

§ 1.367(b)-3

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(see also § 601.601(d)(2) of this chapter). The term pre-1987 section 960 earnings and profits does not include earnings and profits that represent previously taxed earnings and profits described in section 959.

(7) *Pre-1987 section 960 foreign income taxes.* The term *pre-1987 section 960 foreign income taxes* means the foreign income taxes related to pre-1987 section 960 earnings and profits, determined in accordance with the principles of § 1.902-1(a)(10)(iii), except that the U.S. dollar amounts of pre-1987 section 960 foreign income taxes are determined by reference to the exchange rates in effect when the taxes were paid or accrued.

(8) *Earnings and profits.* For purposes of §§ 1.367(b)-7 and 1.367(b)-9, the term *earnings and profits* means post-1986 undistributed earnings, pre-1987 accumulated profits, and pre-1987 section 960 earnings and profits.

(9) *Pooling corporation.* The term *pooling corporation* means a foreign corporation with respect to which the requirements of section 902(c)(3)(B) have been met in the current taxable year or any prior taxable year.

(10) *Nonpooling corporation.* The term *nonpooling corporation* means a foreign corporation that is not a pooling corporation.

(11) *Separate category.* The term *separate category* has the meaning set forth in section 904(d)(1), and shall also include any other category of income to which section 904(a), (b), and (c) are applied separately under any other provision of the Internal Revenue Code (e.g., sections 56(g)(4)(C)(iii)(IV), 245(a)(10), 865(h), 901(j), and 904(h)(10) (or section 904(g)(10) for taxable years beginning on or before December 31, 2006).

(12) *Passive category.* The term *passive category* means the separate category that includes income described in section 904(d)(1)(A).

(13) *General category.* The term *general category* means the separate category that includes income described in section 904(d)(1)(B) (or section

904(d)(1)(I) for taxable years beginning on or before December 31, 2006).

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§ 1.367(b)-3 Repatriation of foreign corporate assets in certain non-recognition transactions.

(a) *Scope.* This section applies to an acquisition by a domestic corporation (the domestic acquiring corporation) of the assets of a foreign corporation (the foreign acquired corporation) in a liquidation described in section 332 or an asset acquisition described in section 368(a)(1).

(b) *Exchange of stock owned directly by a United States shareholder or by certain foreign corporate shareholders—(1) Scope.* This paragraph (b) applies in the case of an exchanging shareholder that is either—

(i) A United States shareholder of the foreign acquired corporation; or

(ii) A foreign corporation with respect to which there are one or more United States shareholders.

(2) *United States shareholder.* For purposes of this section (and for purposes of the other section 367(b) regulation provisions that specifically refer to this paragraph (b)(2)), the term *United States shareholder* means any shareholder described in section 951(b) (without regard to whether the foreign corporation is a controlled foreign corporation), and also any shareholder described in section 953(c)(1)(A) (but only if the foreign corporation is a controlled foreign corporation as defined in section 953(c)(1)(B) subject to the rules of section 953(c)).

(3) *Income inclusion—(i) Inclusion of all earnings and profits amount.* An exchanging shareholder shall include in income as a deemed dividend the all earnings and profits amount with respect to its stock in the foreign acquired corporation. For the consequences of the deemed dividend, see § 1.367(b)-2(e). Notwithstanding § 1.367(b)-2(e), however, a deemed dividend from the foreign acquired corporation to an exchanging foreign corporate shareholder shall not qualify for the exception from foreign personal

holding company income provided by section 954(c)(3)(A)(i), although it may qualify for the look-through treatment provided by section 904(d)(3) if the requirements of that section are met with respect to the deemed dividend.

(ii) *Examples.* The following examples illustrate the rules of paragraph (b)(3)(i) of this section:

Example 1. (i) *Facts.* DC, a domestic corporation, owns all of the outstanding stock of FC, a foreign corporation. The stock of FC has a value of \$100, and DC has a basis of \$30 in such stock. The all earnings and profits amount attributable to the FC stock owned by DC is \$20, of which \$15 is described in section 1248(a) and the remaining \$5 is not (for example, because it accumulated prior to 1963). FC has a basis of \$50 in its assets. In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled.

(ii) *Result.* Under paragraph (b)(3)(i) of this section, DC must include \$20 in income as a deemed dividend from FC. Under section 337(a) FC does not recognize gain or loss in the assets that it distributes to DC, and under section 334(b), DC takes a basis of \$50 in such assets. Because the requirements of section 902 are met, DC qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FC.

