(3) *Expiration date*. The applicability of this paragraph (e) will expire on July 1, 2011.

[T.D. 8087, 51 FR 17942, May 16, 1986, as amended by T.D. 9406, 73 FR 38115, July 3, 2008]

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

(a) *In general*. This section provides rules concerning the transfer of stock or securities by a U.S. person to a foreign corporation in an exchange described in section 367(a). In general, a transfer of stock or securities by a U.S. person to a foreign corporation that is described in section 351, 354 (including a reorganization described in section 368(a)(1)(B) and including an indirect stock transfer described in paragraph (d) of this section), 356 or section 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless one of the exceptions set forth in paragraph (b) of this section (regarding transfers of foreign stock or securities), paragraph (c) of this section (regarding transfers of domestic stock or securities), or paragraph (e) of this section (regarding transfers of stock or securities in a section 361 exchange) applies. For rules applicable when, pursuant to section 304(a)(1), a United States person is treated as transferring stock of a domestic or foreign corporation to a foreign corporation in exchange for stock of such foreign corporation in a transaction to which section 351(a) applies, see §1.367(a)–9T. In addition, if, in an exchange described in section 354 or 356, a U.S. person exchanges stock or securities of a foreign corporation in a reorganization described in section 368(a)(1)(E), or a U.S. person exchanges stock or securities of a domestic or foreign corporation pursuant to an asset reorganization that is not treated as an indirect stock transfer under paragraph (d) of this section, such section 354 or 356 exchange is not a transfer to a foreign corporation subject to section 367(a). See paragraph (d)(3) *Example 16* of this section. For purposes of this section, an asset reorganization is defined as a reorganization described in section 368(a)(1) involving a transfer of assets under section 361. If, in a transfer described in section 361, a domestic merging corporation transfers stock of a controlling corporation to a foreign surviving corporation in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E), such section 361 transfer is not subject to section 367(a) if the stock of the controlling corporation is provided to the merging corporation by the controlling corporation pursuant to the plan of reorganization; a section 361 transfer of other property, including stock of the controlling corporation not provided by the controlling corporation pursuant to the plan of reorganization, by the domestic merging corporation to the foreign surviving corporation pursuant to such a reorganization is subject to section 367(a). For special basis and holding period rules involving foreign corporations that are parties to certain triangular reorganizations under section 368(a)(1), see §1.367(b)–13. For additional rules relating to an exchange involving a foreign corporation in connection with which there is a transfer of stock, see section 367(b) and the regulations under that section. For additional rules regarding a transfer of stock or securities in an exchange described in section 361(a) or (b), see section 367(a)(5) and any regulations under that section. For rules regarding reporting requirements with respect to transfers described under section 367(a), see section 6038B and the regulations thereunder. For rules related to expatriated entities, see section 7874 and the regulations thereunder.

(b) *Transfers by U.S. persons of stock or securities of foreign corporations to foreign corporations*—(1) *General rule*.Except as provided in section 367(a)(5) and 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 shall not be subject to section 367(a)(1) if either—

(i) *Less than 5-percent shareholder*. The U.S. person owns less than five percent (applying the attribution rules of section 318, as modified by section 958(b)) of both the total voting power and the

total value of the stock of the transferee foreign corporation immediately after the transfer; or

(ii) *5-percent shareholder*. The U.S. person enters into a five-year gain recognition agreement with respect to the transferred stock or securities as provided in § 1.367(a)–8.

(2) *Certain transfers subject to sections 367(a) and (b)*—(i)*In general*. A transfer of stock or securities described in section 367(a) or the regulations thereunder as well as in section 367(b) or the regulations thereunder shall be subject concurrently to sections 367(a) and (b) and the respective regulations thereunder, except as provided in paragraph (b)(2)(i)(A) through (C) of this section. See paragraph (d)(3) *Examples 11* and *14* of this section.

(A) Section 367(b) and the regulations thereunder shall not apply if a foreign corporation is not treated as a corporation under section 367(a)(1). See the example in paragraph (b)(2)(ii) of this section and paragraph (d)(3) *Example 14* of this section.

(B) If a foreign corporation transfers assets to a domestic corporation in a transaction to which § 1.367(b)–3(a) and (b) and the indirect stock transfer rules of paragraph (d) of this section apply, and all the earnings and profits amount attributable to the stock of an exchanging shareholder under § 1.367(b)–3(b) is greater than the amount of gain in such stock subject to section 367(a) pursuant to the indirect stock transfer rules of paragraph (d) of this section, then the rules of section 367(b), and not the rules of section 367(a), shall apply to the exchange. See paragraph (d)(3) *Example 15* of this section.

(C) [Reserved] For further guidance, see § 1.367(a)–3T(b)(2)(i)(C).

(ii) *Example*. The following example illustrates the provisions of this paragraph (b)(2):

Example. (i) *Facts*. DC, a domestic corporation, owns all of the stock of FC1, a controlled foreign corporation within the meaning of section 957(a). DC's basis in the stock of FC1 is $50, and the value of such stock is $100. The section 1248 amount with respect to such stock is $30. FC2, also a foreign corporation, is owned entirely by foreign individuals who are not related to DC or FC1. In a reorganization described in section 368(a)(1)(B), FC2 acquires all of the stock of FC1 from DC in exchange for 20 percent of the voting stock of FC2. FC2 is not a controlled foreign corporation after the reorganization.

(ii) *Result without gain recognition agreement*. Under the provisions of this paragraph (b), if DC fails to enter into a gain recognition agreement, DC is required to recognize in the year of the transfer the $50 of gain that it realized upon the transfer, $30 of which will be treated as a dividend under section 1248.

(iii) *Result with gain recognition agreement*. If DC enters into a gain recognition agreement under § 1.367(a)–8 with respect to the transfer of FC1 stock, the exchange will also be subject to the provisions of section 367(b) and the regulations thereunder to the extent that it is not subject to tax under section 367(a)(1). In such case, DC will be required to recognize the section 1248 amount of $30 on the exchange of FC1 for FC2 stock. See § 1.367(b)–4(b). The deemed dividend of $30 recognized by DC will increase its basis in the FC1 stock exchanged in the transaction and, therefore, the basis of the FC2 stock received in the transaction. The remaining gain of $20 realized by DC (otherwise recognizable under section 367(a)) in the exchange of FC1 stock will not be recognized if DC enters into a gain recognition agreement with respect to the transfer. (The result would be unchanged if, for example, the exchange of FC1 stock for FC2 stock qualified as a section 351 exchange, or as an exchange described in both sections 351 and 368(a)(1)(B).)

(c) *Transfers by U.S. persons of stock or securities of domestic corporations to foreign corporations*—(1) *In general*.Except as provided in section 367(a)(5) and 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 shall not be subject to section 367(a)(1) if the domestic corporation the stock or securities of which are transferred (referred to as the U.S. target company) complies with the reporting requirements in paragraph (c)(6) of this section and if each of the following four conditions is met:

(i) Fifty percent or less of both the total voting power and the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by U.S. transferors (*i.e.*, the amount of stock received does not exceed the 50-percent ownership threshold).

(ii) Fifty percent or less of each of the total voting power and the total value of the stock of the transferee foreign corporation is owned, in the aggregate, immediately after the transfer by U.S. persons that are either officers or directors of the U.S. target company or that are five-percent target shareholders (as defined in paragraph (c)(5)(iii) of this section) (*i.e.*, there is no control group). For purposes of this paragraph (c)(1)(ii), any stock of the transferee foreign corporation owned by U.S. persons immediately after the transfer will be taken into account, whether or not it was received in the exchange for stock or securities of the U.S. target company.

(iii) Either—

(A) The U.S. person is not a five-percent transferee shareholder (as defined in paragraph (c)(5)(ii) of this section); or

(B) The U.S. person is a five-percent transferee shareholder and enters into a five-year agreement to recognize gain with respect to the U.S. target company stock or securities it exchanged in the form provided in §1.367(a)–8; and

(iv) The active trade or business test (as defined in paragraph (c)(3) of this section) is satisfied.

(2) *Ownership presumption*. For purposes of paragraph (c)(1) of this section, persons who transfer stock or securities of the U.S. target company in exchange for stock of the transferee foreign corporation are presumed to be U.S. persons. This presumption may be rebutted in accordance with paragraph (c)(7) of this section.

(3) *Active trade or business test*—(i) *In general*. The tests of this paragraph (c)(3), collectively referred to as the active trade or business test, are satisfied if:

(A) The transferee foreign corporation or any qualified subsidiary (as defined in paragraph (c)(5)(vii) of this section) or any qualified partnership (as defined in paragraph (c)(5)(viii) of this section) is engaged in an active trade or business outside the United States, within the meaning of §1.367(a)–2T(b)(2) and (3), for the entire 36-month period immediately before the transfer;

(B) At the time of the transfer, neither the transferors nor the transferee foreign corporation (and, if applicable, the qualified subsidiary or qualified partnership engaged in the active trade or business) have an intention to substantially dispose of or discontinue such trade or business; and

(C) The substantiality test (as defined in paragraph (c)(3)(iii) of this section) is satisfied.

(ii) *Special rules*. For purposes of paragraphs (c)(3)(i)(A) and (B) of this section, the following special rules apply:

(A) The transferee foreign corporation, a qualified subsidiary, or a qualified partnership will be considered to be engaged in an active trade or business for the entire 36-month period preceding the exchange if it acquires at the time of, or any time prior to, the exchange a trade or business that has been active throughout the entire 36-month period preceding the exchange. This special rule shall not apply, however, if the acquired active trade or business assets were owned by the U.S. target company or any affiliate (within the meaning of section 1504(a) but excluding the exceptions contained in section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the acquisition. Nor will this special rule apply if the principal purpose of such acquisition is to satisfy the active trade or business test.

(B) An active trade or business does not include the making or managing of investments for the account of the transferee foreign corporation or any affiliate (within the meaning of section 1504(a) but excluding the exceptions contained in section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein). (This paragraph (c)(3)(ii)(B) shall not create any inference as to the scope of §1.367(a)–2T(b)(2) and (3) for other purposes.)

(iii) *Substantiality test*—(A) *General rule*. A transferee foreign corporation will be deemed to satisfy the substantiality test if, at the time of the transfer, the fair market value of the transferee foreign corporation is at least equal to the fair market value of the U.S. target company.

(B) *Special rules*. (*1*) For purposes of paragraph (c)(3)(iii)(A) of this section,

the value of the transferee foreign corporation shall include assets acquired outside the ordinary course of business by the transferee foreign corporation within the 36-month period preceding the exchange only if either—

(*i*) Both—

(*A*) At the time of the exchange, such assets or, as applicable, the proceeds thereof, do not produce, and are not held for the production of, passive income as defined in section 1297(b); and

(*B*) Such assets are not acquired for the principal purpose of satisfying the substantiality test; or

(*ii*) Such assets consist of the stock of a qualified subsidiary or an interest in a qualified partnership. See paragraph (c)(3)(iii)(B)(*2*) of this section.

(*2*) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall not include the value of the stock of any qualified subsidiary or the value of any interest in a qualified partnership, held directly or indirectly, to the extent that such value is attributable to assets acquired by such qualified subsidiary or partnership outside the ordinary course of business and within the 36-month period preceding the exchange unless those assets satisfy the requirements in paragraph (c)(3)(iii)(B)(*1*) of this section.

(*3*) For purposes of paragraph (c)(3)(iii)(A) of this section, the value of the transferee foreign corporation shall not include the value of assets received within the 36-month period prior to the acquisition, notwithstanding the special rule in paragraph (c)(3)(iii)(B)(*1*) of this section, if such assets were owned by the U.S. target company or an affiliate (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the transaction.

(4) *Special rules*—(i) *Treatment of partnerships*. For purposes of this paragraph (c), if a partnership (whether domestic or foreign) owns stock or securities in the U.S. target company or the transferee foreign corporation, or transfers stock or securities in an exchange described in section 367(a), each partner in the partnership, and not the partnership itself, is treated as owning and as having transferred, or as owning, a proportionate share of the stock or securities. See §1.367(a)–1T(c)(3).

(ii) *Treatment of options*. For purposes of this paragraph (c), one or more options (or an interest similar to an option) will be treated as exercised and thus will be counted as stock for purposes of determining whether the 50-percent threshold is exceeded or whether a control group exists if a principal purpose of the issuance or the acquisition of the option (or other interest) was the avoidance of the general rule contained in section 367(a)(1).

