

the conditions and requirements of section 367(a)(5).

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

(a) through (d)(2)(vi)(A) [Reserved]—For further guidance, see § 1.367(a)-3(a) through (d)(2)(vi)(A).

(B) *Exceptions.* (1) If a transaction is described in paragraph (d)(2)(vi)(A) of this section, section 367(a) and (d) will not apply to the extent a domestic corporation (domestic acquired corporation) transfers assets to a foreign corporation (foreign acquiring corporation) in an asset reorganization, and those assets (re-transferred assets) are transferred to a domestic corporation (domestic controlled corporation) in a controlled asset transfer, provided that each of the following conditions is satisfied:

(i) The domestic controlled corporation's adjusted basis in the re-transferred assets is not greater than the domestic acquired corporation's adjusted basis in those assets. For this purpose, any increase in basis in the re-transferred assets that results because the domestic acquired corporation recognized gain or income with respect to the re-transferred assets in the transaction is not taken into account.

(ii) The domestic acquired corporation includes a statement described in paragraph (d)(2)(vi)(C) of this section with its U.S. income tax return for the taxable year of the transfer; and

(iii) The requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iv), and (c)(6) of this section are satisfied with respect to the indirect transfer of stock in the domestic acquired corporation.

(2) Sections 367(a) and (d) shall not apply to transfers described in paragraph (d)(1)(vi) of this section if 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 adjusted basis in the assets is not greater than the adjusted basis that the U.S. person had in such assets. Any increase in adjusted

basis in the assets that results because the U.S. person recognized gain or income with respect to such assets in the initial section 351 exchange is not taken into account for purposes of determining whether the domestic transferee's adjusted basis in the assets is not greater than the U.S. person's adjusted basis in such assets. This paragraph (d)(2)(vi)(B)(2) will not, however, apply to an exchange described in section 351 that is also an exchange described in section 361(a) or (b). An exchange described in section 351 that is also an exchange described in section 361(a) or (b) is only eligible for the exception in paragraph (d)(2)(vi)(B)(1) of this section.

(C) through (d)(3), *Example 6A* [Reserved] For further guidance, see § 1.367(a)-3(d)(2)(vi)(C) through (d)(3), *Example 6A*.

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 paragraph (d)(3), *Example 6A* of this section, except that R is a domestic corporation.

(ii) *Result.* As in paragraph (d)(3) *Example 6A* of this section, the outbound transfer of the Business A assets to F is not affected by the rules of § 1.367-3(d) and is subject to the general rules under section 367. Subject to the conditions and requirements of section 367(a)(5) and § 1.367(a)-7(c), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a)(1). The Business B and C assets are part of an indirect stock transfer under § 1.367-3(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)(1) 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 not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iv), and (c)(6) of this section are satisfied, and Z attaches a statement described in paragraphs (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. 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, and assuming the other requirements of paragraph (c) of this section are satisfied, V must enter into a gain recognition agreement in the amount of \$50, which equals the aggregate gain in the

Business B and C assets, because the transfer of those assets by Z was not taxable under section 367(a)(1) and constitute 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, gain must be recognized on the transfer of those assets under section 367(a)(1) because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5) and §1.367(a)-7(b). The Business B and C assets are part of an indirect stock transfer under paragraph (d) of this section, 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) and §1.367(a)-7(b). 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. 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)(2)(vi)(B) of this section, the indirect transfer of Z stock satisfies the requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(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), (c)(1)(ii), and (c)(1)(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 paragraph (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 through Example 8(C) [Reserved] For further guidance, see §1.367(a)-3(d)(3), *Example 7 through (d)(3), Example 8(C)*.

