporation in a transaction described in § 1.368-2(k). Comments are requested in this regard, including regarding the appropriate adjustment to the domestic corporation's basis in the stock of the foreign corporation to which the acquired assets are transferred to ensure that the basis of such stock reflects an after-tax amount.

E. Other Proposed Regulations Under Section 367(a)

The proposed regulations under section 367(a) would revise current § 1.367(a)-1T(b)(4)(i)(B) to provide that an increase to basis for the amount of gain recognized by a U.S. person under section 367(a) in connection with a transfer of property to a foreign corporation is allocated among the transferred property with respect to which gain is recognized in proportion to the gain realized by the U.S. person on the transfer of such property. The IRS and Treasury Department believe the current temporary regulation may produce inappropriate results because it allocates the basis increase among the transferred property with respect to which gain is recognized in proportion

to the amount realized by the U.S. person on the transfer of such property.

The proposed regulations also clarify that a transfer of property by a U.S. person to a foreign corporation that is subject to section 367(a) is not recharacterized for U.S. Federal tax purposes merely because the U.S. person is required to recognize gain in connection with such transfer under section 367(a). For example, if a U.S. person transfers appreciated stock of a CFC to another CFC in a section 351 exchange, the section 351 exchange is not recharacterized as other than a section 351 exchange for U.S. Federal tax purposes merely because the U.S. person recognizes gain in connection with the exchange under section 367(a).

F. Other Proposed Regulations Under Section 1248

The proposed regulations under section 1248(a) remove as deadwood an exception from the application of section 1248(a) for gain recognized under section 356. In addition, consistent with Notice 87-64, the proposed regulations under section 1248(e) suspend the application of section 1248(e) for periods when capital gains are taxed at a rate that equals or exceeds the rate of tax on ordinary income.

G. Effective/Applicability Dates

1. Sections 367(a)(5) and 6038B

Section 1.367(a)-7 and the revisions to § 1.6038B-1 apply to transfers occurring on or after the date that is 30 days after the date these regulations are published as final regulations in the **Federal Register**.

2. Section 1248(e)

In accordance with Notice 87-64 (1987-2 CB 375), § 1.1248-6(d) (suspending application of section 1248(e)) applies to sales, exchanges, or other dispositions of stock of a domestic corporation occurring on or after September 21, 1987.

3. Changes to Coordination Rule Exception

The revisions to § 1.367(a)-3(d)(2)(vi)(B)(1) and (2) described in Notice 2008-10 (2008-3 IRB 277) generally apply to transactions occurring on or after December 28, 2007. The requirement to treat section 367(d) property as section 367(a) property for purposes of the coordination rule exception (as discussed in part D.2 of this preamble) applies to transactions occurring on or after August 19, 2008.

4. Sections 1248(f) and 367(b)

Section 1.1248-8(b)(2)(iv), §§ 1.1248(f)-1 through 1.1248(f)-3, and the modifications to § 1.367(b)-4 apply to transfers or distributions occurring on or after the date that is 30 days after the date these regulations are published as final regulations in the **Federal Register**.

H. Adjustments Under Section 367(a)(5) Before Final Regulations Are Published

The general rule of section 367(a)(5) is that the exceptions to section 367(a)(1) provided by section 367(a)(2) and (a)(3) are not available for a transfer of property by a domestic corporation to a foreign corporation in a section 361 exchange, including a section 351 exchange that also qualifies as a section 361 exchange. However, until the date that is 30 days after the date these regulations are published as final regulations, taxpayers may make reasonable adjustments, as described in the legislative history to section 367(a)(5), that are consistent with the policy of section 367(a)(5) so that the exceptions provided by section 367(a)(2) and (a)(3) may apply to the transfer of property by a U.S. transferor to a foreign corporation in a section 361 exchange.

Reasonable adjustments must include adjusting the basis of the stock received by the control group members in the transaction that is attributable to section 367(a) property so that each control group member's basis of such stock equals the lesser of (1) the control group member's section 358 basis in the stock or (2) the control group member's proportionate share of the basis of the section 367(a) property transferred by the U.S. transferor in the section 361 exchange. Adjusting the basis of stock of the foreign acquiring corporation held by a control group member before the section 361 exchange shall not be a reasonable adjustment.

In addition, the U.S. transferor must recognize gain to the extent it has shareholders that are not control group members and to the extent any built-in gain in the section 367(a) property transferred in the section 361 exchange cannot be preserved in the hands of the control group members through their ownership of stock received in the transaction in exchange for the stock or securities of the U.S. transferor. For example, the U.S. transferor may recognize gain if the control group members receive non-qualifying property in the transaction, if the foreign acquiring corporation assumes liabilities of the U.S. transferor in the section 361 exchange, or if the U.S. transferor distributes the stock received in the section 361 exchange

disproportionately to its shareholders. For this purpose, the stock or other property received by the U.S. transferor in the section 361 exchange must be allocated between the section 367(a) property and all other property transferred in the section 361 exchange consistent with general tax principles, including the principles of Rev. Rul. 68-55, 1968-1 CB 140, and the authorities cited therein.

Adjustments made in accordance with the proposed regulations under section 367(a)(5) included in this document shall be considered reasonable and in accordance with the policy of section 367(a)(5).

Availability of IRS Documents

IRS notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Effect on Other Documents

The following publications are proposed to be obsolete as of the date 30 days after the date these regulations are published as final regulations in the **Federal Register**:

- Notice 87-64 (1987-2 CB 375).
- Notice 2008-10 (2008-3 IRB 277).

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) apply to these regulations.

It is hereby certified that the collection of information contained in this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. This regulation primarily will affect large domestic corporations engaged in cross-border corporate transactions. Thus, the number of affected small entities will not be substantial. A certain number of small domestic corporations may be shareholders of a larger domestic corporation the stock or assets of which are acquired by a foreign corporation in connection with an asset reorganization, and such shareholders may be required to make certain adjustments in the stock of the foreign acquiring corporation. Nonetheless, the IRS and Treasury Department do not anticipate the number of such shareholders to be substantial. Furthermore, the IRS and Treasury Department estimate that any small entities that are affected by the

regulations will likely face a burden of approximately ten hours (at an hourly rate of \$200) from the adjustments made to the basis of the stock received in the reorganization. Considering that the collections of information enable taxpayers to defer or avoid the recognition of potentially large amounts of gain, the IRS and Treasury Department believe that \$2000 is not a significant economic impact. Comments about the accuracy of this certification may be submitted to the addresses provided in the preamble. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Administrator of the Small Business Administration for comment on their impact on small business.

Comments and Request for a Public Hearing

Before these regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Daniel McCall of the Office of Associate Chief Counsel (International), within the Office of Chief Counsel, Internal Revenue Service. Other personnel from offices of the IRS and Treasury Department participated in developing the regulations.

List of Subjects in 26 CFR Part 1

Income taxes, Corporations, Corporate distributions, Corporate adjustments, Reorganizations.

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 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.367(a)-3(d)(2)(vi)(B)(1)(i) also issued under 26 U.S.C. 367(d).

Section 1.367(a)-7 also issued under 26 U.S.C. 367(a), (b), (c), and 337(d).

Section 1.1248-6 also issued under 26 U.S.C. 1248(e).

Section 1.1248-8(b)(2)(iv) also issued under 26 U.S.C. 1248(a), (c), and (f).

Section 1.1248(f)-1 also issued under 26 U.S.C. 367(b) and 1248(f).

Section 1.1248(f)-2 also issued under 26 U.S.C. 367(b) and 1248(f).

Section 1.1248(f)-3 also issued under 26 U.S.C. 367(b) and 1248(f). * * *

Par. 2. Section 1.358-6 is amended by adding a new sentence at the end of paragraph (e) to read as follows:

§ 1.358-6 Stock basis in certain triangular reorganizations.

* * * * *

(e) * * * For rules relating to certain triangular reorganizations involving transfers to which the exception provided in § 1.367(a)-7(c) applies, see § 1.367(b)-4(b)(1)(ii)(B).

* * * * *

Par. 3. Section 1.367(a)-1T is amended by:

- 1. Revising the second sentence of paragraph (b)(4)(i)(B).
- 2. Adding new paragraphs (b)(4)(i)(C) and (g)(4).

The revision and additions to read as follows:

§ 1.367(a)-1T Transfers to foreign corporations subject to section 367(a): In general (temporary).

* * * * *

(b) * * *

(4) * * *

(i) * * *

(B) * * * Any increase in the basis of the property received by the foreign corporation under section 362(a) or (b) for gain recognized by a U.S. person due to the application of section 367(a) shall be allocated to the transferred property with respect to which gain is recognized in proportion to the gain realized by the U.S. person on the transfer of such property. * * *

(C) A transfer of property by a U.S. person to a foreign corporation shall not be recharacterized for U.S. Federal tax purposes solely because the U.S. person recognizes gain in connection with the transfer under section 367(a)(1). For example, if a U.S. person transfers appreciated stock or securities to a foreign corporation in an exchange described in section 351, the transfer is not recharacterized as other than an exchange described in section 351 solely because the U.S. person recognizes gain in connection with the transfer under section 367(a)(1).

* * * * *

(g) * * *

(4) The rules in paragraphs (b)(4)(i)(B) and (C) of this section apply to transfers occurring on or after the date 30 days after the date these regulations are published as final regulations in the **Federal Register**. For guidance with respect to paragraph (b)(4)(i)(B) of this section before the date 30 days after the date these regulations are published as final regulations in the **Federal Register**, see 26 CFR part 1 revised as of April 1 for the year before the date these regulations are published as final regulations in the **Federal Register**.

Par. 4. Section 1.367(a)-3 is amended by:

1. Revising the third to the last sentence of paragraph (a).
 2. Revising paragraphs (b)(1) and (c)(1).
 3. Revising paragraphs (d)(2)(vi)(B)(1) and (d)(2)(vi)(B)(1)(i).
 4. Adding two new sentences at the end of paragraph (d)(2)(vi)(B)(2).
 5. Revising the first and fourth sentences of paragraph (d)(3), *Example 6A* (ii).
 6. Revising the second and fifth sentences of paragraph (d)(3), *Example 6B* (ii), and add two new sentences after the fifth sentence.
 7. Revising the second and fourth sentences of paragraph (d)(3), *Example 6C* (ii).
 8. Adding a new sentence between the second and third sentences of paragraph (d)(3), *Example 8* (ii).
 9. Revising the first sentence of paragraph (d)(3), *Example 8B* (ii).
 10. Revising the first sentence of paragraph (d)(3), *Example 8C* (ii).
 11. Revising the second sentence of paragraph (d)(3), *Example 9* (ii), and removing the third sentence.
 12. Revising the third sentence of paragraph (d)(3), *Example 10* (ii).
 13. Revising the second to last sentence of paragraph (d)(3), *Example 11* (ii), and adding a new sentence after the second to last sentence.
 14. Revising the second sentence of paragraph (d)(3), *Example 12* (ii), and removing the last sentence.
 15. The heading for paragraph (g) is revised.
 16. Paragraph (g)(1)(E) is revised.
- The revisions and additions to read as follows:

§ 1.367(a)-3 Treatment of transfers of stock or securities to foreign corporations.

(a) * * * For additional rules regarding a transfer of stock or securities in an exchange described in section 361(a) or (b), see section 367(a)(5) and § 1.367(a)-7. * * *

(b) *Transfers by U.S. persons of stock or securities of foreign corporations to*

foreign corporations—(1) *General rule.* Except as provided in § 1.367(a)-7, a transfer of stock or securities of a foreign corporation by a U.S. person to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section shall not be subject to section 367(a)(1) if either—

* * * * *

(c) *Transfers by U.S. persons of stock or securities of domestic corporations to foreign corporations*—(1) *In general.* Except as provided in § 1.367(a)-7, a transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section shall not be subject to section 367(a)(1) if the domestic corporation the stock or securities of which are transferred (referred to as the U.S. target company) complies with the reporting requirements in paragraph (c)(6) of this section and if each of the following four conditions is met:

* * * * *

(d) * * *

(2) * * *

(vi) * * *

(B) *Exceptions.* (1) If a transaction is described in paragraph (d)(2)(vi)(A) of this section, section 367(a) and (d) shall not apply to the extent a domestic corporation (domestic acquired corporation) transfers assets to a foreign corporation (foreign acquiring corporation) in an asset reorganization, and such assets (re-transferred assets) are transferred to a domestic corporation (domestic controlled corporation) in a controlled asset transfer, provided that the domestic controlled corporation's basis in the re-transferred assets is not greater than the domestic acquired corporation's basis in such assets and the conditions contained in paragraphs (d)(2)(vi)(B)(1)(i) or (d)(2)(vi)(B)(1)(ii) of this section are satisfied. For purposes of determining whether the domestic controlled corporation's basis in the re-transferred assets is not greater than the domestic acquired corporation's basis in such assets, the domestic acquired corporation's basis in the re-transferred assets shall reflect any increase in basis due to gain recognized by the domestic acquired corporation on the transfer of the re-transferred assets to the foreign acquiring corporation.

(i) The conditions and requirements of section 367(a)(5) and § 1.367(a)-7(c) are satisfied with respect to the domestic acquired corporation's transfer of assets to the foreign acquiring corporation. To the extent any of the re-transferred assets constitutes property to which section 367(d) applies (section

367(d) property), however, the exception under paragraph (d)(2)(iv)(B)(1) shall apply only if such property is treated as property subject to section 367(a) for purposes of satisfying the conditions and requirements of section 367(a)(5) and § 1.367(a)-7(c). The preceding sentences shall apply before the application of the exception under paragraph (d)(2)(vi)(B)(1) of this section. See paragraph (g)(1)(E)(3) of this section for rules under this paragraph (d)(2)(vi)(B)(1)(i) that apply to transactions that occur on or after December 28, 2007, and before the date 30 days after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

(2) * * * This paragraph (d)(2)(vi)(B)(2) shall not, however, apply to an exchange described in section 351 that is also an exchange described in section 361(a) or (b). An exchange described in section 351 that is also an exchange described in section 361(a) or (b) is only eligible for the exception in paragraph (d)(2)(vi)(B)(1) of this section.

