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Internal Revenue Service

26 CFR Parts 1 and 602

Certain Outbound Property Transfers by Domestic Corporations; Certain Stock Distributions by Domestic Corporations; Indirect Stock Transfers and the Coordination Rule Exceptions; Transfers of Stock or Securities in Outbound Asset Reorganizations; Final Rules and Proposed Rule

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Parts 1 and 602**

[TD 9614]

RIN 1545-AM97

**Certain Outbound Property Transfers by Domestic Corporations; Certain Stock Distributions by Domestic Corporations****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final and temporary regulations.

**SUMMARY:** This document contains final and temporary regulations that apply to transfers of certain property by a domestic corporation to a foreign corporation in certain nonrecognition exchanges, or to distributions of stock of certain foreign corporations by a domestic corporation in certain nonrecognition distributions. The final regulations also establish reporting requirements for property transfers and stock distributions to which the final regulations apply. The regulations affect domestic corporations that transfer property to foreign corporations in certain nonrecognition transactions, or that distribute the stock of certain foreign corporations in certain nonrecognition distributions, and certain domestic shareholders of those domestic corporations.

**DATES:** *Effective date:* These regulations are effective on March 19, 2013.

*Applicability dates:* For dates of applicability, see §§ 1.367(a)-1(g), 1.367(a)-3(g), 1.367(a)-7(j), 1.367(b)-6, 1.1248-1(g), 1.1248-6(e), 1.1248-8(d), 1.1248(f)-3(b), and 1.6038B-1(g).

**FOR FURTHER INFORMATION CONTACT:** Robert B. Williams, Jr., (202) 622-3860 (not a toll-free number).**SUPPLEMENTARY INFORMATION:****Paperwork Reduction Act**

The collections of information contained in the regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2183.

The collections of information are in §§ 1.367(a)-7(c) and (e)(2), 1.367(a)-8(c), 1.1248(f)-2(a)(3), (b)(1) and (c)(1), and 1.6038B-1(c)(6). The collections of information are mandatory. The likely respondents are domestic corporations.

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.

Books and records relating to a collection of information must be retained as long as their contents might 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**

On August 20, 2008, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued proposed regulations under sections 367, 1248, and 6038B of the Internal Revenue Code (Code) (2008 proposed regulations) concerning transfers of property by a domestic corporation to a foreign corporation in an exchange described in section 361(a) or (b) (section 361 exchange), and certain nonrecognition distributions of stock of a foreign corporation by a domestic corporation (REG-209006-89; 73 FR 49278, 2008-41 IRB 867). A correction to the 2008 proposed regulations was published in the **Federal Register** on September 26, 2008 (73 FR 56535; 2008-41 IRB 867). No public hearing on the 2008 proposed regulations was requested or held; however, comments were received. Based, in part, on comments received, the Treasury Department and the IRS adopt the 2008 proposed regulations, with modifications, as final regulations. As discussed in paragraph G. of this preamble, a portion of the 2008 proposed regulations is adopted, with modifications, in temporary regulations published elsewhere in this issue of the **Federal Register**. Those temporary regulations also modify final regulations under section 367(a) concerning transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange. All comments will be available at [www.regulations.gov](http://www.regulations.gov) or upon request.

**Summary of Comments and Explanation of Revisions***A. Regulations Under Section 367(a)(5)*

## 1. Overview

In general, section 367(a)(5) provides that the exceptions to section 367(a)(1) in section 367(a)(2) and (a)(3) do not apply in the case of a section 361 exchange in which a domestic corporation (U.S. transferor) transfers assets to a foreign corporation, unless the U.S. transferor is controlled (within the meaning of section 368(c)) by five or fewer (but at least one) domestic corporations (each a control group member, and together the control group)

and basis adjustments and other conditions as provided in regulations are satisfied. The policy underlying section 367(a)(5) is the protection of corporate-level gain on appreciated property following the repeal of the *General Utilities* doctrine. See H.R. Rep. No 795, 100th Cong., 2d Sess. 60 (1988).

The 2008 proposed regulations would implement section 367(a)(5) by providing that, as a general rule, the exceptions to section 367(a)(1) do not apply to a transfer of certain property by the U.S. transferor to a foreign acquiring corporation in a section 361 exchange. An exception to the general rule is provided, at the election of the U.S. transferor and members of the control group (elective exception), subject to conditions that are intended, in part, to ensure that the net gain (if any) realized by the U.S. transferor in connection with the transfer of property subject to section 367(a) (defined as *inside gain*) is, in the aggregate, recognized currently by the U.S. transferor or, to the extent permitted, preserved in the stock received in the reorganization by certain domestic corporate shareholders of the U.S. transferor.

Section 337(d) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986 (concerning the repeal of the *General Utilities* doctrine), including regulations providing for appropriate coordination of the provisions of section 337 with the provisions of the Code relating to taxation of foreign corporations and their shareholders.

## 2. Calculation of Inside Gain

In addition to the adjusted basis of certain transferred property, for purposes of computing inside gain, the 2008 proposed regulations take into account certain liabilities of the U.S. transferor that would give rise to a deduction when paid (deductible liabilities). Under the 2008 proposed regulations, a deductible liability would be defined as a liability assumed in the section 361 exchange or satisfied in connection with the reorganization (within the meaning of section 361(c)(3)), but only if payment of the liability would give rise to a deduction. Section 361(c)(3) provides that the U.S. transferor recognizes no gain or loss on the satisfaction of a liability with stock received in connection with the reorganization, but does not prevent the U.S. transferor from obtaining a deduction on payment of the liability with the stock received. The policy for allowing a deductible liability to reduce

inside gain is that the U.S. transferor has not received a tax benefit for such liability but the liability reduces the value of the stock received.

Accordingly, under the final regulations, a deductible liability is limited to a liability that is assumed in the section 361 exchange if payment of the liability would give rise to a deduction.

Several comments suggested that other tax attributes of the U.S. transferor should also be taken into account in computing inside gain (in particular, net operating losses and foreign tax credits) because those other tax attributes are similar to the adjusted basis of the transferred property and deductible liabilities. Recognizing the complexity that would result if other tax attributes were taken into account, other comments suggested that the final regulations permit the U.S. transferor to elect to recognize an amount of gain sufficient to utilize all or a portion of any additional tax attributes. Another comment, however, considered this recommendation to be inconsistent with the basic approach of section 367(a)(1), which only takes into account the adjusted basis of the transferred property in determining the amount of gain required to be recognized by the U.S. transferor.

The Treasury Department and the IRS believe that taking into account other tax attributes of the U.S. transferor in determining inside gain would substantially increase the complexity of the final regulations and IRS examinations of these transactions. In addition, a U.S. transferor can utilize any other available tax attributes by not electing to apply the elective exception. Accordingly, the comment was not adopted.

### 3. Built-In Loss in Stock of the U.S. Transferor Corporation

To qualify for the elective exception under the 2008 proposed regulations, each control group member must reduce its adjusted basis (as determined under section 358) in the stock received in the reorganization by the amount (if any) that its portion of the inside gain exceeds the gain (or loss) in that stock (outside gain) but for the application of section 367(a)(5). In certain cases, the required basis adjustment will convert built-in loss stock into built-in gain stock. For example, assume that prior to the application of the elective exception the control group member has a \$150x adjusted basis (as determined under section 358) in stock received that has a fair market value of \$100x (that is, there is a \$50x built-in loss in the stock). If the control group member's share of

inside gain is \$30x, its adjusted basis in the stock received must be reduced to \$70x, resulting in \$30x of built-in gain in the stock and eliminating the \$50x pre-existing built-in loss.

Several comments suggested that reducing the adjusted basis of built-in loss stock to this extent is inappropriate and recommended that final regulations treat a reduction to an existing built-in loss the same as a reduction to basis that would increase built-in gain. For example, under the previous assumed facts, the approach in these comments would reduce the adjusted basis of the stock by \$30x (the control group member's share of inside gain), reducing the built-in loss to \$20x.

Another comment recommended that the provisions be modified to preserve both the domestic corporate shareholder's share of inside gain as well as the built-in gain (or loss) existing in the stock received before any required basis adjustment. Specifically, the comment suggested that any outside built-in gain (loss) should be treated as a deferred gain (loss) that would be taken into account based on principles similar to those of section 267(a)(1).

Consistent with the legislative history to section 367(a)(5), the Treasury Department and the IRS believe that the amount of outside built-in gain or loss should not affect the required reduction to the adjusted basis of the stock received in the transaction. That is, the basis must be reduced to an amount such that the gain in the stock corresponds to the proportionate amount of inside gain. See S. Rep. No. 445, 100th Cong., 2d Sess. 62-3 (1988). Therefore, the final regulations do not adopt these recommendations. The final regulations do, however, clarify that if a U.S. transferor does not have inside gain, that is, there is no net built-in gain in the U.S. transferor's assets, stock basis adjustments are not required to be made by control group members, even if the outside stock loss of a control group member is greater than the net built-in loss attributable to the control group member.

### 4. Disposition of a Significant Amount of Section 367(a) Property

The 2008 proposed regulations would deny the application of the elective exception if, with a principal purpose of avoiding U.S. tax, the foreign acquiring corporation disposes of a significant amount of the property received from the U.S. transferor (disposition rule).

Several comments recommended that the disposition rule be conformed to the provisions of § 1.367(a)-8 concerning gain recognition agreements. Specifically, one comment

recommended that a defined period be set for the reach of the disposition rule. In this regard, the gain recognition agreement provisions generally require gain recognition only if a triggering event occurs during the term of the gain recognition agreement, which is the period ending with the close of the fifth full taxable year (not less than 60 months) following the year in which the transfer requiring the gain recognition agreement occurred.

Another comment recommended that the final regulations include provisions similar to those of the gain recognition provisions in § 1.367(a)-8(k)(14) to address nonrecognition transfers of property. Those provisions generally provide that a transfer of assets subject to a gain recognition agreement during the term of the gain recognition agreement in certain nonrecognition transactions will not be triggering events if specified conditions are satisfied. Other comments suggested that this disposition rule is not necessary because § 1.367(a)-2T(c)(1) denies the exception under section 367(a)(3) in certain cases when the transferred property is re-transferred to another person as part of the same transaction.

The Treasury Department and the IRS believe that safeguards in addition to § 1.367(a)-2T(c)(1) are needed in the case of outbound reorganizations that qualify for the elective exception, but agree that adopting certain aspects of the gain recognition agreement provisions is appropriate. Accordingly, the final regulations deny the elective exception only if, with a principal purpose of avoiding U.S. tax, the foreign acquiring corporation disposes of a significant amount of the property received from the U.S. transferor during the 60-month period that begins on the date of distribution or transfer (within the meaning of § 1.381(b)-1(b)), which generally is the date on which the transfer of property by the U.S. transferor to the foreign acquiring corporation is completed.

Furthermore, the final regulations provide that property that is subsequently transferred pursuant to a nonrecognition provision is not treated as disposed of for purposes of the disposition rule, provided such transfer satisfies, and is treated in a manner consistent with the principles underlying § 1.367(a)-8(k) (concerning non-triggering events with respect to gain recognition agreements) and more generally the provisions of § 1.367(a)-8 concerning gain recognition agreements.

Finally, one comment suggested that dispositions of property in the ordinary course of business should not deny the application of the elective exception,

even if the disposition occurs within the two-year “presumption of tax avoidance” period following the reorganization. The Treasury Department and the IRS agree with this comment. Accordingly, the final regulations provide an exception for dispositions of property occurring in the ordinary course of business.

#### 5. Definitions of Section 367(a) Property and Section 367(d) Property

Subject to a special rule, the 2008 proposed regulations define section 367(a) property as any property other than section 367(d) property. The 2008 proposed regulations define section 367(d) property as property to which section 367(d) applies.

In response to a comment, the final regulations clarify that section 367(d) property is property described in section 936(h)(3)(B). Section 367(d)(1) provides that, except as provided in regulations, if a United States person transfers any intangible property (within the meaning of section 936(h)(3)(B)) to a foreign corporation in an exchange described in section 351 or 361, section 367(d) (and not section 367(a)) applies to such transfer. Accordingly, income or gain attributable to the transfer of property by a U.S. person to a foreign corporation in a section 351 exchange or section 361 exchange is taken into account either in accordance with section 367(d)(2)(A)(ii)(I) or (d)(2)(A)(ii)(II), or in accordance with section 367(a) and the regulations thereunder in the case of a section 361 exchange subject to section 367(a)(5). For guidance concerning transfers of section 367(d) property in outbound asset reorganizations, see Notice 2012–39 (IRB 2012–31) (see § 601.601(d)(2)(ii)(b) of this chapter).

#### 6. Treatment of a RIC, REIT, or S Corporation

One comment suggested that if the policy of section 367(a)(5) is to preserve U.S. taxing jurisdiction over corporate-level gain, then section 367(a)(5) should not generally apply to a regulated investment company (RIC), real estate investment trust (REIT), or S corporation (collectively, special corporate entities), because those entities generally are not subject to corporate-level tax. The comment further suggested that to the extent those special corporate entities are subject to corporate-level tax, the final regulations should incorporate a targeted gain recognition rule to address those limited situations. In contrast, another comment noted that exempting special corporate entities from the application of section 367(a)(5) could facilitate the use of

special corporate entities to avoid U.S. tax. A third comment asserted that, at a minimum, even though special corporate entities may not generally be subject to corporate-level tax, special corporate entities should be permitted to be members of the control group, because the amount of inside gain preserved in stock received by special corporate entities could, when recognized, be wholly or partly subject to U.S. tax in the hands of shareholders of the special corporate entities.

The Treasury Department and the IRS remain concerned about exempting special corporate entities from the application of section 367(a)(5). Section 367(a)(1) addresses transfers of certain appreciated property by a United States person to a foreign corporation in certain nonrecognition exchanges described in subchapter C of the Code. This general rule applies equally to special corporate entities, as it does to any U.S. person, including any domestic corporation. Although special corporate entities are generally not subject to entity-level tax, the underlying income (including built-in gain in assets) flows through to their owners. Because the owners of special corporate entities generally receive a basis determined under section 358 in the shares of the foreign acquiring corporation, preservation of corporate-level tax on the inside gain is not assured.

The Treasury Department and the IRS also remain concerned about allowing special corporate entities to be members of the control group. If a special corporate entity was allowed to be a member of the control group, whether the inside gain preserved in the hands of a special corporate entity is ever subject to U.S. corporate tax would depend on the extent of the domestic corporate ownership of the special corporate entity at the time the gain is recognized. The domestic corporate ownership at the time the gain is recognized may decrease or increase from the time the reorganization occurred.

Accordingly, the final regulations do not adopt the recommendations to provide relief from the application of section 367(a)(5) to special corporate entities, or allow special corporate entities to be control group members.

#### 7. Indirect Stock Ownership

Several comments recommended that the final regulations permit indirect ownership of the U.S. transferor through partnerships or foreign corporations to be taken into account for purposes of satisfying the control requirement of section 367(a)(5). Section 367(a)(5), however, incorporates the control

requirement of section 368(c), which requires the direct ownership of stock. Furthermore, there is no indication in the legislative history to section 367(a)(5) that indirect stock ownership should also be considered for this purpose. In addition, as noted in the preamble to the 2008 proposed regulations, the Treasury Department and the IRS are concerned with the additional complexity that would result if indirect ownership were taken into account. Thus, the final regulations do not adopt this recommendation.

#### 8. Treatment of Affiliated Group Members as a Single Corporation

The 2008 proposed regulations provide that members of an affiliated group of corporations (within the meaning of section 1504) are treated as a single corporation for purposes of the control requirement of section 367(a)(5). Several comments stated that the wording of this aggregation rule could be read to suggest that the affiliated group members are also treated as a single corporation for other purposes, including, for example, to determine the amount of any required stock basis adjustments. The final regulations revise the aggregation rule to clarify that affiliated group members are treated as a single corporation only for purposes of the control requirement.

#### 9. Transfers Described in Other Nonrecognition Provisions

The 2008 proposed regulations clarify that section 367(a)(5) applies to a transfer of property described in section 351 if the transfer is also described in section 361(a) or (b). This clarification ensures that the policies underlying section 367(a)(5) are not undermined by transfers described in section 361(a) or (b) that also qualify for nonrecognition under section 351.

One comment suggested that transfers described in section 361(a) or (b) could also be described in nonrecognition provisions other than section 351, such as section 354. In response to this comment, the general rule in the final regulations is modified to provide that, unless an exception applies, the U.S. transferor recognizes any gain realized with respect to section 367(a) property. Thus, for purposes of recognizing gain under the general rule it is irrelevant whether, in addition to section 361(a) or (b), the transfer is also eligible for nonrecognition treatment under other exchanges enumerated in section 367(a)(1). Moreover, the general rule is issued under regulatory authority granted under both section 367(a)(5) and section 337(d). Accordingly, if a transfer of items of property that is described in

section 361(a) or (b) is also described in a nonrecognition provision that is not enumerated in section 367(a)(1) (such as section 1036), the U.S. transferor recognizes gain or loss realized on the transfer of such items of property, but the amount of loss recognized on the property shall not exceed the amount of gain recognized on the property. The Treasury Department and the IRS believe that permitting the recognition of losses to the extent of gains in such a case is consistent with the repeal of the *General Utilities* doctrine. See section 337(d). However, losses described in the prior sentence may be subject to other limitations, including, for example, section 267(f).

#### 10. Other Clarifications and Modifications

The 2008 proposed regulations provide for various determinations to be made “at the time of the section 361 exchange,” and therefore do not take into account the possibility that the property of the U.S. transferor may not be transferred on a single date to the foreign acquiring corporation. Accordingly, the final regulations no longer use the phrase “at the time of the section 361 exchange” as the time for making certain determinations required under the regulations. For example, under the final regulations the determination as to whether the control requirement is satisfied is instead made immediately before the reorganization.

Under the final regulations, the computation of a shareholder's ownership interest percentage in the U.S. transferor for purposes of various calculations also generally must be made immediately before the reorganization. However, the final regulations further revise the computation of the ownership interest percentage to take into account certain distributions by the U.S. transferor of a portion of its property. Specifically, under the final regulations, the ownership interest percentage is determined after taking into account any distribution by the U.S. transferor of money or other property not received from the foreign acquiring corporation in exchange for property of the U.S. transferor acquired in the section 361 exchange.

The final regulations remove references in the 2008 proposed regulations to stock that is deemed received because references to stock received necessarily include stock that is deemed received. No substantive change is intended by the removal of references to stock that is deemed received. Similarly, in describing a control group member's stock basis

adjustments, the final regulations remove references to blocks of stock because such references are not necessary to the determination of which basis in stock is reduced. No substantive change is intended by this modification.

The 2008 proposed regulations contain a reasonable cause relief provision in § 1.367(a)-7(e)(2), pursuant to which a control group member's failure to timely comply with any requirement of § 1.367(a)-7 will be deemed not to have occurred if the failure was due to reasonable cause and not willful neglect. The reasonable cause relief provision includes a provision that the control group member will be deemed to have established that the failure to comply was due to reasonable cause and not willful neglect if the control group member requesting relief is not notified by the IRS within 120 days of IRS acknowledgement of receipt of the request. As discussed in the preamble to temporary regulation published elsewhere in this issue of the **Federal Register**, the Treasury Department and the IRS believe it is appropriate to eliminate the 120-day provision from the reasonable cause relief provision of § 1.367(a)-7(e)(2). Other than the elimination of the 120-day provision, the reasonable cause relief provision is retained in the temporary regulations.

Other modifications to § 1.367(a)-7 are generally intended to coordinate the rules with other provisions, such as §§ 1.367(a)-3T(e), 1.367(b)-4, 1.1248(f)-1, and 1.1248(f)-2, when the property transferred in the section 361 exchange is stock or securities.

#### B. Other Regulations Under Section 367(a)

The 2008 proposed regulations would modify § 1.367(a)-1T(b)(4)(i)(B) to provide that an increase in basis under section 362 for gain recognized by the U.S. transferor under section 367(a) is allocated among the transferred property with respect to which gain is recognized in proportion to the gain realized by the U.S. transferor.

The final regulations clarify this rule to provide that if gain is recognized under section 367 with respect to a particular item of property, the foreign transferee corporation increases its basis in that item of property for such gain. The final regulations further clarify that any gain recognized that is not with respect to a particular item of property (for example, gain recognized under the branch loss recapture rules) is then allocated in proportion to the gain realized by the U.S. transferor with respect to all items of property transferred, but for this purpose the gain

realized is determined after taking into account gain recognized under other provisions of section 367 that apply with respect to particular items of property.