Example 9. Indirect stock transfer by reason of a controlled asset transfer—(i) Facts. The facts are the same as in paragraph (d)(3) *Example 8* of this section, 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 if M's basis in the Business A assets is not greater than the basis of the assets in the hands of Z, the requirements of paragraphs (c)(1)(i), (c)(1)(ii), (c)(1)(iv), and (c)(6) of this section are satisfied, and Z includes a statement described in paragraph (d)(2)(vi)(C) of this section with its U.S. income tax return for the taxable year of the transfer. Subject to the conditions and requirements of section 367(a)(5) and §1.367(a)-7(c), Z's transfer of the Business B assets to R (which are not re-transferred to M) qualifies for the active trade or business exception under section 367(a)(3). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(I) 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 gain recognition agreement and comply with the requirements of §1.367(a)-8. However, pursuant to paragraph (d)(2)(vii)(B), paragraph (d)(2)(vii)(A) 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 stock of a domestic corporation 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 gain recognition agreement (separate from the gain recognition agreement described above with respect to the deemed transfer of stock of a foreign corporation to F) and comply with the requirements of §1.367(a)-8. Under paragraphs (d)(2)(i) and (d)(2)(ii) of this section, the transferee foreign corporation is F and the transferred corporation is R (with respect to the transfer of stock of a foreign corporation) and M (with respect to the transfer of stock of a domestic corporation). Pursuant to paragraph (d)(2)(iv) of this section, a disposition by F of the stock of R would trigger both gain recognition agreements. In addition, a disposition by R of the stock of M would trigger the gain recognition agreement filed with respect to the transfer of the stock of a domestic corporation. To determine whether there is a triggering event under §1.367(a)-8(j)(2)(i) for the gain recognition agreement filed with respect to the transfer of stock of the domestic corporation, the Business A assets in M must be considered. To determine whether there is such a triggering event for the gain recognition agreement filed with respect to the transfer of stock of the foreign corporation, the Business B assets in R must be considered.

Example 10 through Example 16 [Reserved] For further guidance, see §1.367(a)-3(d)(3), *Example 10 through Example 16*.

(e) *Transfers of stock or securities by a domestic corporation to a foreign corporation in a section 361 exchange*—(1) *Overview*—(i) *Scope and definitions*. This paragraph (e) applies to a domestic corporation (U.S. transferor) that transfers stock or securities of a domestic or foreign corporation (transferred stock or securities) to a foreign corporation (foreign acquiring corporation) in a section 361 exchange. Except as otherwise provided in this paragraph (e), paragraphs (b) and (c) of this section do not apply to the U.S. transferor's transfer of the transferred stock or securities in the section 361 exchange. For purposes of this paragraph (e), the

definitions of *control group*, *control group member*, and *non-control group member* in §1.367(a)-7(f)(1), *ownership interest percentage* in §1.367(a)-7(f)(7), *section 361 exchange* in §1.367(a)-7(f)(8), and *U.S. transferor shareholder* in §1.367(a)-7(f)(13), shall apply.

(ii) *Ordering rules*. Except as otherwise provided, this paragraph (e) shall apply to the transfer of the transferred stock or securities in the section 361 exchange prior to the application of any other provision of section 367 to such transfer. Furthermore, any gain recognized (including gain treated as a deemed dividend pursuant to section 1248(a)) by the U.S. transferor under this paragraph (e) shall be taken into account for purposes of applying any other provision of section 367 (including §§1.367(a)-6T, 1.367(a)-7, and 1.367(b)-4) to the transfer of the transferred stock or securities.

(2) *General rule*. Except as provided in paragraph (e)(3) of this section, the transfer by the U.S. transferor of the transferred stock or securities to the foreign acquiring corporation in the section 361 exchange shall be subject to section 367(a)(1), and therefore the U.S. transferor shall recognize any gain (but not loss) realized with respect to the transferred stock or securities. Realized gain is recognized pursuant to the prior sentence notwithstanding that the transfer is described in any other nonrecognition provision enumerated in section 367(a)(1) (such as section 351 or 354).

(3) *Exception*. The general rule of paragraph (e)(2) of this section shall not apply if the conditions of paragraphs (e)(3)(i), (e)(3)(ii), and (e)(3)(iii) of this section are satisfied.

(i) The conditions set forth in §1.367(a)-7(c) are satisfied with respect to the section 361 exchange.