* * * * *

(3) * * *

Example 6A. * * *

(ii) * * * The transfer of the Business A assets by Z to F does not constitute an indirect stock transfer under paragraph (d) of this section, and, subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)-7(c), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a)(1). * * *

* * * Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)-7(c), the Business B assets qualify for the active trade or business exception under section 367(a)(3). * * *

Example 6B. * * *

(ii) * * * However, subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)-7(c), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a)(1). * * *

* * * However, pursuant to paragraph (d)(2)(vi)(B)(1) of this section and subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)-7(c), the Business B and C assets are not subject to section 367(a) or (d), provided that the basis of the Business B and C assets in the hands of R is no greater than the basis of the assets in the hands of Z. If all or a portion of the Business B and C assets constituted section 367(d) property, as defined in § 1.367(a)-7(f)(10), then

paragraph (d)(2)(vi)(B)(1) of this section would apply to Z's transfer of such property only if such property is treated as property subject to section 367(a) for purposes of satisfying the conditions and requirements of section 367(a)(5) and § 1.367(a)–7(c). Treating such section 367(d) property as property subject to section 367(a) for this purpose could further reduce V's basis in the F stock received in the reorganization, or result in the recognition of additional gain by Z, under section 367(a)(5) and § 1.367(a)–7(c). * * *

Example 6C. * * *

(ii) * * * However, gain must be recognized on the transfer of such assets under section 367(a)(1) because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5) and § 1.367(a)–7(b). * * *

* * * The transfer of the Business B assets (which otherwise would satisfy the section 367(a)(3) active trade or business exception) generally is subject to section 367(a)(1) pursuant to section 367(a)(5) and § 1.367(a)–7(b). * * *

Example 8. * * *

(ii) * * * Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)–7(c), the Business B assets qualify for the active trade or business exception under section 367(a)(3). * * *

Example 8B. * * *

(ii) * * * Under section 367(a)(5) and § 1.367(a)–7(b), the active trade or business exception under section 367(a)(3) does not apply to Z's transfer of assets to R. * * *

Example 8C. * * *

(ii) * * * Under section 367(a)(5) and § 1.367(a)–7(b), the active trade or business exception under section 367(a)(3) does not apply to Z's transfer of assets to R. * * *

Example 9. * * *

(ii) * * * Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)–7(c), Z's transfer of the Business B assets to R (which are not retransferred to M) qualifies for the active trade or business exception under section 367(a)(3). * * *

Example 10. * * *

(ii) * * * Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)–7(c), the Business B assets qualify for the active trade or business exception under section 367(a)(3). * * *

Example 11. * * *

(ii) * * * Because D is owned by F, a foreign corporation, the control requirement of section 367(a)(5) and § 1.367(a)–7(c)(1) cannot be satisfied.

Therefore, section 367(a)(5) and § 1.367(a)–7(b) preclude the application of the active trade or business exception under section 367(a)(3) from applying to any assets transferred by D to Z. * * *

Example 12. * * *

(ii) * * * Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)–7(c), the active trade or business exception under section 367(a)(3) applies to E's transfer of Business X assets. * * *

* * * * *

(g) *Effective/applicability dates.*

(1) * * *

(E)(1) Except as provided in paragraphs (g)(1)(E)(2) through (g)(1)(E)(4) of this section, the rules of paragraph (d)(2)(vi) of this section apply only to transactions occurring on or after January 23, 2006. See § 1.367(a)–3(d)(2)(vi), as contained in 26 CFR part 1 revised as of April 1, 2005, for transactions occurring on or after July 20, 1998 and before January 23, 2006.

(2) Except to the extent provided in paragraph (g)(1)(E)(3) of this section, paragraph (d)(2)(vi)(B)(1)(i) of this section applies to transactions occurring on or after the date 30 days after the date these regulations are published as final regulations in the **Federal Register**.

(3)(i) For purposes of paragraph (d)(2)(vi)(B)(1) of this section, except as provided in paragraph (g)(1)(E)(3)(iii) of this section, the conditions of paragraph (d)(2)(vi)(B)(1)(i) of this section shall be satisfied for transactions occurring on or after December 28, 2007, and before the date 30 days after the date these regulations are published as final regulations in the **Federal Register**, provided the conditions in paragraph (g)(1)(E)(3)(ii) are satisfied.

(ii) The domestic acquired corporation is controlled (within the meaning of section 368(c)) by five or fewer (but at least one) domestic corporations (controlling domestic corporations) at the time of the section 361 exchange, appropriate basis adjustments under section 367(a)(5) are made to the stock received (or deemed received) by the controlling domestic corporations in the reorganization, and any other conditions as provided in regulations under section 367(a)(5) are satisfied. For purposes of determining whether the domestic acquired corporation is controlled by five or fewer domestic corporations, all members of the same affiliated group within the meaning of section 1504 shall be treated as one corporation. Any adjustments to stock basis required under section 367(a)(5) must be made to the stock received (or deemed received) by the controlling domestic corporations in the reorganization such that the

appropriate amount of built-in gain in the property transferred by the domestic acquired corporation to the foreign acquiring corporation in the section 361 exchange is reflected in such stock. The basis adjustment requirement cannot be satisfied by adjusting the basis in stock of the foreign acquiring corporation held by the controlling domestic corporations before the reorganization. To the extent the appropriate amount of built-in gain in the property transferred by the domestic acquired corporation to the foreign acquiring corporation in the section 361 exchange cannot be preserved in the stock received (or deemed received) by the controlling domestic corporations in the reorganization, the domestic acquired corporation's transfer of property to the foreign acquiring corporation shall be subject to sections 367(a) and (d).

(iii) The second sentence of paragraph (d)(2)(vi)(B)(1)(i) shall apply to transactions occurring on or after August 19, 2008 and before the date 30 days after the date these regulations are published as final regulations in the **Federal Register**.

(4) The last two sentences of paragraph (d)(2)(vi)(B)(2) shall apply to transactions occurring on or after December 28, 2007.

* * * * *

Par. 5. Section 1.367(a)–7 is added to read as follows:

§ 1.367(a)–7 Rules under section 367(a)(5) applicable to exchanges described in section 361(a) or (b).

(a) *Scope and purpose.* This section provides rules under section 367(a)(5) that apply to a transfer of certain property, including stock and securities, by a domestic corporation (U.S. transferor) to a foreign corporation (foreign acquiring corporation) in an exchange described in section 361(a) or (b), or in an exchange described in section 351 that is also described in section 361(a) or (b) (collectively, a section 361 exchange). The purpose of this section is to ensure that the net gain realized by the U.S. transferor in connection with the transfer of certain property to the foreign acquiring corporation in the section 361 exchange is, in the aggregate, recognized currently by the U.S. transferor or, to the extent permitted under the rules of this section, preserved in the stock received (or deemed received) in the reorganization by certain domestic corporate shareholders of the U.S. transferor in exchange for stock or securities of the U.S. transferor. This section applies only to the transfer of section 367(a) property in the section 361 exchange. See section 367(d) and

the regulations under that section for rules applicable to transfers of section 367(d) property.

(b) *General rule.* Except as provided in paragraph (c) of this section, the exceptions to section 367(a)(1) provided in section 367(a) and the regulations under that section shall not apply to a transfer of section 367(a) property by a U.S. transferor to a foreign acquiring corporation in a section 361 exchange.

(c) *Exception.* Except to the extent provided in paragraph (d) of this section, paragraph (b) of this section shall not apply to the transfer of section 367(a) property in a section 361 exchange if the conditions of paragraphs (c)(1) through (c)(4) of this section are satisfied and an election to apply the exception provided by this paragraph (c) is made in the manner provided by paragraph (c)(5) of this section. If paragraph (b) of this section does not apply to a section 361 exchange, see, for example, §§ 1.367(a)-2T, 1.367(a)-3, 1.367(a)-4T, or 1.367(a)-5T, as applicable, for additional requirements that must be satisfied to avoid the application of section 367(a)(1) to the transfer of section 367(a) property in the section 361 exchange. Nothing in this section shall permit the nonrecognition of gain not otherwise permitted under another provision of the Internal Revenue Code or the regulations under that section. See, for example, section 367(a)(3)(B) and § 1.367(a)-5T.

(1) *Control.* At the time of the section 361 exchange, the U.S. transferor is controlled (within the meaning of section 368(c)) by five or fewer, but at least one, control group members.

(2) *Gain recognition*—(i) *Gain recognition due to non-control group members.* The U.S. transferor recognizes gain equal to the product of the inside gain and the aggregate ownership interest (by value) in the U.S. transferor by all shareholders of the U.S. transferor at the time of the section 361 exchange that are not control group members.

(ii) *Gain recognition where control group member is unable to preserve gain.* With respect to each control group member, the U.S. transferor recognizes gain equal to the amount, if any, by which—

(A) The product of the inside gain and the control group member's ownership interest (by value) in the U.S. transferor at the time of the section 361 exchange; exceeds

(B) The product of the section 367(a) percentage and the fair market value of the stock received (or deemed received) by the control group member in exchange for stock or securities of the U.S. transferor under section 354, 355, or 356. For an illustration of gain

recognition under this paragraph, see paragraph (g) of this section, *Example 2.*

(3) *Basis adjustments*—(i) *General rule.* Except as provided in paragraphs (c)(3)(ii)(A) and (C) of this section, each control group member's aggregate basis in the stock received (or deemed received) in exchange for stock or securities of the U.S. transferor under section 354, 355, or 356, as determined under section 358 and the regulations under that section (section 358 basis), is reduced by the amount, if any, by which—

(A) The product of the inside gain and the control group member's ownership interest (by value) in the U.S. transferor at the time of the section 361 exchange, reduced by any gain recognized by the U.S. transferor with respect to such control group member under paragraph (c)(2)(ii) of this section; exceeds

(B) The control group member's outside gain.

(ii) *Special rules*—(A) *General applicability.* Paragraph (c)(3)(i) of this section shall apply only to stock that was received by the U.S. transferor in the section 361 exchange and distributed to the control group member.

(B) *Multiple blocks of stock.* If a control group member holds multiple blocks of stock received (or deemed received) in the transaction, the section 358 basis of each block of stock must be reduced pro rata based on the relative section 358 basis of each block of stock.

(C) *Successive distributions to which section 355 applies.* Paragraph (c)(3)(i) of this section shall not apply to a control group member that distributes the stock of a foreign acquiring corporation received from the U.S. transferor in a distribution to which section 355 applies (section 355 distribution), that is in connection with a transaction described in paragraph (d) of this section. If paragraph (c)(3)(i) of this section does not apply to a control group member pursuant to the previous sentence, then paragraph (c)(3)(i) of this section shall apply to the final distributee (as defined in paragraph (d) of this section) that receives the stock of the foreign acquiring corporation in the final section 355 distribution described in paragraph (d) of this section. If the final distributee holds multiple blocks of stock of the foreign acquiring corporation after the final section 355 distribution, the rules of paragraph (c)(3)(ii)(B) of this section shall apply to reduce the section 358 basis of such blocks of stock.

(iii) *Applicable cross-references.* For illustrations of the adjustment to stock basis under paragraph (c)(3)(i) of this section, see paragraph (g) of this section,

Example 1 and *Example 2*, and § 1.1248(f)-2(d), *Example 2.* For an illustration of the adjustment to stock basis under paragraph (c)(3)(ii)(A) of this section, see § 1.1248(f)-2(d), *Example 4.* For an illustration of the adjustment to stock basis under paragraph (c)(3)(ii)(B) of this section, see paragraph (g) of this section, *Example 3.*

(4) *Agreement to amend or file a U.S. income tax return*—(i) *General rule.* Except as provided in paragraph (c)(4)(ii) of this section, the U.S. transferor complies with the requirements of § 1.6038B-1(c)(6)(iii).

(ii) *Exception.* Section 1.6038B-1(c)(6)(iii) shall not apply to the extent any section 367(a) property transferred in the section 361 exchange is transferred in connection with a transaction described in § 1.367(a)-3(e) and a gain recognition agreement is filed pursuant to § 1.367(a)-8 with respect to the transfer of such property.

(5) *Election and reporting requirements*—(i) *General rule.* The U.S. transferor and each control group member elect to apply the provisions of paragraph (c) of this section in the manner provided under paragraph (c)(5)(ii) or (iii) of this section, as applicable, and by entering into a written agreement described in paragraph (c)(5)(iv) of this section. If a control group member distributes the stock of the foreign acquiring corporation received from the U.S. transferor in a section 355 distribution that is in connection with a transaction described in paragraph (d) of this section, the final distributee that receives such stock in the final section 355 distribution elects to apply the provisions of this paragraph (c) and enters into the written agreement instead of the control group member.

(ii) *Election and reporting by control group member or final distributee*—(A) *Time and manner of making election.* Each control group member (or final distributee) elects to apply the provisions of paragraph (c) of this section by including a statement (in the form and with the content specified in paragraph (c)(5)(ii)(B) of this section) on or with its timely-filed return for the taxable year in which the section 361 exchange occurs. If the control group member (or final distributee) is a member of a consolidated group for the taxable year of the section 361 exchange, the common parent of the consolidated group makes the election on behalf of the control group member (or final distributee).

(B) *Form and content of election statement.* The statement shall be entitled, STATEMENT TO ELECT TO

APPLY EXCEPTION UNDER § 1.367(a)–7(c) and must set forth:

(1) The name and taxpayer identification number of the control group member (or final distributee);

(2) The name and taxpayer identification number of the common parent of the consolidated group, if any;

(3) The amount of the adjustment (if any) to stock basis required under paragraph (c)(3)(i) of this section, the resulting adjusted basis in such stock, and the fair market value of such stock; and

(4) The date on which the written agreement described in paragraph (c)(5)(iv) of this section was entered into.

(iii) *Statement by U.S. transferor.* The U.S. transferor elects to apply the provisions of paragraph (c) of this section in the form and manner set forth in § 1.6038B–1(c)(6)(ii).

(iv) *Written agreement.* The U.S. transferor and each control group member (or final distributee) must enter into a written agreement on or before the due date (including extensions) for the U.S. transferor's tax return for the taxable year during which the section 361 exchange occurs. Each party to the agreement must retain the original or a copy of the agreement in the manner specified by § 1.6001–1(e). Each party to the agreement must provide a copy of the agreement to the Internal Revenue Service within 30 days of the receipt of a request for the copy of the agreement in connection with an examination of the taxable year during which the section 361 exchange occurs. The written agreement must—

(A) State the document constitutes an agreement entered into pursuant to paragraph (c)(5) of this section;

(B) Identify the U.S. transferor and each control group member (or final distributee);

(C) State the amount of gain (if any) recognized by the U.S. transferor under paragraph (c)(2) of this section; and

(D) With respect to each control group member (or final distributee), state the amount of the adjustment (if any) to stock basis required under paragraph (c)(3)(i) of this section, the resulting adjusted basis in such stock, and the fair market value of such stock.

(d) *Section 361 exchange followed by successive distributions to which section 355 applies.* If the U.S. transferor distributes stock of the foreign acquiring corporation received in the section 361 exchange to a control group member in a section 355 distribution and, as part of a plan or series of related transactions, such stock is further distributed in one or more successive section 355 distributions, paragraph (c) of this

section shall apply to the section 361 exchange only to the extent each subsequent section 355 distribution is to a member of the affiliated group (within the meaning of section 1504) that includes the U.S. transferor at the time of the section 361 exchange. In such a case, each affiliated group member that receives stock of the foreign acquiring corporation in the final section 355 distribution (final distributee) shall be subject to the requirements of paragraphs (c)(3) and (c)(5) of this section.

(e) *Other rules—(1) Section 367(a) property on which gain is recognized.* Gain recognized by the U.S. transferor pursuant to paragraph (c)(2) of this section shall be treated as recognized with respect to the section 367(a) property transferred in the section 361 exchange in proportion to the amount of gain realized by the U.S. transferor on the transfer of each item of section 367(a) property. This paragraph (e)(1) shall be applied after taking into account any gain recognized by the U.S. transferor on the transfer of the section 367(a) property in the section 361 exchange pursuant to all other provisions under section 367(a) and the regulations under that section. See, for example, section 367(a)(3)(B) and § 1.367(a)–4T. See § 1.367(a)–1T(b)(4) for additional rules on the character, source, and adjustments relating to gain recognized under section 367(a).

