Example 19. Creditor treated as a shareholder.

(i) Facts. Individuals A and B equally own DC1. The liabilities of DC1 exceed the value of its assets. Pursuant to a plan, FA, a newly formed corporation, acquires substantially all of the properties held by DC1 in exchange solely for FA stock. Pursuant to the plan, the DC1 stock held by individuals A and B is cancelled, and the creditors of DC1 receive all the FA stock in exchange for their claims against DC1.

(ii) Analysis. Because immediately before the first date on which properties are acquired as part of the acquisition described in section 7874(a)(2)(B)(i), the liabilities of DC1 exceed the value of its assets, under paragraph (i)(1) of this section, the class B partnership interests will be treated as FA stock for purposes of section 7874.

Example 20. Conversion to a domestic corporation and application of section 367. (i) Facts. Individuals A and B are United States persons and equally own DC1. Pursuant to a plan, individuals A and B transfer their DC1 stock to FA in exchange solely for 80% of the outstanding FA stock. After the acquisition, the expanded affiliated group that includes FA does not have substantial business activities in Country A when compared to the total business activities of the expanded affiliated group.

(ii) Analysis. Under paragraph (e)(1)(i) of this section, for purposes of section 7874(a)(2)(B)(i), FA is treated as acquiring all of the properties held by DC1 on the date of the stock acquisition. After the acquisition, the former shareholders of DC1 own 80% of the stock of FA by reason of holding DC1 stock. Therefore, FA is considered a surrogate foreign corporation that is treated as a domestic corporation under section 7874(b).
(1) Group employees—(i) Number of employees. The number of group employees based in the relevant foreign country is at least 25 percent of the total number of group employees on the applicable date.

(ii) Employee compensation. The employee compensation incurred with respect to group employees based in the relevant foreign country is at least 25 percent of the total employee compensation incurred with respect to all group employees during the testing period.

(2) Group assets. The value of the group assets located in the relevant foreign country is at least 25 percent of the total value of all group assets on the applicable date.

(3) Group income. The group income derived in the relevant foreign country is at least 25 percent of the total group income during the testing period.

(c) Items not to be considered. The following items are not taken into account in the denominator, for each of the tests described in paragraphs (b)(1) through (b)(3) of this section:

(1) Any group assets, group employees, or group income attributable to business activities that are associated with properties or liabilities the transfer of which is disregarded under section 7874(c)(4).

(2) Any group assets or group employees located in, or group income derived in, the relevant foreign country as part of a plan with a principal purpose of avoiding the purposes of section 7874.

(3) Any group assets or group employees located in, or group income derived in, the relevant foreign country if such group assets or group employees, or the business activities to which such group income is attributable, are subsequently transferred to another country in connection with a plan that existed at the time of the acquisition described in section 7874(a)(2)(B)(i).

(d) Definitions and application of rules. The following definitions and rules apply for purposes of this section:

(1) The term acquisition date means the date on which the acquisition described in section 7874(a)(2)(B)(i) is completed.

(2) The term applicable date means either of the following dates, applied consistently for all purposes of this section:

(i) The acquisition date; or

(ii) The last day of the month immediately preceding the month in which the acquisition described in section 7874(a)(2)(B)(i) is completed.

(3) The term employee compensation means all amounts incurred by members of the expanded affiliated group that directly relate to services performed by group employees (including, for example, wages, salaries, deferred compensation, employee benefits, and employer payroll taxes). Employee compensation is determined in U.S. dollars translated, if necessary, using the weighted average exchange rate (as defined in § 1.980(b)-1) for the testing period.

(4) The term expanded affiliated group means the affiliated group defined in section 7874(c)(1) determined at the close of the acquisition date. The term member of the expanded affiliated group means an entity included in the expanded affiliated group. A reference to a member of the expanded affiliated group includes a predecessor with respect to such member.