(ii) If the transferred stock or securities are of a domestic corporation, the U.S. target company (as defined in paragraph (c)(1) of this section) complies with the reporting requirements of paragraph (c)(6) of this section, and the conditions of paragraphs (c)(1)(i), (c)(1)(ii), and (c)(1)(iv) of this section are satisfied with respect to the transferred stock or securities.

(iii) If the U.S. transferor owns (applying the attribution rules of section

318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the transfer of the transferred stock or securities in the section 361 exchange, then the conditions set forth in paragraphs (e)(3)(iii)(A), (e)(3)(iii)(B), and (e)(3)(iii)(C) of this section are satisfied.

(A) Except as otherwise provided in this paragraph (e)(3)(iii)(A), each U.S. transferor shareholder that is a qualified U.S. person (as defined in paragraph (e)(6)(vii) of this section) owning (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of the transferee foreign corporation immediately after the reorganization enters into a gain recognition agreement that satisfies the conditions of paragraph (e)(6) of this section and §1.367(a)-8. A U.S. transferor shareholder is not required to enter into a gain recognition agreement pursuant to this paragraph if the amount of gain that would be subject to the gain recognition agreement (as determined under paragraph (e)(6)(i) of this section) is zero.

(B) With respect to non-control group members that are not described in paragraph (e)(3)(iii)(A) of this section, the U.S. transferor recognizes gain equal to the product of the aggregate ownership interest percentage of such non-control group members multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities.

(C) With respect to each control group member that is not described in paragraph (e)(3)(iii)(A) of this section, the U.S. transferor recognizes gain equal to the product of the ownership interest percentage of such control group member multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities.

(4) *Application of certain rules at U.S. transferor-level.* For purposes of paragraphs (c)(5)(iii), (e)(3)(ii), and (e)(3)(iii) of this section, ownership of the stock of the transferee foreign corporation is determined by reference to stock

owned by the U.S. transferor immediately after the transfer of the transferred stock or securities to the foreign acquiring corporation in the section 361 exchange, but prior to and without taking into account the U.S. transferor's distribution under section 361(c)(1) of the stock received.

(5) *Transferee foreign corporation*—(i) *General rule.* Except as provided in paragraph (e)(5)(ii) of this section, the transferee foreign corporation for purposes of applying paragraph (e) of this section and §1.367(a)-8 shall be the foreign corporation that issues stock or securities to the U.S. transferor in the section 361 exchange.

(ii) *Special rule for triangular asset reorganizations involving the receipt of stock or securities of a domestic corporation.* In the case of a triangular asset reorganization described in §§1.358-6(b)(2)(i), (b)(2)(ii) or (b)(2)(iii), or §1.358-6(b)(2)(v) (triangular asset reorganization) in which the U.S. transferor receives stock or securities of a domestic corporation that is in control (within the meaning of section 368(c)) of the foreign acquiring corporation, the transferee foreign corporation shall be the foreign acquiring corporation.

(6) *Special requirements for gain recognition agreements.* A gain recognition agreement filed by a U.S. transferor shareholder pursuant to paragraph (e)(3)(iii)(A) of this section is, in addition to the terms and conditions of §1.367(a)-8, subject to the conditions of this section (e)(6).

(i) The amount of gain subject to the gain recognition agreement shall equal the product of the ownership interest percentage of the U.S. transferor shareholder multiplied by the gain realized by the U.S. transferor on the transfer of the transferred stock or securities, reduced (but not below zero) by the sum of the amounts described in paragraphs (e)(6)(i)(A), (e)(6)(i)(B), (e)(6)(i)(C), and (e)(6)(i)(D) of this section.

(A) Gain recognized by the U.S. transferor with respect to the transferred stock or securities under section 367(a)(1) (including any portion treated as a deemed dividend under section 1248(a)) that is attributable to such U.S. transferor shareholder pursuant to §1.367(a)-7(c)(2) or §1.367(a)-7(e)(5).

(B) A deemed dividend included in the income of the U.S. transferor with respect to the transferred stock under § 1.367(b)-4(b)(1)(i) that is attributable to such U.S. transferor shareholder pursuant to § 1.367(a)-(e)(4).