(2) *Reasonable cause exception for failure to comply—(i) Request for relief.* If a control group member (or final distributee) fails to comply with any requirement of this section, the control group member (or final distributee) shall be considered to have complied with such requirement if it submits a request for relief as provided under paragraph (e)(2)(ii) of this section and can demonstrate to the Area Director, Field Examination, Small Business/Self Employed or the Director of Field Operations, Large and Mid-Size Business (Director) having jurisdiction of the control group member's (or final distributee's) tax return for the taxable year, that such failure was due to reasonable cause and not willful neglect. Whether the failure to comply was due to reasonable cause and not willful neglect will be determined by the Director after considering all the facts and circumstances. The Director shall notify the control group member (or final distributee) in writing within 120 days if it is determined that the failure to comply was not due to reasonable cause, or if additional time will be needed to make such determination. For this purpose, the 120-day period shall begin on the date

the Internal Revenue Service notifies the control group member (or final distributee) in writing that the request for relief has been received and assigned for review. Once such period commences, if the control group member (or final distributee) is not again notified within 120 days, then the control group member (or final distributee) shall be deemed to have established reasonable cause.

(ii) *Requirements for reasonable cause relief—(A) Time of submission.* Requests for reasonable cause relief under paragraph (e)(2)(i) of this section will be considered only if as soon as the control group member (or final distributee) becomes aware of the failure to comply with any requirement of this section, the control group member (or final distributee) attaches the statements or other documents that should have been filed, as well as a complete written statement setting forth the reasons for the failure to comply, to an amended return that amends the return to which the documents should have been attached pursuant to this section. The amended return and all required attachments must be filed with the applicable Internal Revenue Service Center with which the control group member (or final distributee) filed its original return to which the documents should have been attached.

(B) *Notice requirement.* In addition to the requirement of paragraph (e)(2)(ii)(A) of this section, the control group member (or final distributee) must comply with the requirements of paragraph (e)(2)(ii)(B)(1) or (2) of this section, as applicable.

(1) If the control group member (or final distributee) is under examination for any taxable year when the request for reasonable cause relief is filed, a copy of the amended return and attachments must be provided to the Internal Revenue Service personnel conducting the examination.

(2) If the control group member (or final distributee) is not under examination for any taxable year when the request for reasonable cause relief is filed, a copy of the amended return and attachments must be provided to the Director having jurisdiction over the return.

(iii) *Cross-reference for reasonable cause relief requests by U.S. transferor.* If the U.S. transferor fails to comply with any requirement of this section, the U.S. transferor shall be treated as having complied with such requirement if the U.S. transferor (or the foreign acquiring corporation on behalf of the U.S. transferor) complies with the reasonable cause exception procedures described in § 1.6038B–1(f)(3).

(f) *Definitions.* The following definitions apply for purposes of this section:

(1) *Block of stock* is a group of shares of the same class of stock and that have an identical basis.

(2) *Control group and control group member*—(i) *General rule.* Except as provided in paragraph (f)(2)(ii) of this section, the *control group* is the five or fewer, but at least one, domestic corporations that control (within the meaning of section 368(c)) the U.S. transferor at the time of the section 361 exchange. If the U.S. transferor is controlled by more than five domestic corporations at the time of the section 361 exchange, but some combination of five or fewer domestic corporations control the U.S. transferor at such time, the U.S. transferor shall designate the five domestic corporations that comprise the control group on Form 926, "Return by a U.S. Transferor of Property to a Foreign Corporation." For purposes of this paragraph, members of the same affiliated group (within the meaning of section 1504) shall be treated as one corporation. Except as provided in paragraph (f)(2)(ii) of this section, a *control group member* is a domestic corporation that is part of the control group.

(ii) *Exception for certain entities.* Neither a regulated investment company (as defined in section 851(a)), nor a real estate investment trust (as defined in section 856(a)), nor an S corporation (as defined in section 1361(a)) shall be a control group member.

(3) *Deductible liability* is any liability of the U.S. transferor that is assumed in the section 361 exchange or satisfied in connection with the reorganization (within the meaning of section 361(c)(3)), but only if the payment of such liability would give rise to a deduction.

(4) *Gross fair market value* means fair market value determined without regard to mortgages, liens, pledges, or other liabilities. The fair market value of any property subject to a nonrecourse indebtedness shall not be less than the amount of such indebtedness.

(5) *Inside basis* is the amount equal to the aggregate bases of the section 367(a) property transferred by the U.S. transferor in the section 361 exchange, increased by any gain recognized by the U.S. transferor on the transfer of such property in the section 361 exchange, including gain treated as a dividend under section 1248(a), but not including any gain recognized under paragraph (c)(2) of this section (including any such gain treated as a dividend under section 1248(a)).

(6) *Inside gain* is the amount by which the aggregate gross fair market value of the section 367(a) property transferred in the section 361 exchange exceeds the sum of the inside basis and the product of the section 367(a) percentage and the aggregate deductible liabilities of the U.S. transferor.

(7) *Outside gain* is the product of the section 367(a) percentage and the amount by which—

(i) The aggregate fair market value of the stock received (or deemed received) by a control group member in exchange for stock or securities of the U.S. transferor under section 354, 355, or 356; exceeds

(ii) The control group member's aggregate section 358 basis of such stock (as determined without regard to any adjustment to such basis required under paragraph (c)(3) of this section).

(8) *Section 367(a) percentage* is the ratio of the aggregate gross fair market value of the section 367(a) property transferred by the U.S. transferor in the section 361 exchange to the aggregate gross fair market value of all property transferred by the U.S. transferor in the section 361 exchange.

(9) *Section 367(a) property*—(i) *General rule.* Except as provided in paragraph (f)(9)(ii) of this section, *section 367(a) property* is any property other than section 367(d) property.

(ii) *Special rule.* Any property that would otherwise constitute section 367(a) property under paragraph (f)(9)(i) of this section shall not constitute section 367(a) property for purposes of any determination under this section for which the amount of section 367(a) property transferred in the section 361 exchange is relevant, if such property is acquired by the U.S. transferor in connection with the section 361 exchange with a principal purpose of affecting any such determination, including, for example, the section 367(a) percentage, inside gain, and inside basis.

(10) *Section 367(d) property* is property to which section 367(d) applies.

(11) *Timely-filed return* is a U.S. income tax return filed on or before the due date set forth in section 6072(b), plus any extension of time to file such return granted under section 6081.

(g) *Examples.* The rules of this section are illustrated by the following examples. The analysis of the following examples is limited to a discussion of issues under this section. Unless otherwise indicated, for purposes of the following examples assume: DP1, DP2, and DC are domestic corporations that do not join in the filing of a consolidated return; FP and FA are

foreign corporations that are unrelated to DP1, DP2, and DC; each corporation has a single class of stock outstanding; each shareholder of DC owns one block of stock in DC; DC's Business A constitutes section 367(a) property that could qualify for the exception to section 367(a)(1) under § 1.367(a)–2T; DC has no liabilities, and the requirements in paragraph (c)(5) of this section and § 1.6038B–1(c)(6)(ii) are satisfied.

Example 1. Tainted assets and non-control group ownership. (i) *Facts.* DP1, DP2, and FP own 50%, 30%, and 20%, respectively, of the outstanding stock of DC. DP1's DC stock has a \$80x basis and \$100x fair market value. DP2's DC stock has a \$50x basis and \$60x fair market value. DC owns inventory with a \$40x basis and a \$100x fair market value. DC also owns Business A with a \$10x basis and \$100x fair market value. In a reorganization described in section 368(a)(1)(F), DC transfers the inventory and Business A to FA, a newly formed corporation, in exchange for all of the outstanding stock of FA. DC's transfer of the inventory and Business A to FA qualifies as a section 361 exchange. DP1, DP2, and FP exchange the DC stock for a proportionate amount of FA stock pursuant to section 354.

(ii) *Result.* (A) Under section 367(a)(3)(B), DC must recognize \$60x gain on the transfer of the inventory to FA. Under § 1.367(a)–1T(b)(4)(i)(B), the section 362 basis increase is allocated to the inventory such that FA's basis in the inventory is \$100x. Under section 367(a)(5) and paragraph (b) of this section, DC's transfer of Business A to FA is subject to the general rule of section 367(a)(1). As a result, DC must also generally recognize \$90x gain on the transfer of Business A to FA notwithstanding the application of section 351 or section 361. However, if the conditions and requirements of paragraph (c) of this section are met, DC's transfer of Business A to FA may be partially eligible for the active foreign trade or business exception provided by section 367(a)(3) and § 1.367(a)–2T. See § 1.367(a)–2T for the requirements of the active foreign trade or business exception.

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by DP1 and DP2 at the time of the section 361 exchange.

(C) Under paragraph (c)(2)(i) of this section, DC must recognize \$18x gain on the transfer of Business A with respect to FP, a non-control group member. The \$18x gain equals the product of the inside gain (\$90x) and FP's 20% ownership interest (by value) in DC at the time of the section 361 exchange. Under paragraph (f)(6) of this section, the \$90x inside gain is the amount by which the aggregate gross fair market value (\$200x) of the section 367(a) property (the inventory and Business A) exceeds the \$110x inside basis. Under paragraph (f)(5) of this section, the inside basis equals the \$50x aggregate basis of the section 367(a) property transferred in the section 361 exchange, increased by the \$60x gain recognized by DC on the transfer of the inventory to FA, but not

by the \$18x gain recognized by DC under paragraph (c)(2)(i) of this section with respect to FP. Under paragraph (e)(1) of this section, the \$18x gain recognized under paragraph (c)(2)(i) of this section is treated as recognized with respect to Business A.

(D) DC is not required to recognize gain under paragraph (c)(2)(ii) of this section with respect to either DP1 or DP2. DP1's share of inside gain (\$45x) does not exceed the product of the section 367(a) percentage (100%) and the fair market value of the FA stock (\$100x) received in exchange for its DC stock. DP1's share of inside gain is determined based on its 50% ownership interest (by value) in DC at the time of the section 361 exchange. DP2's share of inside gain (\$27x) does not exceed the product of the section 367(a) percentage (100%) and the fair market value of the FA stock (\$60x) received in exchange for its DC stock. DP2's share of inside gain is determined based on its 30% ownership interest (by value) in DC at the time of the section 361 exchange.

(E) Under paragraph (c)(3) of this section, DP1's section 358 basis in the FA stock (\$80x) received in exchange for its DC stock must be reduced by \$25x, the amount by which DP1's share of inside gain (\$45x) exceeds DP1's \$20x outside gain. DP1's share of inside gain is determined based on its 50% ownership interest (by value) in DC at the time of the section 361 exchange. Because DC does not recognize gain on the section 361 exchange with respect to DP1, DP1's share of inside gain is not reduced under paragraph (c)(3)(i)(A) of this section. DP1's \$20x outside gain equals the product of the section 367(a) percentage (100%) and the amount by which the fair market value (\$100x) of the FA stock received by DP1 in exchange for its DC stock exceeds the section 358 basis of such FA stock (\$80x). As adjusted, DP1's basis in its FA stock is \$55x. Similarly, under paragraph (c)(3) of this section, DP2's section 358 basis in the FA stock (\$50x) received in exchange for its DC stock must be reduced by \$17x, the amount by which DP2's share of inside gain (\$27x) exceeds DP1's \$10x outside gain. DP2's share of inside gain is determined based on its 30% ownership interest (by value) in DC at the time of the section 361 exchange. Because DC does not recognize gain on the section 361 exchange with respect to DP2, DP2's share of inside gain is not reduced under paragraph (c)(3)(i)(A) of this section. DP2's \$10x outside gain equals the product of the section 367(a) percentage (100%) and the amount by which the fair market value (\$60x) of the FA stock received by DP2 in exchange for its DC stock exceeds the section 358 basis of such stock (\$50x). As adjusted, DP2's basis in its FA stock is \$33x.

(F) Under paragraph (c)(4) of this section, DC must comply with the requirements of § 1.6038B-1(c)(6)(iii).

Example 2. Triangular reorganization involving the exchange of section 367(d) property for stock and cash. (i) *Facts.* (A) DP1 wholly owns DC. DP1 and DC file a consolidated return. DP1's DC stock has a \$175x basis and \$200x fair market value. DC owns Business A (\$10x basis and \$150x fair market value) and a patent (\$0x basis and \$50x fair market value). The patent is section 367(d) property. FP wholly owns FA.

(B) In a triangular reorganization described in section 368(a)(1)(A) by reason of section 368(a)(2)(D), DC transfers Business A and the patent to FA in exchange for \$180x of FP stock and \$20x cash. DC's transfer of Business A and the patent to FA is a section 361 exchange. DP1 exchanges its DC stock for the \$180x of FP stock and the \$20x cash pursuant to section 356. The triangular reorganization constitutes an indirect stock transfer under § 1.367(a)-3(d)(1)(i), and DP1 files a gain recognition agreement under § 1.367(a)-8 with respect to such transfer.

(ii) *Result.* (A) Under section 367(a)(5) and paragraph (b) of this section, DC's transfer of Business A to FA is subject to the general rule of section 367(a)(1). As a result, DC must generally recognize \$140x gain on the transfer of Business A to FA notwithstanding the application of section 361. However, if the requirements of paragraph (c) of this section are satisfied, DC's transfer of Business A to FA may be eligible for the active foreign trade or business exception provided by section 367(a)(3) and § 1.367(a)-2T. See § 1.367(a)-2T for the requirements of the active foreign trade or business exception. For rules applicable to DC's transfer of the patent to FA, see section 367(d) and the regulations under that section.

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by DP1 at the time of the section 361 exchange.

(C) DC is not required to recognize gain under paragraph (c)(2)(i) of this section because at the time of the section 361 exchange DC is wholly owned by DP1, a control group member. Under paragraph (c)(2)(ii) of this section, DC must recognize \$5x gain, the amount by which the product of the inside gain (\$140x) and DP1's 100% ownership interest (by value) in DC at the time of the section 361 exchange exceeds the product of the section 367(a) percentage (75%) and the fair market value (\$180x) of the FP stock received by DP1 in exchange for DC stock. The \$140x inside gain equals the aggregate gross fair market value of Business A (\$150x) less the inside basis (\$10x). Under paragraph (e)(1) of this section, the \$5x gain recognized is allocated to Business A. Under § 1.1502-32(b)(2), DP1 increases the basis of its DC stock by \$5x.

(D) Under paragraph (c)(3) of this section, DP1's section 358 basis (\$180x) in the FP stock (\$180x basis of DC stock, decreased by \$20x cash received, and increased by the \$20x gain recognized under section 356) is reduced by \$135x, the amount by which the product of the \$140x inside gain, reduced by the \$5x recognized by DC under paragraph (c)(2)(ii) (\$135x) and DP1's 100% ownership interest (by value) in DC at the time of the exchange exceeds DP1's outside gain (\$0x). The \$0x outside gain equals the product of the section 367(a) percentage (75%) and the amount by which the fair market value of the FP stock received by DP1 (\$180x) exceeds the section 358 basis of such stock (\$180x). As adjusted, DP1's basis in the FP stock is \$45x.