Example 2. (i) *Facts.* DC, a domestic corporation, owns all of the outstanding stock of FC, a foreign corporation. The stock of FC has a value of \$100, and DC has a basis of \$30 in such stock. The all earnings and profits amount attributable to the FC stock owned by DC is \$75. FC has a basis of \$50 in its assets. In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled.

(ii) *Result.* Under paragraph (b)(3)(i) of this section, DC must include \$75 in income as a deemed dividend from FC. Under section 337(a) FC does not recognize gain or loss in the assets that it distributes to DC, and under section 334(b), DC takes a basis of \$50 in such assets. Because the requirements of section 902 are met, DC qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FC.

Example 3. (i) *Facts.* DC, a domestic corporation, owns 80 percent of the outstanding stock of FC, a foreign corporation. DC has owned its 80 percent interest in FC since FC was incorporated. The remaining 20 percent of the outstanding stock of FC is owned by a person unrelated to DC (the minority shareholder). The stock of FC owned by DC has a value of \$80, and DC has a basis of \$24 in such stock. The stock of FC owned by the minority shareholder has a value of \$20, and the

minority shareholder has a basis of \$18 in such stock. FC's only asset is land having a value of \$100, and FC has a basis of \$50 in the land. Gain on the land would not generate earnings and profits qualifying under section 1248(d) for an exclusion from earnings and profits for purposes of section 1248. FC has earnings and profits of \$20 (determined under the rules of § 1.367(b)-2(d)(2) (i) and (ii)), \$16 of which is attributable to the stock owned by DC under the rules of § 1.367(b)-2(d)(3). FC subdivides the land and distributes to the minority shareholder land with a value of \$20 and a basis of \$10. As part of the same transaction, in a liquidation described in section 332, FC distributes the remainder of its land to DC, and the FC stock held by DC and the minority shareholder is canceled.

(ii) *Result.* Under section 336, FC must recognize the \$10 of gain it realizes in the land it distributes to the minority shareholder, and under section 331 the minority shareholder recognizes its gain of \$2 in the stock of FC. Such gain is included in income by the minority shareholder as a dividend to the extent provided in section 1248 if the minority shareholder is a United States person that is described in section 1248(a)(2). Under § 1.367(b)-2(d)(2)(iii), the \$10 of gain recognized by FC increases its earnings and profits for purposes of computing the all earnings and profits amount and, as a result, \$8 of such increase (80 percent of \$10) is considered to be attributable to the FC stock owned by DC under § 1.367(b)-2(d)(3)(i)(A)(i). DC's all earnings and profits amount with respect to its stock in FC is \$24 (the \$16 of initial all earnings and profits amount with respect to the FC stock held by DC, plus the \$8 addition to such amount that results from FC's recognition of gain on the distribution to the minority shareholder). Under paragraph (b)(3)(i) of this section, DC must include the \$24 all earnings and profits amount in income as a deemed dividend from FC.

Example 4. (i) *Facts.* DC1, a domestic corporation, owns all of the outstanding stock of DC2, a domestic corporation. DC1 also owns all of the outstanding stock of FC, a foreign corporation. The stock of FC has a value of \$100, and DC1 has a basis of \$30 in such stock. The assets of FC have a value of \$100. The all earnings and profits amount with respect to the FC stock owned by DC1 is \$20. In a reorganization described in section 368(a)(1)(D), DC2 acquires all of the assets of FC solely in exchange for DC2 stock. FC distributes the DC2 stock to DC1, and the FC stock held by DC1 is canceled.

(ii) *Result.* DC1 must include \$20 in income as a deemed dividend from FC under paragraph (b)(3)(i) of this section. Under section 361, FC does not recognize gain or loss in the assets that it transfers to DC2 or in the DC2 stock that it distributes to DC1, and under section 362(b) DC2 takes a basis in the assets that it acquires from FC equal to the basis

that FC had therein. Under § 1.367(b)-2(e)(3)(ii) and section 358(a)(1), DC1 takes a basis of \$50 (its \$30 basis in the stock of FC, plus the \$20 that was treated as a deemed dividend to DC1) in the stock of DC2 that it receives in exchange for the stock of FC. Under § 1.367(b)-2(e)(3)(iii) and section 312(a), the earnings and profits of FC are reduced by the \$20 deemed dividend.