#### C. Regulations Under Section 367(b)

##### 1. Modified Example 4 of § 1.367(b)-4(b)(1)

Final regulations issued under section 367(b) on January 24, 2000, provide that if a U.S. transferor that is a section 1248 shareholder of a foreign acquired corporation transfers the stock of such corporation to a foreign acquiring corporation in a section 361 exchange, the U.S. transferor must include in income the section 1248 amount attributable to the stock of the foreign acquired corporation. As part of the analysis, the final regulations state that immediately after the exchange, the U.S. transferor is not a section 1248 shareholder because the stock of the U.S. transferor is cancelled. This is the case even if the foreign acquiring corporation and the foreign acquired corporation are controlled foreign corporations (within the meaning of § 1.367(b)-2(a)). See § 1.367(b)-4(b)(1)(iii), *Example 4*. The 2008 proposed regulations would modify § 1.367(b)-4(b)(1)(iii), *Example 4*, to provide that the requirements in § 1.367(b)-4(b)(1)(i)(B) are applied immediately after the section 361 exchange (and before the distribution of the foreign stock under section 361(c)(1)).

One comment requested that the analysis in *Example 4*, as revised by the 2008 proposed regulations, be clarified to address the fact that the stock of the foreign corporation received in the transaction is immediately distributed by the U.S. transferor. That is, the comment questioned whether the analysis has the effect of respecting the transitory ownership of stock for purposes of applying § 1.367(b)-4. The comment further noted that Revenue Ruling 83-23 (1983-1 CB 82) disregards transitory ownership of stock for purposes of applying the section 367(b) regulations then in effect.

Unless otherwise provided, judicial doctrines and principles, such as substance-over-form and the step-transaction doctrine, apply in determining whether the conditions for an income inclusion under § 1.367(b)-4(b)(1) are satisfied, just as such principles and doctrines apply for purposes of determining the appropriate treatment of a transaction under any provision of section 367 (and more generally, section 1248). Thus, for example, an issuance of stock by the

foreign acquiring corporation in connection with the exchange being tested under § 1.367(b)-4 would be taken into account in determining whether an income inclusion under § 1.367(b)-4(b)(1) is required. Nevertheless, for purposes of applying § 1.367(b)-4(b)(1), the Treasury Department and the IRS believe it is appropriate to respect the ownership of stock by the U.S. transferor in the context of outbound section 361 exchanges (such as the transaction addressed in *Example 4*). This treatment is appropriate because the section 1248 amount in the stock of the foreign acquired corporation will, in the aggregate, either be preserved in the hands of certain domestic corporate shareholders of the U.S. transferor pursuant to § 1.1248(f)-2(c), or be included in the gross income of the U.S. transferor as a result of the distribution of such stock under section 361(c) pursuant to § 1.1248(f)-1(b)(3). Accordingly, the final regulations provide that in the case of an outbound transfer of stock of a foreign corporation in a section 361 exchange, the requirements of § 1.367(b)-4(b)(1)(ii)(B) apply after the section 361 exchange, but prior to and without taking into account the U.S. transferor's distribution under section 361(c)(1).

## 2. Other Modifications to § 1.367(b)-4

The final regulations modify § 1.367(b)-4(b)(1) by expanding the type of exchanges for which an income inclusion is not required to include a section 361 exchange of foreign stock by a foreign target that is itself acquired in a triangular asset reorganization involving stock of a domestic controlling (parent) corporation. Furthermore, the final regulations modify the format and organization of § 1.367(b)-4(a) and (b)(1) to clarify its application.

### D. Section 1248(f) Regulations and Section 1.1248-8

#### 1. Section 337 Distributions

The 2008 proposed regulations under section 1248(f) would provide exceptions to the operative rule of section 1248(f)(1) that requires a domestic corporation (distributing corporation) that distributes stock of certain foreign corporations under sections 337, 355(c)(1), or 361(c)(1) to include in income the section 1248 amount (if any) in the foreign stock distributed. Except in the case of a section 337 distribution, the exceptions apply only if an affirmative election is made (assuming the requirements for making the election are satisfied). The

requirements for the election include making adjustments to the basis and holding period of the stock in the hands of the distributee to the extent necessary to preserve the section 1248 amount in the foreign stock in the hands of the distributee. In the case of a section 337 distribution, the exception applies if certain conditions are satisfied without the need to make adjustments to the basis or holding period of the distributed stock, which should generally be the case. However, the Treasury Department and the IRS believe that taxpayers should be permitted to elect to make any necessary basis and holding period adjustments to avoid a section 1248 inclusion for section 337 distributions. The final regulations are modified accordingly.

#### 2. Section 361(c)(1) Distributions of Stock Involving Section 361 Exchanges

##### (a) Interaction With Regulations Under Section 367(a)

Application of the 2008 proposed regulations under section 1248(f), in combination with the 2008 proposed regulations under § 1.367(a)-7, could in certain cases result in aggregate basis adjustments and gain recognition (or deemed dividend inclusions) that exceed the built-in gain in the property transferred by the U.S. transferor in the section 361 exchange. The final regulations are modified to address this result.

##### (b) Allocation of Section 358 Basis to Portions of a Share

If in a section 361 exchange the U.S. transferor transfers property, other than a single block of stock of a foreign corporation with respect to which the U.S. transferor is a section 1248 shareholder, each share of stock of the foreign distributed corporation is required to be divided into portions. The 2008 proposed regulations would provide that for purposes of computing basis in a portion of a share of stock of the foreign distributed corporation, the distributee section 1248 shareholder's section 358 basis in that share is allocated to a portion of a share pro rata based on the fair market value of the property to which the portion relates relative to the aggregate fair market value of all property received by the foreign distributed corporation.

The final regulations modify this rule, providing that the distributee's section 358 basis in a share of the distributed foreign corporation is allocated to a portion of a share pro rata based on the basis of the property to which the portion relates relative to the aggregate basis of all property received by the

foreign distributed corporation. As a result of this modification, the aggregate built-in gain in the respective portion of all shares to which a block of foreign stock transferred with a section 1248 amount relates will more closely match the built-in gain in such foreign stock transferred. Because the section 1248 amount is limited to the built-in gain in the stock, the modification will minimize basis reductions to portions of shares that may otherwise be required to preserve the section 1248 amount in foreign stock transferred.

##### (c) Preservation of the Section 1248(f) Amount

The 2008 proposed regulations would provide that if the section 1248(f) amount attributable to a portion of a share of stock (including a whole share, if appropriate) of the foreign distributed corporation received by a distributee section 1248 shareholder in the distribution exceeds the distributee section 1248 shareholder's postdistribution amount in the portion (excess amount), then the distributee section 1248 shareholder's section 358 basis in the portion is reduced by the excess amount.

The final regulations modify the 2008 proposed regulations to provide that the section 358 basis in the portion is not reduced below zero, and therefore to the extent the excess amount exceeds the section 358 basis in the portion, the domestic distributing corporation must include that portion of the section 1248(f) amount attributable to the portion of the share in gross income as a dividend. The excess amount can exceed the section 358 basis in the portion, for example, where the section 1248(f) amount attributable to the control group member exceeds the inside gain attributable to the control group member.

The Treasury Department and the IRS considered whether a distributee required to decrease basis in a portion of a share should be allowed to increase the basis in another portion of the same share or in another share (or portion thereof). Due to additional complexities that would arise from such rules, such as ensuring that the basis increase does not decrease the section 1248(f) amount in another portion or create (or increase) a built-in loss in another portion, the Treasury Department and the IRS decline to provide such rules. However, the modification made by the final regulations providing that the section 358 basis in a share of stock is allocated among portions of such share of stock based on the basis (rather than the fair market value) of the property transferred to the foreign distributed corporation in the section 361 exchange will, in many

cases, minimize the amount of basis decreases.

#### (d) Multiple Classes of Stock

The 2008 proposed regulations did not provide rules for situations in which multiple classes of stock of the foreign distributed corporation are received. The final regulations provide that if multiple classes of stock are received by a control group member, the section 1248(f) amount “traced” to such control group member is attributed to a share (or portion of a share) of stock received by the control group member based on the ratio of the fair market value of such share to the fair market value of all shares received by the control group member. Furthermore, the final regulations make consistent modifications to the regulations under § 1.1248–8 (concerning the attribution of section 1248 earnings and profits of stock of a foreign corporation transferred in a section 361 exchange to a share or portion of a share of stock of the foreign distributed corporation received by a section 1248 shareholder).

#### 3. Other Modifications to the Section 1248(f) Regulations

The final regulations clarify that if the domestic distributing corporation distributes stock of the foreign distributed corporation that it did not receive in a section 361 exchange (existing stock) in addition to stock of the foreign distributed corporation that it did receive in the section 361 exchange (new stock), then certain rules apply to the existing stock and another set of rules apply to the new stock. This could occur, for example, if the domestic distributing corporation owns an existing foreign subsidiary and as part of the plan that includes a distribution of that stock that qualifies under section 355, the domestic distributing corporation contributes additional property to the foreign subsidiary in exchange for additional stock of the foreign subsidiary.

The final regulations refer to a distribution of stock that is not received in a section 361 exchange as an “existing stock distribution,” and a distribution of stock received in a section 361 exchange as a “new stock distribution.”

The 2008 proposed regulations contain a reasonable cause relief provision in § 1.1248(f)–3, pursuant to which a reporting person’s failure to timely comply with any requirement of § 1.1248(f)–2 will be deemed not to have occurred if the failure was due to reasonable cause and not willful neglect. The reasonable cause relief provision includes a provision that the

reporting person will be deemed to have established that the failure to comply was due to reasonable cause and not willful neglect if the control group member requesting relief is not notified by the IRS within 120 days of IRS acknowledgement of receipt of the request. As discussed in the preamble to temporary regulation published elsewhere in this issue of the **Federal Register**, the Treasury Department and the IRS believe it is appropriate to eliminate the 120-day provision from the reasonable cause relief provision of § 1.1248(f)–3. Other than the elimination of the 120-day provision, the reasonable cause relief provision is retained in the temporary regulations.

#### E. Definition of “Sale or Exchange” for Purposes of Section 1248

The 2008 proposed regulations amended § 1.1248–1(b) to clarify the definition of the term “sale or exchange” to include gain recognized under section 301(c)(3). No changes to § 1.1248–1(b) are included as part of these final regulations because after issuance of the 2008 proposed regulations a temporary regulation was issued that included this amendment. See § 1.1248–1T(b), issued in TD 9444 (February 10, 2009), and changes finalized by TD 9585 (April 24, 2012).

#### F. Regulations Under Section 6038B

The 2008 proposed regulations contain various reporting requirements. For example, the 2008 regulations under section 6038B describe how the U.S. transferor makes the election under § 1.367(a)–7(c), including requiring the U.S. transferor to file a statement containing specified information. The final regulations identify certain additional items of information that must be included with the statement making the election. The 2008 regulations also require the U.S. transferor to file a statement agreeing to file an amended return in certain cases if the foreign acquiring corporation subsequently disposes of a significant amount of section 367(a) property acquired in the section 361 exchange. The final regulations modify the disposition rules to provide that certain dispositions of section 367(a) property are not dispositions for this purpose.

Finally, as discussed in the preamble to temporary regulation published elsewhere in this issue of the **Federal Register**, the Treasury Department and the IRS believe it is appropriate to eliminate the 120-day provision from the reasonable cause relief procedures of § 1.6038B–1(f)(3). Other than the elimination of the 120-day provision,

the reasonable cause relief provision is retained in the temporary regulations.

#### G. Elimination of Coordination Rule Exception in § 1.367(a)–3(d)(2)(vi)(B)(1)(i)

Section 1.367(a)–3(d)(2)(vi)(A) (coordination rule) provides that if in connection with an indirect stock transfer, as defined in § 1.367(a)–3(d)(1), a U.S. person transfers assets to a foreign corporation (direct asset transfer) in an exchange described in sections 351 or 361, the rules of section 367 and the regulations under that section apply first to the direct asset transfer and then to the indirect stock transfer. However, the regulations provide two exceptions to the coordination rule for asset reorganizations to the extent the foreign acquiring corporation re-transfers the transferred assets to a controlled domestic corporation, but only if such domestic corporation’s basis in the re-transferred assets is not greater than the U.S. transferor corporation’s basis in the assets and the conditions in either paragraph § 1.367(a)–3(d)(2)(vi)(B)(1)(i) or (d)(2)(vi)(b)(1)(ii) are satisfied. The 2008 proposed regulations would modify the exceptions to the coordination rule exceptions, including clarifications described in Notice 2008–10 (2008–1 CB 277).

As discussed in the preamble to temporary regulations published elsewhere in this issue of the **Federal Register**, the Treasury Department and the IRS believe it is appropriate to eliminate the coordination rule exception under § 1.367(a)–3(d)(2)(vi)(B)(1)(i). The coordination rule exception in § 1.367(a)–3(d)(2)(vi)(B)(1)(ii) is retained in the temporary regulations.

#### H. Effective/Applicability Dates

##### 1. Regulations Under Sections 367(a) and 6038B

Section 1.367(a)–7 and the revisions to §§ 1.367(a)–1 and 1.6038B–1 apply to transfers occurring on or after April 18, 2013.

##### 2. Regulations Under Sections 367(b) and 1248

The 2008 proposed regulations provide that the rules under sections 367(b) and 1248(f), including the modification to *Example 4* of § 1.367(b)–4(b)(1)(iii), apply to distributions or exchanges, respectively, occurring on or after the date that is 30 days after the date the regulations are published as final regulations in the **Federal Register**.

Comments requested that taxpayers be allowed to rely on the modifications to

*Example 4* of § 1.367(b)–4(b)(1)(iii) and § 1.1248–8, and the regulations under section 1248(f) for all open tax years. Other comments requested that these regulations be effective on the date the regulations are published as final regulations in the **Federal Register**, rather than 30 days after such date.

The Treasury Department and the IRS do not believe that taxpayers should be able to rely on the modifications to *Example 4* of § 1.367(b)–4(b)(1)(iii) and § 1.1248–8, and the regulations under section 1248(f) prior to the effective date. Taxpayers must apply section 1248(f), which does not include the exceptions provided in § 1.1248(f)–2 for such prior periods. Accordingly, distributions described in section 1248(f)(1) during such period result in an inclusion unless the exception described in section 1248(f)(2) applies. Similarly, taxpayers must take into account *Example 4* of § 1.367(b)–4(b)(1)(iii) (before amendment by these final regulations) for such prior periods. The Treasury Department and the IRS also believe, because the regulations under sections 367(b) and 1248(f) operate together with the rules of § 1.367(a)–7, the provisions should be subject to consistent effective dates. Therefore, the final regulations retain the 30-day delay in the effective date for these rules.

Modifications to § 1.1248–6 apply to a sale, exchange, or other disposition of the stock of a domestic corporation on or after September 21, 1987.

Subject to rules implementing the effective dates announced in Notice 87–64 (1987–2 CB 375), the final regulations under section 1248(f) are applicable as of the date that is 30 days following the issuance of the final regulations.

#### 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 publication is obsolete as of April 18, 2013:

Notice 87–64 (1987–2 CB 375).

#### 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. These regulations primarily will affect large domestic corporations that transfer property to a foreign corporation in certain corporate reorganizations. Thus, the number of affected small entities will not be substantial. Small domestic corporations could be shareholders of a larger domestic corporation involved in a transaction subject to the regulations, and the small domestic corporations could be required to make certain adjustments to basis and holding period under the regulations. However, the exceptions requiring the adjustments are elective and, moreover, the Treasury Department and the IRS do not anticipate the number of these shareholders to be substantial. Furthermore, the Treasury Department and the IRS 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 Treasury Department and the IRS believe that \$2,000 is not a significant economic impact. Pursuant to section 7805(f), the notice of proposed rule making preceding this regulation was submitted to the Administrator of the Small Business Administration for comment on its impact on small business.

#### Drafting Information

The principal authors of these regulations are Robert B. Williams, Jr. of the Office of Associate Chief Counsel (International) and Sean W. Mullaney, formerly of the Office of Associate Chief Counsel (International); however, other personnel from the Treasury Department and the IRS participated in their development.

#### List of Subjects

##### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

##### 26 CFR Part 602

Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are 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)–1 also issued under 26 U.S.C. 367(a).  
 Section 1.367(a)–1T also issued under 26 U.S.C. 367(a).  
 Section 1.367(a)–3 also issued under 26 U.S.C. 367(a).  
 Section 1.367(a)–7 also issued under 26 U.S.C. 367(a), (b), (c), and 337(d).  
 Section 1.367(a)–8 also issued under 26 U.S.C. 367(a).  
 Section 1.367(b)–0 also issued under 26 U.S.C. 367(b).  
 Section 1.367(b)–4(b)(1) also issued under 26 U.S.C. 367(b).  
 Section 1.367(b)–6 also issued under 26 U.S.C. 367(b).  
 Section 1.367(e)–1(a) also issued under 26 U.S.C. 367(e).  
 Section 1.1248–1 also issued under 26 U.S.C. 1248(a).  
 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. 367(b), 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).  
 Section 1.6038B–1 also issued under 26 U.S.C. 6038B.

■ **Par. 2.** Section 1.367(a)–1 is amended by:

- 1. Adding paragraphs (b)(4)(i)(B) and (C).
- 2. Adding paragraph (g)(4).

The additions read as follows:

#### § 1.367(a)–1 Transfers to foreign corporations subject to section 367(a): In general.

(a) through (b)(4)(i)(A) [Reserved]. For further guidance see § 1.367(a)–1T(a) through (b)(4)(i)(A).

(B) Appropriate adjustments to earnings and profits, basis, and other affected items will be made according to otherwise applicable rules, taking into account the gain recognized under section 367(a)(1). For purposes of applying section 362, the foreign corporation's basis in the property received is increased by the amount of gain recognized by the U.S. transferor under section 367(a) and the regulations issued pursuant to that section. To the extent the regulations provide that the U.S. transferor recognizes gain with



respect to a particular item of property, the foreign corporation increases its basis in that item of property by the amount of such gain recognized. For example, §§ 1.367(a)-3, 1.367(a)-4T, and 1.367(a)-5T provide that gain is recognized with respect to particular items of property. To the extent the regulations do not provide that gain recognized by the U.S. transferor is with respect to a particular item of property, such gain is treated as recognized with respect to items of property subject to section 367(a) in proportion to the U.S. transferor's gain realized in such property, after taking into account gain recognized with respect to particular items of property transferred under any other provision of section 367(a). For example, § 1.367(a)-6T provides that branch losses must be recaptured by the recognition of gain realized on the transfer but does not associate the gain with particular items of property. See also § 1.367(a)-1T(c)(3) for rules concerning transfers by partnerships or of partnership interests.

(C) The transfer will 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 the transfer under section 367(a)(1).

(b)(4)(ii) through (d)(2) [Reserved]. For further guidance see § 1.367(a)-1T(b)(4)(ii) through (d)(2).

(d)(4) through (g)(3) [Reserved]. For further guidance see § 1.367(a)-1T(d)(4) through (g)(3).

(4) The rules in paragraphs (b)(4)(i)(B) and (b)(4)(i)(C) of this section apply to transfers occurring on or after April 18, 2013. For guidance with respect to paragraph (b)(4)(i)(B) of this section before April 18, 2013, see 26 CFR part 1 revised as of April 1, 2012.

■ Par. 3. Section 1.367(a)-1T is amended by revising paragraph (b)(4)(i)(B) and adding paragraphs (b)(4)(i)(C) and (g)(4) to read as follows:

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

\* \* \* \* \*

- (b) \* \* \*
- (4) \* \* \*
- (i) \* \* \*

(B) [Reserved]. For further guidance see § 1.367(a)-1(b)(4)(i)(B).

(C) [Reserved]. For further guidance see § 1.367(a)-1(b)(4)(i)(C).

\* \* \* \* \*

- (g) \* \* \*

(4) [Reserved]. For further guidance see § 1.367(a)-1(g)(4).