(C) If the U.S. transferor shareholder is subject to an election under § 1.1248(f)-2(c)(1), a deemed dividend included in the income of the U.S. transferor pursuant to § 1.1248(f)-2(c)(3) that is attributable to the U.S. transferor shareholder.

(D) If the U.S. transferor shareholder is not subject to an election under § 1.1248(f)-2(c)(1), the hypothetical section 1248 amount (as defined in § 1.1248(f)-1(c)(4)) with respect to the stock of each foreign corporation transferred in the section 361 exchange attributable to the U.S. transferor shareholder.

(ii) The gain recognition agreement shall include the election described in § 1.367(a)-8(c)(2)(vi).

(iii) The gain recognition agreement shall designate the U.S. transferor shareholder as the U.S. transferor for purposes of § 1.367(a)-8.

(iv) If the transfer of the transferred stock or securities in the section 361 exchange is pursuant to a triangular asset reorganization, the gain recognition agreement shall include appropriate provisions that are consistent with the principles of § 1.367(a)-8 for gain recognition agreements involving multiple parties. See § 1.367(a)-8(j)(9).

(v) The gain recognition agreement shall not be eligible for termination upon a taxable disposition pursuant to § 1.367(a)-8(o)(1) unless the value of the stock or securities received by the U.S. transferor shareholder in exchange for the stock or securities of the U.S. transferor under section 354 or 356 is at least equal to the amount of gain subject to the gain recognition agreement filed by such U.S. transferor shareholder.

(vi) Except as otherwise provided in this paragraph (e)(6)(vi), if gain is subsequently recognized by the U.S. transferor shareholder under the terms of the gain recognition agreement pursuant to § 1.367(a)-8(c)(1)(i), the increase in stock basis provided under § 1.367(a)-8(c)(4)(i) with respect to the stock received by the U.S. transferor share-

holder shall not exceed the amount of the stock basis adjustment made pursuant to § 1.367(a)-7(c)(3) with respect to the stock received by the U.S. transferor shareholder. This paragraph (e)(6)(vi) shall not apply if the U.S. transferor shareholder and the U.S. transferor are members of the same consolidated group at the time of the reorganization.

(vii) For purposes of this section, a *qualified U.S. person* means a U.S. person, as defined in § 1.367(a)-1T(d)(1), but for this purpose does not include domestic partnerships, regulated investment companies (as defined in section 851(a)), real estate investment trusts (as defined in section 856(a)), and S corporations (as defined in section 1361(a)).

(7) *Gain subject to section 1248(a)*. If the U.S. transferor recognizes gain under paragraphs (e)(3)(iii)(B) or (e)(3)(iii)(C) of this section with respect to transferred stock that is stock in a foreign corporation to which section 1248(a) applies, then the portion of such gain treated as a deemed dividend under section 1248(a) is the product of the amount of the gain multiplied by the section 1248(a) ratio. The section 1248(a) ratio is the ratio of the amount that would be treated as a deemed dividend under section 1248(a) if all the gain in the transferred stock were recognized to the amount of gain realized in all the transferred stock.

(8) *Examples*. The following examples illustrate the provisions of paragraph (e) of this section. Except as otherwise indicated: US1, US2, and UST are domestic corporations that are not members of a consolidated group; X is a United States citizen; US1, US2, and X are unrelated parties; CFC1, CFC2, and FA are foreign corporations; each corporation described herein has a single class of stock issued and outstanding and a tax year ending on December 31; the section 1248 amount (within the meaning of § 1.367(b)-2(c)) with respect to the stock of CFC1 and CFC2 is zero; Asset A is section 367(a) property that, but for the application of section 367(a)(5), would qualify for the active foreign trade or business exception under § 1.367(a)-2T; the requirements of § 1.367(a)-7(c)(2) through 1.367(a)-7(c)(5) are satisfied with respect to a section 361 exchange; the provisions of

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§ 1.367(a)-6T (regarding branch loss recapture) are not applicable; and none of the foreign corporations in the examples is a surrogate foreign corporation (within the meaning of section 7874) as a result of the transactions described in the examples because one or more of the conditions of section 7874(a)(2)(B) is not satisfied.