(E) Under paragraph (c)(4)(i) of this section, DC must comply with the requirements of § 1.6038B-1(c)(6)(iii).

Example 3. Adjustment to basis of multiple blocks of stock. (i) *Facts.* (A) DP1 wholly

owns DC. DP1's DC stock is divided into two blocks of stock (Block 1 and Block 2). Block 1 has a \$60x basis and \$100x fair market value. Block 2 has a \$120x basis and \$100x fair market value. DC owns Business A (\$15x basis and \$150x fair market value) and a patent (\$0x basis and \$50x fair market value). The patent is section 367(d) property.

(B) In a reorganization described in section 368(a)(1)(F), DC transfers Business A and the patent to FA, a newly-formed corporation, in exchange for 2 shares of FA stock. DC's transfer of Business A and the patent to FA qualifies as a section 361 exchange. DP1 exchanges Block 1 and Block 2 for the two shares of FA stock pursuant to section 354. Pursuant to § 1.358-2(a)(2)(i), one share of the FA stock corresponds to Block 1 (Share 1) and the other share of FA stock corresponds to Block 2 (Share 2). The basis and holding period of Share 1 and Share 2 correspond to the basis and holding period of Block 1 and Block 2, respectively.

(ii) *Result.* (A) Under section 367(a)(5) and paragraph (b) of this section, DC's transfer of Business A to FA is subject to the general rule of section 367(a)(1). As a result, DC must generally recognize \$135x gain on the transfer of Business A to FA notwithstanding the application of section 351 or section 361. However, if the requirements of paragraph (c) of this section are met, DC's transfer of Business A to FA may be eligible for the active foreign trade or business exception provided in section 367(a)(3). See § 1.367(a)-2T for the requirements of the active foreign trade or business exception. For rules applicable to DC's transfer of the patent to FA, see section 367(d) and the regulations under that section.

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by DP1 at the time of the section 361 exchange.

(C) DC is not required to recognize gain under paragraph (c)(2)(i) of this section because, at the time of the section 361 exchange, DC is wholly owned by DP1. DC is not required to recognize gain under paragraph (c)(2)(ii) of this section because DP1's 100% share of inside gain (\$135x) does not exceed the product of the section 367(a) percentage (75%) and the fair market value (\$200x) of the FA stock received by DP1 in exchange for its DC stock (\$150x). Under paragraph (f)(6) of this section, the \$135x inside gain equals the aggregate gross fair market value of the section 367(a) property (\$150x) less the inside basis (\$15x).

(D) Under paragraph (c)(3) of this section, DP1's aggregate section 358 basis in Share 1 (\$60x) and Share 2 (\$120x) must be reduced by \$120x, the amount by which DP1's 100% share of inside gain (\$135x) exceeds DP1's \$15x outside gain. The \$15x outside gain equals the product of the section 367(a) percentage (75%) and the amount by which the fair market value of the FA stock received by DP1 (\$200x) exceeds the section 358 basis of the FA stock (\$180x) (75% of \$20x).

(E) Under paragraph (c)(3)(ii)(B) of this section, the \$120x reduction to basis is allocated between Share 1 and Share 2 based on the relative section 358 basis of each share. Therefore, the basis in Share 1 is

reduced by \$40x (\$120x multiplied by \$60x/\$180x). As adjusted, DP1's basis in Share 1 is \$20x. The basis in Share 2 is reduced by \$80x (\$120x multiplied by \$120x/\$180x). As adjusted, DP1's basis in Share 2 is \$40x.

(F) Under paragraph (c)(4)(i) of this section, DC must comply with the requirements of § 1.6038B-1(c)(6)(iii).

(h) *Applicable cross-references.* For rules relating to the character, source, and adjustments resulting from gain recognized by a U.S. transferor under section 367(a), see § 1.367(a)-1T(b)(4). For rules relating to the acquisition of the stock or assets of a foreign corporation by another foreign corporation, see § 1.367(b)-4. For rules relating to transfers of section 367(d) property by a U.S. transferor to a foreign corporation, see section 367(d) and the regulations under that section. For rules relating to distributions of stock of a foreign corporation by a domestic corporation under section 355 or 361, see §§ 1.1248(f)-1 through -3. For additional rules relating to certain reporting requirements of a U.S. transferor, see § 1.6038B-1.

(i) [Reserved.]

(j) *Effective/applicability date.* This section shall apply to transfers occurring on or after the date 30 days after the date these regulations are published as final regulations in the **Federal Register**.

Par. 6. Section 1.367(b)-4 is amended by:

1. Revising paragraphs (b)(1)(i)(B)(2), (b)(1)(ii), and (b)(1)(iii), *Example 4* (ii).
2. Adding paragraph (b)(1)(iii), *Example 5*.

The revisions and additions to read as follows:

§ 1.367(b)-4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

* * * * *

- (b) * * *
 (1) * * *
 (i) * * *
 (B) * * *

(2) Immediately after the exchange, the foreign acquiring corporation or the foreign acquired corporation (if any, such as in the case of the acquisition of the stock of a foreign acquired corporation) is not a controlled foreign corporation as to which the United States person described in paragraph (b)(1)(i)(A) of this section is a section 1248 shareholder.

(ii) *Special rules for certain triangular reorganizations—(A) Exception for receipt of domestic stock.* In the case of a triangular reorganization described in § 1.358-6(b)(2), or a reorganization described in section 368(a)(1)(G) and

(a)(2)(D), an exchange is not described in paragraph (b)(1)(i) of this section if—

(i) The stock received in the exchange is stock of a domestic corporation that immediately after the exchange is a section 1248 shareholder of—

(i) The foreign acquired corporation, in the case of a triangular B reorganization or a reorganization in which stock of the foreign acquired corporation is acquired pursuant to a transfer to which the exception provided in § 1.367(a)-7(c) applies; or

(ii) The surviving corporation, in the case of a transaction that is not described in paragraph (b)(1)(ii)(A)(1)(i) of this section and that is a triangular C reorganization, a forward triangular merger, a reorganization described in section 368(a)(1)(G) and (a)(2)(D), or a reverse triangular merger; and

(2) The foreign acquired corporation or surviving corporation is a controlled foreign corporation. See paragraph (b)(1)(iii) of this section, *Example 3B* for an illustration of this rule.

(B) *Adjustments to basis of stock of foreign acquiring corporation—(1) Transfers to which exception under § 1.367(a)-7(c) applies.* If the stock of the foreign acquired corporation is acquired by the foreign acquiring corporation pursuant to a triangular reorganization described in § 1.358-6(b)(2)(i) through (iii), or a reorganization described in section 368(a)(1)(G) and (a)(2)(D), to which the exception provided in § 1.367(a)-7(c) applies and that is not described in paragraph (b)(1)(i) of this section, the corporation (foreign or domestic) that controls the foreign acquiring corporation shall apply the principles of § 1.367(b)-13 to adjust the basis of the stock of the foreign acquiring corporation so that the section 1248 amount attributable to the stock of the foreign acquired corporation (determined when the foreign acquiring corporation acquires such stock) is reflected in the stock of the foreign acquiring corporation immediately after the exchange. See paragraph (b)(1)(iii) of this section, *Example 5*, for an illustration of this rule.

(2) *Other triangular reorganizations.* See § 1.367(b)-13(c) for rules regarding the adjustment to the basis of the stock of the foreign acquiring corporation in other triangular reorganizations described in paragraph (b)(1)(ii)(A)(1)(ii) of this section.

(iii) * * *

Example 4. * * *

(ii) *Result.* DC2, the exchanging shareholder, is a U.S. person and a section 1248 shareholder with respect to FC2, the foreign acquired corporation. Whether DC2 is required to include in income the section

1248 amount attributable to the FC2 stock under paragraph (b)(1)(i) of this section depends on whether, immediately after DC2's exchange of the FC2 stock for FC1 stock (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)), FC1 and FC2 are controlled foreign corporations as to which DC2 is a section 1248 shareholder. If, immediately after the exchange, FC1 and FC2 are both controlled foreign corporations as to which DC2 is a section 1248 shareholder, then DC2 is not required to include in income the section 1248 amount attributable to the FC2 stock under paragraph (b)(1)(i) because neither condition in paragraph (b)(1)(i)(B) is satisfied. Alternatively, if immediately after the exchange either FC1 or FC2 is not a controlled foreign corporation as to which DC2 is a section 1248 shareholder then, pursuant to paragraph (b)(1)(i) of this section, DC2 must include in income the section 1248 amount attributable to the FC2 stock exchanged. For the treatment of DC2's transfer of assets to FC1, see also section 367(a)(1) and (a)(3) and the regulations under that section. Because DC2's transfer of assets to FC1 is described in section 361(a) or (b), see section 367(a)(5) and § 1.367(a)-7. If any of the assets transferred are intangible assets, see section 367(d) and the regulations under that section. With respect to DC2's distribution of the FC1 stock to DC1 under section 361(c)(1), see section 1248(f)(1), § 1.1248(f)-1 and § 1.1248(f)-2.

Example 5. (i) Facts. DC1, a domestic corporation, wholly owns DC2, a domestic corporation. DC1's DC2 stock has a \$30 basis and a \$100 fair market value. DC2's only asset is all the outstanding stock of FC2, a foreign corporation. DC2's FC2 stock has a \$30 basis, \$100 fair market value and a \$20 section 1248 amount. USP, a domestic corporation unrelated to DC1, DC2 or FC2, wholly owns FC1, a foreign corporation. In a triangular reorganization described in section 368(a)(1)(C), DC2 transfers all the FC2 stock to FC1 in exchange solely for voting stock of USP and then distributes the USP stock to DC1 under section 361(c)(1). DC1 exchanges its DC2 stock for the USP stock under section 354. DC2's transfer of the FC2 stock to FC1 is described in section 361(a) and therefore, under section 367(a)(5) and § 1.367(a)-7, is generally subject to section 367(a)(1). However, DC2's transfer of the FC2 stock to FC1 qualifies for the exception provided in § 1.367(a)-7(c). DC1 and DC2 elect to apply the rules of § 1.367(a)-7(c) in accordance with § 1.367(a)-7(c)(5). DC1 is not required to adjust the basis of its USP stock (determined under section 358) under section 367(a)(5) and § 1.367(a)-7(c)(3).

(ii) *Result.* Under paragraph (b)(1)(ii)(A) of this section, because the stock received by DC2 in exchange for its FC2 stock is stock of a domestic corporation (USP) and, immediately after the exchange, USP is a section 1248 shareholder of FC2 (the foreign acquired corporation) and FC2 is a controlled foreign corporation, DC2's exchange of its FC2 stock for USP stock is not described in paragraph (b)(1)(i) of this section. Therefore, DC2 is not required to include in income the section 1248 amount attributable to the FC2 stock. Under paragraph (b)(1)(ii)(B)(1) of this section, USP must apply the principles of

§ 1.367(b)–13 to adjust the basis of its FC1 stock so that the §20 section 1248 amount attributable to the FC2 stock at the time of the exchange is reflected in the FC1 stock immediately after the exchange. Under the principles of § 1.367(b)–13, each share of FC1 stock held by USP after the exchange must be divided into one portion attributable to the FC1 stock immediately before the exchange and one portion attributable to the FC2 stock acquired in the exchange. The §30 basis in the FC2 stock and the earnings and profits attributable to the FC2 stock before the exchange are attributable to the divided portions of the FC1 stock to which the FC2 stock relates.

* * * * *

Par. 7. Section 1.367(b)–6 is amended by revising paragraph (a)(1) to read as follows:

§ 1.367(b)–6 Effective dates and coordination rules.

(a) Effective date—(1) In general—(A) Except as otherwise provided in this paragraph (a)(1) and paragraph (a)(2) of this section, §§ 1.367(b)–1 through 1.367(b)–5, and this section, apply to section 367(b) exchanges that occur on or after February 23, 2000.

(B) The rules of §§ 1.367(b)–3 and 1.367(b)–4, as they apply to reorganizations described in section 368(a)(1)(A) (including reorganizations described in section 368(a)(2)(D) or (E)) involving a foreign acquiring or foreign acquired corporation, apply only to transfers occurring on or after January 23, 2006.

(C) The second sentence of paragraph (a) in § 1.367(b)–4 applies to section 304(a)(1) transactions occurring on or after February 23, 2006; however, taxpayers may rely on this sentence for all section 304(a)(1) transactions occurring in open taxable years.

(D) Section 1.367(b)–1(c)(2)(v), (c)(3)(ii)(A), (c)(4)(iv), (c)(4)(v), § 1.367(b)–2(j)(1)(i), (l), and § 1.367(b)–3(e) and (f), apply to section 367(b) exchanges that occur on or after November 6, 2006. For guidance with respect to § 1.367(b)–1(c)(3)(ii)(A) and (c)(4)(iv) and (v) and § 1.367(b)–2(j)(1)(i) for exchanges that occur before November 6, 2006, see 26 CFR part 1 revised as of April 1, 2006.

(E) Section 1.367(b)–4(b)(1)(ii) and § 1.367(b)–4(b)(1)(iii), Examples 4 and 5 apply to section 367(b) exchanges that occur on or after the date that is 30 days after the date these regulations are published as final regulations in the Federal Register. For guidance with respect to § 1.367(b)–4(b)(1)(ii) and § 1.367(b)–4(b)(1)(iii), Example 4, for exchanges that occur before the date 30 days after the date these regulations are published as final regulations in the Federal Register, see 26 CFR part 1

revised as of April 1 for the year before the date these regulations are published as final regulations in the Federal Register.

* * * * *

Par. 8. For each entry in the table in the “Section” column, remove the language in the “Remove” column and add the language in the “Add” column in its place.

Section	Remove	Add
1.1248–1(a)(1), second to last sentence.	1248(f)	1248(g)
1.1248–1(a)(1), last sentence.	1248(g)	1248(h)
1.1248–3(a)(6), first sentence.	1.1248–4	1.1248–2
1.1248–3(a)(6), first sentence.	1.1248–7	1.1248–8
1.1248–7(a)(1), second to last sentence.	1248(g)	1248(h)

Par. 9. Section 1.1248–1 is amended by:

1. Revising paragraphs (b) and (e).
2. Revising the second sentence of paragraph (c).

The revisions to read as follows.

§ 1.1248–1 Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

* * * * *

(b) Sale or exchange. For purposes of this section and §§ 1.1248–2 through 1.1248–8, the term sale or exchange includes the receipt of a distribution that is treated as in exchange for stock under section 302(a) (relating to distributions in redemption of stock) or section 331(a) (relating to distributions in complete liquidation of a corporation).

(c) * * * Thus, for example, if a United States person exchanges stock in a foreign corporation and no gain is recognized on such exchange under section 332, 351, 354, 355, or 361, taking into account the application of section 367, then no amount is includible in the gross income of such person as a dividend under section 1248(a).