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

- 1. Revising the second sentence of paragraph (a)(3).
- 2. Revising paragraphs (b)(1) and (c)(1).
- 3. Adding a sentence at the end of paragraph (d)(2)(vi)(D)(2).
- 4. Revising paragraph (d)(3), *Example 6A* (ii).
- 5. Adding a sentence between the second and third sentences of paragraph (d)(3), *Example 8* (ii).
- 6. Revising the first sentence of paragraph (d)(3), *Example 8B* (ii).
- 7. Revising the first sentence of paragraph (d)(3), *Example 8C* (ii).
- 8. Revising the third sentence of paragraph (d)(3), *Example 10* (ii).
- 9. Revising paragraph (d)(3), *Example 11* (ii).
- 10. Revising the second and third sentences of paragraph (d)(3), *Example 12* (ii), and removing the last sentence.
- 11. Revising paragraph (d)(3), *Example 16* (ii).
- 12. Revising the paragraph (g) subject heading.
- 13. Revising paragraph (g)(1)(v)(A) and (B).

The revisions and additions to read as follows:

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

(a) \* \* \*

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

(b) *Transfers of stock or securities of foreign corporations*—(1) *General rule.*

Except as provided in paragraph (e) of this section, 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 will not be subject to section 367(a)(1) if either—

\* \* \* \* \*

(c) *Transfers of stock or securities of domestic corporations*—(1) *General rule.*

Except as provided in paragraph (e) of this section, 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 will 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) \* \* \*
- (D) \* \* \*

(2) \* \* \* For this purpose, a disposition by the foreign acquiring corporation of stock of the domestic controlled corporation more than 5 years after completion of the transfer described in paragraph (d)(2)(vi)(A) of this section is deemed to not have a principal purpose of tax avoidance.

\* \* \* \* \*

- (3) \* \* \*

*Example 6A.* \* \* \*

(ii) *Result.* 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). The transfer of the Business B and C assets by Z to F must first be tested under sections 367(a)(1), (a)(3), and (a)(5). Z recognizes \$20 of gain on the outbound transfer of the Business C assets, as those assets do not qualify for an exception 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). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(2) of this section, V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section. V must enter into the gain recognition agreement in the amount of \$30 to preserve Z's nonrecognition treatment with respect to its transfer of Business B assets. Under paragraphs (d)(2)(i) and (d)(2)(ii) of this section, F is the transferee foreign corporation and R is the transferred corporation.

\* \* \* \* \*

*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 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) *Result.* Under paragraph (d)(1)(ii) of this section, V is treated as indirectly transferring Z stock to F. V must recognize gain on its indirect transfer of Z stock to F under section 367(a) (and section 1248 will be applicable) if V does not enter into a gain recognition agreement with respect to the indirect stock transfer in accordance with § 1.367(a)–8. Under paragraph (b)(2) of this section, if V enters into a gain recognition agreement with respect to the indirect stock transfer, the exchange will be subject to the provisions of section 367(b) and the regulations pursuant to such section as well as section 367(a). Under § 1.367(b)–4(b), however, no income inclusion is required because, immediately after the exchange, F and Z are controlled foreign corporations with respect to which V is a section 1248 shareholder. Under paragraphs (d)(2)(i) and (d)(2)(ii) of this section, the transferee foreign corporation is F, and the transferred corporation is Z (the acquiring corporation). If F disposes (within the meaning of § 1.367(a)–8(j)(1)) of all (or a portion) of Z stock within the term of the gain recognition agreement, V must either file an amended return for the year of the indirect stock transfer and include in income, with interest, the gain realized but not recognized on the initial exchange or if a valid election under § 1.367(a)–8(c)(2)(vi) was made, currently recognize the gain and pay the related interest. Under paragraph (d)(2)(v)(B) of this section, to determine whether, for purposes of the gain recognition agreement, Z (the transferred corporation) disposes of substantially all of its assets, only the assets held by Z immediately before the transaction are taken into account. Because D is wholly 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) to any property transferred by D to Z. Thus, under section 367(a)(1), D must recognize the gross amount of gain in each asset transferred to Z, or \$40.

*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. E's transfer of its N stock could qualify for nonrecognition treatment if D satisfies the requirements in § 1.367(a)–3T(e)(3). \* \* \*

*Example 16.* \* \* \*

(ii) *Result.* The section 368(a)(1)(D) reorganization is not an indirect stock transfer described in paragraph (d) of this section. Moreover, the section 354 exchange by D of F1 stock for F2 stock is not an exchange described under section 367(a). See paragraph (a)(2)(ii) of this section.

(g) *Effective/applicability dates.*

(1) \* \* \*

(v) \* \* \*

(A) Except as provided in paragraphs (g)(1)(v)(B) of this section and § 1.367(a)–3T(g)(1)(ix), 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.

(B)(1) For purposes of paragraph (d)(2)(vi)(B)(1) of this section as contained in 26 CFR part 1 revised as of April 1, 2007, except as provided in paragraph (g)(1)(v)(B)(3) of this section, the following conditions must be satisfied for transactions occurring on or after December 28, 2007, and before March 18, 2013: The conditions and requirements of section 367(a)(5) and paragraph (g)(1)(v)(B)(2) of this section must be satisfied with respect to the domestic acquired corporation's transfer of assets to the foreign acquiring corporation and those conditions and requirements apply before the application of the exception under paragraph (d)(2)(vi)(B)(1) of this section as contained in 26 CFR part 1 revised as of April 1, 2007.

(2) 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) immediately before the reorganization, appropriate basis adjustments under section 367(a)(5) are made to the stock 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 are treated as one corporation. Any adjustments to stock basis required under section 367(a)(5) must be made to the stock received by the controlling domestic corporation in the reorganization so 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 the stock received. The basis adjustment requirement cannot be satisfied by adjusting the basis in stock of the foreign acquiring corporation held by the controlling domestic corporation 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 by the controlling domestic corporation in the reorganization, the domestic acquired corporation's transfer of property to the foreign acquiring corporation is subject to section 367(a) and (d).

(3) For transactions occurring on or after August 19, 2008, and before March 18, 2013, the following condition also applies: To the extent any of the retransferred assets constitute property to which section 367(d) applies, the exception under paragraph (d)(2)(iv)(B)(1) of this section, as contained in 26 CFR part 1 revised as of April 1, 2007, applies only if the property to which section 367(d) applies is treated as property subject to section 367(a) for purposes of satisfying the conditions and requirements of section 367(a)(5).

\* \* \* \* \*

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

**§ 1.367(a)–7 Outbound transfers of property described in section 361(a) or (b).**

(a) *Scope and purpose.* This section provides rules under section 367(a)(5) that apply to the transfer of certain property (including stock or securities) by a domestic corporation (U.S. transferor) to a foreign corporation (foreign acquiring corporation) in a section 361 exchange. This section applies only to the transfer of section 367(a) property. See section 367(d) for rules applicable to transfers of section 367(d) property. Paragraph (b) of this section provides the general rule requiring the recognition of gain on the transfer of section 367(a) property, while paragraph (c) of this section provides an elective exception to the general rule that is available if certain requirements are satisfied. Paragraph (d) of this section provides rules for applying the elective exception to a section 361 exchange followed by successive distributions to which section 355 applies. Paragraph (e) of this section provides rules for recognizing gain on section 367(a) property, reasonable cause relief provisions, an anti-abuse rule, and special rules that take into account income inclusions under § 1.367(b)–4 and gain recognition under § 1.367(a)–6T. Paragraph (f) of this section provides definitions, and paragraph (g) of this section provides examples. Paragraph (h) of this section provides applicable cross-references, paragraph (i) of this section is reserved, and paragraph (j) of this section provides effective/applicability dates.

(b) *General rule—(1) Nonrecognition exchanges enumerated in section 367(a)(1).* Except to the extent provided in paragraphs (b)(2) and (c) of this

section, the exceptions to section 367(a)(1) provided in section 367(a) and the regulations under that section do 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, and the U.S. transferor shall recognize any gain (but not loss) realized with respect to the section 367(a) property under section 367(a)(1). Realized gain is recognized pursuant to the prior sentence notwithstanding the application of any other nonrecognition provision enumerated in section 367(a)(1) to the transfer (such as section 351 or 354).

(2) *Nonrecognition exchanges not enumerated in section 367(a)(1)*. To the extent a transfer of items of property described in paragraph (b)(1) of this section also qualifies for nonrecognition under a provision that is not enumerated in section 367(a)(1) (such as section 1036), the U.S. transferor recognizes gain or loss realized on the transfer of such items of property, but the amount of loss recognized on the property shall not exceed the amount of gain recognized on the property. See section 337(d).

(c) *Elective exception*. Except to the extent provided in paragraph (d) of this section, paragraph (b) of this section does not apply to the transfer of section 367(a) property by a U.S. transferor to a foreign acquiring corporation in a section 361 exchange if the conditions of paragraphs (c)(1), (c)(2), (c)(3), and (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 this paragraph (c) applies to the section 361 exchange, see, for example, §§ 1.367(a)-2T, 1.367(a)-3T, 1.367(a)-4T, 1.367(a)-5T, or 1.367(a)-6T, as applicable, for additional requirements that must be satisfied in order for the U.S. transferor to not recognize gain under section 367(a)(1) on the transfer of section 367(a) property in the section 361 exchange. Nothing in this section provides for the nonrecognition of gain not otherwise permitted under another provision of the Internal Revenue Code (Code) or the regulations.

(1) *Control*. Immediately before the reorganization, the U.S. transferor is controlled (within the meaning of section 368(c)) by five or fewer, but at least one, control group members. For illustrations of this rule, see paragraph (g) of this section, *Example 4* and *Example 5*.

(2) *Gain recognition*—(i) *Non-control group members*. The U.S. transferor recognizes gain equal to the product of the inside gain multiplied by the

aggregate ownership interest percentage of all non-control group members, reduced (but not below zero) by the sum of the amounts described in paragraphs (c)(2)(i)(A), (c)(2)(i)(B), and (c)(2)(i)(C) of this section.

(A) Gain recognized with respect to stock or securities under § 1.367(a)-3T(e)(3)(iii)(B) (including any portion treated as a deemed dividend under section 1248(a));

(B) Gain recognized with respect to stock or securities under § 1.367(a)-6T (including any portion treated as a deemed dividend under section 1248(a)) attributable to non-control group members (as determined pursuant to § 1.367(a)-7(e)(5)); and

(C) A deemed dividend included in income under § 1.367(b)-4 attributable to non-control group members (as determined pursuant to § 1.367(a)-7(e)(4)).

(ii) *Control group members*. With respect to each control group member, the U.S. transferor recognizes gain equal to the amount, if any, by which the amount described in paragraph (c)(2)(ii)(A) of this section exceeds the amount described in paragraph (c)(2)(ii)(B) of this section.

(A) The product of the inside gain multiplied by such control group member's ownership interest percentage, reduced (but not below zero) by the sum of the amounts described in paragraphs (c)(2)(ii)(A)(1), (c)(2)(ii)(A)(2), and (c)(2)(ii)(A)(3) of this section (attributable inside gain).

(1) Gain recognized with respect to stock or securities under § 1.367(a)-3T(e)(3)(iii)(C) (including any portion treated as a deemed dividend under section 1248(a)) attributable to the control group member;

(2) Gain recognized with respect to stock or securities under § 1.367(a)-6T (including any portion treated as a deemed dividend under section 1248(a)) attributable to the control group member (as determined pursuant to § 1.367(a)-7(e)(5)); and

(3) A deemed dividend included in income under § 1.367(b)-4 attributable to the control group member (as determined pursuant to § 1.367(a)-7(e)(4)).

(B) The product of the section 367(a) percentage multiplied by the fair market value of the stock received by the U.S. transferor in the section 361 exchange and distributed to the control group member under section 354, 355, or 356.

(iii) *Illustration of rules*. For an illustration of gain recognition under paragraph (c)(2)(i) of this section, see paragraph (g) of this section, *Example 1*. For an illustration of gain recognition under paragraph (c)(2)(ii) of this section,

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

(3) *Basis adjustments required for control group members*—(i) *General rule*. Except as provided in paragraph (c)(3)(iv) of this section, if there is any attributable inside gain (determined under paragraph (c)(2)(ii)(A) of this section) with respect to a control group member, then such control group member's aggregate basis in the stock received in exchange for (or with respect to, as applicable) 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 in paragraph (c)(3)(i)(A), (c)(3)(i)(B), or (c)(3)(i)(C) of this section, as applicable.

(A) If the control group member has outside gain, the amount, if any, by which the attributable inside gain, reduced by any gain recognized by the U.S. transferor with respect to the control group member under paragraph (c)(2)(ii) of this section, exceeds the control group member's outside gain.

(B) If the control group member has outside loss, the amount, if any, by which the attributable inside gain, reduced by any gain recognized by the U.S. transferor with respect to the control group member under paragraph (c)(2)(ii) of this section, exceeds the control group member's outside loss (for this purpose, treating the outside loss as a negative amount).

(C) If the control group member has no outside gain or outside loss, the amount of the attributable inside gain, reduced by any gain recognized by the U.S. transferor with respect to the control group member under paragraph (c)(2)(ii) of this section.

(ii) *Stock received in the section 361 exchange*. This paragraph (c)(3) applies only to stock received by the U.S. transferor in the section 361 exchange and distributed to the control group member in exchange for (or with respect to, as applicable) stock or securities of the U.S. transferor.

(iii) *Pro rata adjustments*. The section 358 basis of each share of stock received by the control group member must be reduced pro rata based on the relative section 358 basis of all shares of stock received by the control group member.

(iv) *Successive distributions to which section 355 applies*. Paragraph (c)(3) of this section does 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 satisfying the requirements of section 355 (section 355 distribution) that is in connection with a transaction described in paragraph (d) of this

section (relating to successive section 355 distributions). If paragraph (c)(3) of this section does not apply to a control group member pursuant to this paragraph (c)(3)(iv), then paragraph (c)(3) 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.

(v) *Illustration of rules.* 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*, § 1.367(a)-3T(e)(8), *Example 3*, and § 1.1248(f)-2(e), *Example 3*. For an illustration of the adjustment to stock basis under paragraph (c)(3)(iii) 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), relating to the requirement to report gain that was not recognized by the U.S. transferor upon certain subsequent dispositions by the foreign acquiring corporation of section 367(a) property received from the U.S. transferor in the section 361 exchange.

(ii) *Exception.* To the extent section 367(a) property transferred in the section 361 exchange is subject to § 1.367(a)-3T(e) (relating to transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange), § 1.6038B-1(c)(6)(iii) does not apply with respect to the transfer of that 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 (c)(5)(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 that 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. For this purpose, the term *control group member* will be replaced by the term *final distributee*, as appropriate.

(ii) *Control group member—(A) Time and manner of making election.* Each control group member 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 a timely filed return for the taxable year in which the reorganization occurs. If the control group member is a member of a consolidated group but is not the common parent of the consolidated group, the common parent makes the election on behalf of the control group member.

(B) *Form and content of election statement.* The statement must be entitled, “ELECTION TO APPLY EXCEPTION UNDER § 1.367(a)-7(c),” and set forth:

(1) The name and taxpayer identification number (if any) of the control group member, the U.S. transferor, the foreign acquiring corporation and, in the case of a triangular reorganization (within the meaning of § 1.358-6(b)(2)), the corporation that controls the foreign acquiring corporation; the control group member’s ownership interest percentage in the U.S. transferor; and the percentage of voting stock and non-voting stock of the U.S. transferor owned by the control group member for purposes of satisfying the control requirement of paragraph (c)(1) of this section;

(2) If the control group member is a member of a consolidated group but is not the common parent, the name and taxpayer identification number of the common parent;

(3) The amount of the adjustment (if any) to stock basis required under paragraph (c)(3) of this section, the resulting adjusted basis in the stock, and the fair market value of the stock, or if no stock was received, indicate no stock was received; 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 must enter into a written agreement satisfying the conditions of this paragraph on or before the due date (including extensions) for the U.S. transferor’s tax return for the taxable year in which the reorganization 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. 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, the foreign acquiring corporation, the corporation that controls the foreign acquiring corporation (in the case of a triangular reorganization within the meaning of § 1.358-6(b)(2)), and each control group member, and provide the taxpayer identification number (if any) for each corporation;

(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, state the amount of the adjustment (if any) to stock basis required under paragraph (c)(3) of this section, the resulting adjusted basis in the stock, and the fair market value of the stock. Alternatively, if a control group member did not receive any stock, indicate that no stock was received.

(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, that stock is further distributed in one or more successive section 355 distributions, paragraph (c) of this section can 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 immediately before the reorganization. In that case, each affiliated group member that receives stock of the foreign acquiring corporation in the final section 355 distribution (final distributee) is subject to the requirements of paragraphs (c)(3) and (c)(5) of this section. If this paragraph (d) applies, then for purposes of applying paragraphs (c)(3), (c)(5) or (e)(2) of this section the term *control group member* is replaced by the term *final distributee*, as appropriate.

(e) *Other rules—(1) Section 367(a) property with respect to which gain is recognized.* Except as otherwise provided in this paragraph (e)(1), gain recognized by the U.S. transferor pursuant to paragraph (c)(2) of this section will 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) will be applied after taking into account any gain or deemed dividends (including any deemed dividends under section 1248(a)) 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 of sections 367(a) and (b) and the regulations under that section. See, for example, §§ 1.367(a)-2T, 1.367(a)-3T(e), 1.367(a)-4T, 1.367(a)-5T, 1.367(a)-6T, and 1.367(b)-4. If the U.S. transferor recognizes gain (including gain treated as a deemed dividend under section 1248(a)) pursuant to § 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C) with respect to stock or securities transferred in the section 361 exchange, the realized gain in such stock or securities shall not be taken into account for purposes of applying this paragraph (e)(1) to gain recognized under paragraph (c)(2) of this section attributable to U.S. transferor shareholders described in § 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C). Accordingly, gain recognized under paragraph (c)(2) attributable to such U.S. transferor shareholders shall not be treated as recognized with respect to such stock or securities under this paragraph. Furthermore, to the extent gain recognized by the U.S. transferor under paragraph (c)(2) is treated as recognized with respect to stock in a foreign corporation transferred in the section 361 exchange to which section 1248(a) applies, the portion of such gain treated as a deemed dividend under section 1248(a) is the product of the amount of the gain multiplied by the ratio of the amount that would be treated as a deemed dividend under section 1248(a) if all gain in the transferred stock were recognized under § 1.367(a)-7(b) and the amount of gain realized in the transferred stock. See § 1.367(a)-1T(b)(4) and § 1.367(a)-1(b)(4)(i)(B) for additional rules on the character, source, and adjustments relating to gain recognized under section 367(a)(1), and § 1.367(b)-2(e) for rules on the timing, treatment, and effect of amounts included in income as deemed dividends pursuant to regulations under section 367(b).

(2) [Reserved]. For further guidance see § 1.367(a)-7T(e)(2).

(3) *Anti-abuse rule.* Any property of the U.S. transferor acquired with a principal purpose of affecting any determination under this section (including, for example, the section 367(a) percentage, inside gain, or inside basis) shall not be taken in account for

purposes of any determination under this section. Nothing in this paragraph (e)(3) constitutes a limitation on or modification to judicial doctrines, including step-transaction or substance-over-form.

(4) *Certain income inclusions under § 1.367(b)-4—(i) Income inclusion attributable to U.S. transferor shareholder described in § 1.367(a)-3T(e)(3)(iii)(A).* If pursuant to § 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C) the U.S. transferor is required to recognize gain on the transfer of foreign stock (all or a portion of which is treated as a deemed dividend under section 1248(a)), and if pursuant to § 1.367(b)-4(b)(1)(i) the U.S. transferor is also required to include in income as a deemed dividend the section 1248 amount (within the meaning of § 1.367(b)-2(c)) in the foreign stock, then the section 1248 amount included in income under § 1.367(b)-4(b)(1)(i) is attributable to each U.S. transferor shareholder described in § 1.367(a)-3T(e)(3)(iii)(A) pursuant to this paragraph (e)(4)(i). The portion of the section 1248 amount attributable to each U.S. transferor shareholder described in § 1.367(a)-3T(e)(3)(iii)(A) is the portion of the section 1248 amount that bears the same ratio as such U.S. transferor shareholder's ownership interest percentage bears to the aggregate ownership interest percentage of all U.S. transferor shareholders described in § 1.367(a)-3T(e)(3)(iii)(A).

(ii) *Ordering rules for determining section 1248 amount.* The section 1248 amount (within the meaning of § 1.367(b)-2(c)) included in income as a deemed dividend under § 1.367(b)-4(b)(1)(i) is determined after taking into account any gain recognized under §§ 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C) or 1.367(a)-6T that is treated as a deemed dividend under section 1248(a). See § 1.367(a)-3T(e)(7) and paragraph (e)(5)(ii) of this section for rules to determine the amount of gain recognized under §§ 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C) or 1.367(a)-6T, respectively, that is treated as a deemed dividend under section 1248(a).