(iii) *U.S. target has a vestigial ownership interest in transferee foreign corporation*. In cases where, immediately after the transfer, the U.S. target company owns, directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)), stock of the transferee foreign corporation, that stock will not in any way be taken into account (and, thus, will not be treated as outstanding) in determining whether the 50-percent threshold under paragraph (c)(1)(i) of this section is exceeded or whether a control group under paragraph (c)(1)(ii) of this section exists.

(iv) *Attribution rule*. Except as otherwise provided in this section, the rules of section 318, as modified by the rules of section 958(b) shall apply for purposes of determining the ownership or receipt of stock, securities or other property under this paragraph (c).

(5) *Definitions*—(i) *Ownership statement*. An ownership statement is a statement, signed under penalties of perjury, stating—

(A) The identity and taxpayer identification number, if any, of the person making the statement;

(B) That the person making the statement is not a U.S. person (as defined in paragraph (c)(5)(iv) of this section);

(C) That the person making the statement either—

(*1*) Owns less than 1 percent of the total voting power and total value of a U.S. target company the stock of which is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the

same effect) promulgated by the Securities and Exchange Commission under the Securities and Exchange Act of 1934 (15 USC 78m), and such person did not acquire the stock with a principal purpose to enable the U.S. transferors to satisfy the requirement contained in paragraph (c)(1)(i) of this section; or

(*2*) Is not related to any U.S. person to whom the stock or securities owned by the person making the statement are attributable under the rules of section 958(b), and did not acquire the stock with a principal purpose to enable the U.S. transferors to satisfy the requirement contained in paragraph (c)(1)(i) of this section;

(D) The citizenship, permanent residence, home address, and U.S. address, if any, of the person making the statement; and

(E) The ownership such person has (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such person in the exchange.

(ii) *Five-percent transferee shareholder*. A five-percent transferee shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer described in section 367(a)(1). For special rules involving cases in which stock is held by a partnership, see paragraph (c)(4)(i) of this section.

(iii) *Five-percent target shareholder and certain other 5-percent shareholders*. A five-percent target shareholder is a person that owns at least five percent of either the total voting power or the total value of the stock of the U.S. target company immediately prior to the transfer described in section 367(a)(1). If the stock of the U.S. target company (or any company through which stock of the U.S. target company is owned indirectly or constructively) is described in Rule 13d–1(d) of Regulation 13D (17 CFR 240.13d–1(d)) (or any rule or regulation to generally the same effect), promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 USC 78m), then, in the absence of actual knowledge to the contrary, the existence or absence of filings of Schedule 13–D or 13–G (or any similar schedules) may be relied upon for purposes of identifying five-percent target shareholders (or a five-percent shareholder of a corporation which itself is a five-percent shareholder of the U.S. target company). For special rules involving cases in which U.S. target company stock is held by a partnership, see paragraph (c)(4)(i) of this section.

(iv) *U.S. Person*. For purposes of this section, a U.S. person is defined by reference to §1.367(a)–1T(d)(1). For application of the rules of this section to stock or securities owned or transferred by a partnership that is a U.S. person, however, see paragraph (c)(4)(i) of this section.

(v) *U.S. Transferor*. A U.S. transferor is a U.S. person (as defined in paragraph (c)(5)(iv) of this section) that transfers stock or securities of one or more U.S. target companies in exchange for stock of the transferee foreign corporation in an exchange described in section 367.

(vi) *Transferee foreign corporation*. Except as provided in paragraph (d)(2)(i)(B) of this section, a transferee foreign corporation is the foreign corporation whose stock is received in the exchange by U.S. persons.

(vii) *Qualified Subsidiary*. A qualified subsidiary is a foreign corporation whose stock is at least 80-percent owned (by total voting power and total value), directly or indirectly, by the transferee foreign corporation. However, a corporation will not be treated as a qualified subsidiary if it was affiliated with the U.S. target company (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) at any time during the 36-month period prior to the transfer. Nor will a corporation be treated as a qualified subsidiary if it was acquired by the transferee foreign corporation at any time during the 36-month period prior to the transfer for the principal purpose of satisfying the active trade or business test, including the substantiality test.

(viii) *Qualified partnership*. (A) Except as provided in paragraph (c)(5)(viii)(B)

or (C) of this section, a qualified partnership is a partnership in which the transferee foreign corporation—

(*1*) Has active and substantial management functions as a partner with regard to the partnership business; or —

(*2*) Has an interest representing a 25 percent or greater interest in the partnership's capital and profits.

(B) A partnership is not a qualified partnership if the U.S. target company or any affiliate of the U.S. target company (within the meaning of section 1504(a) but without the exceptions under section 1504(b) and substituting ''50 percent'' for ''80 percent'' where it appears therein) held a 5 percent or greater interest in the partnership's capital and profits at any time during the 36-month period prior to the transfer.

(C) A partnership is not a qualified partnership if the transferee foreign corporation's interest was acquired by that corporation at any time during the 36-month period prior to the transfer for the principal purpose of satisfying the active trade or business test, including the substantiality test.

(6) *Reporting requirements of U.S. target company.* (i) In order for a U.S. person that transfers stock or securities of a domestic corporation to qualify for the exception provided by this paragraph (c) to the general rule under section 367(a)(1), in cases where 10 percent or more of the total voting power or the total value of the stock of the U.S. target company is transferred by U.S. persons in the transaction, the U.S. target company must comply with the reporting requirements contained in this paragraph (c)(6). The U.S. target company must attach to its timely filed U.S. income tax return for the taxable year in which the transfer occurs a statement titled ''Section 367(a)—Reporting of Cross-Border Transfer Under Reg. §1.367(a)–3(c)(6),'' signed under penalties of perjury by an officer of the corporation to the best of the officer's knowledge and belief, disclosing the following information—

(A) A description of the transaction in which a U.S. person or persons transferred stock or securities in the U.S. target company to the transferee foreign corporation in a transfer otherwise subject to section 367(a)(1);

(B) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company. For additional information that may be required to rebut the ownership presumption of paragraph (c)(2) of this section in cases where more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation is received in the transaction, in the aggregate, by persons who transferred stock or securities of the U.S. target company, see paragraph (c)(7) of this section;

(C) The amount (if any) of transferee foreign corporation stock owned directly or indirectly (applying the attribution rules of sections 267(c)(1) and (5)) immediately after the exchange by the U.S. target company;

(D) A statement that there is no control group within the meaning of paragraph (c)(1)(ii) of this section;

(E) A list of U.S. persons who are officers, directors or five-percent target shareholders and the percentage of the total voting power and the total value of the stock of the transferee foreign corporation owned by such persons both immediately before and immediately after the transaction; and

(F) A statement that includes the following—

(*1*) A statement that the active trade or business test described in paragraph (c)(3) of this section is satisfied by the transferee foreign corporation and a description of such business;

(*2*) A statement that on the day of the transaction, there was no intent on the part of the transferee foreign corporation (or its qualified subsidiary, if relevant) or the transferors of the transferee foreign corporation (or qualified subsidiary, if relevant) to substantially discontinue its active trade or business; and

(*3*) A statement that the substantiality test described in paragraph (c)(3)(iii) of this section is satisfied, and documentation that such test is satisfied, including the value of the transferee foreign corporation and the

value of the U.S. target company on the day of the transfer, and either one of the following—

(*i*) A statement demonstrating that the value of the transferee foreign corporation 36 months prior to the acquisition, plus the value of any assets described in paragraph (c)(3)(iii)(B) of this section (including stock) acquired by the transferee foreign corporation within the 36-month period, less the amount of any liabilities acquired during that period, exceeds the value of the U.S. target company on the acquisition date; or

(*ii*) A statement demonstrating that the value of the transferee foreign corporation on the date of the acquisition, reduced by the value of any assets not described in paragraph (c)(3)(iii)(B) of this section (including stock) acquired by the transferee foreign corporation within the 36-month period, exceeds the value of the U.S. target company on the date of the acquisition.

(ii) For purposes of this paragraph (c)(6), an income tax return will be considered timely filed if such return is filed, together with the statement required by this paragraph (c)(6), on or before the last date for filing a Federal income tax return (taking into account any extensions of time therefor) for the taxable year in which the transfer occurs. If a return is not timely filed within the meaning of this paragraph (c)(6), the District Director may make a determination, based on all facts and circumstances, that the taxpayer had reasonable cause for its failure to file a timely filed return and, if such a determination is made, the requirement contained in this paragraph (c)(6) shall be waived.

(7) *Ownership statements*. To rebut the ownership presumption of paragraph (c)(2) of this section, the U.S. target company must obtain ownership statements (described in paragraph (c)(5)(i) of this section) from a sufficient number of persons that transfer U.S. target company stock or securities in the transaction that are not U.S. persons to demonstrate that the 50-percent threshold of paragraph (c)(1)(i) of this section is not exceeded. In addition, the U.S. target company must attach to its timely filed U.S. income tax return (as described in paragraph (c)(6)(ii) of this section) for the taxable year in which the transfer occurs a statement, titled ''Section 367(a)—Compilation of Ownership Statements Under Reg. §1.367(a)–3(c),'' signed under penalties of perjury by an officer of the corporation, disclosing the following information:

(i) The amount (specified as to the percentage of the total voting power and the total value) of stock of the transferee foreign corporation received, in the aggregate, by U.S. transferors;

(ii) The amount (specified as to the percentage of total voting power and total value) of stock of the transferee foreign corporation received, in the aggregate, by foreign persons that filed ownership statements;

(iii) A summary of the information tabulated from the ownership statements, including—

(A) The names of the persons that filed ownership statements stating that they are not U.S. persons;

(B) The countries of residence and citizenship of such persons; and

(C) Each of such person's ownership (by voting power and by value) in the U.S. target company prior to the exchange and the amount of stock of the transferee foreign corporation (by voting power and value) received by such persons in the exchange.

(8) *Certain transfers in connection with performance of services*. Section 367(a)(1) shall not apply to a domestic corporation's transfer of its own stock or securities in connection with the performance of services, if the transfer is considered to be to a foreign corporation solely by reason of §1.83–6(d)(1). The transfer may still, however, be reportable under section 6038B. See §1.6038B–1(b)(2)(i)(A)(*4*) and (b)(2)(i)(B)(*4*).

(9) *Private letter ruling option*. The Internal Revenue Service may, in limited circumstances, issue a private letter ruling to permit the taxpayer to qualify for an exception to the general rule under section 367(a)(1) if—

(i) A taxpayer is unable to satisfy all of the requirements of paragraph (c)(3) of this section relating to the active trade or business test of paragraph (c)(1)(iv) of this section, but such taxpayer meets all of the other requirements contained in paragraphs (c)(1)(i)

through (c)(1)(iii) of this section, and such taxpayer is substantially in compliance with the rules set forth in paragraph (c)(3) of this section; or

(ii) A taxpayer is unable to satisfy any requirement of paragraph (c)(1) of this section due to the application of paragraph (c)(4)(iv) of this section. Notwithstanding the preceding sentence, in no event will the Internal Revenue Service rule on the issue of whether the principal purpose of an acquisition was to satisfy the active trade or business test, including the substantiality test.

(10) *Examples.* This paragraph (c) may be illustrated by the following examples:

Example 1. Ownership presumption. (i) FC, a foreign corporation, issues 51 percent of its stock to the shareholders of S, a domestic corporation, in exchange for their S stock, in a transaction described in section 367(a)(1).

(ii) Under paragraph (c)(2) of this section, all shareholders of S who receive stock of FC in the exchange are presumed to be U.S. persons. Unless this ownership presumption is rebutted, the condition set forth in paragraph (c)(1)(i) of this section will not be satisfied, and the exception in paragraph (c)(1) of this section will not be available. As a result, all U.S. persons that transferred S stock will recognize gain on the exchange. To rebut the ownership presumption, S must comply with the reporting requirements contained in paragraph (c)(6) of this section, obtaining ownership statements (described in paragraph (c)(5)(i) of this section) from a sufficient number of non-U.S. persons who received FC stock in the exchange to demonstrate that the amount of FC stock received by U.S. persons in the exchange does not exceed 50 percent.

Example 2. Filing of Gain Recognition Agreement. (i) The facts are the same as in *Example 1,* except that FC issues only 40 percent of its stock to the shareholders of S in the exchange. FC satisfies the active trade or business test of paragraph (c)(1)(iv) of this section. A, a U.S. person, owns 10 percent of S's stock immediately before the transfer. All other shareholders of S own less than five percent of its stock. None of S's officers or directors owns any stock in FC immediately after the transfer. A will own 15 percent of the stock of FC immediately after the transfer, 4 percent received in the exchange, and the balance being stock in FC that A owned prior to and independent of the transaction. No S shareholder besides A owns five percent or more of FC immediately after the transfer. The reporting requirements under paragraph (c)(6) of this section are satisfied.