Example 5. (i) *Facts.* DC1, a domestic corporation, owns all of the outstanding stock of FC1, a foreign corporation. FC1 owns all of the outstanding stock of FC2, a foreign corporation. The all earnings and profits amount with respect to the FC2 stock owned by FC1 is \$20. In a reorganization described in section 368(a)(1)(A), DC2, a domestic corporation unrelated to FC1 or FC2, acquires all of the assets and liabilities of FC2 pursuant to a State W merger. FC2 receives DC2 stock and distributes such stock to FC1. The FC2 stock held by FC1 is canceled, and FC2 ceases its separate legal existence.

(ii) *Result.* FC1 must include \$20 in income as a deemed dividend from FC2 under paragraph (b)(3)(i) of this section. The deemed dividend is treated as a dividend for purposes of the Internal Revenue Code as provided in § 1.367(b)-2(e)(2); however, under paragraph (b)(3)(i) of this section the deemed dividend cannot qualify for the exception from foreign personal holding company income provided by section 954(c)(3)(A)(i), even if the provisions of that section would otherwise have been met in the case of an actual dividend.

Example 6. (i) *Facts.* DC1, a domestic corporation, owns 99 percent of USP, a domestic partnership. The remaining 1 percent of USP is owned by a person unrelated to DC1. DC1 and USP each directly own 9 percent of the outstanding stock of FC, a foreign corporation that is not a controlled foreign corporation subject to the rule of section 953(c). In a reorganization described in section 368(a)(1)(C), DC2, a domestic corporation, acquires all of the assets and liabilities of FC in exchange for DC2 stock. FC distributes to its shareholders DC2 stock, and the FC stock held by its shareholders is canceled.

(ii) *Result.* (A) DC1 and USP are United States persons that are exchanging shareholders in a transaction described in paragraph (a) of this section. As a result, DC1 and USP are subject to the rules of paragraph (b) of this section if they qualify as United States shareholders as defined in paragraph (b)(2) of this section. Alternatively, if they do not qualify as United States shareholders as defined in paragraph (b)(2) of this section, DC1 and USP are subject to the rules of paragraph (c) of this section. Paragraph (b)(2) of this section defines the term United States shareholder to include any shareholder described in section 951(b) (without regard to whether the foreign corporation is a controlled foreign corporation). A shareholder described in section 951(b) is a United States

person that is considered to own, applying the rules of section 958(a) and 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of a foreign corporation. Under section 958(b), the rules of section 318(a), as modified by section 958(b) and the regulations thereunder, apply so that, in general, stock owned directly or indirectly by a partnership is considered as owned proportionately by its partners, and stock owned directly or indirectly by a partner is considered as owned by the partnership. Thus, under section 958(b), DC1 is treated as owning its proportionate share of FC stock held by USP, and USP is treated as owning all of the FC stock held by DC1.

(B) Accordingly, for purposes of determining whether DC1 is a United States shareholder under paragraph (b)(2) of this section, DC1 is considered as owning 99 percent of the 9 percent of FC stock held by USP. Because DC1 also owns 9 percent of FC stock directly, DC1 is considered as owning more than 10 percent of FC stock. DC1 is thus a United States shareholder of FC under paragraph (b)(2) of this section and, as a result, is subject to the rules of paragraph (b) of this section. However, for purposes of determining DC1's all earnings and profits amount, DC1 is not treated as owning the FC stock held by USP. Under § 1.367(b)-2(d)(3), DC1's all earnings and profits amount is determined by reference to the 9 percent of FC stock that it directly owns.

(C) For purposes of determining whether USP is a United States shareholder under paragraph (b)(2) of this section, USP is considered as owning the 9 percent of FC stock held by DC1. Because USP also owns 9 percent of FC stock directly, USP is considered as owning more than 10 percent of FC stock. USP is thus a United States shareholder of FC under paragraph (b)(2) of this section and, as a result, is subject to the rules of paragraph (b) of this section. However, for purposes of determining USP's all earnings and profits amount, USP is not treated as owning the FC shares held by DC1. Under § 1.367(b)-2(d)(3), USP's all earnings and profits amount is determined by reference to the 9 percent of FC stock that it directly owns.