(5) *Certain gain under § 1.367(a)-6T—(i) Gain attributable to U.S. transferor shareholder described in § 1.367(a)-3T(e)(3)(iii)(A).* If pursuant to § 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C), the U.S. transferor is required to recognize gain on the transfer of stock or securities, and if pursuant to § 1.367(a)-6T the U.S. transferor is also required to recognize gain, then gain recognized under § 1.367(a)-6T (including any portion treated as a deemed dividend under section 1248(a)) to the extent treated as

recognized with respect to the stock or securities, is attributable to each U.S. transferor shareholder described in § 1.367(a)-3T(e)(3)(iii)(A) pursuant to this paragraph (e)(5)(i). The portion of the gain (including any portion treated as a deemed dividend under section 1248(a)) that is attributable to each U.S. transferor shareholder described in § 1.367(a)-3T(e)(3)(iii)(A) is the portion of the gain that bears the same ratio as such U.S. transferor shareholder's ownership interest percentage bears to the aggregate ownership interest percentage of all U.S. transferor shareholders described in § 1.367(a)-3T(e)(3)(iii)(A).

(ii) *Gain subject to section 1248(a).* If the U.S. transferor recognizes gain under § 1.367(a)-6T with respect to transferred stock that is stock in a foreign corporation to which section 1248(a) applies, the portion of such gain treated as a deemed dividend under section 1248(a) is determined after taking into account any gain recognized under § 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C) and the amount of such gain treated as a deemed dividend under section 1248(a) pursuant to § 1.367(a)-3T(e)(7).

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

(1) *Control group, control group member, and non-control group member—(i) General rule.* Except as provided in paragraph (f)(1)(ii) of this section, the *control group* is the group of five or fewer, but at least one, domestic corporations that controls (within the meaning of section 368(c)) the U.S. transferor immediately before the reorganization. If the U.S. transferor is owned directly by more than five domestic corporations immediately before the reorganization, but some combination of five or fewer domestic corporations controls the U.S. transferor, 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." For purposes of identifying the control group, members of an affiliated group (within the meaning of section 1504) are treated as a single corporation. Except as provided in paragraph (f)(1)(ii) of this section, a *control group member* is a domestic corporation that is part of the control group. A *non-control group member* is a shareholder of the U.S. transferor immediately before the reorganization that is not a control group member.

(ii) *Exception for certain entities.* Regulated investment companies (as defined in section 851(a)), real estate

investment trusts (as defined in section 856(a)), and S corporations (as defined in section 1361(a)) cannot be control group members.

(2) *Deductible liability* is any liability of the U.S. transferor that is assumed in the section 361 exchange if payment of the liability would give rise to a deduction.

(3) *Fair market value* is the fair market value determined without regard to mortgages, liens, pledges, or other liabilities. For this purpose, the fair market value of any property subject to a nonrecourse indebtedness shall be treated as being not less than the amount of any nonrecourse indebtedness to which such property is subject.

(4) *Inside basis* is the aggregate basis of the section 367(a) property transferred by the U.S. transferor in the section 361 exchange and, except as otherwise provided in this paragraph (f)(4), increased by any gain recognized or any deemed dividend included in income by the U.S. transferor under section 367(a) property in the section 361 exchange, but not including any gain recognized under paragraph (c)(2) of this section. If the U.S. transferor transfers stock or securities and recognizes gain under § 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C) with respect to such stock or securities, then inside basis is not increased for gain recognized or deemed dividends included in income that are described in paragraph (f)(4)(i), (f)(4)(ii), or (f)(4)(iii) of this section.

(i) Gain recognized under § 1.367(a)-3T(e)(3)(iii)(B) or (e)(3)(iii)(C) (including any portion treated as a deemed dividend under section 1248(a));

(ii) Gain recognized under § 1.367(a)-6T (including any portion treated as a deemed dividend under section 1248(a)) attributable to U.S. transferor shareholders described in § 1.367(a)-3T(e)(3)(iii)(A) (as determined pursuant to § 1.367(a)-7(e)(5));

(iii) A deemed dividend included in income under § 1.367(b)-4(b) attributable to U.S. transferor shareholders described in § 1.367(a)-3T(e)(3)(iii)(A) (as determined pursuant to § 1.367(a)-7(e)(4)).

(5) *Inside gain* is the amount (but not below zero) by which the aggregate fair market value of the section 367(a) property transferred in the section 361 exchange exceeds the sum of:

(i) The inside basis; and

(ii) The product of the section 367(a) percentage multiplied by the aggregate deductible liabilities of the U.S. transferor.

(6) *Outside gain or loss* is the product of the section 367(a) percentage multiplied by the difference between—

(i) The aggregate fair market value of the stock received by a control group member in exchange for (or with respect to, as applicable) stock or securities of the U.S. transferor under section 354, 355, or 356, and

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

(7) *Ownership interest percentage* is the ratio of the fair market value of the stock in the U.S. transferor owned by a shareholder to the fair market value of all of the outstanding stock of the U.S. transferor. Except as provided in this paragraph (f)(7), the ownership interest percentage of a shareholder is determined immediately before the reorganization. For purposes of determining the ownership interest percentage with respect to each shareholder, however, the numerator and denominator of the fraction are first reduced as described in this paragraph (f)(7). The numerator is reduced (but not below zero) by any distributions by the U.S. transferor of money or other property (within the meaning of section 356) to such shareholder pursuant to the plan of reorganization, but only to the extent such money or other property is not provided by the foreign acquiring corporation in exchange for property of the U.S. transferor acquired in the section 361 exchange. Furthermore, the denominator of the fraction is reduced (but not below zero) by all such distributions by the U.S. transferor to all shareholders. For illustrations of this definition, see paragraph (g) of this section, *Example 4* and *Example 5*.

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

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

(10) *Section 367(a) property*. Except as provided in paragraph (e)(3) of this section, *section 367(a) property* is any property, as defined in § 1.367(a)-1T(d)(4), other than section 367(d) property.

(11) *Section 367(d) property* is property described in section 936(h)(3)(B).

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

(13) *U.S. transferor shareholder* is a person that is either a control group member or a non-control group member.

(g) *Examples*. The rules of this section are illustrated by the examples set forth in this paragraph (g). See also § 1.367(a)-3T(e)(8), *Example 2* and *Example 3*. 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: DP1, DP2, and DC are domestic corporations that do not join in the filing of a consolidated return and none of which is a regulated investment company, a real estate investment trust, or an S corporation; FP and FA are foreign corporations created or organized under the laws of Country B and are unrelated to DP1, DP2, and DC; each corporation has a single class of stock outstanding; each share of stock of DC owned by a shareholder of DC has an identical stock basis; Business A consists solely of section 367(a) property whose fair market value exceeds its basis and that, but for the application of this section, would qualify for the active foreign trade or business exception under § 1.367(a)-2T; the fair market value of any FA stock received in a reorganization is equal to the fair market value of property exchanged therefor; FA is not a surrogate foreign corporation for purposes of section 7874 because one or more of the conditions of section 7874(a)(2)(B) is not satisfied; DC has no liabilities; DP1 and DP2 satisfy the requirements of paragraph (c)(5) of this section, and DC satisfies the requirements of § 1.6038B-1(c)(6)(ii).

*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 and DP2 are members of the same affiliated group within the meaning of section 1504. DP1's DC stock has a \$120x 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 (excluding the inventory) 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)(i), DC must recognize \$60x gain (\$100x fair market value less \$40x basis) on the transfer of the inventory to FA. The basis of the inventory in the hands of FA is increased by the gain recognized of \$60x (that is, increased from \$40x to \$100x). See § 1.367(a)-1(b)(4)(i)(B). 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 (\$100x fair market value less \$10x basis) on the transfer of Business A to FA notwithstanding the application of section 361 (or any other nonrecognition provision enumerated in section 367(a)(1)). However, if the conditions and requirements of paragraph (c) of this section are met, DC's transfer of Business A to FA would qualify for the active foreign trade or business exception provided by section 367(a)(3) and § 1.367(a)-2T.

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation because DP1 and DP2 together own 80% of the stock of DC). DP1 and DP2 are treated as a single domestic corporation for this purpose under paragraph (f)(1)(i) of this section because DP1 and DP2 are members of the same affiliated group.

(C) Paragraph (c)(2)(i) of this section would be satisfied only if DC recognizes \$18x gain on the transfer of Business A, which is the amount of inside gain attributable to FP, a non-control group member. The \$18x gain equals the product of the inside gain (\$90x) multiplied by FP's ownership interest percentage (20%) in DC, reduced by \$0x (the sum of the amounts described in paragraphs (c)(2)(i)(A) through (c)(2)(i)(C) of this section). Under paragraph (f)(5) of this section, the \$90x inside gain is the amount by which the aggregate fair market value (\$200x) of the section 367(a) property (inventory and Business A) exceeds \$110x, the sum of the inside basis of \$110x and the product of the section 367(a) percentage (100%) multiplied by the deductible liabilities of DC (\$0x). Under paragraph (f)(4) 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 attributable to FP. The section 367(a) percentage is 100% because the only assets transferred are the inventory and Business A, which are section 367(a) property. 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. FA's basis in Business A as determined under section 362 is increased for the \$18x gain recognized. See § 1.367(a)-1(b)(4)(i)(B).

(D) Paragraph (c)(2)(ii) of this section is not applicable with respect to either DP1 or DP2 because the attributable inside gain with respect to each such shareholder can be preserved in the FA stock received. As stated

in paragraph (ii)(C) of this *Example 1*, the amount of the inside gain is \$90x. The attributable inside gain with respect to DP1 of \$45x (equal to the product of \$90x inside gain multiplied by DP1's 50% ownership interest percentage, reduced by \$0x (the sum of the amounts described in paragraphs (c)(2)(ii)(A)(1) through (c)(2)(ii)(A)(3) of this section)) does not exceed \$100x (equal to the product of the section 367(a) percentage of 100% multiplied by \$100x fair market value of FA stock received by DP1). Similarly, the attributable inside gain with respect to DP2 of \$27x (equal to the product of \$90x inside gain multiplied by DP2's 30% ownership interest percentage, reduced by \$0x (the sum of the amounts described in paragraphs (c)(2)(ii)(A)(1) through (c)(2)(ii)(A)(3) of this section)) does not exceed \$60x (equal to the product of the section 367(a) percentage of 100% multiplied by \$60x fair market value of FA stock received by DP2).

(E) Each control group member (DP1 and DP2) separately computes any required adjustment to stock basis under paragraph (c)(3) of this section. DP1's section 358 basis in the FA stock received of \$120x (the amount of DP1's basis in the DC stock exchanged) is reduced to preserve the attributable inside gain with respect to DP1, less any gain recognized with respect to DP1 under paragraph (c)(2)(ii) of this section. Because DC does not recognize gain on the section 361 exchange with respect to DP1 under paragraph (c)(2)(ii) of this section (as determined in paragraph (ii)(D) of this *Example 1*), the attributable inside gain of \$45x with respect to DP1 is not reduced under paragraph (c)(3)(i)(B) of this section. DP1's outside loss in the FA stock is \$20x, the product of the section 367(a) percentage of 100% multiplied by \$20x loss (equal to the difference between \$100x fair market value and \$120x section 358 basis in FA stock). Thus, DP1's \$120x section 358 basis in the FA stock must be reduced by \$65x (excess of \$45x, reduced by \$0x, over \$20x outside loss) to \$55x.

(F) DP2's aggregate section 358 basis in the FA stock received of \$50x (the amount of DP2's basis in the DC stock exchanged) is reduced to preserve the attributable inside gain with respect to DP2, less any gain recognized with respect to DP2 under paragraph (c)(2)(ii) of this section. Because DC does not recognize gain on the section 361 exchange with respect to DP2 (as determined in paragraph (ii)(D) of this *Example 1*), the attributable inside gain of \$27x with respect to DP2 is not reduced under paragraph (c)(3)(i)(A) of this section. DP2's outside gain in the FA stock is \$10x, the product of the section 367(a) percentage of 100% multiplied by \$10x gain (equal to the difference between \$60x fair market value and \$50x section 358 basis in FA stock). Thus, DP2's \$50x section 358 basis in the FA stock must be reduced by \$17x (excess of \$27x, reduced by \$0x, over the \$10x outside gain) to \$33x.

(G) Paragraph (c)(4) of this section would be satisfied only if DC complies with the requirements of § 1.6038B-1(c)(6)(iii), including filing with its timely filed return for the year of the reorganization a statement agreeing to file an amended return reporting

the gain realized but not recognized on the section 361 exchange in certain cases if a significant amount of the section 367(a) property received in the section 361 exchange is disposed of, directly or indirectly, in one or more related transactions within the prescribed 60-month period.

*Example 2. Triangular reorganization involving an exchange of section 367(a) property for foreign stock and cash.*

(i) *Facts.* (A) DP1 wholly owns DC. DP1 and DC file a consolidated return. DP1's DC stock has a \$170x basis and \$200x fair market value. DC owns Business A, which has a \$10x basis and \$200x fair market value. 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 to FA in exchange for \$180x of FP stock and \$20x cash. DC's transfer of Business A to FA qualifies as a section 361 exchange. DP1 exchanges its DC stock for \$180x of FP stock and \$20x cash pursuant to section 356. The triangular reorganization constitutes an indirect stock transfer under § 1.367(a)-3(d)(1)(i), and DP1 properly files a gain recognition agreement under § 1.367(a)-8 with respect to the transfer. See also § 1.367(a)-3(d)(2)(vii).

(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 \$190x gain (\$200x fair market value less \$10x basis) on the transfer of Business A to FA notwithstanding the application of section 361 (or any other nonrecognition exchange enumerated in section 367(a)(1)). However, if the requirements of paragraph (c) of this section are satisfied, DC's transfer of Business A to FA would qualify for the active foreign trade or business exception provided in section 367(a)(3) and § 1.367(a)-2T.

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1).

(C) DC is not required to recognize gain under paragraph (c)(2)(i) of this section because, immediately before the reorganization, DC is wholly owned by DP1, a control group member. In addition, DP1's ownership interest percentage is 100%. Paragraph (c)(2)(ii) of this section would be satisfied only if DC recognizes \$10x gain, computed as the amount by which the attributable inside gain with respect to DP1 of \$190x (the product of \$190x inside gain multiplied by DP1's ownership interest percentage of 100%, reduced by \$0x (the sum of the amounts in paragraphs (c)(2)(ii)(A)(1) through (c)(2)(ii)(A)(3) of this section)) exceeds \$180x (the product of the section 367(a) percentage of 100% multiplied by \$180x fair market value of FP stock received by DP1). Under paragraph (f)(5) of this section, the \$190x inside gain is the amount by which the \$200x aggregate fair market value of Business A exceeds \$10x (the sum of the inside basis of \$10x and the product

of the section 367(a) percentage (100%) multiplied by the deductible liabilities of DC (\$0x). Under paragraph (f)(4) of this section, the inside basis equals the \$10x aggregate basis of the section 367(a) property transferred in the section 361 exchange (not increased by the \$10x gain recognized by DC under paragraph (c)(2)(ii) of this section). The section 367(a) percentage is 100% because the only asset transferred is Business A, which is section 367(a) property. Under § 1.1502-32(b)(2), DP1 increases the basis of its DC stock by the \$10x gain recognized, that is, from \$170x to \$180x. Under paragraph (e)(1) of this section, the \$10x gain recognized under paragraph (c)(2)(ii) of this section is treated as recognized with respect to Business A. FA's basis in Business A as determined under section 362 is increased for the \$10x gain recognized. See § 1.367(a)-1(b)(4)(i)(B).

(D) Paragraph (c)(3) of this section would be satisfied only if DP1's section 358 basis in the FP stock is reduced by the amount by which the attributable inside gain with respect to DP1, reduced by any gain recognized by DC with respect to DP1 under paragraph (c)(2)(ii) of this section, exceeds DP1's outside gain in the FP stock. DP1's section 358 basis in the FP stock is \$180x, computed as \$180x basis in DC stock, as determined in paragraph (ii)(C) of this *Example 2*, decreased by \$20x cash received and increased by \$20x gain recognized under section 356 (such amount equal to the lesser of the \$20x cash received and the \$20x gain in the DC stock, computed as \$200x fair market value less \$180x basis). Because DC recognizes \$10x gain on the section 361 exchange with respect to DP1 under paragraph (c)(2)(ii) of this section as determined in paragraph (ii)(C) of this *Example 2*, the \$190x attributable inside gain with respect to DP1 is reduced by \$10x to \$180x under paragraph (c)(3)(i)(C) of this section. DP1's outside gain in the FP stock is \$0x, the product of the section 367(a) percentage of 100% multiplied by \$0x gain (the difference between \$180x fair market value and \$180x section 358 basis in FP stock). Thus, DP1's section 358 basis in the FP stock (\$180x) must be reduced by \$180x (\$190x attributable inside gain reduced by \$10x) to \$0x.

(E) Paragraph (c)(4)(i) of this section would be satisfied only if DC complies with the requirements of § 1.6038B-1(c)(6)(iii), including filing with its tax return for the year of the reorganization a statement agreeing to file an amended return reporting the gain on the section 361 exchange in certain cases if a significant amount of the section 367(a) property received in the section 361 exchange is disposed of, directly or indirectly, in one or more related transactions within the prescribed 60-month period.

*Example 3. Adjustment to basis of multiple blocks of stock; transfer of section 367(d) property.*

(i) *Facts.* (A) DP1 wholly owns DC. One half of DP1's shares of stock in DC, each with an identical basis, has an aggregate basis of \$60x and fair market value of \$100x (Block 1). The other one half of DP's shares of stock in DC, each with an identical basis, has an

aggregate basis of \$120x and fair market value of \$100x (Block 2). DC owns Business A (\$15x basis and \$150x fair market value) (excluding the patent) 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 of Share 1 and Share 2 correspond to the basis 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 of gain on the transfer of Business A to FA notwithstanding the application of section 361 (or any other nonrecognition exchange described in section 367(a)(1)). However, if the requirements of paragraph (c) of this section are met, DC's transfer of Business A to FA would qualify for the active foreign trade or business exception provided in section 367(a)(3). For rules applicable to DC's transfer of the patent to FA, see section 367(d).

(B) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1).

(C) Paragraph (c)(2)(i) of this section is not applicable because, immediately before the reorganization, DC is wholly owned by DP1, a control group member. In addition, DP1's ownership interest percentage is 100%. Paragraph (c)(2)(ii) of this section is not applicable because the attributable inside gain with respect to DP1 can be preserved in the FA stock received. The attributable inside gain with respect to DP1 of \$135x (equal to the product of \$135x inside gain multiplied by DP1's 100% ownership interest percentage, reduced by \$0x (the sum of the amounts in paragraphs (c)(2)(ii)(A)(1) through (c)(2)(ii)(A)(3) of this section)) does not exceed \$150x (equal to the product of the section 367(a) percentage of 75% multiplied by \$200x fair market value of FA stock received by DP1). Under paragraph (f)(5) of this section, the \$135x inside gain is the amount by which the aggregate fair market value of Business A (\$150x) exceeds \$15x, the sum of the inside basis of Business A (\$15x) and the product of the section 367(a) percentage (75%) multiplied by the deductible liabilities of DC (\$0x). Under paragraph (f)(4) of this section, the inside basis equals the \$15x aggregate basis of the section 367(a) property transferred in the exchange. The section 367(a) percentage of 75% is equal to the ratio of the fair market value of the section 367(a) property (\$150x for Business A) to the fair market value of all

the property transferred (\$200x, the sum of \$150x for Business A and \$50x for the patent).

(D) Under paragraph (c)(3) of this section, DP1's aggregate section 358 basis of \$180x in the stock of FA (computed as the sum of \$60x basis in Share 1 and \$120x basis in Share 2) is reduced by the amount by which the attributable inside gain with respect to DP1, reduced by any gain recognized by DC with respect to DP1 under paragraph (c)(2)(ii) of this section, exceeds DP1's outside gain in the FP stock received. Because DC recognizes no gain on the section 361 exchange with respect to DP1 under paragraph (c)(2)(ii) of this section as determined in paragraph (ii)(C) of this *Example 3*, the \$135x attributable inside gain with respect to DP1 is not reduced under paragraph (c)(3)(i)(A) of this section. DP1's outside gain in Share 1 and Share 2 in the aggregate is \$15x, the product of the section 367(a) percentage of 75% multiplied by \$20x (the difference between \$200x aggregate fair market value and \$180x aggregate section 358 basis in the FA stock received by DP1). Thus, DP1's section 358 basis in the FA stock (\$180x) must be reduced by \$120x (the excess of \$135x attributable inside gain, reduced by \$0x, over \$15x outside gain) to \$60x.