* * * * *

(e) Exceptions. Under section 1248(g), this section and §§ 1.1248–2 through 1.1248–8 shall not apply to:

- (1) Distributions to which section 303 (relating to distributions in redemption of stock to pay death taxes) applies; or
- (2) Any amount to the extent that such amount is, under any other provision of the Internal Revenue Code (Code), treated as (i) a dividend, (ii) gain from the sale of an asset which is not a capital asset, or (iii) gain from the sale

of an asset held for not more than 1 year.

* * * * *

Par. 10. Section 1.1248–6 is amended by:

1. Adding a new sentence at the end of paragraph (a).
2. Adding paragraphs (d) and (e).
The additions to read as follows:

1.1248–6 Sale or exchange of stock in certain domestic corporations.

(a) * * * See paragraph (d) of this section for a rule suspending the application of this section in certain circumstances.

* * * * *

(d) Temporary suspension of section 1248(e). Section 1248(e) and the rules of this section shall not apply to a sale, exchange, or other disposition of the stock of a domestic corporation during a period when capital gains are taxed at a rate that equals or exceeds the rate at which ordinary income is taxed.

(e) Effective/applicability date.

Paragraph (d) of this section shall apply to a sale, exchange, or other disposition of the stock of a domestic corporation on or after September 21, 1987.

Par. 11. Section 1.1248–8 is amended by:

1. Revising paragraphs (a)(3), (b)(1)(iv)(A), (b)(2)(i), and (d).
2. Adding new paragraph (b)(2)(iv).

The revisions and addition to read as follows:

§ 1.1248–8 Earnings and profits attributable to stock following certain non-recognition transactions.

(a) * * *

(3) Application of section 381. Stock of a foreign corporation that receives assets in a transfer to which section 361(a) or (b) applies in connection with a reorganization described in section 368(a)(1)(A), (C), (D), (F), or (G), or in a distribution to which section 332 applies, and to which section 381(c)(2)(A) and § 1.381(c)(2)–1(a) apply. See paragraph (b)(6) of this section; or

* * * * *

(b) * * *

(1) * * *

(iv) * * *

(A) In a restructuring transaction qualifying as a nonrecognition transaction within the meaning of section 7701(a)(45) and described in section 354, 356, or 361(a) or (b), stock in an acquired corporation for stock in either a foreign acquiring corporation or a foreign corporation that is in control, within the meaning of section 368(c), of an acquiring corporation (whether domestic or foreign); or

* * * * *

(2) * * *

(i) *Exchanging shareholder exchanges property that is not stock of a foreign acquired corporation with respect to which the exchanging shareholder is a section 1248 shareholder or a foreign corporate shareholder.* Except as provided in paragraph (b)(2)(iv) of this section, where the exchanging shareholder exchanges in a restructuring transaction property that is not stock of a foreign acquired corporation with respect to which the exchanging shareholder is a section 1248 shareholder or a foreign corporate shareholder immediately before such transaction, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction shall be determined in accordance with § 1.1248-2 or § 1.1248-3, whichever is applicable, without regard to any portion of the section 1223(1) holding period in that stock that is before the restructuring transaction. See paragraph (b)(7) Example 1 of this section.

* * * * *

(iv) *Exchanging shareholder exchanges stock of a domestic acquired corporation for stock of a foreign corporation with respect to which the exchanging shareholder is a section 1248 shareholder after the exchange.* If in a restructuring transaction described in § 1.1248(f)-2(c) and to which the exception provided by § 1.1248(f)-2(c)(1) applies, the earnings and profits attributable to a portion of a share of stock of a foreign corporation created pursuant to § 1.1248(f)-2(c)(2) (or a whole share, if no division is required) shall be determined pursuant to paragraphs (b)(2)(iv)(A) and (B) of this section.

(A) The earnings and profits attributable to a portion of a share of stock created pursuant to § 1.1248(f)-2(c)(2)(i) (or a whole share, if no division is required) shall be the earnings and profits attributable to the stock of the foreign corporation received by the section 1248 shareholder under section 354, 355, or 356 determined in accordance with § 1.1248-2 or § 1.1248-3, whichever is applicable, without regard to any portion of the section 1223(1) holding period in that stock that is before the restructuring transaction.

(B) The earnings and profits attributable to a portion of a share of stock created under § 1.1248(f)-2(c)(2)(ii) (or whole share, if no division is required) shall be the sum of—

(1) The earnings and profits attributable to the stock of the foreign corporation transferred in the section 361 exchange that relates to such

portion (or share) multiplied by the section 1248 shareholder's ownership interest (by value) in the domestic distributing corporation at the time of the restructuring transaction; and

(2) The earnings and profits attributable to the stock of the foreign corporation received by the section 1248 shareholder under section 354, 355, or 356 determined in accordance with § 1.1248-2 or § 1.1248-3, whichever is applicable, without regard to any portion of the section 1223(1) holding period in that stock that is before the restructuring transaction. See § 1.1248(f)-2(d), *Examples 2 through 4.*

* * * * *

(d) *Effective/applicability dates—(1) General rule.* Except as provided in paragraph (d)(2) of this section, this section applies to income inclusions that occur on or after July 30, 2007.

(2) *Exception.* Paragraph (b)(2)(iv) of this section applies to restructuring transactions occurring on or after the date 30 days after the date these regulations are published as final regulations in the **Federal Register**.

Par. 12. Section 1.1248(f)-1 is added to read as follows:

§ 1.1248(f)-1 Certain nonrecognition distributions.

(a) *Scope and purpose.* This section and §§ 1.1248(f)-2 and 1.1248(f)-3 provide rules that apply when a domestic corporation (domestic distributing corporation) distributes stock of a foreign corporation (foreign distributed corporation) in a distribution to which section 337, 355, or 361 applies. The purpose of this section is to confirm the general rule of section 1248(f)(1) that requires the domestic distributing corporation to include in gross income the section 1248 amount or section 1248(f) amount, as applicable, that is attributable to the stock of the foreign distributed corporation distributed under section 337, 355, or 361, and to provide exceptions to the general rule to the extent the section 1248 amount or section 1248(f) amount, as applicable, can be preserved immediately following the distribution in the hands of a distributee that is a domestic corporation. This section provides the general rule and definitions. Section 1.1248(f)-2 provides the exceptions to the general rule. Section 1.1248(f)-3 provides a reasonable cause exception for a failure to comply with certain requirements of § 1.1248(f)-2. Section 1.1248(f)-3 also provides the effective dates of this section and § 1.1248(f)-2.

(b) *General rule—(1) Section 337 distributions.* Except as provided in § 1.1248(f)-2(a), a domestic distributing

corporation that is a section 1248 shareholder of a foreign distributed corporation and that distributes stock of such corporation in a distribution to which section 337 applies (section 337 distribution), shall, notwithstanding any other provision of subtitle A, include in gross income as a dividend the section 1248 amount attributable to the distributed stock. This paragraph (b)(1) shall apply only to the extent the domestic distributing corporation does not recognize gain on the section 337 distribution under any other provision of subtitle A.

(2) *Certain section 355 distributions.* Except as provided in § 1.1248(f)-2(b), a domestic distributing corporation that is a section 1248 shareholder of a foreign distributed corporation and that distributes stock of such corporation, other than stock received in a section 361 exchange, in a distribution to which section 355 applies (section 355 distribution), shall, notwithstanding any other provision of subtitle A, include in gross income as a dividend the section 1248 amount attributable to the distributed stock. This paragraph (b)(2) shall apply only to the extent the domestic distributing corporation does not recognize gain on the section 355 distribution under any other provision of subtitle A.

(3) *Distributions pursuant to a plan of reorganization.* Except as provided in § 1.1248(f)-2(c), a domestic distributing corporation that is a section 1248 shareholder of a foreign distributed corporation and that distributes stock of such corporation received in a section 361 exchange in a section 355 distribution or a distribution to which section 361 applies (section 361 distribution), shall, notwithstanding any other provision of subtitle A, include in gross income as a dividend the section 1248(f) amount attributable to the stock distributed. This paragraph (b)(3) shall apply without regard to the amount of gain realized by the domestic distributing corporation on the distribution.

(c) *Definitions.* Except as otherwise provided, the following definitions apply for purposes of this section and §§ 1.1248(f)-2 and 1.1248(f)-3.

(1) *80-percent distributee* is a corporation described in section 337(c).

(2) *Block of stock* has the meaning set forth in § 1.1248-2(b).

(3) *Distributee* is a shareholder of the domestic distributing corporation that receives stock of a foreign distributed corporation in a section 355 distribution or section 361 distribution.

(4) *Postdistribution amount* is the section 1248 amount attributable to the stock of a foreign distributed

corporation received (or deemed received) by a distributee, computed immediately after the distribution but without taking into account any adjustments to the basis of such stock under § 1.1248(f)-2(b)(3) or (c)(3). The postdistribution amount attributable to stock of a foreign distributed corporation received in a section 355 distribution described in paragraph (b)(2) of this section shall be determined based on the distributee's holding period in such stock as adjusted under § 1.1248(f)-2(b)(2). The postdistribution amount attributable to stock of a foreign distributed corporation received in a section 355 distribution or section 361 distribution described in paragraph (b)(3) of this section shall be determined after applying the rules in §§ 1.1248-8(b)(2)(iv) and 1.1248(f)-2(c)(2).

(5) *Section 358 basis* is the basis of stock determined under section 358 and the regulations under that section.

(6) *Section 361 exchange* is an exchange described in section 361(a) or (b).

(7) *Section 1248 amount* is the net positive earnings and profits (if any) attributable to the stock of the foreign distributed corporation under § 1.1248-2 or § 1.1248-3 (as adjusted by § 1.1248-8) and that would be included in gross income as a dividend under section 1248(a) if the stock were sold by the holder of such stock.

(8) *Section 1248(f) amount* is the aggregate amount of the net positive earnings and profits (if any) attributable to the stock of each foreign corporation, under § 1.1248-2 or § 1.1248-3 (as adjusted by § 1.1248-8), transferred by the domestic distributing corporation to the foreign distributed corporation in the section 361 exchange that precedes the section 355 distribution or section 361 distribution of the stock of the foreign distributed corporation, and that would be included in gross income as a dividend under section 964(e) by the foreign distributed corporation if it sold such stock immediately after the section 361 exchange. The section 1248(f) amount is attributable to the stock of the foreign distributed corporation received in the section 361 exchange.

(9) *Section 1248 shareholder* is a domestic corporation that satisfies the ownership requirements of section 1248(a)(2) with respect to a foreign corporation.

(10) *Timely-filed return* is a U.S. income tax return filed on or before the due date set forth in section 6072(b), plus any extension of time to file such return granted under section 6081.

Par. 13. Section 1.1248(f)-2 is added to read as follows:

§ 1.1248(f)-2 Exceptions for certain distributions.

(a) *Section 337 distributions.* Section 1.1248(f)-1(b)(1) shall not apply to a section 337 distribution of stock of the foreign distributed corporation if the conditions of paragraphs (a)(1) through (a)(3) of this section are satisfied.

(1) *80-percent distributee is a section 1248 shareholder.* Immediately after the section 337 distribution, the 80-percent distributee is a section 1248 shareholder with respect to the foreign distributed corporation.

(2) *Holding period.* The 80-percent distributee is treated as holding the stock of the foreign distributed corporation received in the section 337 distribution for the period during which the stock was held by the domestic distributing corporation.

(3) *Basis.* The 80-percent distributee's basis in the stock of the foreign distributed corporation received in the section 337 distribution does not exceed the domestic distributing corporation's basis in such stock at the time of the section 337 distribution.

(b) *Certain section 355 distributions.* Section 1.1248(f)-1(b)(2) shall not apply to a section 355 distribution of stock of the foreign distributed corporation not received by the domestic distributing corporation in a section 361 exchange to a distributee that is a section 1248 shareholder with respect to the foreign distributed corporation immediately after the distribution, if the domestic distributing corporation and all such section 1248 shareholders elect to apply the provisions of this paragraph (b) in accordance with paragraph (b)(1) of this section. See paragraphs (b)(2) and (b)(3) of this section for adjustments that occur as a result of electing to apply the provisions of this paragraph (b).

(1) *Election and reporting—(i) Statement required by section 1248 shareholders and domestic distributing corporation—(A) In general.* The domestic distributing corporation and the section 1248 shareholders elect to apply the provisions of paragraph (b) of this section by each including a statement, described in paragraph (b)(1)(i)(B) of this section, with its timely-filed return for the taxable year during which the section 355 distribution occurs and by entering into a written agreement described in paragraph (b)(1)(ii) of this section. If the domestic distributing corporation or a section 1248 shareholder is a member of a consolidated group at the time of the section 355 distribution, the common parent of the consolidated group makes the election on behalf of the domestic distributing corporation or section 1248

shareholder. The election made under this paragraph (b)(1) is irrevocable.

(B) *Form and content.* The statement of election must be entitled, STATEMENT TO ELECT TO APPLY EXCEPTION UNDER § 1.1248(f)-2(b). The statement must state that the domestic distributing corporation and each section 1248 shareholder have entered into a written agreement described in paragraph (b)(1)(ii) of this section and must set forth the adjustment to each section 1248 shareholder's holding period or section 358 basis (if any) in the stock of the foreign distributed corporation received in the section 355 distribution required under paragraph (b)(2) or (b)(3) of this section.

(ii) *Written agreement.* The domestic distributing corporation and the section 1248 shareholders must enter into a written agreement described in this paragraph (b)(1)(ii) on or before the due date (including extensions) of the domestic distributing corporation's U.S. income tax return for the taxable year during which the section 355 distribution occurs. Each party to the agreement must retain the original or a copy of the agreement as part of its records in the manner specified by § 1.6001-1(e). Each party to the agreement must provide a copy of the agreement to the Internal Revenue Service within 30 days of the receipt of a request for the agreement in connection with an examination of the taxable year during which the section 355 distribution occurs. The agreement must—

(A) State the document is an agreement under paragraph (b)(1)(ii) of this section;

(B) Identify the domestic distributing corporation and each section 1248 shareholder;

(C) With respect to each section 1248 shareholder, state the holding period in the stock of the foreign distributed corporation received in the section 355 distribution as adjusted under paragraph (b)(2) of this section; and

(D) With respect to each section 1248 shareholder, identify the section 358 basis of the stock of the foreign distributed corporation received in the section 355 distribution and the adjustment (if any) to such basis under paragraph (b)(3) of this section.

(2) *Holding period adjustment.* For purposes of section 1248, immediately after the section 355 distribution, each section 1248 shareholder's holding period in the stock of the foreign distributed corporation received in the section 355 distribution shall equal the domestic distributing corporation's

holding period in such stock at the time of the distribution.