(ii) The condition set forth in paragraph (c)(1)(i) of this section is satisfied because, even after application of the presumption in paragraph (c)(2) of this section, U.S. transferors could not receive more than 50 percent of FC's stock in the transaction. There is no control group because five-percent target shareholders and officers and directors of S do not, in the aggregate, own more than 50 percent of the stock of FC immediately after the transfer (A, the sole five-percent target shareholder, owns 15 percent of the stock of FC immediately after the transfer, and no officers or directors of S own any stock of FC immediately after the transfer). Therefore, the condition set forth in paragraph (c)(1)(ii) of this section is satisfied. The facts assume that the condition set forth in paragraph (c)(1)(iv) of this section is satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, a five-percent transferee shareholder, will not be required to include in income any gain realized on the exchange in the year of the transfer if he files a 5-year gain recognition agreement (GRA) and complies with section 6038B.

Example 3. Control Group. (i) The facts are the same as in *Example 2,* except that B, another U.S. person, is a 5-percent target shareholder, owning 25 percent of S's stock immediately before the transfer. B owns 40 percent of the stock of FC immediately after the transfer, 10 percent received in the exchange, and the balance being stock in FC that B owned prior to and independent of the transaction.

(ii) A control group exists because A and B, each a five-percent target shareholder within the meaning of paragraph (c)(5)(iii) of this section, together own more than 50 percent of FC immediately after the transfer (counting both stock received in the exchange and stock owned prior to and independent of the exchange). As a result, the condition set forth in paragraph (c)(1)(ii) of this section is not satisfied, and all U.S. persons (not merely A and B) who transferred S stock will recognize gain on the exchange.

Example 4. Partnerships. (i) The facts are the same as in *Example 3,* except that B is a partnership (domestic or foreign) that has five equal partners, only two of whom, X and Y, are U.S. persons. Under paragraph (c)(4)(i) of this section, X and Y are treated as the owners and transferors of 5 percent each of the S stock owned and transferred by B and as owners of 8 percent each of the FC stock owned by B immediately after the transfer. U.S. persons that are five-percent target shareholders thus own a total of 31 percent of the stock of FC immediately after the transfer (A's 15 percent, plus X's 8 percent, plus Y's 8 percent).

(ii) Because no control group exists, the condition in paragraph (c)(1)(ii) of this section is satisfied. The conditions in paragraphs (c)(1)(i) and (iv) of this section also are satisfied. Thus, U.S. persons that are not five-percent transferee shareholders will not recognize gain on the exchange of S shares for FC shares. A, X, and Y, each a five-percent transferee shareholder, will not be required to include in income in the year of the transfer any gain realized on the exchange if they file 5-year GRAs and comply with section 6038B.

(11) *Effective date.* This paragraph (c) applies to transfers occurring after January 29, 1997. However, taxpayers may elect to apply this section in its entirety to all transfers occurring after April 17, 1994, provided that the statute of limitations of the affected tax year or years is open.

(d) *Indirect stock transfers in certain nonrecognition transfers*—(1) *In general.* For purposes of this section, a U.S. person who exchanges, under section 354 (or section 356) stock or securities in a domestic or foreign corporation for stock or securities in a foreign corporation (or in a domestic corporation in control of a foreign acquiring corporation in a triangular section 368(a)(1)(B) reorganization) in connection with a transaction described in paragraphs (d)(1)(i) through (v) of this section (or who is deemed to make such an exchange under paragraph (d)(1)(vi) of this section) shall, except as provided in paragraph (d)(2)(vii) of this section, be treated as having made an indirect transfer of such stock or securities to a foreign corporation that is subject to the rules of this section, including, for example, the requirement, where applicable, that the U.S. transferor enter into a gain recognition agreement to preserve nonrecognition treatment under section 367(a). If the U.S. person exchanges stock or securities of a foreign corporation, see also section 367(b) and the regulations thereunder. For examples of the concurrent application of the indirect stock transfer rules under section 367(a) and the rules of section 367(b), see paragraph (d)(3) *Examples 14* and *15* of this section. For purposes of this paragraph (d), if a corporation acquiring assets in an asset reorganization transfers all or a portion of such assets to a corporation controlled (within the meaning of section 368(c)) by the acquiring corporation as part of the same transaction, the subsequent transfer of assets to the controlled corporation will be referred to as a controlled asset transfer. See section 368(a)(2)(C).

(i) *Mergers described in sections 368(a)(1)(A) and (a)(2)(D) and reorganizations described in sections 368(a)(1)(G) and (a)(2)(D).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for stock or securities of a foreign corporation that controls the acquiring corporation in a reorganization described in either sections 368(a)(1)(A) and (a)(2)(D), or in sections 368(a)(1)(G) and (a)(2)(D). See paragraph (d)(3) *Example 1* of this section for an example of a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) involving domestic acquired and acquiring corporations, and see paragraph (d)(3) *Example 10* of this section for an example involving a domestic acquired corporation and a foreign acquiring corporation.

(ii) *Mergers described in sections 368(a)(1)(A)* and *(a)(2)(E).* A U.S. person exchanges stock or securities of a corporation (the acquiring corporation) for stock or securities in a foreign corporation that controls the acquired corporation in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E). See paragraph (d)(3) *Example 2* of this section for an example of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) involving domestic acquired and acquiring corporations, and see paragraph (d)(3) *Example 11* of this section for an example involving a domestic acquired corporation and a foreign acquiring corporation.

(iii) *Triangular reorganizations described in section 368(a)(1)(B)*—(A) A U.S. person exchanges stock or securities of the acquired corporation for voting stock or securities of a foreign corporation that is in control (as defined in section 368(c)) of the acquiring corporation in a reorganization described in section 368(a)(1)(B). See paragraph (d)(3) *Example 5* of this section.

(B) A U.S. person exchanges stock or securities of the acquired corporation for voting stock or securities of a domestic corporation that is in control

(as defined in section 368(c)) of a foreign acquiring corporation in a reorganization described in section 368(a)(1)(B). See paragraph (d)(3) *Example 5A* of this section.

(iv) *Triangular reorganizations described in section 368(a)(1)(C).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for voting stock or securities of a foreign corporation that controls the acquiring corporation in a reorganization described in section 368(a)(1)(C). See, e.g., paragraph (d)(3) *Example 6* of this section (for an example of a triangular section 368(a)(1)(C) reorganization involving domestic acquired and acquiring corporations), and paragraph (d)(3) *Example 8* of this section (for an example involving a domestic acquired corporation and a foreign acquiring corporation). If the acquired corporation is a foreign corporation, see paragraph (d)(3) *Example 14* of this section, and section 367(b) and the regulations thereunder.

(v) *Transfers of assets to subsidiaries in certain section 368(a)(1) reorganizations.* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for stock or securities of a foreign acquiring corporation in an asset reorganization (other than a triangular section 368(a)(1)(C) reorganization described in paragraph (d)(1)(iv) of this section, a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) or sections 368(a)(1)(G) and (a)(2)(D) described in paragraph (d)(1)(i) of this section, a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) described in paragraph (d)(1)(ii) of this section, or a same-country section 368(a)(1)(F) reorganization) that is followed by a controlled asset transfer. For purposes of this section, a same-country section 368(a)(1)(F) reorganization is a reorganization described in section 368(a)(1)(F) in which both the acquired corporation and the acquiring corporation are foreign corporations and are created or organized under the laws of the same foreign country. In the case of a transaction described in this paragraph (d)(1)(v) in which some but not all of the assets of the acquired corporation are transferred in a controlled asset transfer, the transaction shall be considered to be an indirect transfer of stock or securities subject to this paragraph (d) only to the extent of the assets so transferred. The remaining assets shall be treated as having been transferred by the acquired corporation in an asset transfer rather than an indirect stock transfer, and, if the acquired corporation is a domestic corporation, such asset transfer shall be subject to the other provisions of section 367, including sections 367(a)(1), (3), and (5), and (d). See paragraph (d)(3) *Examples 6A* and *6B* of this section.

(vi) *Successive transfers of property to which section 351 applies.* A U.S. person transfers property (other than stock or securities) to a foreign corporation in an exchange described in section 351, and all or a portion of such assets transferred to the foreign corporation by such person are, in connection with the same transaction, transferred to a second corporation that is controlled by the foreign corporation in one or more exchanges described in section 351. For purposes of this paragraph (d)(1) and § 1.367(a)–8, the initial transfer by the U.S. person shall be deemed to be a transfer of stock described in section 354. (Any assets transferred to the foreign corporation that are not transferred by the foreign corporation to a second corporation shall be treated as a transfer of assets subject to the general rules of section 367, including sections 367(a)(1), (3), (5) and (d), and not as an indirect stock transfer under the rules of this paragraph (d).) See, e.g., paragraph (d)(3) *Example 13* and *Example 13A* of this section.

(2) *Special rules for indirect transfers.* If a U.S. person is considered to make an indirect transfer of stock or securities described in paragraph (d)(1) of this section, the rules of this section and § 1.367(a)–8 shall apply to the transfer. For purposes of applying the rules of this section and § 1.367(a)–8:

(i) *Transferee foreign corporation*—(A) *General rule.* Except as provided in paragraph (d)(2)(i)(B) of this section, the transferee foreign corporation shall be the foreign corporation that issues stock or securities to the U.S. person in the exchange.

(B) *Special rule for triangular reorganizations described in paragraph (d)(1)(iii)(B) of this section.* In the case

of a triangular reorganization described in paragraph (d)(1)(iii)(B) of this section, the transferee foreign corporation shall be the foreign acquiring corporation. See paragraph (d)(3) *Example 5A* of this section.

(ii) *Transferred corporation.* The transferred corporation shall be the acquiring corporation, except as provided in this paragraph (d)(2)(ii). In the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii) of this section, the transferred corporation shall be the acquired corporation. In the case of an indirect stock transfer described in paragraph (d)(1)(i), (ii), or (iv) of this section followed by a controlled asset transfer, or an indirect stock transfer described in paragraph (d)(1)(v) of this section, the transferred corporation shall be the controlled corporation to which the assets are transferred. In the case of successive section 351 transfers described in paragraph (d)(1)(vi) of this section, the transferred corporation shall be the corporation to which the assets are transferred in the final section 351 transfer. The transferred property shall be the stock or securities of the transferred corporation, as appropriate under the circumstances.

(iii) *Amount of gain.* For purposes of determining the amount of gain that a U.S. person is required to include in income as a result of a triggering event, see §1.367(a)–8(c)(1)(i).

(iv) *Gain recognition agreements involving multiple parties.* The U.S. person's agreement to recognize gain, as provided in §1.367(a)–8, shall include appropriate provisions consistent with the principles of §1.367(a)–8. See *Examples 5* and *5A* of this section and §1.367(a)–8(j)(9).

(v) *Determination of whether substantially all of the transferred corporation's assets are disposed of.* For purposes of applying §1.367(a)–8(j)(2)(i) to determine whether substantially all of the assets of the transferred corporation have been disposed of, the following assets shall be taken into account (but only if such assets are not fully taxable under section 367 in the taxable year that includes the indirect transfer)—

(A) In the case of a reorganization described in paragraph (d)(1)(i) of this section (a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) or sections 368(a)(1)(G) and (a)(2)(D)) or a reorganization described in section (d)(1)(iv) of this section (a triangular section 368(a)(1)(C) reorganization), the assets of the acquired corporation;

(B) In the case of a sections 368(a)(1)(A) and (a)(2)(E) reorganization described in paragraph (d)(1)(ii) of this section, the assets of the acquiring corporation immediately prior to the transaction;

(C) In the case of an asset reorganization followed by a controlled asset transfer, as described in paragraph (d)(1)(v) of this section, the assets of the acquired corporation that are transferred to the corporation controlled by the acquiring corporation;

(D) In the case of a triangular reorganization described in section 368(a)(1)(C) followed by a controlled asset transfer, a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) followed by a controlled asset transfer, or a reorganization described in sections 368(a)(1)(G) and (a)(2)(D) followed by a controlled asset transfer, the assets of the acquired corporation including those transferred to the corporation controlled by the acquiring corporation;

(E) In the case of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) followed by a controlled asset transfer, the assets of the acquiring corporation including those transferred to the corporation controlled by the acquiring corporation; and

(F) In the case of successive section 351 exchanges described in paragraph (d)(1)(vi) of this section, the assets that are both transferred initially to the foreign corporation, and transferred by the foreign corporation to a second corporation.