(E) Under paragraph (c)(3)(iii) 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 (\$60x less \$40x). The basis in Share 2 is reduced by \$80x (\$120x multiplied by \$120x/\$180x). As adjusted, DP1's basis in Share 2 is \$40x (\$120x less \$80x).

(F) Paragraph (c)(4)(i) of this section would be satisfied only if DC complies with the requirements of § 1.6038B-1(c)(6)(iii), including filing with its tax return for the year of the reorganization, a statement agreeing to file an amended return reporting the gain realized but not recognized on the section 361 exchange in certain cases if a significant amount of the section 367(a) property received in the section 361 exchange is disposed of, directly or indirectly, in one or more related transactions within the prescribed 60-month period.

*Example 4. Control requirement and ownership interest percentage; non-qualified property provided by foreign acquiring corporation.*

(i) *Facts.* DP1 and FP own 80% and 20%, respectively, of the outstanding stock of DC. DC owns Business A with a basis of \$0x and \$100x fair market value. DP1's DC stock has a fair market value of \$80x, and FP's DC stock has a fair market value of \$20x. In a reorganization described in section 368(a)(1)(D), DC transfers Business A to FA in exchange for \$80x of FA stock and \$20x cash. DC's transfer of Business A to FA qualifies as a section 361 exchange. DP1 exchanges its \$80x of DC stock for \$60x of FA stock and \$20x cash, and FP exchanges its \$20x of DC stock for \$20x of FA stock.

(ii) *Result.* (A) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning



of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1). The fact that the \$20x cash is distributed solely to DP1 does not change the analysis of the control requirement. The control requirement is determined immediately before the reorganization and is not affected by distributions of property.

(B) Pursuant to paragraph (f)(7) of this section, the ownership interest percentages of DP1 and FP immediately before the reorganization are 80% ( $\$80x/(\$80x + \$20x)$ ) and 20% ( $\$20x/(\$80x + \$20x)$ ), respectively. The fact that the \$20x of cash is distributed solely to DP1 does not change this result. The distribution of the \$20x of cash is not taken into account for purposes of the ownership interest percentage computation because the \$20x of cash distributed by DC is provided by FA to DC in the section 361 exchange.

*Example 5. Control requirement and ownership interest percentage; non-qualified property provided by U.S. transferor.* (i) *Facts.* The facts are the same as in *Example 4*, except as follows. Business A has a fair market value of \$80x (and not \$100x) and DC also owns inventory with a basis of \$0x and fair market value of \$20x. DC transfers Business A, but not the inventory, to FA in exchange for \$80x of FA stock. DP1 exchanges its \$80x of DC stock for \$60x of FA stock and the \$20x of inventory, and FP exchanges its \$20x of DC stock for \$20x of FA stock.

(ii) *Result.* (A) The requirement of paragraph (c)(1) of this section is satisfied because DC is controlled (within the meaning of section 368(c)) by five or fewer domestic corporations immediately before the reorganization (in this case, by a single domestic corporation, DP1). The fact that the \$20x of inventory is not transferred to FA, but is instead distributed solely to DP1, does not change the analysis of the control requirement. The control requirement is determined immediately before the reorganization, and is not affected by distributions of property.

(B) Pursuant to the general rule of paragraph (f)(7) of this section, the ownership interest percentages of DP1 and FP immediately before the reorganization would be 80% ( $\$80x/(\$80x + \$20x)$ ) and 20% ( $\$20x/(\$80x + \$20x)$ ), respectively. In this case, however, the distribution of the \$20x inventory to DP1 is taken into account for purposes of computing the ownership interest percentage of DP1 and FP because the inventory is not provided by FA to DC in the section 361 exchange. With respect to DP1, the numerator of the ownership interest percentage computation is \$60x, computed as the fair market value of DC stock owned by DP1 immediately before the reorganization but reduced by the fair market value of the inventory distributed to DP1 (\$80x less \$20x). With respect to FP, the numerator of the ownership interest percentage computation is \$20x, the fair market value of the DC stock owned by FP immediately before the reorganization. With respect to both DP1 and FP, the denominator of the ownership interest percentage computation is \$80x, computed as the fair market value of

all DC stock immediately before the reorganization, but reduced by the fair market value of the inventory distributed to DP1 (\$100x, less \$20x). Accordingly, the ownership interest percentage of DP1 is 75% ( $\$60x/\$80x$ ), and the ownership interest percentage of FP is 25% ( $\$20x/\$80x$ ).

(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)–1(b)(4)(i)(B) and § 1.367(a)–1T(b)(4). For rules relating to transfers of stock or securities in a section 361 exchange, see § 1.367(a)–3T(e). 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). For rules relating to distributions of stock of a foreign corporation by a domestic corporation under section 355 or 361, see §§ 1.367(b)–5, 1.367(e)–1, and 1.1248(f)–1 through 1.1248(f)–3. For additional rules relating to certain reporting requirements of a U.S. transferor, see § 1.6038B–1. For rules regarding expatriated entities, see section 7874 and the regulations under that section.

(i) [Reserved].

(j) *Effective/applicability date.* This section applies to transfers occurring on or after April 18, 2013.

■ **Par. 6.** Section 1.367(a)–8 is amended by:

- 1. Adding paragraph (c)(6).
- 2. Revising the first sentence of paragraph (j)(9).

The addition and revision read as follows:

**§ 1.367(a)–8 Gain recognition agreement requirements.**

\* \* \* \* \*

(c) \* \* \*

(6) *Cross-reference.* For gain recognition agreements entered into pursuant to certain outbound asset reorganizations, see § 1.367(a)–3T(e)(6).

\* \* \* \* \*

(j) \* \* \*

(9) *Gain recognition agreement filed in connection with indirect stock transfers and certain triangular asset reorganizations.* With respect to a gain recognition agreement entered into in connection with an indirect stock transfer (as defined in § 1.367(a)–3(d)), or a triangular asset reorganization described in § 1.367(a)–3T(e)(6)(iv), an indirect disposition of the transferred stock or securities. \* \* \*

\* \* \* \* \*

■ **Par. 7.** Section 1.367(b)–0 is amended by:

- 1. Revising the entry for § 1.367(b)–4(b)(1)(ii).
- 2. Revising the heading for § 1.367(b)–6.
- 3. Revising the entry for § 1.367(b)–6(a).

The revisions read as follows:

**§ 1.367(b)–0 Table of contents.**

\* \* \* \* \*

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

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(ii) *Special Rules*

\* \* \* \* \*

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

(a) *Effective/applicability dates*

\* \* \* \* \*

■ **Par. 8.** Section 1.367(b)–4 is amended by:

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

The revisions and addition read as follows:

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

(a) *Scope.* This section applies to an acquisition by a foreign corporation (the foreign acquiring corporation) of the stock of a foreign corporation in an exchange described in section 351 or of the stock or assets of a foreign corporation in a reorganization described in section 368(a)(1) (in either case, the foreign acquired corporation). For rules applicable when, pursuant to section 304(a)(1), a foreign acquiring corporation is treated as acquiring the stock of a foreign acquired corporation in a transaction to which section 351(a) applies, see § 1.367(b)–4T(e). For purposes of this section, the term *triangular reorganization* means a reorganization described in § 1.358–6(b)(2)(i) through (b)(2)(v) (forward triangular merger, triangular C reorganization, reverse triangular merger, triangular B reorganization, and triangular G reorganization, respectively). In the case of a triangular reorganization other than a reverse triangular merger, the surviving corporation is the foreign acquiring corporation that acquires the assets or stock of the foreign acquired corporation, and the reference to controlling corporation (foreign or

domestic) is to the corporation that controls the surviving corporation. In the case of a reverse triangular merger, the surviving corporation is the entity that survives the merger, and the controlling corporation (foreign or domestic) is the corporation that before the merger controls the merged corporation. In the case of a reverse triangular merger, this section applies if stock of the foreign surviving corporation is exchanged for stock of a foreign corporation in control of the merging corporation; in such a case, the foreign surviving corporation is treated as a foreign acquired corporation for purposes of this section. A foreign corporation that undergoes a reorganization described in section 368(a)(1)(E) is treated as both the foreign acquired corporation and the foreign acquiring corporation for purposes of this section. See § 1.367(a)–3(b)(2) for transactions subject to the concurrent application of sections 367(a) and (b).

(b) \* \* \*  
(1) \* \* \*  
(i) \* \* \*  
(B) \* \* \*

(2) Immediately after the exchange, the foreign acquiring corporation or the foreign acquired corporation (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—(A) Receipt of foreign stock in an exchange to which § 1.367(a)–7(c) applies.* If an exchanging shareholder is a domestic corporation that transfers stock of a foreign acquired corporation in an exchange under section 361(a) or (b) (section 361 exchange) to which the exception to section 367(a)(5) in § 1.367(a)–7(c) applies, and the exchanging shareholder receives stock in either the foreign acquiring corporation or foreign controlling corporation (in the case of a triangular reorganization), such exchange will not be described in paragraph (b)(1)(i) of this section only if immediately after the exchanging shareholder's receipt of the foreign stock in the section 361 exchange, but prior to, and without taking into account, the exchanging shareholder's distribution of the foreign stock under section 361(c)(1), the foreign acquired corporation, foreign acquiring corporation, and foreign controlling corporation (in the case of a triangular reorganization) are controlled foreign corporations as to which the exchanging shareholder is a section 1248 shareholder. See paragraph (b)(1)(iii) of

this section, *Example 4*, for an illustration of this rule. If an exchange is not described in paragraph (b)(1)(i) of this section as a result of the application of this paragraph, see §§ 1.1248(f)–1(b)(3) and 1.1248(f)–2(c), as applicable. For adjustments to the basis of stock of the foreign surviving corporation in certain triangular reorganizations, see paragraph (b)(1)(ii)(B)(2)(i) of this section.

(B) *Special rules for certain triangular reorganizations—(1) Receipt of domestic stock.* In the case of a triangular reorganization in which the stock received in the exchange is stock of a domestic controlling corporation, such exchange is not described in paragraph (b)(1)(i) of this section if immediately after the exchange the following foreign corporations are controlled foreign corporations as to which the domestic controlling corporation is a section 1248 shareholder—

(i) The foreign acquired corporation and foreign surviving corporation, in the case of a section 354 exchange of the stock of the foreign acquired corporation pursuant to a triangular B reorganization.

(ii) The foreign surviving corporation, in the case of a section 354 or section 356 exchange of the stock of the foreign acquired corporation pursuant to a forward triangular merger, triangular C reorganization, reverse triangular merger, or triangular G reorganization. See paragraph (b)(1)(iii) of this section, *Example 3B* for an illustration of this rule.

(iii) The foreign acquired corporation and foreign surviving corporation, in the case of a section 361 exchange of the stock of the foreign acquired corporation by an exchanging shareholder that is a foreign corporation described in paragraph (b)(1)(i)(A)(2) of this section and that is a foreign acquired corporation the assets of which are acquired in a triangular reorganization described in paragraph (b)(1)(ii)(B)(1)(i) of this section.

(iv) The foreign acquired corporation and foreign surviving corporation, in the case of a section 361 exchange of the stock of the foreign acquired corporation by an exchanging shareholder that is a domestic corporation described in paragraph (b)(1)(i)(A)(1) of this section and that is acquired in a triangular reorganization to which the exception to section 367(a)(5) in § 1.367(a)–7(c) applies. See paragraph (b)(1)(iii) of this section, *Example 5* for an illustration of this rule.

(2) *Adjustments to basis of stock of foreign surviving corporation—(i) Section 361 exchanges to which § 1.367(a)–7(c) applies.* If stock of the

foreign acquired corporation is acquired by the foreign surviving corporation in a section 361 exchange by reason of triangular reorganization (other than a triangular B reorganization) to which the exception to section 367(a)(5) provided in § 1.367(a)–7(c) applies, and if paragraph (b)(1)(i) of this section does not apply to the section 361 exchange by reason of (b)(1)(ii)(A) of this section (if the stock received is stock of a foreign controlling corporation) or by reason of (b)(1)(ii)(B)(1)(iv) of this section (if the stock received is stock of a domestic controlling corporation), then the controlling corporation (foreign or domestic) must apply the principles of § 1.367(b)–13 to adjust the basis of the stock of the foreign surviving corporation so that the section 1248 amount in the stock of the foreign acquired corporation (determined when the foreign surviving corporation acquires such stock) is reflected in the stock of the foreign surviving corporation immediately after the exchange. See paragraph (b)(1)(iii) of this section, *Example 5*, for an illustration of this rule.

(ii) *Other exchanges.* See § 1.367(b)–13 for rules regarding the adjustment to the basis of the stock of the foreign surviving corporation in exchanges pursuant to triangular reorganizations that are not subject to paragraph (b)(1)(ii)(B)(2)(i) of this section.

(iii) \* \* \*

*Example 4. (i) Facts.* DC1, a domestic corporation, owns all of the outstanding stock of DC2, a domestic corporation. DC2 owns various assets, including all of the outstanding stock of FC2, a foreign corporation. The stock of FC2 has a value of \$100, and DC2 has a basis of \$30 in the stock. The section 1248 earnings and profits attributable to the FC2 stock held by DC2 is \$20. DC2 does not own any stock other than the FC2 stock. FC1 is a foreign corporation that is unrelated to DC1, DC2, and FC2. In a reorganization described in section 368(a)(1)(C), FC1 acquires all of the assets of DC2 in exchange for the assumption of DC2's liabilities and voting stock of FC1 that represents 20% of the outstanding voting stock of FC1. DC2 distributes the FC1 stock to DC1 under section 361(c)(1), and the DC2 stock held by DC1 is canceled. The exception to section 367(a)(5) provided in § 1.367(a)–7(c) applies to the section 361 exchange. DC1 properly files a gain recognition agreement that satisfies the conditions of §§ 1.367(a)–3T(e)(6) and 1.367(a)–8 to qualify for nonrecognition treatment under section 367(a) with respect to DC2's transfer of the FC2 stock to FC1. See § 1.367(a)–3T(e). FC1 is not a surrogate foreign corporation (within the meaning of section 7874) because DC1 does not hold at least 60% of the stock of FC1 by reason of holding stock of DC2.

(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 section 361 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. See paragraph (b)(1)(ii)(A) of this section. If, immediately after the section 361 exchange (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)), 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) of this section because neither condition in paragraph (b)(1)(i)(B) of this section is satisfied. Alternatively, if immediately after the section 361 exchange (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)) 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. For the treatment of DC2's transfer of assets other than the FC2 stock to FC1, see section 367(a)(1) and (a)(3) and the regulations under that section. Furthermore, because DC2's transfer of any other assets to FC1 is pursuant to a section 361 exchange, see section 367(a)(5) and § 1.367(a)-7. If any of the assets transferred are intangible assets for purposes of section 367(d), see section 367(d). With respect to DC2's distribution of the FC1 stock to DC1 under section 361(c)(1), see section 1.248(f)(1), and §§ 1.1248(f)-1 and 1.1248(f)-2.

*Example 5.* (i) *Facts.* DC1, a domestic corporation, wholly owns DC2, a domestic corporation. The DC2 stock has a \$100x fair market value, and DC1 has a basis of \$30x in the stock. DC2's only asset is all of the outstanding stock of FC2, a foreign corporation. The FC2 stock has a \$100x fair market value, and DC2 has a basis of \$30x in the stock. There are \$20x of earnings and profits attributable to the FC2 stock for purposes of section 1248. USP, a domestic corporation unrelated to DC1, DC2, and 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 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, the exception to section 367(a)(5) provided in § 1.367(a)-7(c) applies to the section 361 exchange. In addition, 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). DC1 properly files a gain recognition agreement that satisfies the conditions of §§ 1.367(a)-3T(e)(6) and 1.367(a)-8 to qualify for nonrecognition treatment under section

367(a) with respect to DC2's transfer of the FC2 stock to FC1. See § 1.367(a)-3T(e).

(ii) *Result.* Immediately after the exchange, FC1 and FC2 are controlled foreign corporations as to which USP is a section 1248 shareholder because USP directly and indirectly owns all the FC1 stock and FC2 stock, respectively. Because DC2 receives stock of a domestic corporation (USP) in exchange for the FC2 stock and, immediately after the exchange, FC1 and FC2 are controlled foreign corporations as to which USP is a section 1248 shareholder, DC2's exchange of the FC2 stock for the USP stock is not described in paragraph (b)(1)(i) of this section. See paragraph (b)(1)(ii)(B)(1)(iv) of this section. Therefore, DC2 is not required to include in income the section 1248 amount in the FC2 stock. Under paragraph (b)(1)(ii)(B)(2)(i) of this section, USP must apply the principles of § 1.367(b)-13 to adjust the basis of its FC1 stock to preserve the section 1248 amount (\$20x) in the FC2 stock. Under the principles of § 1.367(b)-13, each share of FC1 stock held by USP after the exchange must be divided into portions, one portion attributable to the FC1 stock owned before the exchange and one portion attributable to the FC2 stock received in the exchange. The \$30x basis in the FC2 stock and the \$20x 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. 9.** Section 1.367(b)-6 is amended by revising the section heading and paragraph (a)(1) to read as follows:

**§ 1.367(b)-6 Effective/applicability dates and coordination rules.**

(a) *Effective/applicability dates*—(1) *In general.* (i) 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.

(ii) 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 (a)(2)(E)) involving a foreign acquiring or foreign acquired corporation, apply only to transfers occurring on or after January 23, 2006.

(iii) The second sentence of paragraph § 1.367(b)-4(a) 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.

(iv) 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) and (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),

(c)(4)(iv), and (c)(4)(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.

(v) Section 1.367(b)-4(a), § 1.367(b)-4(b)(1)(i)(B)(2), § 1.367(b)-4(b)(1)(ii), § 1.367(b)-4(b)(1)(iii), *Example 4* and *Example 5* apply to section 367(b) exchanges that occur on or after April 18, 2013. For guidance with respect to § 1.367(b)-4(a), § 1.367(b)-4(b)(1)(i)(B)(2), § 1.367(b)-4(b)(1)(ii) and § 1.367(b)-4(b)(1)(iii), *Example 4*, for exchanges that occur before April 18, 2013, see 26 CFR part 1 revised as of April 1, 2012.

\* \* \* \* \*

■ **Par. 10.** Section 1.367(e)-1 is amended by:

- 1. Revising the fifth sentence of paragraph (a).
- 2. Revising paragraph (e).
- 3. Revising the paragraph (f) subject heading.
- The revisions read as follows:

**§ 1.367(e)-1 Distributions described in section 367(e)(1).**

(a) *Purpose and scope.* \* \* \* Paragraph (e) of this section provides cross-references. \* \* \*

(e) *Cross-references.* For additional rules relating to the distribution of the stock of a foreign corporation by a domestic corporation, see §§ 1.367(a)-3T(e), 1.367(a)-7, 1.367(b)-5, and 1.1248(f)-1 through 1.1248(f)-3. See the regulations under section 6038B for reporting requirements for distributions under this section.

(f) *Effective/applicability date.* \* \* \*

■ **Par. 11-12.** In § 1.1248-1, for each entry in the table below in the "Section" column, remove the language in the "Remove" column and add the language in the "Add" column in its place, and:

- 1. Revise paragraphs (c) and (e).
- 2. Add paragraph (g)(3).

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).

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

\* \* \* \* \*

(c) *Gain recognized.* Section 1248(a) applies to a sale or exchange of stock in

a foreign corporation only if gain is recognized in whole or in part upon the sale or exchange. Thus, for example, if a United States person exchanges stock in a foreign corporation and no gain is recognized on the exchange under section 332, 351, 354, 355, 356, or 361, taking into account the application of section 367, then no amount is includible in the gross income of the person as a dividend under section 1248(a). But see §§ 1.1248(f)-1 and 1.1248(f)-2, providing that a domestic distributing corporation must include in gross income amounts under section 1248(f) as a result of certain foreign stock distributed pursuant to section 337, 355(c)(1), or 361(c)(1) (in certain cases without regard to the amount of gain realized by the domestic distributing corporation in the distribution).

\* \* \* \* \*

(e) *Exceptions.* Under section 1248(g), this section and §§ 1.1248-2 through 1.1248-8 do 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 the 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.