(iii) *Recognition of exchange gain or loss with respect to capital.* [Reserved]

(4) *Reserved.* For further guidance concerning section 367(b) exchanges occurring before February 23, 2001, see § 1.367(b)-3T(b)(4).

(c) *Exchange of stock owned by a United States person that is not a United States shareholder—(1) Scope.* This paragraph (c) applies in the case of an exchanging shareholder that is a United States person not described in paragraph (b)(1)(i) of this section (*i.e.*, a

United States person that is not a United States shareholder of the foreign acquired corporation).

(2) *Requirement to recognize gain.* An exchanging shareholder described in paragraph (c)(1) of this section shall recognize realized gain (but not loss) with respect to the stock of the foreign acquired corporation.

(3) *Election to include all earnings and profits amount.* In lieu of the treatment prescribed by paragraph (c)(2) of this section, an exchanging shareholder described in paragraph (c)(1) of this section may instead elect to include in income as a deemed dividend the all earnings and profits amount with respect to its stock in the foreign acquired corporation. For the consequences of a deemed dividend, see § 1.367(b)-2(e). Such election may be made only if—

(i) The foreign acquired corporation (or its successor in interest) has provided the exchanging shareholder information to substantiate the exchanging shareholder's all earnings and profits amount with respect to its stock in the foreign acquired corporation; and

(ii) The exchanging shareholder complies with the section 367(b) notice requirement described in § 1.367(b)-1(c), including the specific rules contained therein concerning the time and manner for electing to apply the rules of this paragraph (c)(3).

(4) *De minimis exception.* This paragraph (c) shall not apply in the case of an exchanging shareholder whose stock in the foreign acquired corporation has a fair market value of less than \$50,000 on the date of the section 367(b) exchange.

(5) *Examples.* The following examples illustrate the rules of this paragraph (c):

Example 1. (i) *Facts.* DC1, a domestic corporation, owns 5 percent of the outstanding stock of FC, a foreign corporation that is not a controlled foreign corporation subject to the rule of section 953(c). Persons unrelated to DC1 own the remaining 95 percent of the outstanding stock of FC. DC1 has owned its 5 percent interest in FC since FC was incorporated. DC1's stock in FC has a basis of \$40,000 and a value of \$100,000. The all earnings and profits amount with respect to DC1's stock in FC is \$50,000. In a reorganization described in section 368(a)(1)(C), DC2, a domestic corporation, acquires all of the as-

sets and liabilities of FC in exchange for DC2 stock. FC distributes DC2 stock to its shareholders, and the FC stock held by its shareholders is canceled.

(ii) *Alternate result 1.* If DC1 does not make the election described in paragraph (c)(3) of this section, then the general rule of paragraph (c)(2) of this section applies and DC1 must recognize its \$60,000 gain in the FC stock. Under section 358(a)(1), DC1 has a \$100,000 basis (its \$40,000 basis in the FC stock, plus the \$60,000 recognized gain) in the DC2 stock that it receives in exchange for its FC stock. Because DC1 is not a shareholder described in section 1248(a)(2), section 1248 does not apply to recharacterize any of DC1's gain as a dividend.

(iii) *Alternate result 2.* If DC1 makes a valid election under paragraph (c)(3) of this section, then DC1 must include in income as a deemed dividend the \$50,000 all earnings and profits amount with respect to its FC stock. Under § 1.367(b)-2(e)(3) and section 358(a)(1), DC1 has a \$90,000 basis (its \$40,000 basis in the FC stock, plus the \$50,000 that was treated as a deemed dividend to DC1) in the DC2 stock that it receives in exchange for its FC stock. Because DC1 owns less than 10 percent of the voting stock of FC, DC1 does not qualify for a deemed paid foreign tax credit under section 902.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that DC1's stock in FC has a fair market value of \$48,000 on the date DC1 receives the DC2 stock.

(ii) *Result.* Because DC1's stock in FC has a fair market value of less than \$50,000 on the date of the section 367(b) exchange, the de minimis exception of paragraph (c)(4) of this section applies. As a result, DC1 is not subject to the gain or income inclusion requirements of this paragraph (c).

(d) *Carryover of certain foreign taxes—*
(1) *Rule.* Excess foreign taxes under section 904(c) allowable to the foreign acquired corporation under section 906 shall carry over to the domestic acquiring corporation and become allowable under section 901, subject to the limitations prescribed by the Internal Revenue Code (for example, sections 383, 904 and 907). The domestic acquiring corporation shall not succeed to any other foreign taxes paid or incurred by the foreign acquired corporation.