(5) The term group assets means tangible personal property or real property used or held for use in the active conduct of a trade or business by members of the expanded affiliated group, provided such property is owned by members of the expanded affiliated group at the close of the acquisition date. A group asset is considered to be located in the relevant foreign country only if the asset was physically present in such country at the close of the acquisition date and for more time than in any other country during the testing period. All group assets must be valued consistently and on a gross basis (that is, not reduced by liabilities) using either the adjusted tax basis or fair market value determined in U.S. dollars translated, if necessary, at the spot rate determined under the principles of § 1.988-1(d)(1), (2), and (4). Tangible personal property or real property that is rented by members of the expanded affiliated group from a person other than a member of the expanded affiliated group is also treated as a group asset.
provided such property is used in the active conduct of a trade or business and is being rented by members of the expanded affiliated group at the close of the acquisition date. For purposes of this section, a group asset is rented if the net annual rent paid or accrued with respect to the property by members of the expanded affiliated group.

(6) The term group employees means employees of members of the expanded affiliated group. A group employee is considered to be based in the relevant foreign country only if the employee spent more time providing services in such country than in any other single country during the testing period.

(7) The term group income means gross income of members of the expanded affiliated group from transactions occurring in the ordinary course of business with customers that are not related persons. Group income is translated into U.S. dollars, if necessary, using the weighted average exchange rate (as defined in §1.989(b)-1) for the testing period. Group income is considered derived in the relevant foreign country only if it is derived from a transaction with a customer located in such country.

(8) The term net annual rent means the annual rent paid or accrued with respect to property, less any payments received or accrued from subleasing such property (or other similar arrangement).

(9) The term related person has the meaning specified in section 954(d)(3), except that section 954(d)(3) is applied by substituting “one or more members of the expanded affiliated group” for “a controlled foreign corporation” and “the controlled foreign corporation” each place they appear.

(10) The term relevant foreign country means the foreign country in which, or under the law of which, the foreign corporation was created or organized.

(11) The term testing period means the one-year period ending on the applicable date.

(e) Treatment of partnerships. For purposes of this section, if one or more members of the expanded affiliated group own, in the aggregate, more than 50 percent (by value) of the interests in a partnership, such partnership will be treated as a corporation that is a member of the expanded affiliated group. Thus, all items of such a partnership are taken into account for purposes of this section. No items of a partnership are taken into account for purposes of this section unless the partnership is treated as a member of the expanded affiliated group pursuant to this paragraph.

(f) Effective/applicability and expiration dates. Except as otherwise provided in this paragraph, this section shall apply to acquisitions that were either described in a filing with the Securities and Exchange Commission on or before June 7, 2012, or that were subject to a written agreement that was binding on June 7, 2012, and at all times thereafter, taxpayers may apply either the rules in §1.7874–2T(g), as contained in 26 CFR part 1 revised as of April 12, 2012, or the rules set forth in this section. The applicability of this section expires on June 5, 2015.

[T.D. 9592, 77 FR 34787, June 12, 2012]

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Source: Sections 1.9000–1 through 1.9000–8 contained in T.D. 6500, 25 FR 12155, Nov. 26, 1960, unless otherwise noted.

§ 1.9000–1 Statutory provisions.

The Act of June 15, 1955 (Pub. L. 74, 84th Cong., 69 Stat. 134), provides as follows:

"Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,"

Sec. 1. Repeal of sections 452 and 462—(a) Prepaid income. Section 452 of the Internal Revenue Code of 1954 is hereby repealed.

(b) Reserves for estimated expenses, etc. Section 462 of the Internal Revenue Code of 1954 is hereby repealed.

Sec. 2. Technical amendments. The following provisions of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) Subsection (c) of section 381 is amended by striking out paragraph (7) (relating to carryover of prepaid income in certain corporate acquisitions).

(2) The table of sections for subpart B of part II of subchapter E of chapter 1 (relating to taxable year for which items of gross income included) is amended by striking out "Sec. 452. Prepaid income."