\* \* \* \* \*

(g) *Effective/applicability date.* \* \* \*

(3) Paragraphs (c) and (e) of this section apply to transactions occurring on or after April 18, 2013.

■ **Par. 13.** Section 1.1248-6 is amended by:

■ 1. Adding a sentence at the end of paragraph (a).

■ 2. Adding paragraphs (d) and (e).  
The additions 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 do 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 applies to a sale, exchange, or other disposition of

the stock of a domestic corporation on or after September 21, 1987.

■ **Par. 14.** Section 1.1248-8 is amended by:

■ 1. Revising paragraphs (a)(3), (b)(1)(iv)(A), and (b)(2)(i).

■ 2. Adding paragraph (b)(2)(iv).

■ 3. Revising paragraph (d).

The revisions and addition read as follows:

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

(a) \* \* \*

(3) *Section 381 transactions.* 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 the transaction, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction will 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 there is a restructuring transaction described in § 1.1248(f)-1(b)(3) to which the exception provided by § 1.1248(f)-2(c) applies with respect to a distribution by a domestic acquired corporation of stock of a foreign corporation to one or more exchanging shareholders, the earnings and profits attributable to a portion of a share of stock as provided under § 1.1248(f)-2(c)(2) (or a whole share, if no division is required) will be determined pursuant to paragraphs (b)(2)(iv)(A) and (b)(2)(iv)(B) of this section.

(A) The earnings and profits attributable to a portion of a share of stock as provided under § 1.1248(f)-2(c)(2)(i) (or a whole share, if no division is required) will be determined in accordance with § 1.1248-2 or § 1.1248-3 (and this section, as applicable), without regard to any portion of the section 1223(1) holding period in that portion of a share (or whole share) that is before the restructuring transaction.

(B) The earnings and profits attributable to a portion of a share of stock as provided under § 1.1248(f)-2(c)(2)(ii) (or whole share, if no division is required) is the amount in paragraph (b)(2)(iv)(B)(1) of this section, increased by the amounts described in paragraph (b)(2)(iv)(B)(2) of this section.

(1) The amount equal to the product of the ratio of the value of the share of stock to the value of all shares of stock received by the exchanging shareholder multiplied by the amount in paragraph (b)(2)(iv)(B)(1)(i) of this section, reduced by the amount in paragraph (b)(2)(iv)(B)(1)(ii) of this section.

(j) The amount equal to the product of the exchanging shareholder's ownership interest percentage (within the meaning of § 1.367(a)-7(f)(7)) in the domestic acquired corporation multiplied by the earnings and profits attributable to the block of stock of the foreign corporation transferred in the section 361 exchange that relates to the portion (or whole share), determined in accordance with § 1.1248-2 or § 1.1248-3 (and this section, as applicable) immediately before the restructuring transaction (and without taking into account the application of sections 367 and 1248 to the transfer of the stock of the foreign corporation in the section 361 exchange).

(ii) The amount of any dividend included in the domestic acquiring corporation's gross income under section 1248(a) on the transfer of the block of stock of the foreign corporation, which relates to the portion or whole share, in the section 361 exchange by reason of gain recognized under §§ 1.367(a)-6T or 1.367(a)-7(c)(2) attributable to the exchanging shareholder.

(2) The earnings and profits determined in accordance with § 1.1248-2 or § 1.1248-3 (and this section, as 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(e), *Example 2* and *Example 3*.

\* \* \* \* \*

(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 April 18, 2013.

■ **Par. 15.** 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 under section 1248(f) 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(c)(1), or 361(c)(1) applies. Paragraph (b) of this section provides the general rule that requires the domestic distributing corporation, depending on the type of distribution, to include in gross income either the section 1248 amount or the total section 1248(f) amount. Paragraph (c) of this section provides definitions that apply for purposes of this section and §§ 1.1248(f)-2 and 1.1248(f)-3. Section 1.1248(f)-2 provides exceptions to the general rule contained in paragraph (b) of this section that apply, depending on the type of distribution. Section 1.1248(f)-3 provides reasonable cause relief procedures for failures to timely comply with certain filing requirements and effective/applicability dates.

(b) *General rule*—(1) *Section 337 distribution.* This paragraph (b)(1) applies if a domestic distributing corporation that is a section 1248 shareholder of a foreign distributed corporation distributes stock of the foreign distributed corporation in a

distribution to which section 337 applies (section 337 distribution). Except as provided in § 1.1248(f)-2(a), the domestic distributing corporation must, notwithstanding any other provision of subtitle A of the Internal Revenue Code (Code), include in gross income as a dividend the section 1248 amount with respect to the stock of the foreign distributed corporation. This paragraph (b)(1) applies only to the extent the domestic distributing corporation does not recognize gain with respect to the stock of the foreign distributed corporation as a result of the section 337 distribution under another provision of subtitle A of the Code.

(2) *Existing stock distribution under section 355 or 361.* This paragraph (b)(2) applies to the extent a domestic distributing corporation distributes stock of the foreign distributed corporation that is not received in a section 361 exchange that is part of the plan of distribution, provided the distribution is described in section 355(c)(1) or section 361(c)(1) (existing stock distribution). Except as provided in § 1.1248(f)-2(b), the domestic distributing corporation must, notwithstanding any other provision of subtitle A of the Code, include in gross income as a dividend the section 1248 amount with respect to the stock of the foreign distributed corporation. This paragraph (b)(2) only applies to the extent the domestic distributing corporation does not recognize gain with respect to the stock of the foreign distributed corporation as a result of the existing stock distribution under another provision of subtitle A of the Code.

(3) *New stock distribution under section 361.* This paragraph (b)(3) applies to the extent a domestic distributing corporation distributes stock of the foreign distributed corporation that is received in a section 361 exchange that is part of the plan of distribution (and, to the extent applicable, also distributes any cash or other property), provided the distribution is described in section 361(c)(1) (new stock distribution). Except as provided in § 1.1248(f)-2(c), the domestic distributing corporation must, notwithstanding any other provision of subtitle A of the Code, include in gross income as a dividend the total section 1248(f) amount with respect to the stock of each foreign corporation transferred in the section 361 exchange. This paragraph (b)(3) applies without regard to the amount of gain realized by the domestic distributing corporation in the new stock 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 provided in § 1.1248-2(b).

(3) *Distributee* is a shareholder of the domestic distributing corporation that receives one or more shares of stock of a foreign distributed corporation in an existing stock distribution (as defined in paragraph (b)(2) of this section) or a new stock distribution (as defined in paragraph (b)(3) of this section).

(4) *Hypothetical section 1248 amount* is, with respect to each distributee or non-stock distributee, the amount in paragraph (c)(4)(i) of this section, reduced by the amount in paragraph (c)(4)(ii) of this section computed with respect to the stock of each foreign corporation transferred in the section 361 exchange by the domestic distributing corporation for which there is not an income inclusion under § 1.367(b)-4(b)(1)(i).

(i) The amount that the domestic distributing corporation would have included in income as a deemed dividend under § 1.367(b)-4(b)(1)(i) if the requirements of § 1.367(b)-4(b)(1)(ii)(A) (involving the receipt of foreign stock in an exchange to which § 1.367(a)-7(c) applies) had not been satisfied and that would have been attributable to such distributee or non-stock distributee under § 1.367(a)-7(e)(4) (providing rules to attribute deemed income inclusions under § 1.367(b)-4 to persons described in § 1.367(a)-3T(e)(3)(iii)(A)).

(ii) The amount of gain recognized by the domestic distributing corporation under § 1.367(a)-7(c)(2) attributable to such distributee or non-stock distributee and allocable to the stock of such foreign corporation under § 1.367(a)-7(e)(1), but only to the extent such gain is treated as a dividend under section 1248(a).

(5) *Non-stock distributee* is a shareholder of the domestic distributing corporation that receives cash or other property but no shares of stock of the foreign distributed corporation in a new stock distribution (as defined in paragraph (b)(3) of this section).

(6) *Postdistribution amount* is the section 1248 amount with respect to the stock (or a portion of a share of stock) of the foreign distributed corporation received by a distributee, computed immediately after the distribution, but without taking into account any adjustments to the basis of the stock under § 1.1248(f)-2(b)(3) (in the case of an existing stock distribution) or

adjustments to the basis of stock or income inclusions under § 1.1248(f)-2(c)(3) (in the case of a new stock distribution). The postdistribution amount in the stock of a foreign distributed corporation received in an existing stock distribution is determined based on the distributee's holding period in the stock as adjusted under § 1.1248(f)-2(b)(2). The postdistribution amount in the stock (or a portion of a share of stock, as applicable) of a foreign distributed corporation received in a new stock distribution is determined after applying the rules in §§ 1.1248-8(b)(2)(iv) and 1.1248(f)-2(c)(2).

(7) *Section 358 basis* is the basis in stock as determined under section 358.

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

(9) *Section 1248 amount* is the net positive earnings and profits (if any) attributable to the stock of the foreign distributed corporation, determined in accordance with § 1.1248-2 or § 1.1248-3 (taking into account § 1.1248-8, if applicable), and that would be included in gross income as a dividend under section 1248(a) if the stock were sold by the domestic distributing corporation in a transaction in which all realized gain is recognized.

(10) *Section 1248(f) amount* is the amount in paragraph (c)(10)(i) of this section, reduced by the amount in paragraph (c)(10)(ii) of this section computed with respect to the stock of each foreign corporation transferred in the section 361 exchange by the domestic distributing corporation for which the domestic distributing corporation does not have an income inclusion under § 1.367(b)-4(b)(1)(i).

(i) The amount that the domestic distributing corporation would have included in income as a dividend under § 1.367(b)-4(b)(1)(i) if the requirements of § 1.367(b)-4(b)(1)(ii)(A) (involving the receipt of foreign stock in an exchange to which § 1.367(a)-7(c) applies) had not been satisfied.

(ii) The amount of gain recognized by the domestic distributing corporation under § 1.367(a)-7(c)(2) and allocable to the stock of such foreign corporation under § 1.367(a)-7(e)(1), but only to the extent such gain is treated as a dividend under section 1248(a).

(11) *Section 1248(f) block amount* is the portion of the section 1248(f) amount, as defined in paragraph (c)(10) of this section, that relates to a block of stock of the foreign corporation if more than a single block of stock of the foreign corporation is transferred in the section 361 exchange.

(12) *Section 1248 shareholder* is a domestic corporation that satisfies the

ownership requirements of section 1248(a)(2) with respect to a foreign corporation, except that a domestic corporation, other than a domestic distributing corporation, that is a regulated investment company (as defined in section 851(a)), a real estate investment trust (as defined in section 856(a)), or an S corporation (as defined in section 1361(a)) cannot be a section 1248 shareholder.

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

(14) *Total section 1248(f) amount* is the sum of each section 1248(f) amount (as defined in paragraph (c)(10) of this section).

■ **Par. 16.** Section 1.1248(f)-2 is added to read as follows:

**§ 1.1248(f)-2 Exceptions for certain distributions and attribution rules.**

(a) *Section 337 stock distribution*—(1) *General exception.* In the case of a section 337 distribution (as defined in § 1.1248-1(b)(1)), § 1.1248(f)-1(b)(1) shall not apply to the distribution of stock of the foreign distributed corporation to the 80-percent distributee if the conditions of paragraphs (a)(1)(i), (a)(1)(ii) and (a)(1)(iii) of this section are satisfied.

(i) *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.

(ii) *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.

(iii) *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.

(2) *Elective exception.* If the conditions of paragraph (a)(1)(ii) or (a)(1)(iii) of this section are not otherwise satisfied, the domestic distributing corporation and the 80-percent distributee may elect to make adjustments to the 80-percent distributee's holding period or basis in the stock of the foreign distributed corporation, as appropriate, such that the conditions described in paragraphs (a)(1)(ii) and (iii) of this section are satisfied. The conditions and procedures for making the election are

described in paragraph (a)(3) of this section. See paragraphs (a)(4) and (5) of this section for adjustments that are required as a result of making the election.

(3) *Election and reporting*—(i) *Statement required by domestic distributing corporation and 80-percent distributee*—(A) *In general.* The domestic distributing corporation and the 80-percent distributee make the election described in paragraph (a)(2) of this section by each including a statement, described in paragraph (a)(3)(i)(B) of this section, with a timely filed return for the taxable year during which the section 337 distribution occurs, and by entering into a written agreement described in paragraph (a)(3)(ii) of this section. If the domestic distributing corporation or the 80-percent distributee are members of a consolidated group at the time of the section 337 distribution but not the common parent, the common parent of the consolidated group makes the election on behalf of the domestic distributing corporation or the 80-percent distributee. The election described in paragraph (a)(2) of this section and made pursuant to this paragraph (a)(3) is irrevocable.

(B) *Form and content.* The statement of election must be entitled, "STATEMENT TO ELECT TO APPLY EXCEPTION UNDER § 1.1248(f)-2(a)(2)," state that the domestic distributing corporation and the 80-percent distributee have entered into a written agreement described in paragraph (a)(3)(ii) of this section, set forth the date of the agreement and the names of the parties to the agreement, and the adjustments to the 80-percent distributee's holding period and/or basis determined under section 334 in the stock of the foreign distributed corporation received in the section 337 distribution required under paragraphs (a)(4) and (a)(5) of this section.

(ii) *Written agreement.* The domestic distributing corporation and the 80-percent distributee must enter into a written agreement described in this paragraph (a)(3)(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 337 distribution occurs. Both the domestic distributing corporation and the 80-percent distributee must retain the original or a copy of the agreement as part of its records in the manner specified by § 1.6001-1(e). Both the domestic distributing corporation and the 80-percent distributee 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 337 distribution occurs. The written agreement must—

(A) State the document is an agreement under paragraph (a)(3)(ii) of this section;

(B) Provide the name and taxpayer identification number (if any) of the domestic distributing corporation, the 80-percent distributee, and the foreign distributed corporation;

(C) With respect to the 80-percent distributee, state the holding period in the stock of the foreign distributed corporation received in the section 337 distribution as adjusted under paragraph (a)(4) of this section; and

(D) With respect to the 80-percent distributee, identify the basis as determined under section 334 of the stock of the foreign distributed corporation received in the section 337 distribution and the adjustment (if any) to such basis under paragraph (a)(5) of this section.

(4) *Holding period adjustment.* For purposes of section 1248, immediately after the section 337 distribution, the 80-percent distributee's holding period in the stock of the foreign distributed corporation received in the section 337 distribution shall equal the domestic distributing corporation's holding period in such stock at the time of the section 337 distribution.

(5) *Basis adjustments.* If the domestic distributing corporation's section 1248 amount with respect to the stock of the foreign distributed corporation received by the 80-percent distributee in the section 337 distribution exceeds the 80-percent distributee's postdistribution amount with respect to such stock (excess amount), the 80-percent distributee's basis as determined under section 334 in such stock shall be reduced by the excess amount.

(b) *Existing stock distribution under sections 355 or 361.* In the case of an existing stock distribution (as defined in § 1.1248(f)-1(b)(2)), § 1.1248(f)-1(b)(2) shall not apply to the distribution of stock of the foreign distributed corporation 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 distributees that are 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 (3) of this section for adjustments that may be required if an election is made to apply the provisions of this paragraph (b).

(1) *Election and reporting—(i) Statement required by domestic distributing corporation and section 1248 shareholders—(A) In general.* The domestic distributing corporation and all distributees that are 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 a timely filed return for the taxable year during which the existing stock 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 but not the common parent, 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, "ELECTION TO APPLY EXCEPTION UNDER § 1.1248(f)-2(b)," state that the domestic distributing corporation and all distributees that are section 1248 shareholders have entered into a written agreement described in paragraph (b)(1)(ii) of this section, the date of the agreement and the names of the parties to the agreement, and set forth any required 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 existing stock distribution under paragraph (b)(2) or (b)(3) of this section, respectively.

(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 existing stock 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 existing stock distribution occurs. The written agreement must—

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

(B) Provide the name and taxpayer identification number (if any) of the domestic distributing corporation, the foreign distributed 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 existing stock distribution as adjusted under paragraph (b)(2) of this section; and

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

(2) *Holding period adjustments.* For purposes of section 1248, immediately after the existing stock distribution, each section 1248 shareholder's holding period in each share of stock of the foreign distributed corporation received in the existing stock distribution will be equal to the domestic distributing corporation's holding period in the share of stock at the time of the existing stock distribution.

(3) *Basis adjustments.* If the domestic distributing corporation's section 1248 amount with respect to a share of stock of the foreign distributed corporation received by a section 1248 shareholder in the existing stock distribution exceeds the section 1248 shareholder's postdistribution amount with respect to the share of stock (excess amount), the section 1248 shareholder's section 358 basis in the share of stock is reduced by the excess amount. For an illustration of the rule in this paragraph (b)(3), see paragraph (e) of this section, *Example 1* and *Example 3*.

(c) *New stock distribution under section 361.* In the case of a new stock distribution (as defined in § 1.1248(f)-1(b)(3)), the amount that the domestic distributing corporation is required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) (total section 1248(f) amount) is reduced by the sum of the portions of any section 1248(f) amount attributable under paragraph (d) of this section to stock of the foreign distributed corporation distributed to distributees that are section 1248 shareholders, but only if the domestic distributing corporation and all the distributees that are 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), (c)(3), and (c)(4) of this section for adjustments or income inclusions that are required if an election is made to apply the provisions of this paragraph (c). The adjustments or income inclusions provided in

paragraphs (c)(2), (c)(3), and (c)(4) of this section apply after any adjustments required under section 367(a)(5) and § 1.367(a)-7(c). For illustrations of this exception, see paragraph (e) of this section, *Example 2* and *Example 3* and § 1.367(a)-3(e)(8), *Example 3*.

(1) *Election and reporting*—(i) *Statement required by domestic distributing corporation and section 1248 shareholders*—(A) *In general.* The domestic distributing corporation and all distributees that are section 1248 shareholders elect to apply the provisions of paragraph (c) of this section by each including a statement, in the form and containing the information listed in paragraph (c)(1)(i)(B) of this section, with a timely filed return for the taxable year during which the new stock 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 new stock distribution but is not the common parent, 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, “ELECTION TO APPLY EXCEPTION UNDER § 1.1248(f)-2(c),” state that the domestic distributing corporation and each distributee that is a section 1248 shareholder have entered into a written agreement described in paragraph (c)(1)(ii) of this section, the date of the agreement and the names of the parties to the agreement, and describe, with respect to each section 1248 shareholder, the extent to which the shares of stock of the foreign distributed corporation received in the new stock distribution are divided into portions under paragraph (c)(2) of this section, any adjustments to the section 358 basis of the stock under paragraph (c)(3) of this section, and the amount the domestic distributing corporation must include in gross income as a dividend under paragraph (c)(3) of this section.

(ii) *Written agreement.* The domestic distributing corporation and all distributees that are 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 domestic distributing corporation’s U.S. income tax return for the taxable year during which the new stock 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 new stock distribution occurs. The written agreement must—

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

(B) Provide the name and taxpayer identification number (if any) of the domestic distributing corporation, the foreign distributed 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 earnings and profits attributable to the stock (or each block of stock, as applicable) of each foreign corporation transferred in the section 361 exchange that is attributable under § 1.1248-8(b)(2)(iv) to the stock of the foreign distributed corporation received in the new stock distribution;

(E) With respect to each section 1248 shareholder, state the amount of the section 1248(f) amount with respect to the stock (or each block of stock, as applicable) of each foreign corporation transferred in the section 361 exchange that is attributable under § 1.1248(f)-2(d) to the stock of the foreign distributed corporation received in the new stock distribution;

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

(G) With respect to each section 1248 shareholder, state the amount the domestic distributing corporation must include in gross income as a dividend under paragraph (c)(3) of this section.

(2) *Portions.* If the domestic distributing corporation transfers property, other than a single block of stock of a foreign corporation with respect to which the domestic distributing corporation is a section 1248 shareholder immediately before the section 361 exchange, to the foreign distributed corporation in the section 361 exchange that precedes the new stock distribution, then each share of stock of the foreign distributed corporation received by a distributee

that is a section 1248 shareholder must be divided into portions as follows:

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

(ii) One portion attributable to each block of stock of each foreign corporation transferred in the section 361 exchange with respect to which the domestic distributing corporation is a section 1248 shareholder immediately before the section 361 exchange. For the determination of the earnings and profits attributable to the stock (or block of stock, as applicable) of each foreign corporation transferred in the section 361 exchange that are attributable to a portion of a share of stock of the foreign distributed corporation, see § 1.1248-8(b)(2)(iv). For the determination of the section 1248(f) amount with respect to the stock (or block of stock, as applicable) of each foreign corporation transferred in the section 361 exchange that is attributable to a portion of a share of stock of the foreign distributed corporation, see paragraph (d)(2) of this section.