(vi) *Coordination between asset transfer rules and indirect stock transfer rules*—(A) *General rule.* Except as otherwise provided in this paragraph (d)(2)(vi), if, pursuant to any of the transactions described in paragraph (d)(1) of this section, a U.S. person transfers (or is deemed to transfer) assets to a foreign corporation in an exchange described in section 351 or section 361, the rules of section 367, including sections 367(a)(1), (a)(3), and (a)(5), as well as section 367(d), and the regulations

thereunder shall apply prior to the application of the rules of this section.

(B) *Exceptions.* (*1*) If a transaction is described in paragraph (d)(2)(vi)(A) of this section, sections 367(a) and (d) shall not apply to the extent a domestic corporation (domestic acquired corporation) transfers its assets to a foreign corporation (foreign acquiring corporation) in an asset reorganization, and such assets (re-transferred assets) are transferred to a domestic corporation (domestic controlled corporation) in a controlled asset transfer, provided that the domestic controlled corporation's basis in such assets is no greater than the basis that the domestic acquired corporation had in such assets and the conditions contained in either of the following paragraphs are satisfied:

(*i*) The domestic acquired corporation is controlled (within the meaning of section 368(c)) by 5 or fewer domestic corporations, appropriate basis adjustments as provided in section 367(a)(5) are made to the stock of the foreign acquiring corporation, 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 5 or fewer domestic corporations, all members of the same affiliated group within the meaning of section 1504 shall be treated as 1 corporation.

(*ii*) The requirements of paragraphs (c)(1)(i), (ii), and (iv), and (c)(6) of this section are satisfied with respect to the indirect transfer of stock in the domestic acquired corporation, and the domestic acquired corporation attaches a statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer.

(*2*) Sections 367(a) and (d) shall not apply to transfers described in paragraph (d)(1)(vi) of this section where a U.S. person transfers assets to a foreign corporation in a section 351 exchange, to the extent that such assets are transferred by such foreign corporation to a domestic corporation in another section 351 exchange, but only if the domestic transferee's basis in the assets is no greater than the basis that the U.S. transferor had in such assets.

(C) *Required statement.* The statement required by paragraph (d)(2)(vi)(B)(*1*)(*ii*) of this section shall be entitled ''Required Statement under §1.367(a)–3(d) for Assets Transferred to a Domestic Corporation'' and shall be signed under penalties of perjury by an authorized officer of the domestic acquired corporation and by an authorized officer of the foreign acquiring corporation. The required statement shall contain a certification that, if the foreign acquiring corporation disposes of any stock of the domestic controlled corporation in a transaction described in paragraph (d)(2)(vi)(D) of this section, the domestic acquired corporation shall recognize gain as described in paragraph (d)(2)(vi)(E) of this section. The domestic acquired corporation (or the foreign acquiring corporation on behalf of the domestic acquired corporation) shall file a U.S. income tax return (or an amended U.S. tax return, as the case may be) for the year of the transfer reporting such gain.

(D) *Gain recognition transaction.* (*1*) A transaction described in this paragraph (d)(2)(vi)(D) is one where a principal purpose of the transfer by the domestic acquired corporation is the avoidance of U.S. tax that would have been imposed on the domestic acquired corporation on the disposition of the retransferred assets. A transfer may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes when taken together.

(*2*) For purposes of paragraph (d)(2)(vi)(D)(*1*) of this section, a transaction is deemed to have a principal purpose of tax avoidance if the foreign acquiring corporation disposes of any stock of the domestic controlled corporation (whether in a recognition or non-recognition transaction) within 2 years of the transfer described in paragraph (d)(2)(vi)(A) of this section. The rule in this paragraph (d)(2)(vi)(D)(*2*) shall not apply if the domestic acquired corporation (or the foreign acquiring corporation on behalf of the domestic acquired corporation) demonstrates to the satisfaction of the Commissioner that the avoidance of U.S. tax was not a principal purpose of the transaction.

(E) *Amount of gain recognized and other matters.* (*1*) In the case of a transaction described in paragraph (d)(2)(vi)(D) of this section, solely for purposes of this paragraph (d)(2)(vi)(E), the domestic acquired corporation shall be treated as if, immediately prior to the transfer described in paragraph (d)(2)(vi)(A) of this section, it transferred the re-transferred assets, including any intangible assets, directly to a domestic corporation in exchange for stock of such domestic corporation in a transaction that is treated as a section 351 exchange, and immediately sold such stock to an unrelated party for its fair market value in a sale in which it shall recognize gain, if any (but not loss). Any gain recognized by the domestic acquired corporation pursuant to this paragraph (d)(2)(vi)(E) will increase the basis that the foreign acquiring corporation has in the stock of the domestic controlled corporation immediately before the transaction described in paragraph (d)(2)(vi)(D) of this section, but will not increase the basis of the re-transferred assets held by the domestic controlled corporation. Section 1.367(d)–1T(g)(6) shall not apply with respect to any intangible property included in the re-transferred assets described in this paragraph.

(*2*) If additional tax is required to be paid as a result of a transaction described in paragraph (d)(2)(vi)(D) 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 domestic acquired corporation's income tax return for the year of the transfer and the date on which the additional tax for that year is paid.

(F) *Examples.* For illustrations of the rules in paragraph (d)(2)(vi) of this section, see paragraph (d)(3) *Examples 6B*, *6C*, *9*, and *13A* of this section.

(vii) *Change in status of a domestic acquired corporation to a foreign corporation.* (A) A U.S. person that exchanges stock or securities of a domestic corporation for stock or securities of a foreign corporation under section 354 (or section 356) will be treated for purposes of this section as having made an indirect stock transfer of the stock or securities of a foreign corporation (and not of a domestic corporation) to a foreign corporation under paragraph (b) of this section (but not paragraph (c) of this section), if the acquired domestic corporation is a subsidiary member (within the meaning of § 1.1502–1(c)) of a consolidated group (within the meaning of § 1.1502–1(h)) immediately before the transaction, and if the transaction is either of the following:

(*1*) Described in paragraph (d)(1)(i) or (iv) of this section, but only if the acquiring corporation is foreign. See paragraph (d)(3) *Examples 8*, *9*, *10* and *12* of this section.

(*2*) Described in paragraph (d)(1)(v) of this section, but only to the extent the controlled asset transfer is to a foreign corporation. See paragraph (d)(3) *Example 6A* of this section.

(B) The rules of paragraph (d)(2)(vii)(A) of this section will not apply to the extent assets transferred to the foreign acquiring corporation in a transaction described in paragraph (d)(2)(vii)(A)(*1*) of this section, or assets transferred to a foreign corporation in a controlled asset transfer in a transaction described in paragraph (d)(2)(vii)(A)(*2*) of this section, are retransferred to a domestic controlled corporation in one or more successive transfers as part of the same transaction. See paragraph (d)(3) *Example 9* of this section.

(3) *Examples.* The rules of this paragraph (d) and § 1.367(a)–8 are illustrated by the following examples. For purposes of these examples, assume section 7874 does not apply.

Example 1. Section 368(a)(1)(A)/(a)(2)(D) reorganization—(i) *Facts.* F, a foreign corporation, owns all the stock of Newco, a domestic corporation. A, a domestic corporation, owns all of the stock of W, also a domestic corporation. A and W file a consolidated Federal income tax return. A does not own any stock in F (applying the attribution rules of section 318, as modified by section 958(b)). In a reorganization described in sections 368(a)(1)(A) and (a)(2)(D), Newco acquires all of the assets of W, and A receives 40% of the stock of F in an exchange described in section 354.

(ii) *Result.* Pursuant to paragraph (d)(1)(i) of this section, the reorganization is subject to the indirect stock transfer rules. F is treated as the transferee foreign corporation, and Newco is treated as the transferred corporation. Provided that the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that A enter into

a five-year gain recognition agreement as described in §1.367(a)–8, A's exchange of W stock for F stock under section 354 will not be subject to section 367(a)(1). If F disposes (within the meaning of §1.367(a)–8(j)(1)) of all (or a portion) of Newco's stock within the five-year term of the agreement (and A has not made a valid election under §1.367(a)–8(c)(2)(vi)), A is required to file an amended return for the year of the transfer and include in income, with interest, the gain realized but not recognized on the initial section 354 exchange. If A has made a valid election under §1.367(a)–8(c)(2)(vi) to include the amount subject to the gain recognition agreement in the year of the triggering event, A would instead include the gain on its tax return for the taxable year that includes the triggering event, together with interest.

Example 1A. Transferor is a subsidiary in consolidated group—(i) *Facts*. The facts are the same as in *Example 1*, except that A is owned by P, a domestic corporation, and for the taxable year in which the transaction occurred, P, A and W filed a consolidated Federal income tax return.

(ii) *Result*. Even though A is the U.S. transferor, P is required under §1.367(a)–8(d)(3) and (e)(1)(i) to enter into the gain recognition agreement and comply with the requirements under §1.367(a)–8. If A leaves the P group, the gain recognition agreement would be triggered pursuant to §1.367(a)–8(j)(5), unless the exception provided under §1.367(a)–8(k)(10) applies.

Example 2. Section 368(a)(1)(A)/(a)(2)(E) reorganization—(i) *Facts*. The facts are the same as in *Example 1*, except that Newco merges into W and Newco receives stock of W which it distributes to F in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E). Pursuant to the reorganization, A receives 40 percent of the stock of F in an exchange described in section 354.

(ii) *Result*. The consequences of the transfer are similar to those described in *Example 1*. Pursuant to paragraph (d)(1)(ii) of this section, A is considered to have transferred its W stock to F pursuant to the indirect stock transfer rules. F is treated as the transferee foreign corporation, and W is treated as the transferred corporation. Provided that the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that A enter into a five-year gain recognition agreement as described in §1.367(a)–8, A's exchange of W stock for F stock under section 354 will not be subject to section 367(a)(1).

Example 3. Taxable transaction pursuant to indirect stock transfer rules—(i) *Facts*. The facts are the same as in *Example 1*, except that A receives 55 percent of either the total voting power or the total value of the stock of F in the transaction.

(ii) *Result*. A is required to include in income in the year of the exchange the amount of gain realized on such exchange. See paragraph (c)(1)(i) of this section. If A fails to include the income on its timely-filed return, A will also be liable for the penalty under section 6038B (together with interest and other applicable penalties) unless A's failure to include the income is due to reasonable cause and not willful neglect. See §1.6038B–1(f).

Example 4. Disposition by U.S. transferred corporation of substantially all of its assets—(i) *Facts*. The facts are the same as in *Example 1*, except that, during the third year of the gain recognition agreement, Newco disposes of substantially all (as described in§1.367(a)–8(j)(2)(i)) of the assets described in paragraph (d)(2)(v)(A) of this section for cash and recognizes currently all of the gain realized on the disposition.

(ii) *Result*. Under §1.367(a)–8(j)(2), the gain recognition agreement is generally triggered when the transferred corporation disposes of substantially all of its assets. However, under the special rule contained in §1.367(a)–8(o)(4), because A owned an amount of stock in W described in section 1504(a)(2) immediately before the transaction, because A and W filed a consolidated Federal income tax return prior to the transaction, and Newco, the transferred corporation, is a domestic corporation, the gain recognition agreement is terminated and has no further effect.

Example 5. Triangular section 368(a)(1)(B) reorganization—(i) *Facts*. F, a foreign corporation, owns all the stock of S, a domestic corporation. U, a domestic corporation, owns all of the stock of Y, also a domestic corporation. U does not own any of the stock of F (applying the attribution rules of section 318, as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(B) and paragraph (d)(1)(iii)(A) of this section, S acquires all the stock of Y, and U receives 10% of the voting stock of F.

(ii) *Result*. U's exchange of Y stock for F stock will not be subject to section 367(a)(1), provided that all of the requirements of paragraph (c)(1) are satisfied, including the requirement that U enter into a five-year gain recognition agreement. For purposes of this section, F is treated as the transferee foreign corporation and Y is treated as the transferred corporation. See paragraphs (d)(2)(i) and (ii) of this section. Under §1.367(a)–8(j)(9), the gain recognition agreement would be triggered if F sold all or a portion of the stock of S.

Example 5A. Triangular section 368(a)(1)(B) reorganization—(i) *Facts*. The facts are the same as in *Example 5*, except that F is a domestic corporation and S is a foreign corporation.