(3) *Basis adjustments.* If the domestic distributing corporation's section 1248 amount attributable to the stock of the foreign distributed corporation received by a section 1248 shareholder in the section 355 distribution exceeds the section 1248 shareholder's postdistribution amount attributable to such stock (excess amount), the section 1248 shareholder's section 358 basis in such stock is reduced by such excess amount. For an illustration of the rule in this paragraph (b)(3), see paragraph (d) of this section, *Examples 1 and 4.*

(c) *Distributions pursuant to a plan of reorganization.* Section 1.1248(f)-1(b)(3) shall not apply to a section 355 distribution or section 361 distribution of stock of the foreign distributed corporation received by the domestic distributing corporation in the section 361 exchange that precedes the distribution, to a distributee that is a section 1248 shareholder with respect to the foreign distributed corporation immediately after the distribution, if the domestic distributing corporation and all such section 1248 shareholders elect to apply the provisions of this paragraph (c) in accordance with paragraph (c)(1) of this section. See paragraphs (c)(2) and (c)(3) of this section for the adjustments that result from electing to apply the provisions of this paragraph (c). The adjustments provided in paragraphs (c)(2) and (c)(3) of this section shall apply after any adjustments required under section 367(a)(5) and § 1.367(a)-7(c). For illustrations of this exception, see paragraph (d) of this section, *Examples 2 through 4.*

(1) *Election and reporting—(i) Statement required by section 1248 shareholders and domestic distributing corporation—(A) In general.* The domestic distributing corporation and the section 1248 shareholders elect to apply the provisions of paragraph (c) of this section by each including a statement, in the form and with the content listed in paragraph (c)(1)(i)(B) of this section, with its timely-filed return for the taxable year during which the distribution occurs and by entering into a written agreement described in paragraph (c)(1)(ii) of this section. If the domestic distributing corporation or a section 1248 shareholder is a member of a consolidated group at the time of the distribution, the common parent of the consolidated group makes the election on behalf of the domestic distributing corporation or section 1248 shareholder. The election made under this paragraph (c)(1) is irrevocable.

(B) *Form and content.* The statement of election must be entitled,

STATEMENT TO APPLY EXCEPTION UNDER § 1.1248(f)-2(c). The statement must state that the domestic distributing corporation and each section 1248 shareholder have entered into a written agreement described in paragraph (c)(1)(ii) of this section and must describe, with respect to each section 1248 shareholder, the extent to which the shares of stock of the foreign distributed corporation received in the section 361 distribution are divided into portions under paragraph (c)(2) of this section and any adjustments to the section 358 basis of such stock under paragraph (c)(3) of this section.

(ii) *Written agreement.* The domestic distributing corporation and the section 1248 shareholders must enter into a written agreement described in this paragraph (c)(1)(ii) on or before the due date (including extensions) of the U.S. transferor's U.S. income tax return for the taxable year during which the distribution occurs. Each party to the agreement must retain the original or a copy of the agreement as part of its records in the manner specified by § 1.6001-1(e). Each party to the agreement must provide a copy of the agreement to the Internal Revenue Service within 30 days of the receipt of a request for the agreement in connection with an examination of the taxable year during which the distribution occurs. The agreement must—

(A) State the document is an agreement under paragraph (c)(1)(ii) of this section;

(B) Identify the domestic distributing corporation and each section 1248 shareholder;

(C) With respect to each section 1248 shareholder, describe the extent to which the shares of stock of the foreign distributed corporation are divided into portions under paragraph (c)(2) of this section;

(D) With respect to each section 1248 shareholder, state the amount of any adjustment to the section 358 basis of the stock of the foreign distributed corporation under paragraph (c)(3) of this section; and

(E) With respect to each section 1248 shareholder, state the amount of earnings and profits attributable to the stock of the foreign distributed corporation received in the distribution. See § 1.1248-8(b)(2)(iv).

(2) *Portions.* If the domestic distributing corporation transfers property to the foreign distributed corporation in the section 361 exchange that precedes the section 355 distribution or section 361 distribution, other than a single block of stock of a foreign corporation with respect to

which the domestic distributing corporation is a section 1248 shareholder at the time of the section 361 exchange, then each share of stock of the foreign distributed corporation received by a section 1248 shareholder in the distribution must be divided into portions as follows:

(i) One portion attributable to all property transferred in the section 361 exchange, other than stock of a foreign corporation with respect to which the domestic distributing corporation is a section 1248 shareholder at the time of the section 361 exchange; and

(ii) One portion attributable to each block of stock of a foreign corporation transferred in the section 361 exchange with respect to which the domestic distributing corporation is a section 1248 shareholder at the time of the section 361 exchange. For the determination of the earnings and profits attributable to a portion of a share of stock of the foreign distributed corporation, see § 1.1248-8(b)(2)(iv).

(3) *Basis adjustments.* If the section 1248(f) amount attributable to a portion of a share of stock (or whole share, if no division is required) of the foreign distributed corporation received (or deemed received) by a section 1248 shareholder in the distribution exceeds the section 1248 shareholder's postdistribution amount attributable to such portion (or whole share, if no division is required) (excess amount), then the section 1248 shareholder's section 358 basis in such portion (or whole share, if no division is required) as adjusted under § 1.367(a)-7(c)(3), is reduced by such excess amount. For an illustration of this rule, see paragraph (d) of this section, *Example 3.*

(4) *Rules applicable to divided shares of stock—(i) Basis.* The basis of a portion of a share of stock of the foreign distributed corporation created under paragraph (c)(2) of this section is that amount of the section 1248 shareholder's section 358 basis (as adjusted under § 1.367(a)-7(c)(3)) in the share of stock that bears the same ratio that the fair market value of the property received by the foreign distributed corporation in the section 361 exchange to which such portion relates bears to the aggregate fair market value of all property received by the foreign distributed corporation in the section 361 exchange. For illustrations of this rule, see paragraph (d) of this section, *Examples 2 and 3.*

(ii) *Fair market value.* The fair market value of a portion of a share of stock of the foreign distributed corporation created under paragraph (c)(2) of this section is that amount of the fair market value of the share of stock of the foreign

corporation that bears the same ratio that the fair market value of the property received by the foreign distributed corporation in the section 361 exchange to which such portion relates bears to the aggregate fair market value of all property received by the foreign distributed corporation in the section 361 exchange. For illustrations of this rule, see paragraph (d) of this section, *Examples 2 and 3*.

(iii) *Rules for subsequent exchanges.* For purposes of determining the gain realized on the sale or exchange of a share of stock of the foreign distributed corporation that has a divided portion pursuant to paragraph (c)(2) of this section, the amount realized on the sale or exchange of such share shall be allocated to each divided portion based on the relative fair market value of the property to which such portion relates as determined at the time of the section 361 exchange.

(iv) *Duration of divided shares.* Shares of stock of the foreign distributed corporation that are divided into portions under paragraph (c)(2) of this section are not required to be divided as of the date on which section 1248(a) would not apply to a sale or exchange of such shares.

(d) *Examples.* The rules of this section are illustrated by the following examples. The analysis of the examples is limited to a discussion of issues under this section. For purposes of the examples, unless otherwise indicated, assume: DP1, DP2, DP3, DC, and USD are domestic corporations; X is a United States resident individual; FP and FA are foreign corporations that are not, and have never been, controlled foreign corporations; CFC1, CFC2, and FC are controlled foreign corporations; each corporation has a single class of stock outstanding and uses the calendar year as its taxable year; each shareholder owns a single block of stock in each corporation; DC owns Business A, which consists solely of section 367(a) property that could satisfy the requirements of the active foreign trade or business exception under section 367(a)(3) and § 1.367(a)-2T; and DC owns no other assets and has no liabilities. Further assume the requirements in § 1.367(a)-7(c)(5) are satisfied, any requirement to file a gain recognition agreement is satisfied, and no earnings and profits of a foreign corporation are described in section 1248(d).

Example 1. Section 355 distribution, gain recognition, and adjustment to stock basis—
(i) *Facts.* DP1, FP, and X own 80%, 10%, and 10%, respectively, of the outstanding stock of USD. DP1's USD stock has a \$140x basis, a \$160x fair market value, and a 2 year holding

period. USD wholly owns FC. USD's FC stock has a \$50x basis, a \$100x fair market value, a \$25x section 1248 amount, and a 3 year holding period. On December 31, Year 3, USD distributes all of the FC stock to DP1, FP, and X on a pro-rata basis in a section 355 distribution. The fair market value of the FC stock received by DP1, FP and X is \$80x, \$10x, and \$10x, respectively. After the distribution, DP1's section 358 basis in its FC stock is \$70x.

(ii) *Result.* (A) Under § 1.367(e)-1(b)(1), USD must recognize \$5x gain on the distribution of FC stock to FP (10% of the \$50x gain in the FC stock). Under § 1.367(b)-5(b)(1)(ii), USD must recognize \$5x gain on the distribution of FC stock to X (10% of the \$50x gain in the FC stock). Of the aggregate \$10x gain recognized by USD, \$5x is recharacterized as a dividend under section 1248(a) (20% of the section 1248 amount (\$25x) attributable to the FC stock). See § 1.1248-1 for additional consequences.

(B) USD's distribution of FC stock to DP1 is described in section 1248(f)(1) and § 1.1248(f)-1(b)(2). As a result, USD must generally include in gross income as a dividend the section 1248 amount attributable to such stock (\$20x, or 80% of the \$25x section 1248 amount). However, if DP1 and USD elect to apply the rules of paragraph (b) of this section (as provided in paragraph (b)(1) of this section), § 1.1248(f)-1(b)(2) shall not apply to USD's distribution of FC stock to DP1. If DP1 and USD make that election, then:

(1) Under paragraph (b)(2) of this section, for purposes of section 1248, immediately after the distribution DP1 will have a 3 year holding period in the FC stock received in the section 355 distribution, the same holding period USD had in such stock at the time of the distribution.

(2) Under paragraph (b)(3) of this section, DP1's section 358 basis in the FC stock (\$70x) received in the distribution is reduced by \$10x, the amount by which USD's section 1248 amount (\$20x) attributable to such FC stock exceeds DP1's postdistribution amount (\$10x) attributable to such stock. As adjusted under paragraph (b)(3) of this section, DP1's basis in the FC stock is \$60x. Under § 1.1248(f)-1(c)(4), DP1's postdistribution amount (\$10x) equals the amount that DP1 would include in gross income as a dividend under section 1248(a) if it sold the FC stock immediately after the distribution (\$80x fair market value, \$70x basis, and \$20x earnings and profits attributable to the FC stock for purposes of section 1248 taking into account DP1's 3-year holding period in such stock as required by paragraph (b)(2) of this section).

Example 2. Section 361 distribution—
(i) *Facts.* DP1, DP2, and FP own 50, 30, and 20, respectively, of the 100 outstanding shares of stock of DC. DP1's DC stock has a \$180x basis and a \$200x fair market value. DP2's DC stock has a \$100x basis and \$120x fair market value. DC owns Business A and wholly owns CFC1 and CFC2. DC's Business A has a \$10x basis and a \$200x fair market value. DC's CFC1 stock has a \$20x basis, a \$40x fair market value, and \$30x of earnings and profits attributable to it for purposes of section 1248(a). DC's CFC2 stock has a \$30x basis, a \$160x fair market value and \$150x

of earnings and profits attributable to it for purposes of section 1248(a). On December 31, Year 3, in a reorganization described in section 368(a)(1)(D), DC transfers CFC1, CFC2 and Business A to FA in exchange for 60 shares of FA stock. DC's transfer of CFC1, CFC2 and Business A to FA in exchange for the 60 shares of FA stock qualifies as a section 361 exchange. DC distributes the FA stock to DP1, DP2 and FP on a pro-rata basis in a section 361 distribution. DP1, DP2 and FP exchange their DC stock for 30, 18, and 12 shares, respectively, of FA stock pursuant to section 354. After the reorganization, FA has 100 shares of stock outstanding. DP3 owns the other 40 shares of FA stock.

(ii) *Result.* (A) In general, under section 367(a)(5) and § 1.367(a)-7(b), DC's transfer of the stock of CFC1 and CFC2 and Business A to FA is subject to the general rule of section 367(a)(1). As a result, DC must generally recognize gain on the transfer of such property to FA in the section 361 exchange. However, if the conditions and requirements of § 1.367(a)-7(c) are met (which includes the making of the election under § 1.367(a)-7(c)(5)), DC's transfer of the stock of CFC1 and CFC2 and Business A to FA may, in part, be eligible for the exceptions to section 367(a)(1) provided by §§ 1.367(a)-2T and -3. See §§ 1.367(a)-2T and -3(b) for additional requirements. In addition, DC may not be required to include in income the section 1248 amount attributable to the CFC1 and CFC2 stock under § 1.367(b)-4(b)(1). However, if the exception provided under paragraph (c) of this section does not apply, then under § 1.1248(f)-1(b)(3) DC must include in gross income as a dividend the section 1248(f) amounts attributable to the FA stock distributed. DC must include in income as a dividend the section 1248(f) amount attributable to the FA stock distributed by FP even if the exception provided by § 1.367(a)-7(c) applies.

(B) The requirement of § 1.367(a)-7(c)(1) is satisfied because DC is controlled (within the meaning of section 368(c)) by DP1 and DP2 at the time of the section 361 exchange.

(C) Under § 1.367(a)-7(c)(2)(i), DC must recognize \$68x gain on the section 361 exchange with respect to FP. The \$68x gain equals the product of FP's 20% ownership interest in DC (by value) at the time of the section 361 exchange and the \$340x inside gain. The inside gain equals the excess of the aggregate gross fair market value of the section 367(a) property (\$400x) over the \$60x inside basis. Under § 1.367(a)-7(e)(1), the \$68x gain recognized is allocated among the CFC1 stock, the CFC2 stock and Business A in proportion to the amount of gain realized by DC on the transfer of such property. The amount allocated to the CFC1 stock is \$4x (\$68x gain multiplied by 20x/\$340x). The amount allocated to the CFC2 stock is \$26x (\$68x gain multiplied by 130x/\$340x). The amount allocated to Business A is \$38x (\$68x gain multiplied by 190x/\$340x). Under § 1.367(a)-1T(b)(4)(i)(B) and section 362(b), the basis of each asset is increased by the amount of gain allocated to such asset. Under section 1248(a), DC must include in gross income as a dividend the \$4x gain recognized with respect to the CFC1 stock (20% of the \$20x section 1248 amount attributable to

such stock) and the \$26x gain recognized with respect to CFC2 stock (20% of the \$130x section 1248 amount attributable to such stock). If the built-in gain in the CFC1 stock or CFC2 stock exceeded the section 1248 amount attributable to such stock, the amount of the gain recognized by DC on the transfer of such stock in the section 361 exchange recharacterized as a dividend under section 1248(a) would be less.

(D) DC is not required to recognize gain on the section 361 exchange under § 1.367(a)-7(c)(2)(ii) with respect to DP1 or DP2. With respect to DP1, the product of the inside gain (\$340x) and DP1's 50% ownership interest (by value) in DC at the time of the section 361 exchange (or \$170x) does not exceed the product of the section 367(a) percentage (100%) and the fair market value of the FA stock received by DP1 (\$200x). With respect to DP2, the product of the inside gain (\$340x) and DP2's 30% ownership percentage (by value) in DC at the time of the section 361 exchange (or \$102x) does not exceed the product of the section 367(a) percentage (100%) and the fair market value of the FA stock received by DP2 (\$120x).