(2) *Example.* The following example illustrates the rules of this paragraph (d):

Example. (i) *Facts.* DC, a domestic corporation owns 100 percent of the outstanding stock of FC, a foreign corporation. FC has net positive earnings and profits, none of which are attributable to DC's FC stock

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under § 1.367(b)-2(d)(3). FC has paid foreign taxes that are not eligible for credit under section 906. In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled.

(ii) *Result.* The liquidation of FC into DC is a section 367(b) exchange. Thus, DC is subject to the section 367(b) regulations, and must file a section 367(b) notice pursuant to § 1.367(b)-1(c). Pursuant to the provisions of paragraph (d)(1) of this section, the foreign taxes paid by FC do not carryover to DC because FC's foreign taxes are not eligible for credit under section 906.

(e) *Net operating loss and capital loss carryovers.* A net operating loss or capital loss carryover of the foreign acquired corporation is described in section 381(c)(1) and (c)(3) and thus is eligible to carry over from the foreign acquired corporation to the domestic acquiring corporation only to the extent the underlying deductions or losses were allowable under chapter 1 of subtitle A of the Internal Revenue Code. Thus, only a net operating loss or capital loss carryover that is effectively connected with the conduct of a trade or business within the United States (or that is attributable to a permanent establishment, in the context of an applicable United States income tax treaty) is eligible to be carried over under section 381. For further guidance, see Rev. Rul. 72-421 (1972-2 C.B. 166) (see also § 601.601(d)(2) of this chapter).

(f) *Carryover of earnings and profits—*
(1) *General rule.* Except to the extent otherwise specifically provided (see, e.g., Notice 89-79 (1989-2 C.B. 392) (see also § 601.601(d)(2) of this chapter)), earnings and profits of the foreign acquired corporation that are not included in income as a deemed dividend under the section 367(b) regulations (or deficit in earnings and profits) are eligible to carry over from the foreign acquired corporation to the domestic acquiring corporation under section 381(c)(2) only to the extent such earnings and profits (or deficit in earnings and profits) are effectively connected with the conduct of a trade or business within the United States (or are attributable to a permanent establishment in the United States, in the context of an applicable United States income tax treaty). All other earnings and profits (or deficit in earnings and profits) of the foreign acquired corporation shall

not carry over to the domestic acquiring corporation and, as a result, shall be eliminated.

(2) *Previously taxed earnings and profits.* [Reserved]

[T.D. 8862, 65 FR 3601, Jan. 24, 2000; 65 FR 66501, Nov. 6, 2000, as amended by T.D. 9243, 71 FR 4288, Jan. 26, 2006; T.D. 9273, 71 FR 44895, Aug. 8, 2006]

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(a)-(b)(3). [Reserved]. For further guidance, see § 1.367(b)-3(a) through (b)(3).

(4) *Election of taxable exchange treatment—*(i) *Rules—*(A) *In general.* In lieu of the treatment prescribed by § 1.367(b)-3(b)(3)(i), an exchanging shareholder described in § 1.367(b)-3(b)(1) may instead elect to recognize the gain (but not loss) that it realizes in the exchange (taxable exchange election). To make a taxable exchange election, the following requirements must be satisfied—

(1) The exchanging shareholder (and its direct or indirect owners that would be affected by the election, in the case of an exchanging shareholder that is a foreign corporation) reports the exchange in a manner consistent therewith (see, e.g., sections 954(c)(1)(B)(i), 1001 and 1248);

(2) The notification requirements of paragraph (b)(4)(i)(C) of this section are satisfied; and

(3) The adjustments described in paragraph (b)(4)(i)(B) of this section are made when the following circumstances are present—

(i) The transaction is described in section 332 or is an asset acquisition described in section 368(a)(1), with regard to which one U.S. person owns (directly or indirectly) 100 percent of the foreign acquired corporation; and

(ii) The all earnings and profits amount described in § 1.367(b)-3(b)(3)(i) with respect to the exchange exceeds the gain recognized by the exchanging shareholder.

(B) *Attribute reduction—*(1) *Reduction of NOL carryovers.* The amount by which the all earnings and profits amount exceeds the gain recognized by the exchanging shareholder (the excess