(ii) *Result*. U's exchange of Y stock for stock of F, a domestic corporation in control of S, the foreign acquiring corporation, is

treated as an indirect transfer of Y stock to a foreign corporation under paragraph (d)(1)(iii)(B) of this section. U's exchange of Y stock for F stock will not be subject to section 367(a)(1) provided that all of the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that U enter into a five-year gain recognition agreement. In satisfying the 50 percent or less ownership requirements of paragraphs (c)(1)(i) and (ii) of this section, U's indirect ownership of S stock (through its direct ownership of F) will determine whether the requirement of paragraph (c)(1)(i) of this section is satisfied and will be taken into account in determining whether the requirement of paragraph (c)(1)(ii) of this section is satisfied. See paragraph (c)(4)(iv) of this section. For purposes of this section, S is treated as the transferee foreign corporation (see paragraph (d)(2)(i)(B) of this section). If Y sold substantially all of its assets (within the meaning of section 368(a)(1)(C)), the gain recognition agreement would be terminated because U owned an amount of stock in Y described in section 1504(a)(2) immediately before the transaction and Y is a domestic corporation. See § 1.367(a)–8(o)(4).

Example 6. Triangular section 368(a)(1)(C) reorganization—(i) *Facts*. F, a foreign corporation, owns all of the stock of R, a domestic corporation that operates an historical business. V, a domestic corporation, owns all of the stock of Z, also a domestic corporation. V does not own any of the stock of F (applying the attribution rules of section 318 as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(C) (and paragraph (d)(1)(iv) of this section), R acquires all of the assets of Z, and V receives 30% of the voting stock of F.

(ii) *Result*. The consequences of the transfer are similar to those described in *Example 1*; V is required to enter into a 5-year gain recognition agreement under § 1.367(a)–8 to secure nonrecognition treatment under section 367(a). Under paragraphs (d)(2)(i) and (ii) of this section, F is treated as the transferee foreign corporation and R is treated as the transferred corporation. In determining whether, in a later transaction, R has disposed of substantially all of its assets under § 1.367(a)–8(j)(2)(i), see paragraph (d)(2)(v)(A) of this section.

Example 6A. Section 368(a)(1)(C) reorganization followed by section 368(a)(2)(C) exchange—(i) *Facts*. The facts are the same as in *Example 6*, except that the transaction is structured as a section 368(a)(1)(C) reorganization with Z transferring its assets to F, followed by a controlled asset transfer, and R is a foreign corporation. The following additional facts are present. Z has 3 businesses: Business A with a basis of $10 and a value of $50, Business B with a basis of $10 and a value of $40, and Business C with a basis of $10 and a value of $30. V and Z file a consolidated Federal income tax return and V has a basis of $30 in the Z stock, which has a value of $120. Assume that Businesses A and B consist solely of assets that will satisfy the section 367(a)(3) active trade or business exception; none of Business C's assets will satisfy the exception. Z transfers all 3 businesses to F in exchange for 30 percent of the F stock, which Z distributes to V pursuant to a section 368(a)(1)(C) reorganization. F then contributes Businesses B and C to R in a controlled asset transfer.

(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 section 367(a)(5), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a). The transfer by Z of the Business B and C assets to F must first be tested under sections 367(a)(1), (3) and (5). Z recognizes $20 of gain on the outbound transfer of the Business C assets, as such assets do not qualify for an exception to section 367(a)(1). Subject to section 367(a)(5), the Business B assets may qualify for the exception under section 367(a)(3) and § 1.367(a)–2T(c)(2) for assets that will be used by R in an active trade or business outside the United States. 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 (ii) of this section, F is the transferee foreign corporation and R is the transferred corporation.

Example 6B. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts*. The facts are the same as in *Example 6A*, except that R is a domestic corporation.

(ii) *Result*. As in *Example 6A*, the outbound transfer of the Business A assets to F is not affected by the rules of this paragraph (d) and is subject to the general rules under section 367. However, subject to section 367(a)(5), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a). The Business B and C assets are part of an indirect stock transfer under this paragraph (d) but must first be tested under section 367(a) and (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3); the Business C assets do not. However, pursuant to paragraph (d)(2)(vi)(B) of this section, the Business B and C assets are not subject to section 367(a) or (d), provided that the basis of the Business B and C assets in the hands of R is no greater than the basis of the assets in the

hands of Z, and appropriate basis adjustments are made pursuant to section 367(a)(5) to the stock of F held by V. V also is deemed to make an indirect transfer of Z stock under the rules of paragraph (d) of this section to the extent the assets are transferred to R. To preserve non-recognition treatment under section 367(a), and assuming the other requirements of paragraph (c) of this section are satisfied, V must enter into a 5-year gain recognition agreement in the amount of $50, the amount of the appreciation in the Business B and C assets, as the transfer of such assets by Z was not taxable under section 367(a)(1) and constituted an indirect stock transfer.

Example 6C. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts.* The facts are the same as in *Example 6B*, except that Z is owned by U.S. individuals, none of whom qualify as five-percent target shareholders with respect to Z within the meaning of paragraph (c)(5)(iii) of this section. The following additional facts are present. No U.S. persons that are either officers or directors of Z own any stock of F immediately after the transfer. F is engaged in an active trade or business outside the United States that satisfies the test set forth in paragraph (c)(3) of this section.

(ii) *Result.* The Business A assets transferred to F are not re-transferred to R and therefore Z's transfer of these assets is not subject to the rules of paragraph (d) of this section. However, the transfer of such assets is subject to gain recognition under section 367(a)(1), because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5). The Business B and C assets are part of an indirect stock transfer under this paragraph (d) but must first be tested with respect to Z under section 367(a) and (d), as provided in paragraph (d)(2)(vi) of this section. The transfer of the Business B assets (which otherwise would satisfy the section 367(a)(3) active trade or business exception) generally is subject to section 367(a)(1) pursuant to section 367(a)(5). The transfer of the Business C assets generally is subject to section 367(a)(1) because these assets do not qualify for the active trade or business exception under section 367(a)(3). However, pursuant to paragraph (d)(2)(vi)(B) of this section, the transfer of the Business B and C assets is not subject to sections 367(a)(1) and (d), provided the basis of the Business B and C assets in the hands of R is no greater than the basis in the hands of Z and certain other requirements are satisfied. Even though Z is not controlled within the meaning of section 368(c) by 5 or fewer domestic corporations, Z may avoid immediate gain recognition under section 367(a) and (d) on the transfers of the Business B and Business C assets to F if, pursuant to paragraph (d)(3)(vi)(B) of this section, the indirect transfer of Z stock satisfies the requirements of paragraphs (c)(1)(i), (ii), and (iv), and (c)(6) of this section, and Z attaches a statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. In general, the statement must contain a certification that, if F disposes of the stock of R (in a recognition or nonrecognition transaction) and a principal purpose of the transfer is the avoidance of U.S. tax that would have been imposed on Z on the disposition of the Business B and C assets transferred to R, then Z (or F on behalf of Z) will file a return (or amended return as the case may be) recognizing gain ($50), as if, immediately prior to the reorganization, Z transferred the Business B and C assets to a domestic corporation in exchange for stock in a transaction treated as a section 351 exchange and immediately sold such stock to an unrelated party for its fair market value. A transaction is deemed to have a principal purpose of U.S. tax avoidance if F disposes of R stock within two years of the transfer, unless Z (or F on behalf of Z) can rebut the presumption to the satisfaction of the Commissioner. See paragraph (d)(2)(vi)(D)(*2*) of this section. With respect to the indirect transfer of Z stock, assume the requirements of paragraphs (c)(1)(i), (ii), and (iv) of this section are satisfied. Thus, assuming Z attaches the statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return and satisfies the reporting requirements of (c)(6) of this section, the transfer of Business B and C assets is not subject to immediate gain recognition under section 367(a) or (d).

Example 7. Triangular section 368(a)(1)(C) reorganization followed by 351 exchange—(i) *Facts.* The facts are the same as in *Example 6,* except that, during the fourth year of the gain recognition agreement, R transfers substantially all of the assets received from Z to K, a wholly-owned domestic subsidiary of R, in an exchange described in section 351.

(ii) *Result.* The disposition by R, the transferred corporation, of substantially all of its assets would terminate the gain recognition agreement if the assets were disposed of in a taxable transaction because V owned an amount of stock in Z described in section 1504(a)(2) immediately before the transaction, and R is a domestic corporation. See §1.367(a)–8(o)(4). Because the assets were transferred in an exchange to which section 351 applies, such transfer does not trigger the gain recognition agreement if V complies with the requirements contained in §1.367(a)–8(k)(4). See also paragraph (d)(2)(iv) of this section. To determine whether substantially all of the assets are disposed of, any assets of Z that were transferred by Z to R and then contributed by R to K are taken into account.

Example 7A. Triangular section 368(a)(1)(C) reorganization followed by section 351 exchange with foreign transferee—(i) *Facts.* The facts are the same as in *Example 7* except that K is a foreign corporation.

(ii) *Result.* This transfer of assets by R to K must be analyzed to determine its effect upon the gain recognition agreement, and such transfer is also an outbound transfer of assets that is taxable under section 367(a)(1) unless the active trade or business exception under section 367(a)(3) applies. If the transfer is fully taxable under section 367(a)(1), the transfer is treated as if the transferred company, R, sold substantially all of its assets. Thus, the gain recognition agreement would terminate because V owned an amount of stock in Z described in section 1504(a)(2) immediately before the transaction, and R is a domestic corporation. See §1.367(a)–8(o)(4). If each asset transferred qualifies for nonrecognition treatment under section 367(a)(3) and the regulations thereunder (which require, under §1.367(a)–2T(a)(2), the transferor to comply with the reporting requirements under section 6038B), the result is the same as in *Example 7.* If a portion of the assets transferred qualify for nonrecognition treatment under section 367(a)(3) and a portion are taxable under section 367(a)(1) (but such portion does not result in the disposition of substantially all of the assets), the gain recognition agreement will not be triggered if such information is reported as required under §1.367(a)–8(g) and V satisfies the requirements contained in §1.367(a)–8(k)(4).

Example 8. Concurrent application of asset transfer and indirect stock transfer rules in consolidated return setting—(i) *Facts.* Assume the same facts as in *Example 6,* except that R is a foreign corporation and V and Z file a consolidated return for Federal income tax purposes. The properties of Z consist of Business A assets, with an adjusted basis of $50 and fair market value of $90, and Business B assets, with an adjusted basis of $50 and a fair market value of $110. Assume that the Business A assets do not qualify for the active trade or business exception under section 367(a)(3), but that the Business B assets do qualify for the exception. V's basis in the Z stock is $100, and the value of such stock is $200.

(ii) *Result.* Under paragraph (d)(2)(vi), the assets of Businesses A and B that are transferred to R must be tested under sections 367(a)(3) and (a)(5) prior to consideration of the indirect stock transfer rules of this paragraph (d). Thus, Z must recognize $40 of income under section 367(a)(1) on the outbound transfer of Business A assets. Under §1.1502–32, because V and Z file a consolidated return, V's basis in its Z stock increases from $100 to $140 as a result of Z's $40 gain. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) 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, and therefore must enter into a gain recognition agreement in the amount of $60 (the gain realized but not recognized by V in the stock of Z after the $40 basis adjustment). If F sells a portion of its stock in R during the term of the agreement, V will be required to recognize a portion of the $60 gain subject to the agreement. To determine whether R disposes of substantially all of its assets (under §1.367(a)–8(j)(2)(i)), only the Business B assets will be considered (because the transfer of the Business A assets was taxable to Z under section 367). See paragraph (d)(2)(v)(A) of this section.

Example 8A. Concurrent application without consolidated returns—(i) *Facts.* The facts are the same as in *Example 8,* except that V and Z do not file consolidated income tax returns.

(ii) *Result.* Z would still recognize $40 of gain on the transfer of its Business A assets, and the Business B assets would still qualify for the active trade or business exception under section 367(a)(3). However, V's basis in its stock of Z would not be increased by the amount of Z's gain. V's indirect transfer of stock will be taxable unless V enters into a gain recognition agreement (as described in §1.367(a)–8) for the $100 of gain realized but not recognized with respect to the stock of Z.

Example 8B. Concurrent application with individual U.S. shareholder—(i) *Facts.* The facts are the same as in *Example 8,* except that V is an individual U.S. citizen.

(ii) *Result.* Section 367(a)(5) would prevent the application of the active trade or business exception under section 367(a)(3). Thus, Z's transfer of assets to R would be fully taxable under section 367(a)(1). Z would recognize $100 of income. V's basis in its stock of Z is not increased by this amount. V is taxable with respect to its indirect transfer of its Z stock unless V enters into a gain recognition agreement in the amount of the $100, the gain realized but not recognized with respect to its Z stock.