Example 1. U.S. transferor owns less than 5% of stock of transferee foreign corporation. (i) *Facts.* US1, US2, and X own 80%, 5%, and 15%, respectively, of the stock of UST with a fair market value of \$160x, \$10x, and \$30x, respectively. UST has two assets, Asset A and 100% of the stock of CFC1. UST has no liabilities. Asset A has a \$150x basis and \$100x fair market value (as defined in § 1.367(a)-7(f)(3)), and the CFC1 stock has a \$0x basis and \$100x fair market value. UST transfers Asset A and the CFC1 stock to FA solely in exchange for \$200x of FA voting stock in a reorganization described in section 368(a)(1)(C). UST's transfer of Asset A and the CFC1 stock to FA qualifies as a section 361 exchange. UST distributes the FA stock received in the section 361 exchange to US1, US2, and X pursuant to the plan of reorganization, and liquidates. US1 receives \$160x of FA stock, US2 receives \$10x of FA stock, and X receives \$30x of FA stock in exchange for the UST stock. Immediately after the transfer of Asset A and the CFC1 stock to FA in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST does not own (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or the total value of the stock of FA.

(ii) *Result.* (A) UST's transfer of the CFC1 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (e)(1)(ii) of this section. Pursuant to the general rule of paragraph (e)(2) of this section, UST must recognize the gain realized of \$100x on the transfer of the CFC1 stock (computed as the excess of the \$100x fair market value over the \$0x basis) unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. In this case, the requirements of paragraph (e)(3) of this section are satisfied. First, the requirement of paragraph (e)(3)(i) of this section is satisfied because the control requirement of § 1.367(a)-7(c)(1) is satisfied, and a stated assumption is that the requirements of §§ 1.367(a)-7(c)(2) through 1.367(a)-7(c)(5) will be satisfied. The control requirement is satisfied because US1 and US2, each a control group member, own in the aggregate

85% of the stock of UST immediately before the reorganization. Second, the requirement of paragraph (e)(3)(ii) of this section is not applicable because that paragraph applies to the transfer of stock of a domestic corporation and CFC1 is a foreign corporation. Third, paragraph (e)(3)(iii) of this section is not applicable because immediately after the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST does not own (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or the total value of the stock of FA. See paragraph (e)(4) of this section. Accordingly, UST does not recognize the \$100x of gain realized in the CFC1 stock pursuant to this section.

(B) In order to meet the requirements of § 1.367(a)-7(c)(2)(i), UST must recognize gain equal to the portion of the inside gain (as defined in § 1.367(a)-7(f)(5)) attributable to non-control group members (X), or \$7.50x. The \$7.50x of gain is computed as the product of the inside gain (\$50x) multiplied by X's ownership interest percentage in UST (15%). Pursuant to § 1.367(a)-7(f)(5), the \$50x of inside gain is the amount by which the aggregate fair market value (\$200x) of the section 367(a) property (as defined in § 1.367(a)-7(f)(10), or Asset A and the CFC1 stock) exceeds the sum of the inside basis (\$150x) of such property and the product of the section 367(a) percentage (as defined in § 1.367(a)-7(f)(9), or 100%) multiplied by UST's deductible liabilities (as defined in § 1.367(a)-7(f)(2), or \$0x). Pursuant to § 1.367(a)-7(f)(4), the inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange (\$150x), increased by any gain or deemed dividends recognized by UST with respect to the section 367(a) property under section 367 (\$0x), but not including the \$7.50x of gain recognized by UST under § 1.367(a)-7(c)(2)(i). Pursuant to § 1.367(a)-7(e)(1), the \$7.50x of gain recognized by UST is treated as recognized with respect to the CFC1 stock and Asset A in proportion to the amount of gain realized in each. However, because there is no gain realized by UST with respect to Asset A, all \$7.50x of the gain is allocated to the CFC1 stock. Furthermore, FA's basis in the CFC1 stock, as determined under section 362 is increased by the \$7.50x of gain recognized by UST. See § 1.367(a)-1(b)(4)(i)(B).