(3) *Basis adjustments and income inclusions.* If the section 1248(f) amount attributable to a portion of a share of stock (or whole share, if no division is required) (as determined under paragraph (d) of this section) of the foreign distributed corporation received by a distributee that is a section 1248 shareholder in the new stock distribution exceeds the section 1248 shareholder’s postdistribution amount in the portion (or whole share, if no division is required) (excess amount), then the section 1248 shareholder’s section 358 basis in the portion as determined under paragraph (c)(4) of this section (or whole share, if no division is required), as adjusted under § 1.367(a)-7(c)(3), is reduced by the excess amount, but not below zero. To the extent the excess amount exceeds the section 358 basis in the portion (or whole share, if no division is required), the domestic distributing corporation must include that portion of the section 1248(f) amount attributable to the portion of the share (or whole share, if no division is required) in gross income as a dividend. For an illustration of this rule, see paragraph (e) of this section, *Example 2*, and § 1.367(a)-3(e)(8), *Example 3*.

(4) *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 the product of the section 1248 shareholder's section 358 basis, as adjusted under § 1.367(a)-7(c)(3), in the share of stock multiplied by the ratio of the basis determined under section 362 (taking into account any gain or deemed dividends recognized under section 367) of the property (section 362 basis) to which the portion relates, to the aggregate section 362 basis of all property received by the foreign distributed corporation in the section 361 exchange. For illustrations of this rule, see paragraph (e) of this section, *Example 2*, and § 1.367(a)-3(e)(8), *Example 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 the product of the fair market value of the share of stock multiplied by the ratio of the fair market value of the property to which the portion relates 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 (e) of this section, *Example 2*, and § 1.367(a)-3(e)(8), *Example 3*.

(iii) *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 divided portions under paragraph (c)(2) of this section, the amount realized on the sale or exchange of the share will be allocated to each divided portion based on the relative fair market value of the property to which the portion relates as determined at the time of the reorganization.

(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 must be divided so long as section 1248(a) would apply to a sale or exchange of the shares.

(d) *Attribution of all or a portion of section 1248(f) amount to certain stock of the foreign distributed corporation.* This paragraph (d) applies if there is a new stock distribution for which an election under § 1.1248(f)-2(c)(1) is made. This paragraph (d) provides rules for attributing all or a portion, as applicable, of the section 1248(f) amount with respect to the stock of each foreign corporation transferred in the section 361 exchange by the domestic distributing corporation to shares of stock, or to portions of shares of stock, as applicable, received in the foreign distributed corporation and distributed to one or more distributees that are section 1248 shareholders with respect

to the foreign distributed corporation. Paragraph (d)(1) of this section provides rules to attribute the applicable section 1248(f) amount among shares of stock of the foreign distributed corporation received by one or more distributees that are section 1248 shareholders. If shares of stock are divided into portions under paragraph (c)(2) of this section, paragraph (d)(2) of this section provides additional rules to attribute the applicable section 1248 amount to portions of shares of stock received by one or more distributees that are section 1248 shareholders.

(1) *Attribution of all or a portion of section 1248(f) amount among shares of stock.* With respect to one or more shares of stock of the foreign distributed corporation distributed to a distributee that is a section 1248 shareholder, the portion of the section 1248(f) amount with respect to the stock of the foreign corporation transferred in the section 361 exchange that is equal to the distributee's hypothetical section 1248 amount is attributed among those shares of stock of the foreign distributed corporation based on the ratio of the value of a share distributed to the distributee to the value of all shares of stock distributed to the distributee (attributable share amount).

(2) *Attribution of all or a portion of section 1248(f) amount to portions of a share of stock—(i) Single block of stock.* If a single block of stock of the foreign corporation is transferred in the section 361 exchange, the attributable share amount (as determined under paragraph (d)(1) of this section) is attributed to the portion of the share that relates to the single block of stock of the foreign corporation.

(ii) *Multiple blocks of stock.* If multiple blocks of stock of the foreign corporation are transferred in the section 361 exchange, the attributable share amount (as determined under paragraph (d)(1) of the section) is attributed among the portions of the share that relate to such multiple blocks of stock of the foreign corporation. The portion of the attributable share amount that is attributable to a portion to which a block of stock relates is that amount that bears the same ratio that the section 1248(f) block amount with respect to that block of stock bears to the section 1248(f) amount with respect to the stock of the foreign corporation.

(e) *Examples.* The rules of this section are illustrated by the following examples. See also § 1.367(a)-3T(e)(8), *Example 3*. For purposes of the examples, unless otherwise indicated: DP and DC are domestic corporations; X is a United States citizen; FP is a foreign corporation; CFC1, CFC2, and FA are

controlled foreign corporations; each corporation has a single class of stock outstanding and uses the calendar year as its taxable year; each shareholder of a corporation owns a single block of stock in the corporation; DC owns Business A, which consists solely of property whose fair market value exceeds its basis and could satisfy the requirements of the active foreign trade or business exception under section 367(a)(3) and § 1.367(a)-2T; DC owns no other assets and has no liabilities; the requirements in § 1.367(a)-7(c)(5) are satisfied; no earnings and profits of a foreign corporation are described in section 1248(d); and none of the foreign corporations in the examples is a surrogate foreign corporation (within the meaning of section 7874) as a result of the transactions described in the examples because one or more of the conditions of section 7874(a)(2)(B) is not satisfied.

*Example 1. Existing stock distribution under section 355(c)(1); gain recognition and adjustment to stock basis.* (i) *Facts.* DP, FP, and X own 80%, 10%, and 10%, respectively, of the outstanding stock of DC. DP's DC stock has a \$140x basis, \$160x fair market value, and a 2-year holding period. DC wholly owns CFC1. DC's CFC1 stock has a \$50x basis, \$100x fair market value (therefore a gain of \$50x), \$25x of earnings and profits attributable to it for purposes of section 1248, and a \$25x section 1248 amount (computed as the lesser of \$50x gain in the CFC1 stock and \$25x of section 1248 earnings and profits), and a 3-year holding period. On December 31, year 3, DC distributes all of the CFC1 stock to DP, FP, and X on a pro-rata basis in a distribution to which section 355 applies. The fair market value of the CFC1 stock received by DP, FP, and X is \$80x, \$10x, and \$10x, respectively. After the distribution, DP's stock in DC has a fair market value of \$80x and DP's section 358 basis in the CFC1 stock is \$70x (a pro rata portion, or 50%, of DP's \$140x basis in the DC stock immediately before the distribution). See § 1.358-2(a)(iv).

(ii) *Result.* (A) Under § 1.367(e)-1(b)(1), DC must recognize \$5x gain on the distribution of CFC1 stock to FP (10% of the \$50x gain in the CFC1 stock). Under § 1.367(b)-5(b)(1)(ii), DC must also recognize \$5x gain on the distribution of CFC1 stock to X (10% of the \$50x gain in the CFC1 stock). Of the aggregate \$10x gain recognized by DC, \$5x is recharacterized as a dividend under section 1248(a), computed as 20% of the \$25x section 1248 amount with respect to the CFC1 stock. See § 1.1248-1 for additional consequences.

(B) DC's distribution of CFC1 stock to DP is described in section 1248(f)(1) and § 1.1248(f)-1(b)(2) because the distribution is pursuant to section 355(c)(1) (an existing stock distribution). As a result, the general rule is that DC must include in gross income as a dividend the section 1248 amount with respect to the CFC1 stock distributed to DP, or \$20x (computed as 80% of the \$25x

section 1248 amount). However, if DP and DC make the election under paragraph (b)(1) of this section, § 1.1248(f)-1(b)(2) will not apply to DC's distribution of CFC1 stock to DP. If DP and DC make the election, then:

(1) Under paragraph (b)(2) of this section, for purposes of section 1248, immediately after the distribution DP will have a 3-year holding period in the CFC1 stock, the same holding period DC had in the CFC1 stock at the time of the distribution.

(2) Under paragraph (b)(3) of this section, DP's section 358 basis in the CFC1 stock (\$70x) is reduced by \$10x, the amount by which DC's section 1248 amount with respect to the CFC1 stock (\$20x) distributed to DP exceeds DP's postdistribution amount with respect to the CFC1 stock (\$10x). Under § 1.1248(f)-1(c)(6), DP's postdistribution amount equals the amount that DP would include in gross income as a dividend under section 1248(a) if DP sold the CFC1 stock immediately after the distribution, or \$10x, which is computed as the lesser of the \$10x gain in the CFC1 stock (\$80x fair market value, less \$70x basis) and \$20x of section 1248 earnings and profits attributable to the CFC1 stock, taking into account DP's 3-year holding period in the stock as required by paragraph (b)(2) of this section. As adjusted under paragraph (b)(3) of this section, DP's basis in the CFC1 stock is \$60x (\$70x basis, less \$10x required basis reduction).

*Example 2. New stock distribution under section 361(c)(1); adjustment to stock basis.*

(i) *Facts.* DP wholly owns DC. DP's DC stock has a \$180x basis and \$200x fair market value. DC wholly owns CFC1 and CFC2. DC's CFC1 stock has a \$70x basis, \$100x fair market value (therefore a gain of \$30x), \$40x of earnings and profits attributable to it for purposes of section 1248, and a section 1248 amount of \$30x (computed as the lesser of the \$30x gain in CFC1 stock and \$40x section 1248 earnings and profits). DC's CFC2 stock has a \$130x basis, \$100x fair market value (therefore a loss of \$30x), \$80x of earnings and profits attributable to it for purposes of section 1248, and a section 1248 amount of \$0x (computed as the lesser of the \$0x gain and \$80x section 1248 earnings and profits). 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 DP. DC's transfer of the CFC1 stock and CFC2 stock to FA in exchange for FA stock qualifies as a section 361 exchange, and DC's distribution of the 100 shares of FA stock to DP is pursuant to section 361(c)(1). DP exchanges its DC stock for the 100 shares of FA stock pursuant to section 354. Immediately after the transaction, DP wholly owns FA. DP and DC elect to apply the provisions of § 1.367(a)-7(c) in accordance with § 1.367(a)-7(c)(5). Pursuant to § 1.367(a)-3T(e)(3)(iii)(A), DP properly files a gain recognition agreement with respect to the CFC1 stock that satisfies the conditions of §§ 1.367(a)-3T(e)(6) and 1.367(a)-8.

(ii) *Result.* (A) DC does not recognize gain under § 1.367(a)-3T(e)(2) with respect to the transfer of the CFC1 stock to FA because the three conditions in § 1.367(a)-3T(e)(3)(i),

(e)(3)(ii), and (e)(3)(iii) are satisfied. First, § 1.367(a)-3T(e)(3)(i) is satisfied because the requirements of § 1.367(a)-7(c) are satisfied, including that an election is made to apply § 1.367(a)-7(c). Second, the requirements under § 1.367(a)-3T(e)(3)(ii) related to transfers of domestic stock are not applicable because CFC1 is a foreign corporation. Third, because DC owns all the stock of FA immediately after DC's receipt of the FA stock in the section 361 exchange but prior to, and without taking into account, DC's distribution of the FA stock to DP, for purposes of satisfying the requirements of § 1.367(a)-3T(e)(3)(iii), DP properly files a gain recognition agreement with respect to the CFC1 stock that satisfies the conditions of §§ 1.367(a)-3T(e)(6) and 1.367(a)-8. Furthermore, DC is not required to recognize gain under § 1.367(a)-7(c)(2)(ii), and DP is not required to reduce its \$180x section 358 basis in the FA stock under § 1.367(a)-7(c)(3), because the inside gain (within the meaning of § 1.367(a)-7(f)(5)) is \$0x (\$200x aggregate fair market value of CFC1 stock and CFC2 stock, less \$200x aggregate basis of CFC1 stock and CFC2 stock). In addition, DC is not required to include in income as a deemed dividend the \$30x section 1248 amount with respect to the CFC1 stock under § 1.367(b)-4(b)(1)(i) because immediately after DC's receipt of the FA stock in the section 361 exchange but prior to, and without taking into account, DC's distribution of the FA stock to DP, CFC1 and FA are controlled foreign corporations as to which DC is a section 1248 shareholder. See § 1.367(b)-4(b)(1)(ii)(A). With respect to the transfer of the CFC2 stock to FA, DC's section 1248 amount with respect to the CFC2 stock is \$0x; therefore, § 1.367(b)-4(b)(1)(i) has no application.

(B) Under § 1.1248(f)-1(b)(3), as a result of the section 361(c)(1) distribution of the FA stock to DP (a new stock distribution), the general rule is that DC must include in gross income as a dividend the total section 1248(f) amount (defined in § 1.1248(f)-1(c)(14)). The total section 1248(f) amount is \$30x, the sum of the section 1248(f) amount (defined in § 1.1248(f)-1(c)(10)) with respect to the CFC1 stock (\$30x) and CFC2 stock (\$0x). The section 1248(f) amount with respect to the CFC1 stock is the amount that DC would have included in income as a deemed dividend under § 1.367(b)-4(b)(1)(i) with respect to the CFC1 stock if the requirements under § 1.367(b)-4(b)(1)(ii)(A) had not been satisfied (\$30x), less the amount of gain recognized by DC under § 1.367(a)-7(c)(2) that is allocable to the CFC1 stock under § 1.367(a)-7(e)(1) and treated as a dividend under section 1248(a) (\$0x). Similarly, the section 1248(f) amount with respect to the CFC2 stock is the amount that DC would have included in income as a deemed dividend under § 1.367(b)-4(b)(1)(i) with respect to the CFC2 stock if the requirements under § 1.367(b)-4(b)(1)(ii)(A) had not been satisfied (\$0x), less the amount of gain recognized by DC under § 1.367(a)-7(c)(2) that is allocable to the CFC2 stock under § 1.367(a)-7(e)(1) and treated as a dividend under section 1248(a) (\$0x).

(C) If, however, DP and DC make the election provided in paragraph (c)(1) of this

section, the amount that DC is required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) (the total section 1248(f) amount of \$30x) is reduced to the extent the section 1248(f) amount with respect to the CFC1 stock (\$30x) and CFC2 stock (\$0x) is attributable under paragraph (d) of this section to the shares of FA stock distributed to one or more distributees that are section 1248 shareholders of FA. The only distributee is DP, and DP is a section 1248 shareholder with respect to FA. If DP and DC elect to apply paragraph (c) of this section, then:

(1) Under paragraph (d)(1) of this section, the portion of the section 1248(f) amount with respect to the CFC1 stock that is attributed to the shares of FA stock distributed to DP is equal to DP's hypothetical section 1248 amount (as defined in § 1.1248(f)-1(c)(4)) with respect to the CFC1 stock. Because DP is the only shareholder of DC, DP's hypothetical section 1248 amount equals the section 1248(f) amount with respect to the CFC1 stock (\$30x). The \$30x hypothetical section 1248 amount is attributed pro rata (based on relative values) among the 100 shares of FA stock distributed to DP, and the attributable share amount (as defined in paragraph (d)(1) of this section) is \$.30x. Paragraph (d)(1) of this section has no application with respect to the CFC2 stock because there is no section 1248(f) amount with respect to the CFC2 stock.

(2) If the shares of FA stock are divided into portions, the rules of paragraph (d)(2) of this section apply to attribute the attributable share amount (\$.30x) to portions of shares of FA stock distributed to DP. Under paragraph (c)(2)(ii) of this section, the 100 shares of FA stock are divided into two portions, one portion related to the single block of CFC1 stock and one portion related to the single block of CFC2 stock. Under paragraph (d)(2)(i) of this section, the attributable share amount of \$.30x is attributed to the portion of the 100 shares of FA stock that relates to the single block of CFC1 stock. Thus, all of the \$30x section 1248(f) amount with respect to the CFC1 stock is attributable to the 100 shares of FA stock.

(3) Because the election under paragraph (c)(1) of this section is made, the total section 1248(f) amount (\$30x) that DC is otherwise required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) is reduced by \$30x, the portion of the section 1248(f) amount with respect to the CFC1 stock that is attributable under paragraph (d) of this section to the shares of FA stock distributed to DP. Thus, the amount DC is required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) is \$0x (\$30x less \$30x).

(4) Under paragraph (c)(4)(i) of this section, the basis of each portion is the product of DP's section 358 basis in the share of FA stock multiplied by the ratio of the section 362 basis of the property (CFC1 stock or CFC2 stock, as applicable) to which the portion relates, to the aggregate section 362 basis of all property (CFC1 stock and CFC2 stock) received by FA in the section 361 exchange. Under paragraph (c)(4)(ii) of this section, the fair market value of each portion is the product of the fair market value of the

share of FA stock multiplied by the ratio of the fair market value of the property (CFC1 stock or CFC2 stock, as applicable) to which the portion relates, to the aggregate fair market value of all property (CFC1 stock and CFC2 stock) received by FA in the section 361 exchange. The section 362 basis of the CFC1 stock and CFC2 stock is \$70x and \$130x, respectively, for a total section 362 basis of \$200x. The CFC1 stock and CFC2 stock each has a fair market value of \$100x, for a total fair market value of \$200x. Therefore, the portions attributable to the CFC1 stock have an aggregate basis of \$63x (\$180x multiplied by  $\frac{70}{200}$ ) and fair market value of \$100x (\$200x multiplied by  $\frac{100}{200}$ ), resulting in aggregate gain in such portions of \$37x (or \$.37x per portion in each of the 100 shares). The portions attributable to the CFC2 stock have an aggregate basis of \$117x (\$180x multiplied by  $\frac{130}{200}$ ) and fair market value of \$100x (\$200x multiplied by  $\frac{100}{200}$ ), resulting in aggregate losses in such portions of \$17x (or \$.17x per portion in each of the 100 shares).

(5) Under § 1.1248-8(b)(2)(iv), the \$40x earnings and profits attributable to the single block of CFC1 stock are attributed to the portions of the 100 shares of FA stock that relate to the CFC1 stock. Similarly, the \$80x of earnings and profits attributable to the single block of CFC2 stock are attributed to the portions of the 100 shares of the FA stock that relate to the CFC2 stock. Thus, DP's postdistribution amount (defined in § 1.1248(f)-1(c)(6)) with respect to the portions of the shares of FA attributable to the CFC1 stock is \$37x, the lesser of the aggregate gain in the portions attributable to the CFC1 stock of \$37x (computed in paragraph (ii)(C)(4) of this *Example 2*) and the \$40x earnings and profits attributable to such portions. Furthermore, DP's postdistribution amount with respect to the portions of the shares of FA attributable to the CFC2 stock is \$0x, the lesser of the aggregate gain in the portions attributable to the CFC2 stock of \$0x (computed in paragraph (ii)(C)(4) of this *Example 2*) to be an aggregate loss of \$17x and the \$80x earnings and profits attributable to such portions.

(6) Under paragraph (c)(3) of this section, DP's section 358 basis in the portions of the 100 shares of FA stock attributable to the CFC1 stock (\$63x, computed in paragraph (ii)(C)(4) of this *Example 2*) is reduced by the amount (if any) by which the section 1248(f) amount attributable to such portions under paragraph (d) of this section (\$30x, as computed in paragraph (ii)(C)(2) of this *Example 2*) exceeds DP's postdistribution amount with respect to such portions (\$37x, computed in paragraph (ii)(C)(5) of this *Example 2*). Thus, there is no basis reduction in the portions of the 100 shares of FA stock attributable to the CFC1 stock. DP's section 358 basis in the portions of the 100 shares of FA stock attributable to the CFC2 stock is not reduced because the section 1248(f) amount attributable to such portions under paragraph (d) of this section is \$0x (computed in paragraph (ii)(C)(2) of this *Example 2*), which equals DP's postdistribution amount with respect to such

portions of \$0x (as computed in paragraph (ii)(C)(5) of this *Example 2*).