Example 8C. Concurrent application with nonresident alien shareholder—(i) *Facts.* The facts are the same as in *Example 8,* except that V is a nonresident alien.

(ii) *Result.* Pursuant to section 367(a)(5), the active trade or business exception under section 367(a)(3) is not available with respect to Z's transfer of assets to R. Thus, Z has $100 of gain with respect to the Business A and B assets. Because V is a nonresident alien, however, V is not subject to section 367(a) with respect to its indirect transfer of Z stock.

Example 9. Indirect stock transfer by reason of a controlled asset transfer—(i) *Facts.* The facts are the same as in *Example 8,* except that R transfers the Business A assets to M, a wholly owned domestic subsidiary of R, in

a controlled asset transfer. In addition, V's basis in its Z stock is $90.

(ii) *Result*. Pursuant to paragraph (d)(2)(vi)(B) of this section, sections 367(a) and (d) do not apply to Z's transfer of the Business A assets to R, because such assets are re-transferred to M, a domestic corporation, provided that the basis of the Business A assets in the hands of M is no greater than the basis of the assets in the hands of Z, and certain other requirements are satisfied. Because Z is controlled (within the meaning of section 368(c)) by V, a domestic corporation, appropriate basis adjustments must be made pursuant to section 367(a)(5) to the stock of F held by V. Section 367(a)(1) does not apply to Z's transfer of its Business B assets to R (which are not re-transferred to M) because such assets qualify for an exception to gain recognition under section 367(a)(3), subject to section 367(a)(5). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, V is generally 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, including the requirement that V enter into a 5-year gain recognition agreement and comply with the requirements of §1.367(a)–8. However, pursuant to paragraph (d)(2)(vii)(B) of this section, paragraph (d)(2)(vii)(A)(1) of this section does not apply to the extent of the transfer of business A assets by R to M, a domestic corporation. As a result, to the extent of the business A assets transferred by R to M, V is deemed to transfer the stock of Z (a domestic corporation) to F in a section 354 exchange subject to the rules of paragraphs (c) and (d) of this section. Thus, with respect to V's indirect transfer of Z stock to F, such transfer is not subject to gain recognition under section 367(a)(1) if the requirements of paragraph (c) of this section are satisfied, including the requirement that V enter into a 5-year gain recognition agreement and comply with the requirements of §1.367(a)–8. Under paragraphs (d)(2)(i) and (ii) of this section, the transferee foreign corporation is F and the transferred corporation is M. Pursuant to paragraph (d)(2)(iv) of this section, a disposition by F of the stock of R, or a disposition by R of the stock of M, will trigger the gain recognition agreement. To determine whether there is a triggering event under§1.367(a)–8(j)(2)(i), both the Business A assets in M and the Business B assets in R must be considered.

Example 10. Concurrent application of asset transfer and indirect stock transfer rules in section 368(a)(1)(A)/(a)(2)(D) reorganization—(i) *Facts*. The facts are the same as in Example 8, except that R acquires all of the assets of Z in a reorganization described in sections 368(a)(1)(A) and (a)(2)(D). Pursuant to the reorganization, V receives 30 percent of the stock of F in a section 354 exchange.

(ii) *Result*. The consequences of the transaction are similar to those in *Example 8*. The assets of Businesses A and B that are transferred to R must be tested under section 367(a) and (d) prior to the consideration of the indirect stock transfer rules of this paragraph (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3), subject to section 367(a)(5). Because the Business A assets do not qualify for the exception, Z must recognize $40 of gain under section 367(a) on the transfer of Business A assets to R. Further, because V and Z file a consolidated return, V's basis in the stock of Z is increased from $100 to $140 as a result of Z's $40 gain. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) 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's indirect transfer of foreign stock will be taxable under section 367(a) unless V enters into a gain recognition agreement in the amount of $60 ($200 value of Z stock less $140 adjusted basis).

Example 11. Concurrent application of section 367(a) and (b) in section 368(a)(1)(A)/(a)(2)(E) reorganization—(i) *Facts*. F, a foreign corporation, owns all the stock of D, a domestic corporation. V, a domestic corporation, owns all the stock of Z, a foreign corporation. V has a basis of $100 in the stock of Z which has a fair market value of $200. D is an operating corporation with assets valued at $100 with a basis of $60. In a reorganization described in sections 368(a)(1)(A) and (a)(2)(E), D merges into Z, and V exchanges its Z stock for 55 percent of the outstanding F stock.

(ii) *Result*. Under paragraph (d)(1)(ii) of this section, V is treated as making an indirect transfer of Z stock to F. V's exchange of Z stock for F stock will be taxable under section 367(a) (and section 1248 will be applicable) if V fails to enter into a 5-year gain recognition agreement in accordance with the requirements of §1.367(a)–8. Under paragraph (b)(2) of this section, if V enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder as well as section 367(a). Under §1.367(b)–4(b), however, no income inclusion is required because both F and Z are controlled foreign corporations with respect to which V is a section 1248 shareholder immediately after the exchange. Under paragraphs (d)(2)(i) and (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 5-year term of the agreement (and V has not made a valid election under§1.367(a)–8(c)(2)(vi), V is required to file an amended return for the year of the transfer and include in income, with interest, the gain realized but not recognized

on the initial section 354 exchange. To determine whether Z (the transferred corporation) disposes of substantially all of its assets, only the assets of Z immediately prior to the transaction are taken into account, pursuant to paragraph (d)(2)(v)(B) of this section. Because D is owned by F, a foreign corporation, section 367(a)(5) precludes any assets of D from qualifying for nonrecognition under section 367(a)(3). Thus, D recognizes $40 of gain on the transfer of its assets to Z under section 367(a)(1).

Example 12. Concurrent application of direct and indirect stock transfer rules—(i) *Facts.* F, a foreign corporation, owns all of the stock of O, also a foreign corporation. D, a domestic corporation, owns all of the stock of E, also a domestic corporation, which owns all of the stock of N, also a domestic corporation. Prior to the transactions described in this *Example 12,* D, E and N filed a consolidated income tax return. D has a basis of $100 in the stock of E, which has a fair market value of $160. The N stock has a fair market value of $100, and E has a basis of $60 in such stock. In addition to the stock of N, E owns the assets of Business X. The assets of Business X have a fair market value of $60, and E has a basis of $50 in such assets. Assume that the Business X assets qualify for nonrecognition treatment under section 367(a)(3). D does not own any stock in F (applying the attribution rules of section 318 as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(C) and paragraph (d)(1)(iv) of this section, O acquires all of the assets of E, and D exchanges its stock in E for 40% of the voting stock of F.

(ii) *Result.* E's transfer of its assets, including the N stock, must be tested under the general rules of section 367(a) before consideration of D's indirect transfer of the stock of E. E's transfer of the assets of Business X qualify for nonrecognition under section 367(a)(3). E's transfer of its N stock could qualify for nonrecognition treatment if D satisfies the requirements in §1.367(a)–3(e). O is the transferee foreign corporation; N is the transferred corporation. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, D 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, and therefore may enter into a gain recognition agreement for such indirect stock transfer as provided in paragraph (b) of this section and §1.367(a)–8. As to this transfer, F is the transferee foreign corporation; O is the transferred corporation. The amount of the gain recognition agreement is $60. See also section 367(a)(5) and any regulations issued thereunder.

Example 13. Successive section 351 exchanges—(i) *Facts.* D, a domestic corporation, owns all the stock of X, a controlled foreign corporation that operates an historical business, which owns all the stock of Y, a controlled foreign corporation that also operates an historical business. The properties of D consist of Business A assets, with an adjusted basis of $50 and a fair market value of $90, and Business B assets, with an adjusted basis of $50 and a fair market value of $110. Assume that the Business B assets qualify for the exception under section 367(a)(3) and §1.367(a)–2T(c)(2), but that the Business A assets do not qualify for the exception. In an exchange described in section 351, D transfers the assets of Businesses A and B to X, and, in connection with the same transaction, X transfers the assets of Business B to Y in another exchange described in section 351.

(ii) *Result.* Under paragraph (d)(1)(vi) of this section, this transaction is treated as an indirect stock transfer for purposes of section 367(a), but the transaction is not recharacterized for purposes of section 367(b). Moreover, under paragraph (d)(2)(vi) of this section, the assets of Businesses A and B that are transferred to X must be tested under section 367(a)(3). The Business A assets, which were not transferred to Y, are subject to the general rules of section 367(a), and not the indirect stock transfer rules described in this paragraph (d). D must recognize $40 of income on the outbound transfer of Business A assets. The transfer of the Business B assets is subject to both the asset transfer rules (under section 367(a)(3)) and the indirect stock transfer rules of this paragraph (d) and §1.367(a)–8. Thus, D's transfer of the Business B assets will not be subject to section 367(a)(1) if D enters into a five-year gain recognition agreement with respect to the stock of Y. Under paragraphs (d)(2)(i) and (ii) of this section, X will be treated as the transferee foreign corporation and Y will be treated as the transferred corporation for purposes of applying the terms of the agreement. If X sells all or a portion of the stock of Y during the term of the agreement, D will be required to recognize a proportionate amount of the $60 gain that was realized by D on the initial transfer of the Business B assets.

Example 13A. Successive section 351 exchanges with ultimate domestic transferee—(i) *Facts.* The facts are the same as in *Example 13,* except that Y is a domestic corporation.

(ii) *Result.* As in *Example 13,* D must recognize $40 of income on the outbound transfer of the Business A assets. Although the Business B assets qualify for the exception under section 367(a)(3) (and end up in U.S. corporate solution, in Y), the $60 of gain realized on the Business B assets is nevertheless taxable under paragraphs (c)(1) and (d)(1)(vi) of this section because the transaction is considered to be a transfer by D of stock of

a domestic corporation, Y, in which D receives more than 50 percent of the stock of the transferee foreign corporation, X. A gain recognition agreement is not permitted.

Example 14. Concurrent application of indirect stock transfer rules and section 367(b)—(i) *Facts.* F, a foreign corporation, owns all of the stock of Newco, which is also a foreign corporation. P, a domestic corporation, owns all of the stock of S, a foreign corporation that is a controlled foreign corporation within the meaning of section 957(a). P's basis in the stock of S is $50 and the value of S is $100. The section 1248 amount with respect to S stock is $30. In a reorganization described in section 368(a)(1)(C) (and paragraph (d)(1)(iv) of this section), Newco acquires all of the properties of S, and P exchanges its stock in S for 49 percent of the stock of F.

(ii) *Result.* P's exchange of S stock for F stock under section 354 will be taxable under section 367(a) (and section 1248 will be applicable) if P fails to enter into a 5-year gain recognition agreement in accordance with §1.367(a)–8. Under paragraph (b)(2) of this section, if P enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder as well as section 367(a). Under §1.367(b)–4(b), P must recognize the section 1248 amount of $30 because P exchanged stock of a controlled foreign corporation, S, for stock of a foreign corporation that is not a controlled foreign corporation, F. The indirect stock transfer rules do not apply with respect to section 367(b). The deemed dividend of $30 recognized by P will increase P's basis in the F stock received in the transaction, and F's basis in the Newco stock. Thus, the amount of the gain recognition agreement is $20 ($50 gain realized on the transfer less the $30 inclusion under section 367(b)). Under paragraphs (d)(2)(i) and (ii) of this section, F is treated as the transferee foreign corporation and Newco is the transferred corporation.

Example 14A. Triangular section 368(a)(1)(C) reorganization involving foreign acquired corporation—(i) *Facts.* Assume the same facts as in Example 14, except that P receives 51 percent of the stock of F.

(ii) *Result.* Assuming §1.367(b)–4(b) does not apply, there is no income inclusion under section 367(b), and the amount of the gain recognition agreement is $50.

Example 15. Concurrent application of indirect stock transfer rules and section 367(b)—(i) *Facts.* F, a foreign corporation, owns all of the stock of Newco, a domestic corporation. P, a domestic corporation, owns all of the stock of FC, a foreign corporation. P's basis in the stock of FC is $50 and the value of FC stock is $100. The all earnings and profits amount with respect to the FC stock held by P is $60. See §1.367(b)–2(d). In a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) (and paragraph (d)(1)(i) of this section), Newco acquires all of the properties of FC, and P exchanges its stock in FC for 20 percent of the stock in F.