(C) The requirement to recognize gain under § 1.367(a)-7(c)(2)(ii) is not applicable because the portion of the inside gain attributable to US1 and US2 (control group members) can be preserved in the stock received by each such shareholder. As described in paragraph (ii)(B) of this *Example 1*, the inside gain is \$50x. US1's attributable inside gain of \$40x (equal to the product of \$50x inside gain multiplied by US1's 80% ownership interest

percentage, reduced by \$0x, the sum of the amounts described in §1.367(a)-7(c)(2)(ii)(A)(I) through (c)(2)(ii)(A)(3)) does not exceed \$160x (equal to the product of the section 367(a) percentage of 100% multiplied by \$160x fair market value of FA stock received by US1). Similarly, US2's attributable inside gain of \$2.50x (equal to the product of \$50x inside gain multiplied by US2's 5% ownership interest percentage, reduced by \$0x, the sum of the amounts described in §1.367(a)-7(c)(2)(ii)(A)(I) through (c)(2)(ii)(A)(3)) does not exceed \$10x (equal to the product of the section 367(a) percentage of 100% multiplied by \$10x fair market value of FA stock received by US2).

(D) Each control group member (US1 and US2) must separately compute any required adjustment to stock basis under §1.367(a)-7(c)(3).

Example 2. U.S. transferor owns 5% or more of the stock of the transferee foreign corporation. (i) *Facts.* The facts are the same as in *Example 1*, except that immediately after the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock pursuant to section 361(c)(1), UST owns (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or value of the stock of FA. Furthermore, immediately after the reorganization, US1 and X (but not US2) each own (applying the attribution rules of section 318, as modified by section 958(b)) five percent or more of the total voting power or value of the stock of FA.

(ii) *Result.* (A) As is the case with *Example 1*, UST's transfer of the CFC1 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (e)(1)(ii) of this section. In addition, UST must recognize the gain realized of \$100x on the transfer of the CFC1 stock (computed as the excess of the \$100x fair market value over the \$0x basis) unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. For the same reasons provided in *Example 1*, the requirement in paragraph (e)(3)(i) of this section is satisfied and the requirement of paragraph (e)(3)(ii) of this section is not applicable.

(B) Unlike *Example 1*, however, UST owns 5% or more of the voting power or value of the stock of FA immediately after the transfer of the CFC1 stock in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock under section 361(c)(1). As a result, paragraph (e)(3)(iii) of this section is applicable to the section 361 exchange of the CFC1 stock. Accordingly, in order to meet the requirements of paragraph (e)(3)(iii)(A) of this section US1 and X must enter into gain recognition

agreements that satisfy the requirements of paragraph (e)(6) of this section and §1.367(a)-8. See paragraph (ii)(G) of this *Example 2* for the computation of the amount of gain subject to each gain recognition agreement.

(C) In order to meet the requirements of paragraph (e)(3)(iii)(C) of this section, UST must recognize \$5x of gain attributable to US2 (computed as the product of the \$100x of gain realized with respect to the transfer of the CFC1 stock multiplied by the 5% ownership interest percentage of US2). The \$5x of gain recognized is not included in the computation of inside basis (see §1.367(a)-7(f)(4)(i)), but reduces (but not below zero) the amount of gain recognized by UST pursuant to §1.367(a)-7(c)(2)(ii) that is attributable to US2. Furthermore, FA's basis in the CFC1 stock as determined under section 362 is increased for the \$5x of gain recognized. See §1.367(a)-1(b)(4)(i)(B). Assuming US1 and X enter into the gain recognition agreements described in paragraph (ii)(B) of this *Example 2*, and UST recognizes the \$5x of gain described in this example, the requirements of paragraph (e)(3) are satisfied and, accordingly, UST does not recognize the remaining \$95x of gain realized in the CFC1 stock pursuant to this section.