(E) Under § 1.367(a)-7(c)(3), DP1's section 358 basis (\$180x) in the FA stock received in the section 361 distribution is reduced by \$150x, the amount by which DP1's 50% share of inside gain (\$170x) exceeds DP1's \$20x outside gain. DP1's share of inside gain is not reduced under § 1.367(a)-7(c)(2)(ii) because DC did not recognize gain with respect to DP1. DP1's \$20x outside gain equals the product of the section 367(a) percentage (100%) and the excess of the fair market value of the FA stock received by DP1 (\$200x) over the section 358 basis of such stock (\$180x). As adjusted, DP1's basis in the FA stock is \$30x. Similarly, DP2's section 358 basis (\$100x) in the FA stock received in the section 361 distribution is reduced by \$82x, the amount by which DP2's 30% share of inside gain (\$102x) exceeds DP1's \$20x outside gain. DP2's share of inside gain is not reduced under § 1.367(a)-7(c)(2)(ii) because DC did not recognize gain with respect to DP2. DP2's \$20x outside gain equals the product of the section 367(a) percentage (100%) and the excess of the fair market value of the FA stock received by DP2 (\$120x) over the section 358 basis of such stock (\$100x). As adjusted, DP2's basis in the FA stock is \$18x.

(F) Under § 1.367(a)-7(c)(4)(i), DC must comply with the requirements of § 1.6038B-1(c)(6)(iii) with respect to Business A. Under § 1.367(a)-7(c)(4)(ii), DC is not required to comply with the requirements of § 1.6038B-1(c)(6)(iii) with respect to the stock of CFC1 or CFC2.

(G) DC is not required to include in income as a dividend the remaining section 1248 amount attributable to the stock of CFC1 (\$16x) or CFC2 (\$104x) under § 1.367(b)-4(b)(1)(i) because immediately after the section 361 exchange, FA, CFC1, and CFC2 are controlled foreign corporations with respect to which DC is a section 1248 shareholder.

(H) Under § 1.1248(f)-1(b)(3), DC must generally include in gross income as a dividend the section 1248(f) amount (\$120x) attributable to the FA stock distributed to

DP1, DP2 and FA in the section 361 distribution. The section 1248(f) amount equals the sum of the amounts that FA would include in income as a dividend under section 964(e) if it sold the CFC1 stock (\$16x gain and \$26x earnings and profits attributable to such stock—calculated in paragraph (K)(3) of this *Example*) and CFC2 stock (\$104x gain and \$124x earnings and profits attributable to such stock—calculated in paragraph (K)(3) of this *Example*) immediately after the section 361 exchange.

(I) [Reserved.]

(J) However, if DP1, DP2, and DC elect to apply the provisions of paragraph (c) of this section (as provided in paragraph (c)(1) of this section), then § 1.1248(f)-1(b)(3) shall not apply to DC's distribution of FA stock to DP1 and DP2. Even if such election is made, however, DC must include in gross income as a dividend the section 1248(f) amount (\$24x) attributable to the 12 shares of FA stock distributed to FP (20% of the \$120x section 1248(f) amount.)

(K) If DP1, DP2, and DC elect to apply the provisions of paragraph (c) of this section, then under paragraph (c)(2) of this section each share of FA stock received by DP1 (30 shares) and DP2 (18 shares) is divided into portions attributable to the CFC1 stock, the CFC2 stock and Business A. Under paragraphs (c)(4)(i) and (ii) of this section, the basis and fair market value of each portion of each share of FA stock is that amount of the total basis and fair market value of the FA stock that bears the same ratio that the fair market value of the property (exchanged for such FA stock) to which such portion relates bears to the aggregate fair market value of all property exchanged for the FA stock in the section 361 exchange.

(1) With respect to DP1's 30 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of \$3x (\$30x multiplied by \$40x/\$400x) and a fair market value of \$20x (\$200x multiplied by \$40x/\$400x); the portions attributable to the CFC2 stock have an aggregate basis of \$12x (\$30x multiplied by \$160x/\$400x) and a fair market value of \$80x (\$200x multiplied by \$160x/\$400x), and the portions attributable to Business A have an aggregate basis of \$15x (\$30x multiplied by \$200x/\$400x) and a fair market value of \$100x (50% of \$200x).

(2) With respect to DP2's 18 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of \$1.8x (\$18x multiplied by \$40x/\$400x) and a fair market value of \$12x (\$120x multiplied by \$40x/\$400x); the portions attributable to the CFC2 stock have an aggregate basis of \$7.2x (\$18x multiplied by \$160x/\$400x) and a fair market value of \$48x (\$120x multiplied by \$160x/\$400x); and the portions attributable to Business A have an aggregate basis of \$9x (\$18x multiplied by \$200x/\$400x) and a fair market value of \$60x (\$120x multiplied by \$200x/\$400x).

(3) Under § 1.1248-8(b)(2)(iv), the earnings and profits of CFC1 attributable to the portions of DP1's 30 shares of FA stock attributable to the CFC1 stock is \$13x (\$26x earnings and profits amount multiplied by DP1's 50% ownership interest (by value) in DC at the time of the section 361 exchange),

and the earnings and profits of CFC2 attributable to the portions of DP1's 30 shares of FA stock attributable to the CFC2 stock is \$62x (\$124x earnings and profits amount multiplied by DP1's 50% ownership interest in DC at the time of the section 361 exchange). Similarly, the earnings and profits of CFC1 attributable to the portions of DP2's 18 shares of FA stock attributable to the CFC1 stock is \$7.8x (\$26x earnings and profits amount multiplied by DP2's 30% ownership interest (by value) in DC at the time of the section 361 exchange), and the amount of earnings and profits of CFC2 attributable to the portions of DP2's 18 shares of FA stock attributable to the CFC2 stock is \$37.2x (\$124x earnings and profits amount multiplied by DP2's 30% ownership interest (by value) in DC at the time of the section 361 exchange). The \$26x earnings and profits with respect to the CFC1 stock equals the \$30x earnings and profits amount attributable to the CFC1 stock immediately before the section 361 exchange reduced by the \$4x included in income by DC as a dividend under section 1248(a) on the transfer of the CFC1 stock to FA in the section 361 exchange. The \$124x earnings and profits with respect to CFC2 equals the \$150x earnings and profits attributable to the CFC2 stock immediately before the section 361 exchange reduced by the \$26x amount included in income by DC as a dividend under section 1248(a) on the transfer of the CFC2 stock to FA in the section 361 exchange. See sections 959(e) and 1248(d)(1).

(L) Under paragraph (c)(3) of this section, DP1 is not required to reduce the aggregate section 358 basis of the portions of its 30 shares of FA stock attributable to the CFC1 stock or CFC2 stock. DP1's postdistribution amount (\$13x) attributable to the portions of its FA shares attributable to the CFC1 stock exceeds its allocable share of the section 1248(f) amount attributable to the CFC1 stock immediately after the section 361 exchange (\$8x, or 50% of \$16x). DP1's postdistribution amount (\$62x) attributable to the portions of its FA shares attributable to the CFC2 stock exceeds its allocable share of the section 1248(f) amount attributable to the CFC2 stock immediately after the section 361 exchange (\$52x, or 50% of \$104x).

(M) Similarly, DP2 is not required to reduce the aggregate section 358 basis of the portions of its 18 shares of FA stock attributable to the CFC1 stock or CFC2 stock. DP2's postdistribution amount (\$7.8x) attributable to the portions of its FA shares attributable to the CFC1 stock exceeds its allocable share of the section 1248(f) amount attributable to the CFC1 stock immediately after the section 361 exchange (\$4.8x, or 30% of \$16x). DP2's postdistribution amount (\$37.2x) attributable to the portions of its FA shares attributable to the CFC2 stock exceeds its allocable share of the section 1248(f) amount attributable to the CFC2 stock immediately after the section 361 exchange (\$31.2x, or 30% of \$104x).

Example 3. Section 361 distribution and adjustment to stock basis. (i) *Facts.* DP1 wholly owns DC. DP1's DC stock has a \$180x basis and a \$200x fair market value. DC wholly owns CFC1 and CFC2. DC's CFC1 stock has a \$70x basis, a \$100x fair market

value, and \$40x of earnings and profits attributable to it for purposes of section 1248. DC's CFC2 stock has a \$130x basis, a \$100x fair market value, and \$80x of earnings and profits attributable to it for purposes of section 1248. On December 31, Year 1, in a reorganization described in section 368(a)(1)(F), DC transfers the CFC1 stock and the CFC2 stock to FA, a newly formed corporation, in exchange for 100 shares of FA stock. DC distributes the 100 shares of FA stock to DP1 in a section 361 distribution. DC's transfer of the stock of CFC1 and CFC2 to FA in exchange for FA stock qualifies as a section 361 exchange. DP1 exchanges its DC stock for the 100 shares of FA stock pursuant to section 354. DP1 and DC elect to apply the rules of § 1.367(a)-7(c) in accordance with § 1.367(a)-7(c)(5). DC is not required to recognize gain under § 1.367(a)-7(c)(2), and DP1 is not required to reduce its section 358 basis in the FA shares under § 1.367(a)-7(c)(3).

(ii) *Result.* (A) DC is not required to include in income as a dividend the section 1248 amount attributable to the CFC1 stock under § 1.367(b)-4(b)(1)(i) because, immediately after the section 361 exchange, FA and CFC1 are controlled foreign corporations with respect to which DC is a section 1248 shareholder. At the time of the section 361 exchange the section 1248 amount attributable to the CFC2 stock is zero.

(B) Under § 1.1248(f)-1(b)(3), DC must generally include in income as a dividend the section 1248(f) amount (\$30x) attributable to the FA stock upon its distribution of such stock to DP1 in the section 361 distribution. The section 1248(f) amount is the amount that FA would include in income as a dividend under section 964(e) if it sold the CFC1 stock immediately after the section 361 exchange. Immediately after the section 361 exchange, the section 1248(f) amount attributable to the CFC2 stock is zero.

(C) However, if DP1 and DC elect to apply the rules of paragraph (c) of this section (as provided in paragraph (c)(1) of this section), then § 1.1248(f)-1(b)(3) shall not apply to DC's distribution of the FA stock to DP1. If that election is made then:

(1) Under paragraph (c)(2)(ii) of this section each share of FA stock received by DP1 is divided into one portion attributable to the CFC1 stock and one portion attributable to the CFC2 stock. Under paragraphs (c)(4)(i) and (ii) of this section, the basis and fair market value of each portion is that amount of the total section 358 basis and fair market value, respectively, of the FA stock that bears the same ratio that the fair market value of the property (the CFC1 stock and CFC2 stock) to which such portion relates bears to the aggregate fair market value of all property exchanged by DC for the FA stock in the section 361 exchange. Therefore, the portions attributable to the CFC1 stock have an aggregate basis of \$90x (\$180x multiplied by \$100x/\$200x) and a fair market value of \$100x (\$200x multiplied by \$100x/\$200x). The portions attributable to the CFC2 stock also have an aggregate basis of \$90x (\$180x multiplied by \$100x/\$200x) and a fair market value of \$100x (\$200x multiplied by \$100x/\$200x).

(2) Under § 1.1248-8(b)(2)(iv), the \$40x earnings and profits attributable to the CFC1

stock at the time of the section 361 exchange are attributed to the portions of the shares of FA stock that relate to the CFC1 stock. Similarly, the \$80x of earnings and profits attributable to the CFC2 stock are attributed to the portions of the 100 shares of the FA stock that relate to the CFC2 stock.

(3) Under paragraph (c)(3) of this section, DP1's aggregate section 358 basis in the portions of the 100 shares of FA stock attributable to the CFC1 stock (\$90x) is reduced by \$20x, the amount by which the section 1248(f) amount attributable to the CFC1 stock (\$30x) exceeds DP1's postdistribution amount (\$10x) with respect to the portions of the shares of FA stock attributable to the CFC1 stock. The postdistribution amount is the section 1248 amount attributable to the portions of the FA stock attributable to the CFC1 stock immediately after the section 361 distribution (\$100x fair market value less \$90x basis, and \$40x earnings and profits attributable to such portions). As adjusted, DP1's aggregate basis in the portions of the shares of FA stock attributable to the CFC1 stock is \$70x. No adjustment is required to DP1's aggregate basis in the portions of the FA stock attributable to the CFC2 stock because no portion of the \$30x section 1248(f) amount is attributable to the CFC2 stock.

Example 4. Section 361 exchange followed by distribution of stock pursuant to plan of reorganization. (i) *Facts.* DP1 owns all 100 outstanding shares of stock of DC. DP1's DC stock has a \$180x basis, \$200x fair market value, and 2 year holding period. DC owns all 60 shares of the outstanding stock of CFC1. DC's CFC1 stock has a \$50x basis, a \$60x fair market value, \$30x of earnings and profits attributable to it for purposes of section 1248, and a 3 year holding period. DC also owns all 40 shares of the outstanding stock of CFC2. DC's CFC2 stock has a \$30x basis, a \$40x fair market value, and \$20x of earnings and profits attributable to it for purposes of section 1248. DC also owns Business A that has a fair market value of \$100x. On December 31, Year 4, in a divisive reorganization described in section 368(a)(1)(D), DC transfers the CFC2 stock to CFC1 in exchange for 40 additional shares of CFC1 stock. DC then distributes the 100 shares of CFC1 stock to DP1. DC's transfer of the CFC2 stock to CFC1 qualifies as a section 361 exchange. DP1 and DC are eligible to and make the elections provided in § 1.367(a)-7(c)(5) and paragraphs (b) and (c) of this section.

(ii) *Result.* (A) DC is not required to recognize gain under § 1.367(a)-7(c)(2).

(B) Under section 358, DP1 must allocate the \$180x pre-distribution section 358 basis in its DC stock between the shares of DC stock and the shares of CFC1 stock held after the distribution based on the relative fair market values of such shares. After the allocation of the pre-distribution basis, the basis of DP1's DC stock is \$90x, and the basis of DP1's CFC1 stock is \$90x. With respect to the \$90x basis in the CFC1 stock, \$36x is attributable to the 40 shares of CFC1 stock received by DC in the section 361 exchange, and \$54x is attributable to the 60 shares of CFC1 stock owned by DC before the section 361 exchange.

(C) Pursuant to § 1.367(a)-7(c)(3)(ii)(A), any adjustment to basis required under § 1.367(a)-7(c)(3) applies only to the 40 shares of CFC1 stock received by DC in the section 361 exchange. Under § 1.367(a)-7(c)(3)(i), DP1 must reduce its section 358 basis (\$36x) in the 40 shares of CFC1 stock by \$6x, the amount by which DP1's 100% share of the inside gain (\$10x) exceeds DP2's outside gain (\$4x). DP1's share of inside gain is not reduced under § 1.367(a)-7(c)(2)(ii) because DC does not recognize gain on the transfer of the section 367(a) property in the section 361 exchange. The outside gain equals the product of the section 367(a) percentage (100%) and the amount by which the fair market value (\$40x) of the 40 shares of CFC1 stock exceeds DP1's section 358 basis of such stock (\$36x). After the \$6x reduction to stock basis required under § 1.367(a)-7(c)(3), but before the application of § 1.1248(f)-2(c)(2), DP1's basis in such 40 shares of CFC1 stock is \$30x.