(ii) *Result.* P's section 354 exchange is considered an indirect stock transfer under paragraph (d)(1)(i) of this section. Further, because the assets of FC were acquired by Newco, a domestic corporation, in an asset reorganization, the transaction is within §1.367(b)–3(a) and (b). Because the transaction is subject to §1.367(b)–3 and the indirect stock rules of paragraph (d) of this section, and because the all earnings and profits amount with respect to the FC stock exchanged by P ($60) is greater than the gain in such stock subject to section 367(a) ($50), the section 367(b) rules (and not the section 367(a) rules) apply to the exchange. See §1.367(a)–3(b)(2)(i)(B). Under the rules of section 367(b), P must include in income the all earnings and profits amount of $60 with respect to its FC stock. See §1.367(b)–3. Alternatively, if P's all earnings and profits amount with respect to its FC stock were $30 (which is less than the gain in such stock subject to section 367(a) ($50)), section 367(b) and the regulations thereunder would not apply if there is gain recognition under section 367(a). Thus, if P failed to enter into a 5-year gain recognition agreement in accordance with §1.367(a)–8, then P would recognize $50 of gain under section 367(a) and there would be no income inclusion under section 367(b). If, instead, P enters into a 5-year gain recognition agreement under §1.367(a)–8, thereby avoiding immediate gain recognition on the entire $50 of section 367(a) gain, P is required to include in income the all earnings and profits amount of $30. In such a case, P will adjust its basis in the FC stock pursuant to §1.367(b)–2(e)(3)(ii) and enter into a gain recognition agreement in the amount of $20.

Example 16. Direct asset reorganization not subject to stock transfer rules—(i) *Facts.* D is a domestic corporation that owns all the stock of F1 and F2, both foreign corporations. In a reorganization described in section 368(a)(1)(D), F2 acquires all of the assets of F1, and D receives 30 percent of the stock of F2 in an exchange described in section 354.

(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) of this section.

(e) *Transfers by a domestic corporation to a foreign corporation in a section 361 exchange*—(1) *General rule.* If a domestic corporation (U.S. transferor) transfers

stock or securities to a foreign corporation (transferee foreign corporation) in an exchange described in section 361(a) or (b), or in an exchange described in section 351 that is also described in section 361(a) or (b) (collectively, a section 361 exchange), such transfer shall be subject to section 367(a)(1), unless the conditions of paragraphs (e)(1)(i) through (iv) of this section are satisfied.

(i) The conditions set forth in section 367(a)(5) and any regulations under that section have been satisfied including that:

(A) The U.S. transferor is controlled (within the meaning of section 368(c)) by five or fewer (but at least one) domestic corporations (control group members) at the time of the section 361 exchange;

(B) The U.S. transferor recognizes the amount of the gain realized in the section 361 exchange that is allocable to any shareholder that is not a control group member (based on the value of the ownership interest in the U.S. transferor held by the shareholder at the time of the section 361 exchange);

(C) The U.S. transferor recognizes the amount of the gain realized in the section 361 exchange allocable to a control group member that cannot be preserved in the stock received by the control group member in the transaction; and

(D) Appropriate adjustments are made to the basis of the stock received by each control group member in the transaction.

(ii) If the stock or securities transferred in the section 361 exchange are of a domestic corporation, the conditions in paragraphs (c)(1)(i), (ii), and (iv) of this section are satisfied.

(iii) Each control group member that owns five percent or more (applying the attribution rules of section 318, as modified by section 958(b)) of the total voting power or the total fair market value of the stock of the transferee foreign corporation immediately after the transaction enters into a gain recognition agreement as provided in § 1.367(a)–8. The amount of gain subject to the gain recognition agreement shall equal the amount of the gain realized by the U.S. transferor on the transfer of the stock or securities in the section 361 exchange that is allocable to such control group member (based on the ownership interest (by value) in the U.S. transferor held by the control group member at the time of the section 361 exchange) reduced by the amount of such allocable gain that is recognized by the U.S. transferor with respect to the control group member. The gain recognition agreement shall designate the control group member as the U.S. transferor for purposes of paragraphs (b) and (c) of this section and § 1.367(a)–8.

(iv) Each control group member that enters into a gain recognition agreement pursuant to paragraph (e)(1)(iii) of this section makes the election described in § 1.367(a)–8(c)(2)(vi).

(2) *Certain triangular asset reorganizations.* If a transfer of stock or securities described in paragraph (e)(1) of this section is pursuant to a triangular asset reorganization described in § 1.358–6(b)(2)(i) through (iii), the gain recognition agreement filed by a control group member pursuant to paragraph (e)(1)(iii) of this section shall include provisions consistent with the principles of § 1.367(a)–8 to account for all the parties to the reorganization. See § 1.367(a)–8(j)(9).

(3) *Examples.* The following examples illustrate the provisions of paragraph (e)(1) of this section. Except as otherwise indicated, assume US1, US2, USP, and UST are domestic corporations; US1 and US2 are not related; CFC1, CFC2, FA, and FC are foreign corporations; the section 1248 amount attributable to the stock of a foreign corporation is zero; and section 7874 does not apply to the transaction.

Example 1. Outbound asset reorganization. (i) *Facts.* US1 and US2 own 60% and 40%, respectively, of the outstanding stock of UST. UST wholly owns FC. The FC stock held by UST has a $20x basis and a $100x fair market value. UST merges with and into FC in an asset reorganization described in section 368(a)(1)(A). In the section 361 exchange that is part of the reorganization, UST transfers all of its FC stock to FA. UST distributes the FA stock it received in the section 361 exchange to US1 and US2 pursuant to the plan of reorganization. The conditions set forth in the second sentence of section 367(a)(5) and the regulations under that section are satisfied, including adjusting the basis of the FA stock received by US1 and US2 in the reorganization, as appropriate.

After the reorganization, US1 and US2 own 6% and 4%, respectively, of the outstanding stock of FA.

(ii) *Result.* If the conditions of paragraph (e)(1)(i) through (iv) of this section are satisfied, the transfer of the FC stock by UST to FA in the section 361 exchange is not subject to section 367(a)(1). Because US1 and US2 complied with the requirements of section 367(a)(5), the requirement of paragraph (e)(1)(i) of this section is satisfied. Paragraph (e)(1)(ii) of this section is not applicable because FC is a foreign corporation. Pursuant to paragraph (e)(1)(iii) of this section, US1 enters into a gain recognition agreement with respect to its share of the gain realized by UST on the transfer of the FC stock to FA in the section 361 exchange ($48x, or 60% of $80x). The amount of gain subject to the gain recognition agreement is $48x because UST did not recognize any amount of such gain under section 367(a)(5) or the regulations under that section with respect to US1. US1 is designated as the U.S. transferor on the gain recognition agreement for purposes of paragraph (b) of this section and §1.367(a)–8. US1 makes the election described in §1.367(a)–8(c)(2)(vi) with respect to the gain recognition agreement. Because US2 owns less than 5% of the stock of FA after the reorganization, US2 is not required to enter into a gain recognition agreement with respect to its share of the gain realized by UST on the transfer of the FC stock to FA in the section 361 exchange.

(iii) *Alternate facts.* The facts are the same as in paragraph (i) of this *Example,* except that, in year 4, FA disposes of 25% of the FC stock in a taxable exchange. Under §1.367(a)–8(c)(1)(i) and (j)(1), the partial disposition of the FC stock requires US1 to include in income 25% of the gain subject to the gain recognition agreement filed in year 1 ($12x, or 25% of $48x) and pay applicable interest on any additional tax due on such inclusion.

(iv) *Alternate facts.* The facts are the same as in paragraph (iii) of this *Example,* except that US1 and US2 are members of a consolidated group of which USP is the common parent. Because US2 is considered to own at least 5% of the stock of FA following the reorganization by reason of the attribution rules of section 318, as modified by section 958(b), a gain recognition agreement must also be entered into on behalf of US2 with respect to the amount of the gain realized but not recognized by UST on the transfer of the FC stock to FA that is allocable to US2 ($32x, or 40% of $80x). Under §1.367(a)–8(d)(3) and §1.1502–77(a)(1), USP enters into the gain recognition agreements on behalf of US1 and US2. In year 4, US1 and US2 must include in income 25% of the amount of gain subject to their respective gain recognition agreement ($12x for US1 and $8x for US2) and pay applicable interest on any additional tax due on such inclusion.

Example 2. Divisive reorganization. (i) *Facts.* US1 wholly owns UST. The UST stock has a $120x basis and $150x fair market value. UST wholly owns CFC2. The CFC2 stock has a $20x basis and a $50x fair market value. UST also owns Business A that has a fair market value of $100x. In a divisive reorganization that satisfies the requirements of section 368(a)(1)(D), UST transfers the CFC2 stock to CFC1, a newly-formed corporation, in exchange solely for CFC1 stock. The transfer of the CFC2 stock to CFC1 is a section 361 exchange. UST then distributes the CFC1 stock to US1 in a transaction that qualifies under section 355. Under section 358, the pre-exchange basis in the UST stock ($120x) is allocated between the UST stock and the CFC1 stock based on the relative fair market values of such stock. Therefore, immediately after the transaction, the basis of the UST stock is $80x ($120x multiplied by $100x/$150x), and the basis of the CFC1 stock is $40x ($120x multiplied by $50x/$150x). The conditions set forth in section 367(a)(5) and the regulations under that section are satisfied, including reducing the basis of the CFC1 stock received by US1 in the transaction by $20x so that the $30x built-in gain in the CFC2 stock transferred in the section 361 exchange is preserved in the CFC1 stock received by US1 in the transaction.

(ii) *Result.* Because US1 complied with the requirements of section 367(a)(5) and regulations under that section, the requirement of paragraph (e)(1)(i) of this section is satisfied. Paragraph (e)(1)(ii) of this section is not applicable because CFC2 is a foreign corporation. Pursuant to paragraph (e)(1)(iii) of this section, US1 enters into a gain recognition agreement with respect to its share of the gain realized by UST on the transfer of the CFC2 stock to CFC1 in the section 361 exchange ($30x). The amount of gain subject to the gain recognition agreement is $30x because UST did not recognize any amount of such gain under section 367(a)(5) or the regulations under that section with respect to US1. US1 is designated as the U.S. transferor on the gain recognition agreement for purposes of paragraph (b) of this section and §1.367(a)–8. US1 makes the election described in §1.367(a)–8(c)(2)(vi) with respect to the gain recognition agreement.

(4) *Cross-references.* For other examples that illustrate the application of this paragraph (e), see §1.367(a)–8(q)(2), *Examples 6* and *24.* For rules relating to an acquisition of the stock of a foreign corporation by another foreign corporation in a section 361 exchange, see §1.367(b)–4(b)(1)(iii), *Example 4.* For rules relating to certain distributions of stock of a foreign corporation by a domestic corporation, see section

1248(f) and the regulations under that section.

(f) [Reserved]

(g) *Effective/applicability date*—(1) *Rules of applicability*. (i) Except as otherwise provided in this paragraph (g), the rules in paragraphs (a), (b), and (d) of this section apply to transfers occurring on or after July 20, 1998.

(ii) The following rules apply to transactions occurring on or after January 23, 2006—

(A) The rules in paragraphs (a) and (d) of this section, as they apply to section 368(a)(1)(A) reorganizations (including reorganizations described in section 368(a)(2)(D) or (E)) involving a foreign acquiring or foreign acquired corporation;

(B) The rules in paragraph (b)(2)(i)(B) of this section;

(C) The rules in paragraph (d) of this section, as they apply to section 368(a)(1)(G) reorganizations (including reorganizations described in section 368(a)(2)(D));

(D) The rules of paragraph (d)(1) and (d)(2)(iv), as they relate to exchanges by a U.S. person of securities of an acquired corporation for voting stock or securities of a foreign corporation in control of the acquiring corporation in a triangular section 368(a)(1)(B) reorganization;

(E) The rules in paragraph (d)(1) and (d)(2)(iv) of this section, as they relate to exchanges by a U.S. person of stock or securities of an acquired corporation for voting stock or securities of a domestic corporation in control of the foreign acquiring corporation in a triangular section 368(a)(1)(B) reorganization; and

(F) The rules in paragraph (d)(2)(vii) of this section.

(iii) The rules of paragraph (a) of this section that apply to transfers of securities in a section 354 or 356 exchange (pursuant to a section 368(a)(1)(E) reorganization or an asset reorganization that is not treated as an indirect stock transfer) that is not subject to section 367(a) apply only to transfers occurring after January 5, 2005 (although taxpayers may apply such provision to transfers of securities occurring on or after July 20, 1998, and on or before January 5, 2005, if done consistently to all transactions).