*Example 3. Combined existing stock distribution and new stock distribution under sections 355(c)(1) and 361(c)(1).* (i) *Facts.* DP owns all 100 outstanding shares of stock of DC. DP's DC stock has a \$180x basis (each of the 100 shares having a basis of \$18), \$200x fair market value, and 2-year holding period. DC owns all 60 shares of the outstanding stock of CFC1; all such shares constitute a single block of stock. DC's CFC1 stock has a \$50x basis, \$60x fair market value, \$30x of earnings and profits attributable to it for purposes of section 1248, a \$10x section 1248 amount (computed as the lesser of \$10x gain and \$30x of section 1248 earnings and profits), and a 3-year holding period. DC also owns all 40 shares of the outstanding stock of CFC2; all such shares constitute a single block of stock. DC's CFC2 stock has a \$30x basis, \$40x fair market value, \$20x of earnings and profits attributable to it for purposes of section 1248, and a \$10x section 1248 amount (computed as the lesser of \$10x gain and \$20x of section 1248 earnings and profits). DC also owns Business A, which 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 shares of newly issued CFC1 stock. DC's transfer of the CFC2 stock to CFC1 qualifies as a section 361 exchange. DC then distributes the 100 shares of CFC1 stock (60 shares held prior to the transaction and 40 shares received in the section 361 exchange) to DP in a transaction that qualifies under section 355. DP properly files a gain recognition agreement with respect to the CFC2 stock that satisfies the conditions of §§ 1.367(a)-3T(e)(6) and 1.367(a)-8. DP and DC properly make the elections provided in § 1.367(a)-7(c)(5) and paragraphs (b) and (c) of this section.

(ii) *Result.* (A) DC does not recognize gain under § 1.367(a)-3T(e)(2) with respect to the transfer of the CFC2 stock to CFC1 because the three conditions in § 1.367(a)-3T(e)(3)(i), (e)(3)(ii), and (e)(3)(iii) are satisfied. First, § 1.367(a)-3T(e)(3)(i) is satisfied because the requirements of § 1.367(a)-7(c) are satisfied, including that an election is made to apply § 1.367(a)-7(c). Second, the requirements under § 1.367(a)-3T(e)(3)(ii) related to transfers of domestic stock are not applicable because CFC2 is a foreign corporation. Third, because DC and DP own all the stock of CFC1 for purposes of satisfying the requirements of § 1.367(a)-3T(e)(3)(iii), DP properly files a gain recognition agreement with respect to the CFC2 stock that satisfies the conditions of §§ 1.367(a)-3T(e)(6) and 1.367(a)-8. See paragraph (ii)(G) of this example for the computation of the amount of gain subject to the gain recognition agreement. In addition, DC is not required to include in income as a dividend the \$10x section 1248 amount with respect to the CFC2 stock under § 1.367(b)-4(b)(1)(i) because immediately after DC's receipt of the CFC1 stock in the section 361 exchange but prior to, and without taking into account, DC's distribution of the CFC1 stock to DP, CFC1 and CFC2 are controlled foreign corporations as to which DC is a section 1248 shareholder. See § 1.367(b)-4(b)(1)(ii)(A).

(B) DC is not required to recognize gain under § 1.367(a)-7(c)(2)(i) because DP, a control group member (as defined in § 1.367(a)-7(f)(1)), owns 100% of DC. DC is not required to recognize gain under § 1.367(a)-7(c)(2)(ii) because the amount described in § 1.367(a)-7(c)(2)(ii)(A) (\$10x) does not exceed the amount described in § 1.367(a)-7(c)(2)(ii)(B) (\$40x). The \$10x described in § 1.367(a)-7(c)(2)(ii)(A) equals the product of the inside gain (as defined in § 1.367(a)-7(f)) (\$10x) multiplied by DP's ownership interest percentage (as defined in § 1.367(a)-7(f)) (100%), reduced by the sum of the amounts in § 1.367(a)-7(c)(2)(ii)(A)(1), (c)(2)(ii)(A)(2), and (c)(2)(ii)(A)(3) (\$0x). Under § 1.367(a)-7(f)(5), the \$10x of inside gain is the amount by which the aggregate fair market value of the section 367(a) property (CFC2 stock with a fair market value of \$40x) exceeds the sum of the inside basis (\$30x) of such property, and \$0x (the product of the section 367(a) percentage (100%) multiplied by DC's deductible liabilities assumed by CFC1 (\$0x)). Under § 1.367(a)-7(f)(4), the \$30x inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange (\$30x), increased by any gain or deemed dividends recognized by DC with respect to the section 367(a) property under section 367 (\$0x). The \$40x described in § 1.367(a)-7(c)(2)(ii)(B) is the product of the section 367(a) percentage (100%) multiplied by the fair market value of the 40 shares of CFC1 stock received by DC in the section 361 exchange and distributed to DP (\$40x).

(C) Under section 358, DP must allocate the \$180x basis in its 100 shares of DC stock between the 100 shares of DC stock (fair market value of \$100x) and the 100 shares of CFC1 stock (fair market value of \$100x) held after the distribution based on the relative fair market values of the shares. Accordingly, after the allocation of the basis under section 358, but prior to the application of § 1.367(a)-7(c)(3), the basis of DP's DC stock is \$90x and the basis of DP's CFC1 stock is \$90x. With respect to the \$90x basis in the 100 shares of CFC1 stock, \$36x is attributable to the 40 shares of CFC1 stock received by DC in the section 361 exchange (\$90x multiplied by  $\frac{40}{100}$ ), and \$54x is attributable to the 60 shares of CFC1 stock owned by DC prior to the section 361 exchange (\$90x multiplied by  $\frac{60}{100}$ ). See § 1.358-2(a)(2)(iv).

(D) Pursuant to § 1.367(a)-7(c)(3)(ii), any adjustment to DP's basis in the CFC1 stock required under § 1.367(a)-7(c)(3)(i) can only be made with respect to the 40 shares of CFC1 stock received by DC in the section 361 exchange. Under § 1.367(a)-7(c)(3)(i)(A), DP must reduce its section 358 basis (\$36x) in the 40 shares of CFC1 stock by \$6x, the amount by which DP's attributable inside gain (\$10x), reduced by the sum of the amounts in § 1.367(a)-7(c)(2)(ii)(A)(1), (c)(2)(ii)(A)(2), and (c)(2)(ii)(A)(3) (\$0x) (as computed in paragraph (ii)(B) of this *Example 3*) exceeds DP's outside gain (as defined in § 1.367(a)-7(f)) (\$4x). DP's \$4x outside gain equals the product of the section 367(a) percentage (as defined in § 1.367(a)-7(f)) (100%) multiplied by the amount by which the fair market value (\$40x) of the 40

shares of CFC1 stock is greater than DP's section 358 basis in the 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)(3), DP's basis in the 40 shares of CFC1 stock is \$30x.

(E) DC's distribution of the 40 shares of newly issued CFC1 stock is subject to § 1.1248(f)-1(b)(3) (a new stock distribution). Except as provided in § 1.1248(f)-2(c), under § 1.1248(f)-1(b)(3) DC must include in gross income as a dividend the total section 1248(f) amount (as defined in § 1.1248(f)-1(c)(14)). The total section 1248(f) amount is \$10x, the sum of the section 1248(f) amount (as defined in § 1.1248(f)-1(c)(10)) with respect to the stock of each foreign corporation transferred in the section 361 exchange. Only the CFC2 stock is transferred in the section 361 exchange; therefore, the total section 1248(f) amount is equal to the section 1248(f) amount with respect to the CFC2 stock (\$10x). The \$10x section 1248(f) amount with respect to the CFC2 stock is the amount that DC would have included in income as a deemed dividend under § 1.367(b)-4(b)(1)(i) with respect to the CFC2 stock if the requirements of § 1.367(b)-4(b)(1)(ii)(A) had not been satisfied (\$10x), reduced by the amount of gain recognized by DC under § 1.367(a)-7(c)(2) allocable to the CFC2 stock and treated as a dividend under section 1248(a) (in this case, \$0x, as described in paragraph (ii)(B) of this *Example 3*).

(F) However, because DC and DP (a section 1248 shareholder of CFC1 immediately after the distribution) elect to apply the provisions of § 1.1248(f)-2(c) (as provided in § 1.1248(f)-2(c)(1)), the amount that DC is required to include in income as a dividend under § 1.1248(f)-1(b)(3) (\$10x total section 1248(f) amount as computed in paragraph (ii)(E) of this *Example 3*) is reduced by the sum of the portions of the section 1248(f) amount with respect to the CFC2 stock that is attributable (under the rules of § 1.1248(f)-2(d)) to the 40 shares of CFC1 stock distributed to DP. As stated in the facts, the election is made to apply § 1.1248(f)-2(c).

(1) Under paragraph (d)(1) of this section, the portion of the section 1248(f) amount with respect to the CFC2 stock that is attributed to the 40 shares of CFC1 stock distributed to DP is equal to DP's hypothetical section 1248 amount (as defined in § 1.1248(f)-1(c)(4)) with respect to the CFC2 stock. Because DP is the only shareholder of DC, DP's hypothetical section 1248 amount equals the section 1248(f) amount with respect to the CFC2 stock (\$10x). The \$10x hypothetical section 1248 amount is attributed pro rata (based on relative values) among the 40 shares of CFC1 stock distributed to DP, and the attributable share amount (as defined in paragraph (d)(1) of this section) is \$.25x.

(2) The 40 shares of CFC1 stock are not divided into portions under paragraph (c)(2) of this section because the only property transferred by DC to CFC1 is a single block of stock of CFC2. If the 40 shares of CFC1 stock were required to be divided into portions, however, the rules of paragraph (d)(2) of this section apply to attribute the attributable share amount (\$.25x) to portions of shares of CFC1 stock distributed to DP.

(3) Because the election under paragraph (c)(1) of this section is made, the total section 1248(f) amount (\$10x) that DC is otherwise required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) is reduced by \$10x, the portion of the section 1248(f) amount with respect to the CFC2 stock that is attributable under paragraph (d) of this section to the 40 shares of CFC1 stock distributed to DP. Thus, the amount DC is required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) is \$0x (\$30x less \$30x).

(4) Under § 1.1248-8(b)(2)(iv), the \$20x earnings and profits attributable to the single block of CFC2 stock are attributed pro rata to the 40 shares of CFC1 stock. Thus, DP's postdistribution amount (defined in § 1.1248(f)-1(c)(6)) with respect to the 40 shares of CFC1 stock attributable to the CFC2 stock is \$10x, the lesser of the aggregate gain in the 40 shares of CFC1 stock of \$10x (\$40x fair market value, less \$30x section 358 basis, as described in paragraph (ii)(D) of this *Example 3*) and the \$20x earnings and profits attributable to such shares.

(5) Under paragraph (c)(3) of this section, DP's section 358 basis in the 40 shares of CFC1 stock (\$30x) is reduced by the amount (if any) by which the section 1248(f) amount attributable to such shares under paragraph (d) of this section (\$10x, as computed in paragraph (ii)(E) of this *Example 3*) exceeds DP's postdistribution amount with respect to such shares (\$10x). Thus, there is no basis reduction in the 40 shares of CFC1 stock.

(G) Pursuant to § 1.367(a)-3T(e)(6), the amount of gain subject to the gain recognition agreement entered into by DP with respect to the CFC2 stock is \$10x, which is the product of DP's ownership interest percentage (100%) multiplied by the gain realized by DC in the 361 exchange prior to taking into account the application of any other provision of section 367 (\$10x), reduced by the sum of the amounts described in § 1.367(a)-3T(e)(6)(i)(A), (e)(6)(i)(B), (e)(6)(i)(C), and (e)(6)(i)(D) (\$0x).

(H) DC's distribution of the 60 shares of CFC1 stock it held before the section 361 exchange is subject to § 1.1248(f)-1(b)(2) (an existing stock distribution); however, because DC and DP make the election provided in paragraph (b)(1) of this section, § 1.1248(f)-1(b)(2) does not apply to the distribution.

(1) Under paragraph (b)(2) of this section, for purposes of section 1248, DP will have a 3-year holding period in the 60 shares of CFC1 stock received, the same holding period that DC had in the 60 shares of CFC1 stock.

(2) Under paragraph (b)(3) of this section, DP's section 358 basis in the 60 shares of CFC1 stock received (\$54x, as computed in paragraph (ii)(C) of this *Example 3*) is reduced by \$4x, the amount by which DC's section 1248 amount (\$10x) with respect to the 60 shares of CFC1 stock exceeds DP's postdistribution amount (\$6x) with respect to the 60 shares of CFC1 stock. Under § 1.1248(f)-1(c)(6), DP's postdistribution amount with respect to the 60 shares of CFC1 stock equals the amount that DP would include in gross income as a dividend under section 1248(a) if DP sold the 60 shares of CFC1 stock immediately after the

distribution, or \$6x, which is computed as the lesser of the \$6x gain in the such shares of CFC1 stock (\$60x fair market value, less \$54x basis) and \$30x of section 1248 earnings and profits attributable to the CFC1 stock, taking into account DP's 3-year holding period in the stock as required by paragraph (b)(2) of this section. As adjusted under paragraph (b)(3) of this section, DP's basis in the 60 shares of CFC1 stock is \$50x (\$54x basis, less \$4x basis reduction).

(f) *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 new stock distribution, see § 1.367(a)-7. If the property transferred includes stock of a corporation, see also §§ 1.367(a)-3T(e) and 1.367(b)-4. For other rules that may apply if a domestic corporation distributes the stock of a foreign corporation in a new stock distribution or an existing stock distribution satisfying the requirements of section 355, see §§ 1.367(b)-5(b)(1) and 1.367(e)-1.

■ **Par. 17.** Section 1.1248(f)-3 is added to read as follows:

**§ 1.1248(f)-3 Reasonable cause and effective/applicability dates.**

(a) *Reasonable cause for failure to comply [Reserved]. For further guidance, see § 1.1248(f)-3T(a).*

(b) *Effective/applicability date—(1) General rule.* Except as provided in paragraph (b)(2)(ii) of this section, §§ 1.1248(f)-1 and 1.1248(f)-2 apply to distributions occurring on or after April 18, 2013.

(2) *Transactions described in Notice 87-64—(i) Gain not otherwise recognized.* For distributions occurring on or after September 21, 1987, and before April 18, 2013, section 1248(f)(1) shall not apply to the extent the domestic distributing corporation recognizes gain with respect to the stock of the foreign distributed corporation as a result of the distribution under another provision of subtitle A of the Internal Revenue Code.

(ii) *Section 355 distributions.* Taxpayers may apply the provisions of § 1.1248(f)-2(b) to distributions occurring on or after September 21, 1987.

■ **Par. 18.** Section 1.6038B-1 is amended by:

- 1. Revising paragraph (c)(6).
- 2. Revising paragraph (f)(3).
- 3. Revising the paragraph heading and the first sentence of paragraph (g)(1).
- 4. Adding paragraph (g)(5).

The addition and revisions 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 (c)(6) applies to a domestic corporation (U.S. transferor) that transfers section 367(a) property (as defined in § 1.367(a)-7(f)(10)) to a foreign corporation in a section 361 exchange (as defined in § 1.367(a)-7(f)(8)) 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, “ELECTION TO APPLY EXCEPTION UNDER § 1.367(a)-7(c),” with its timely filed return (within the meaning of § 1.367(a)-7(f)(12)) for the taxable year during which the reorganization occurs and that includes the information described in paragraphs (c)(6)(ii)(A), (c)(6)(ii)(B), (c)(6)(ii)(C), (c)(6)(ii)(D), (c)(6)(ii)(E), (c)(6)(ii)(F), (c)(6)(ii)(G), and (c)(6)(ii)(H) 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)(1)) or final distributee (as defined in § 1.367(a)-7(d)).

(A) The name and taxpayer identification number (if any) of each control group member and final distributee (if any), the foreign acquiring corporation, and in the case of a triangular reorganization (within the meaning of § 1.358-6(b)(2)) the corporation that controls the foreign acquiring corporation, and the ownership interest percentage (as defined in § 1.367(a)-7(f)(7)) in the U.S. transferor of each control group member.

(B) A calculation of the gain recognized (if any) by the U.S. transferor under § 1.367(a)-7(c)(2)(i) and (c)(2)(ii), and the basis adjustments (if any) required to be made by each control group member under § 1.367(a)-7(c)(3).

(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).

(D) The amount of any deductible liability (as defined by § 1.367(a)-7(f)(2)).

(E) The fair market value (as defined by § 1.367(a)-7(f)(3)) of property transferred to the foreign acquiring corporation in the section 361 exchange.

(F) The inside basis (as defined by § 1.367(a)-7(f)(4)).

(G) The inside gain (as defined by § 1.367(a)-7(f)(5)).

(H) The section 367(a) percentage (as defined by § 1.367(a)-7(f)(9)).

(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)(12)) for the taxable year in which the reorganization 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 a significant amount of the section 367(a) property received by the foreign acquiring corporation from the U.S. transferor in the section 361 exchange is disposed of, directly or indirectly, in one or more related transactions described in paragraph (c)(6)(iii)(B) of this section occurring within the sixty (60) month period that begins on the date of distribution or transfer (within the meaning of § 1.381(b)-1(b)), then the exception provided in § 1.367(a)-7(c) will not apply to the section 361 exchange. Accordingly, the U.S. transferor will recognize the gain realized but not recognized in the section 361 exchange, computed as if the exception provided in § 1.367(a)-7(c) had never applied. A U.S. income tax return (or amended U.S. income tax return, as the case may be) for the year in which the reorganization occurred reporting the gain must be filed. If the section 361 exchange occurs in connection with a triangular reorganization (within the meaning of § 1.358-6(b)(2)) and the corporation that controls the foreign acquiring corporation is foreign, an indirect disposition of the section 367(a) property includes the disposition by such controlling foreign corporation of the stock of the foreign acquiring corporation.

(A) *Disposition of a significant amount*—(1) *General rule.* Except as provided in paragraphs (c)(6)(iii)(A)(2) and (c)(6)(iii)(A)(3) of this section, 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 section 367(a) property transferred in the section 361 exchange.

(2) *Exception for certain nonrecognition exchanges.* Section 367(a) property that is subsequently transferred (retransferred property) pursuant to a nonrecognition provision is not treated as disposed of for purposes of paragraph (c)(6)(iii)(A)(1) of this section, provided such transfer satisfies, and is treated in a manner consistent with the principles underlying § 1.367(a)-8(k). Thus, for example, if section 367(a) property is subsequently transferred to a foreign corporation in exchange solely for stock in a transaction described in section 351, such retransferred property is not treated as disposed of for purposes of paragraph (c)(6)(iii)(A)(1) of this section; in such a case, however, a subsequent disposition of either the retransferred property by the transferee foreign corporation, or of the stock of the transferee foreign corporation received in exchange for the retransferred property, is subject to the provisions of paragraph (c)(6)(iii)(A)(1) of this section.

(3) *Exception for dispositions occurring in the ordinary course of business.* Dispositions of section 367(a) property described in section 1221(a)(2) occurring in the ordinary course of business of the foreign acquiring corporation are not treated as disposed of for purposes of paragraph (c)(6)(iii)(A)(1) of this section.

(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 the two-year period that begins on the date of distribution or transfer (within the meaning of § 1.381(b)-1(b)) (whether in a recognition or nonrecognition transaction) will 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

will not apply if it is demonstrated to the satisfaction of the Director of Field Operations, Large Business & International (or any successor to the roles and responsibilities of such person (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 in which the reorganization occurs and the date on which the additional tax for that year is paid.

\* \* \* \* \*

(f) \* \* \*

(3) *Reasonable cause for failure to comply [Reserved].* For further guidance, see § 1.6038B-1T(f)(3).

\* \* \* \* \*

(g) *Effective/applicability dates.* (1) Except as provided in paragraphs (g)(2) through (g)(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 apply to transfers occurring on or after April 18, 2013. For guidance with respect to paragraphs (c)(6) and (f)(3) of this section before April 18, 2013, see 26 CFR part 1 revised as of April 1, 2012.

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

■ **Par. 19.** The authority citation for part 602 continues to read as follows:

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

■ **Par. 20.** In § 602.101, the following entries are added in numerical order to the table in paragraph (b) to read as follows:

**§ 602.101 OMB Control numbers.**

\* \* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control No.
* * * * *	* * *
1.367(a)-7 .....	1545-2183
* * * * *	* * *
1.367(a)-8 .....	1545-2183
* * * * *	* * *
1.1248(f)-2 .....	1545-2183
* * * * *	* * *
1.6038B-1 .....	1545-2183
* * * * *	* * *

\* \* \* \* \*

**Steven T. Miller,**  
*Deputy Commissioner for Services and Enforcement.*

Approved: February 15, 2013.

**Mark J. Mazur,**  
*Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. 2013-05700 Filed 3-18-13; 8:45 am]

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