(D) DC is not required to include in income as a dividend the section 1248 amount attributable to the CFC2 stock under § 1.367(b)-4(b)(1)(i), because immediately after the section 361 exchange CFC1 and CFC2 are both controlled foreign corporations with respect to which DC is a section 1248 shareholder.

(E) Because DP1 and DC elect to apply the rules under paragraph (c) of this section, § 1.1248(f)-1(b)(3) does not apply to DC's distribution to DP of the 40 shares of CFC1 stock received in the section 361 exchange.

(1) Under paragraph (c)(2) of this section, the 40 shares of CFC1 stock received by DC in the section 361 exchange are attributable to the CFC2 stock. Thus, the 40 shares are not required to be divided into portions under paragraph (c)(2) of this section because DC exchanged a single block of stock of CFC2 for the 40 shares of CFC1 stock in the section 361 exchange. The 40 shares of CFC1 stock have an aggregate basis of \$30x (after the adjustment described in paragraph (C) of this Example) and fair market value of \$40x.

(2) Under § 1.1248-8(b)(2)(iv), the \$20x of earnings and profits attributable to the CFC2 stock at the time of the section 361 exchange are attributable to the 40 shares of CFC1 stock.

(3) DP1's basis (\$30x) in the 40 shares of CFC1 stock attributable to the CFC2 stock is not required to be reduced under paragraph (c)(3) of this section because the section 1248(f) amount (\$10x) attributable to the 40 shares of CFC1 stock does not exceed DP1's postdistribution amount (\$10x) attributable to such stock. The postdistribution amount equals the amount that DP1 would be required to include in income as a dividend under section 1248(a) if it sold the 40 shares of CFC1 stock immediately after the distribution (\$40x fair market value, \$30x basis, and \$20x earnings and profits attributable to such stock for purposes of section 1248). The \$10x section 1248(f) amount equals the amount CFC1 would include in income as a dividend under section 964(e) if it sold the CFC2 stock received from DC immediately after the section 361 exchange.

(F) Because DP1 and DC make the election provided in paragraph (b)(1) of this section,

§ 1.1248(f)–1(b)(2) does not apply to DC's distribution to DP1 of the 60 shares of CFC1 stock it owned before the section 361 exchange.

(1) Under paragraph (b)(2) of this section, for purposes of section 1248, DP1 has a 3-year holding period in the 60 shares of CFC1 stock immediately after the distribution, the same holding period that DC had in such shares at the time of the distribution.

(2) Under paragraph (b)(3) of this section, DP1's section 358 basis in the 60 shares of CFC1 stock (\$54x) must be reduced by \$4x, the amount by which DC's section 1248 amount (\$10x) attributable to such shares immediately before the distribution exceeds DP1's postdistribution amount (\$6x) attributable to such shares immediately after the distribution. The \$6x postdistribution amount equals the amount that DP1 would be required to include in income as a dividend under section 1248(a) if it sold the 60 shares of CFC1 stock immediately after the distribution (\$60x fair market value, \$54x basis, and \$30x earnings and profits attributable to such stock for purposes of section 1248). After the reduction, DP1's basis in the 60 shares of CFC1 stock is \$50x.

(e) *Applicable cross-references.* For rules relating to the attribution of earnings and profits to the stock of a foreign corporation following certain nonrecognition transactions, see § 1.1248–8. For rules relating to a transfer of property by a domestic corporation to a foreign corporation in a section 361 exchange that precedes a section 355 distribution or section 361 distribution to which section 1248(f)(1) applies, see § 1.367(a)–7. For rules relating to an acquisition of the stock of a foreign corporation by another foreign corporation in a section 361 exchange, see § 1.367(b)–4. For rules relating to a section 355 distribution of stock of a foreign corporation by a domestic corporation, see §§ 1.367(b)–5(b)(1) and 1.367(e)–1.

Par. 14. Section 1.1248(f)–3 is added to read as follows:

§ 1.1248(f)–3 Reasonable cause exception and effective dates.

(a) *Reasonable cause exception for failure to comply—(1) General rule.* If a section 1248 shareholder or the domestic distributing corporation fails to comply with any requirement under § 1.1248(f)–2, the section 1248 shareholder or the domestic distributing corporation shall be considered to have complied with such requirement if it submits a request for relief as provided under paragraph (a)(2) of this section and can demonstrate to the Area Director, Field Examination, Small Business/Self Employed or the Director of Field Operations, Large and Mid-Size Business (Director) having jurisdiction of the section 1248 shareholder's or domestic distributing corporation's tax

return for the taxable year during which the distribution occurs, that such failure was due to reasonable cause and not willful neglect. Whether the failure to comply was due to reasonable cause and not willful neglect will be determined by the Director after considering all the facts and circumstances. The Director shall notify the section 1248 shareholder or domestic distributing corporation in writing within 120 days if it is determined that the failure to comply was not due to reasonable cause, or if additional time will be needed to make such determination. For this purpose, the 120-day period shall begin on the date the Internal Revenue Service notifies the section 1248 shareholder or domestic distributing corporation in writing that the request for relief has been received and assigned for review. Once such period commences, if the section 1248 shareholder or domestic distributing corporation is not again notified within 120 days, then the section 1248 shareholder or domestic distributing corporation shall be deemed to have established reasonable cause.

(2) *Requirements for reasonable cause relief—(i) Time of submission.* Requests for reasonable cause relief will only be considered if as soon as the section 1248 shareholder or domestic distributing corporation becomes aware of the failure to comply with any requirement of § 1.1248(f)–2, the section 1248 shareholder or domestic distributing corporation attaches the statements or other documents that should have been filed, as well as a complete written statement setting forth the reasons for the failure to comply, to an amended return that amends the return to which the documents should have been attached pursuant to § 1.1248(f)–2. The amended return and all required attachments must be filed with the applicable Internal Revenue Service Center with which the section 1248 shareholder or domestic distributing corporation filed its original return to which the documents should have been attached.

(ii) *Notice requirement.* In addition to the requirement of paragraph (a)(2)(i) of this section, the section 1248 shareholder or domestic distributing corporation must comply with the requirements of paragraph (a)(2)(ii)(A) or (B) of this section, as applicable.

(A) If the section 1248 shareholder or domestic distributing corporation is under examination for any taxable year when the request for reasonable cause relief is filed, a copy of the amended return and attachments must be provided to the Internal Revenue

Service personnel conducting the examination.

(B) If the section 1248 shareholder or domestic distributing corporation is not under examination for any taxable year when the request for reasonable cause relief is filed, a copy of the amended return and attachments must be provided to the Director having jurisdiction over the return.

(b) *Effective/applicability date.*

Sections 1.1248(f)–1 and 1.1248(f)–2 and this section shall apply to distributions occurring on or after the date 30 days after the date these regulations are published as final regulations in the **Federal Register**.

Par. 15. Section 1.6038B–1 is amended by revising paragraphs (c)(6), (f)(3), and the heading and the first sentence of paragraph (g)(1), and adding paragraph (g)(5), to read as follows:

§ 1.6038B–1 Reporting of certain transfers to foreign corporations.

* * * * *

(c) * * *

(6) *Transfers subject to section 367(a)(5)—(i) In general.* This paragraph applies to a domestic corporation (U.S. transferor) that transfers section 367(a) property (as defined in § 1.367(a)–7(f)(9)) to a foreign corporation in an exchange described in section 361(a) or (b) or in an exchange described in section 351 that is also described in section 361(a) or (b) (collectively, a section 361 exchange) and to which the provisions of § 1.367(a)–7(c) apply. Paragraph (c)(6)(ii) of this section establishes the time and manner for the U.S. transferor to elect to apply the provisions of § 1.367(a)–7(c). Paragraph (c)(6)(iii) of this section establishes the manner for the U.S. transferor to satisfy the requirement of § 1.367(a)–7(c)(4).

(ii) *Election.* The U.S. transferor elects to apply the provisions of § 1.367(a)–7(c) by including a statement entitled, STATEMENT TO ELECT TO APPLY EXCEPTION UNDER § 1.367(a)–7(c) with its timely-filed return (within the meaning of § 1.367(a)–7(f)(11)) for the taxable year during which the section 361 exchange occurs, that includes the information described in paragraphs (c)(6)(ii)(A) through (c)(6)(ii)(C) of this section. See § 1.367(a)–7(c)(5)(ii) for the statement required to be filed by a control group member, as defined in § 1.367(a)–7(f)(2), or final distributee, as defined in § 1.367(a)–7(d).

(A) The name and taxpayer identification number of each control group member and final distributee (if any), and the aggregate ownership interest (by value) in the U.S. transferor of each control group member or final distributee.

(B) A calculation of the gain recognized (if any) by the U.S. transferor under § 1.367(a)-7(c)(2)(i) and (ii).

(C) The date on which the U.S. transferor and each control group member or final distributee entered into the written agreement described in § 1.367(a)-7(c)(5)(iv).

(iii) *Agreement to amend U.S. transferor's tax return.* The U.S. transferor complies with the requirement of § 1.367(a)-7(c)(4)(i) by attaching a statement to its timely-filed return (within the meaning of § 1.367(a)-7(f)(11)) for the taxable year in which the section 361 exchange occurs, entitled STATEMENT UNDER § 1.367(a)-7(c)(4) FOR TRANSFERS OF ASSETS TO A FOREIGN CORPORATION IN A SECTION 361 EXCHANGE. The statement must certify that if the foreign acquiring corporation disposes of a significant amount (as defined in paragraph (c)(6)(iii)(A) of this section) of the section 367(a) property received from the U.S. transferor in the section 361 exchange in one or more related transactions described in paragraph (c)(6)(iii)(B) of this section, then the exception provided in § 1.367(a)-7(c) shall not apply to the section 361 exchange and the U.S. transferor shall recognize the gain realized but not recognized in the section 361 exchange. The U.S. transferor (or the foreign acquiring corporation on behalf of the U.S. transferor) shall file a U.S. income tax return (or amended U.S. income tax return, as the case may be) for the year of the section 361 exchange, reporting such gain.

(A) *Disposition of significant amount.* For purposes of this paragraph (c)(6)(iii), a disposition of a significant amount occurs if, in one or more related transactions, the foreign acquiring corporation disposes of an amount of the section 367(a) property received from the U.S. transferor in the section 361 exchange that is greater than 40 percent of the fair market value of all of the property transferred in the section 361 exchange.

(B) *Gain recognition transaction—(1) General rule.* A transaction is described in this paragraph (c)(6)(iii)(B) if the transaction is entered into with a principal purpose of avoiding the U.S. tax that would have been imposed on the U.S. transferor on the disposition of the property transferred to the foreign acquiring corporation in the section 361 exchange. A disposition may have a principal purpose of tax avoidance even if the tax avoidance purpose is outweighed by other purposes when taken together.

(2) *Presumptive tax avoidance.* For purposes of this paragraph (c)(6)(iii)(B), the principal purpose of the foreign acquiring corporation's disposition of a significant amount of the section 367(a) property within two years of the section 361 exchange (whether in a recognition or nonrecognition transaction) shall be presumed to be the avoidance of the U.S. tax that would have been imposed on the U.S. transferor on the disposition of the property transferred to the foreign acquiring corporation in the section 361 exchange. However, this presumption shall not apply if it is demonstrated to the satisfaction of the Area Director, Field Examination, Small Business/Self Employed or the Director of Field Operations, Large and Mid-Size Business (Director) that the avoidance of U.S. tax was not a principal purpose of the disposition.

(3) *Interest.* If additional tax is required to be paid as a result of a transaction described in paragraph (c)(6)(iii)(B) of this section, then interest must be paid on that amount at rates determined under section 6621 with respect to the period between the date prescribed for filing the U.S. transferor's income tax return for the year of the section 361 exchange and the date on which the additional tax for that year is paid.

* * * * *

(f) * * *

(3) *Reasonable cause exception for failure to comply—(i) Request for relief.* The provisions of paragraph (f)(1) of this section shall not apply if the U.S. transferor can demonstrate to the Area Director, Field Examination, Small Business/Self Employed or the Director of Field Operations, Large and Mid-Size Business (Director) having jurisdiction of the U.S. transferor's tax return for the taxable year, that a failure to comply was due to reasonable cause and not willful neglect. Whether the failure to comply was due to reasonable cause and not willful neglect will be determined by the Director after considering all the facts and circumstances. The Director shall notify the U.S. transferor in writing within 120 days if it is determined that the failure to comply was not due to reasonable cause, or if additional time will be needed to make such determination. For this purpose, the 120-day period shall begin on the date the Internal Revenue Service notifies the U.S. transferor in writing that the request for relief has been received and assigned for review. Once such period commences, if the U.S. transferor is not again notified within 120 days, then the U.S. transferor shall

be deemed to have established reasonable cause.

(ii) *Requirements for reasonable cause relief—(A) Time of submission.* Requests for reasonable cause relief will only be considered if, as soon as the U.S. transferor becomes aware of the failure to comply, the U.S. transferor attaches all the documents that should have been filed, as well as a complete written statement setting forth the reasons for the failure to timely comply, to an amended return that amends the return to which the documents should have been attached pursuant to the rules of section 6038B and the regulations under that section. The amended return and all required attachments must be filed with the applicable Internal Revenue Service Center with which the U.S. transferor filed its original return to which the documents should have been attached.

(B) *Notice requirement.* In addition to the requirement of paragraph (f)(3)(ii)(A) of this section, the U.S. transferor must comply with the requirements of paragraph (f)(3)(ii)(B)(1) or (2), as applicable.

(1) If the U.S. transferor is under examination for any taxable year when it requests relief, the U.S. transferor must provide a copy of the amended return and attachments to the Internal Revenue Service personnel conducting the examination.

(2) If the U.S. transferor is not under examination for any taxable year when it requests relief, the U.S. transferor must provide a copy of the amended return and attachments to the Director having jurisdiction over the U.S. transferor's return.

* * * * *

(g) *Effective/applicability dates.* (1) Except as provided in paragraphs (g)(2) through (5) of this section, this section applies to transfers occurring on or after July 20, 1998, except for transfers of cash made in tax years beginning on or before February 5, 1999 (which are not required to be reported under section 6038B), and except for transfers described in paragraph (e) of this section, which applies to transfers that are subject to §§ 1.367(e)-1(f) and 1.367(e)-2(e). * * *

(5) Paragraphs (c)(6) and (f)(3) of this section shall apply to transfers occurring on or after the date 30 days after the date these regulations are published as final regulations in the **Federal Register**. For guidance with respect to paragraphs (c)(6) and (f)(3) of this section before the date 30 days after the date these regulations are published as final regulations in the **Federal Register**, see 26 CFR part 1 revised as of

April 1 for the year before the date these regulations are published as final regulations in the **Federal Register**.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

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