(iv) The rules in paragraph (d)(1)(v) of this section apply to:

(A) A reorganization described in section 368(a)(1)(C) followed by a controlled asset transfer if such reorganization occurs on or after July 20, 1998;

(B) A reorganization described in section 368(a)(1)(D) followed by a controlled asset transfer if such reorganization occurs after December 9, 2002 (for additional guidance concerning such reorganizations that occur on or after July 20, 1998 and on or before December 9, 2002, see Rev. Rul. 2002–85 (2002–2 C.B. 986) and § 601.601(d)(2) of this chapter); and

(C) A reorganization described in section 368(a)(1)(A), (F), or (G) followed by a controlled asset transfer if such reorganization occurs on or after January 23, 2006.

(v) 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.

(vi) With respect to certain transfers of domestic stock or securities, the rules in paragraph (c) of this section are generally applicable for transfers occurring after January 29, 1997. See § 1.367(a)–3(c)(11). For transition rules regarding certain transfers of domestic stock or securities after December 16, 1987, and before January 30, 1997, and transfers of foreign stock or securities after December 16, 1987, and before July 20, 1998, see paragraph (j) of this section.

(vii) Except as otherwise provided in this paragraph (g)(1)(G), the third sentence of paragraph (a) of this section shall apply to section 304(a)(1) transactions occurring on or after February 21, 2006. However, taxpayers may rely on the third sentence of paragraph (a) of this section for all section 304(a)(1) transactions occurring in open tax years; in such cases any gain recognition agreements filed pursuant to § 1.367(a)–8 with respect to such transactions shall terminate and have no further effect.

(viii)(A) Except as provided in this paragraph (g)(1)(viii), the rules of paragraph (e) of this section apply to transfers of stock or securities occurring on or after March 13, 2009. For matters covered in this section for periods before March 13, 2009, but on or after March 7, 2007, the rules of §1.367(a)–3T(e) (see 26 CFR part 1, revised April 1, 2007) apply. For matters covered in this section for periods before March 7, 2007, but on or after July 20, 1998, the rule of §1.367(a)–8(f)(2)(i) (see 26 CFR part 1, revised April 1, 2006) applies.

(B) Taxpayers may apply the rules of §1.367(a)–3(e) to transfers occurring before March 13, 2009, and during a taxable year for which the period of limitations on assessments under section 6501(a) has not closed, if done consistently to all such transfers occurring during each taxable year. A taxpayer applies the rules of §1.367(a)–3(e) to transfers occurring before March 13, 2009, and during a taxable year for which the period of limitations on assessments under section 6501(a) has not closed, by including the gain recognition agreement, annual certification, or other information filing, that is required as a result of the rules of §1.367(a)–3(e) applying to such a transfer, with an amended tax return for the taxable year in which the transfer occurs that is filed on or before *August 10, 2009*. A taxpayer that wishes to apply the rules of §1.367(a)–3(e) to transfers occurring before *March 13, 2009*, and during a taxable year for which the period of limitations on assessments under section 6501(a) has not closed but that fails to meet the filing requirement described in the preceding sentence must request relief for reasonable cause for such failure as provided in §1.367(a)–8.

(2) *Election*. Notwithstanding paragraphs (g)(1) and (j) of this section, taxpayers may, by timely filing an original or amended return, elect to apply paragraphs (b) and (d) of this section to all transfers of foreign stock or securities occurring after December 16, 1987, and before July 20, 1998, except to the extent that a gain recognition agreement has been triggered prior to July 20, 1998. If an election is made under this paragraph (g)(2), the provisions of §1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) shall apply, and, for this purpose, the term *substantial portion* under §1.367(a)–3T(g)(3)(iii) (see 26 CFR part 1, revised April 1, 1998) shall be interpreted to mean *substantially all* as defined in section 368(a)(1)(C). In addition, if such an election is made, the taxpayer must apply the rules under section 367(b) and the regulations thereunder to any transfers occurring within that period as if the election to apply §1.367(a)–3(b) and (d) to transfers occurring within that period had not been made, except that in the case of an exchange described in section 351 the taxpayer must apply section 367(b) and the regulations thereunder as if the exchange was described in §7.367(b)–7 of this chapter (as in effect before February 23, 2000; see 26 CFR part 1, revised as of April 1, 1999). For example, if a U.S. person, pursuant to a section 351 exchange, transfers stock of a controlled foreign corporation in which it is a United States shareholder but does not receive back stock of a controlled foreign corporation in which it is a United States shareholder, the U.S. person must include in income under §7.367(b)–7 of this chapter (as in effect before February 23, 2000; see 26 CFR part 1, revised as of April 1, 1999) the section 1248 amount attributable to the stock exchanged (to the extent that the fair market value of the stock exchanged exceeds its adjusted basis). Such inclusion is required even though §7.367(b)–7 of this chapter (as in effect before February 23, 2000; see 26 CFR part 1, revised as of April 1, 1999), by its terms, did not apply to section 351 exchanges.

(h) *Former 10-year gain recognition agreements*. If a taxpayer elects to apply the rules of this section to all prior transfers occurring after December 16, 1987, any 10-year gain recognition agreement that remains in effect (has not been triggered in full) on July 20, 1998 will be considered by the Internal Revenue Service to be a 5-year gain recognition agreement with a duration of five full taxable years following the close of the taxable year of the initial transfer.

(i) [Reserved]

(j) *Transition rules regarding certain transfers of domestic or foreign stock or securities after December 16, 1987, and*

prior to July 20, 1998—(1) *Scope*. Transfers of domestic stock or securities described under section 367(a) that occurred after December 16, 1987, and prior to April 17, 1994, and transfers of foreign stock or securities described under section 367(a) that occur after December 16, 1987, and prior to July 20, 1998 are subject to the rules contained in section 367(a) and the regulations thereunder, as modified by the rules contained in paragraph (j)(2) of this section. For transfers of domestic stock or securities described under section 367(a) that occurred after April 17, 1994 and before January 30, 1997, see Temporary Income Regulations under section 367(a) in effect at the time of the transfer (§ 1.367(a)–3T(a) and (c), 26 CFR part 1, revised April 1, 1996) and paragraph (c)(11) of this section. For transfers of domestic stock or securities described under section 367(a) that occur after January 29, 1997, see § 1.367(a)–3(c).

(2) *Transfers of domestic or foreign stock or securities: Additional substantive rules*—(i) *Rule for less than 5-percent shareholders*. Unless paragraph (j)(2)(iii) of this section applies (in the case of domestic stock or securities) or paragraph (j)(2)(iv) of this section applies (in the case of foreign stock or securities), a U.S. transferor that transfers stock or securities of a domestic or foreign corporation in an exchange described in section 367(a) and owns less than 5 percent of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer (taking into account the attribution rules of section 958) is not subject to section 367(a)(1) and is not required to enter into a gain recognition agreement.

(ii) *Rule for 5-percent shareholders*. Unless paragraph (j)(2)(iii) or (iv) of this section applies, a U.S. transferor that transfers domestic or foreign stock or securities in an exchange described in section 367(a) and owns at least 5 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer (taking into account the attribution rules under section 958) may qualify for nonrecognition treatment by filing a gain recognition agreement in accordance with § 1.367(a)–3T(g) in effect prior to July 20, 1998 (see 26 CFR part 1, revised April 1, 1998) for a duration of 5 or 10 years. The duration is 5 years if the U.S. transferor (5-percent shareholder) determines that all U.S. transferors, in the aggregate, own less than 50 percent of both the total voting power and the total value of the transferee foreign corporation immediately after the transfer. The duration is 10 years in all other cases. See, however, § 1.367(a)–3(h). If a 5-percent shareholder fails to properly enter into a gain recognition agreement, the exchange is taxable to such shareholder under section 367(a)(1).

(iii) *Gain recognition agreement option not available to controlling U.S. transferor if U.S. stock or securities are transferred*. Notwithstanding the provisions of paragraph (j)(2)(ii) of this section, in no event will any exception to section 367(a)(1) apply to the transfer of stock or securities of a domestic corporation where the U.S. transferor owns (applying the attribution rules of section 958) more than 50 percent of either the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer (i.e., the use of a gain recognition agreement to qualify for nonrecognition treatment is unavailable in this case).

(iv) *Loss of United States shareholder status in the case of a transfer of foreign stock*. Notwithstanding the provisions of paragraphs (j)(2)(i) and (ii) of this section, in no event will any exception to section 367(a)(1) apply to the transfer of stock of a foreign corporation in which the U.S. transferor is a United States shareholder (as defined in § 7.367(b)–2(b) of this chapter (as in effect before February 23, 2000; see 26 CFR part 1, revised as of April 1, 1999) or section 953(c)) unless the U.S. transferor receives back stock in a controlled foreign corporation (as defined

in section 953(c), section 957(a) or section 957(b)) as to which the U.S. transferor is a United States shareholder immediately after the transfer.

[T.D. 8702, 61 FR 68637, Dec. 30, 1996, as amended by T.D. 8770, 63 FR 33556, June 19, 1998; 64 FR 15687, Apr. 1, 1999; T.D. 8850, 64 FR 72550, Dec. 28, 1999; T.D. 8862, 65 FR 3596, Jan. 24, 2000; T.D. 9243, 71 FR 4282, Jan. 26, 2006; T.D. 9250, 71 FR 8804, Feb. 21, 2006; T.D. 9311, 72 FR 5182, 5183, Feb. 5, 2007; T.D. 9400, 73 FR 30303, May 27, 2008; T.D. 9444, 74 FR 6826, Feb. 11, 2009; T.D. 9446, 74 FR 6957, 6958, Feb. 11, 2009]

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

(a) through (b)(2)(i)(B) [Reserved] For further guidance, see §1.367(a)–3(a) through (b)(2)(i)(B).

(b)(2)(i)(C) If in connection with a transaction described in §1.367(b)–14T, one or more U.S. persons transfer stock of T, as defined in §1.358–6(b)(1)(iii), to a corporation in a transfer described in section 367(a), and the amount of gain in the T stock that would otherwise be recognized under section 367(a) is less than the deemed distribution that would result from the adjustments made under §1.367(b)–14T and that would be treated as a dividend under section 301(c)(1), then section 367(b), and not section 367(a), shall apply to such transaction. This paragraph (b)(2)(i)(C) applies to transfers occurring on or after May 23, 2008.

(b)(2)(ii) through (f) [Reserved] For further guidance, see §1.367(a)–3(b)(2)(ii) through (f).

(g) *Effective/applicability date*. Paragraph (b)(2)(i)(C) of this section applies to transfers occurring on or after May 23, 2008.

(h) *Expiration date*. The applicability of paragraph (b)(2)(i)(C) of this section expires on May 23, 2011.

[T.D. 9446, 74 FR 13340, Mar. 27, 2009]

§ 1.367(a)–4T Special rules applicable to specified transfers of property (temporary).

(a) *In general*. This section provides special rules for determining the applicability of section 367(a)(1) to specified transfers of property. Paragraph (b) of this section provides a special rule requiring the recapture of depreciation upon the transfer abroad of property previously used in the United States. Paragraphs (c) through (f) of this section provide rules for determining whether certain types of property are transferred for use in the active conduct of a trade or business outside of the United States. Paragraph (g) excepts certain transfers to FSCs from the operation of section 367(a)(1). The treatment of any transfer of property described in this section shall be determined exclusively under the rules of this section.

(b) *Depreciated property used in the U.S.*—(1) *In general*. If a U.S. person transfers U.S. depreciated property (as defined in paragraph (b)(2) of this section) to a foreign corporation in an exchange described in section 367(a)(1), then that person shall include in its gross income for the taxable year in which the transfer occurs ordinary income equal to the gain realized that would have been includible in the transferor's gross income as ordinary income under section 617(d)(1), 1245(a), 1250(a), 1252(a), or 1254(a), whichever is applicable, if at the time of the transfer the transferor had sold the property at its fair market value. Recapture of depreciation under this paragraph (b) shall be required regardless of whether any exception to section 367(a)(1) (such as the exception for property transferred for use in the active conduct of a foreign trade or business) would otherwise apply to the transfer. However, any applicable exception shall apply with respect to realized gain that is not included in ordinary income pursuant to this paragraph (b).

(2) *U.S. depreciated property*. U.S. depreciated property subject to the rules of this paragraph (b) is any property that—

(i) Is either mining property (as defined in section 617(f)(2)), section 1245 property (as defined in section 1245(a)(3)), section 1250 property (as defined in section 1250(c)), farm land (as defined in section 1252(a)(2)), or oil, gas, or geothermal property (as defined in section 1254(a)(3)); and

(ii) Has been used in the United States or has qualified as section 38 property by virtue of section 48(a)(2)(B) prior to its transfer.

(3) *Property used within and without the U.S.* If U.S. depreciated property