(D) As described in paragraph (ii)(B) of *Example 1*, UST must recognize \$7.50x of gain pursuant to §1.367(a)-7(c)(2)(i), the amount of the \$50x of inside gain attributable to X. Pursuant to §1.367(a)-7(e)(1), the \$7.50x of gain recognized by UST is treated as recognized with respect to the CFC1 stock and Asset A in proportion to the amount of gain realized in each. However, because there is no gain realized by UST with respect to Asset A, all \$7.50x of the gain is allocated to the CFC1 stock. Furthermore, FA's basis in the CFC1 stock as determined under section 362 is increased for the \$7.50x of gain recognized. See §1.367(a)-1(b)(4)(i)(B).

(E) As described in paragraph (ii)(C) of *Example 1*, the requirement to recognize gain pursuant to §1.367(a)-7(c)(2)(ii) is not applicable because the attributable inside gain of US1 and US2 can be preserved in the stock received by each shareholder. However, if UST were required to recognize gain pursuant to §1.367(a)-7(c)(2)(ii) for inside gain attributable to US2 (for example, if US2 received solely cash rather than FA stock in the reorganization), the amount of such gain would be reduced (but not below zero) by the amount of gain recognized by UST pursuant to paragraph (e)(3)(iii)(C) of this section that is attributable to US2 (computed as \$5x in paragraph (ii)(C) of this *Example 2*). See §1.367(a)-7(c)(2)(ii)(A)(I).

(F) Each control group member (US1 and US2) must separately compute any required adjustment to stock basis under §1.367(a)-7(c)(3).

(G) The amount of gain subject to the gain recognition agreement filed by each of US1 and X is determined pursuant to paragraph (e)(6)(i) of this section. With respect to US1, the amount of gain subject to the gain recognition agreement is \$80x. The \$80x is computed as the product of US1's ownership interest percentage (80%) multiplied by the gain realized by UST in the CFC1 stock as determined prior to taking into account the application of any other provision of section 367 (\$100x), reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (e)(6)(i)(D) of this section attributable to US1 (\$0x). With respect to X, the amount of gain subject to the gain recognition agreement is \$7.50x. The \$7.50x is computed as the product of X's ownership interest percentage (15%) multiplied by the gain realized by UST in the CFC1 stock as determined prior to taking into account the application of any other provision of section 367 (\$100x), reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A) through (e)(6)(i)(D) of this section attributable to X (\$7.50x, as computed in paragraph (ii)(D) of this *Example 2*).

(H) In order to meet the requirements of paragraph (e)(6)(ii) of this section, each gain recognition agreement must include the election described in §1.367(a)-8(c)(2)(vi). Furthermore, pursuant to paragraph (e)(6)(iii) of this section, US1 and X must be designated as the U.S. transferor on their respective gain recognition agreements for purposes of §1.367(a)-8.

Example 3. U.S. transferor owns 5% or more of the stock of the transferee foreign corporation; interaction with section 1248(f). (i) *Facts.* US1, US2, and X own 50%, 30%, and 20%, respectively, of the stock of UST. The UST stock owned by US1 has a \$180x basis and \$200x fair market value; the UST stock owned by US2 has a \$100x basis and \$120x fair market value; and the UST stock owned by X has a \$80x fair market value. UST owns Asset A, and all the stock of CFC1 and CFC2. UST has no liabilities. Asset A has a \$10x basis and \$200x fair market value. The CFC1 stock is a single block of stock (as defined in §1.1248(f)-1(c)(2)) with a \$20x basis, \$40x fair market value, and \$30x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount (as defined in §1.1248(f)-1(c)(9)) is \$20x). The CFC2 stock is also a single block of stock with a \$30x basis, \$160x fair market value, and \$150x of earnings and profits attributable to it for purposes of section 1248 (with the result that the section 1248 amount is \$130x). On December 31, Year 3, in a reorganization described in section 368(a)(1)(D), UST transfers the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for 60 shares of FA stock with a \$400x fair market value. UST's transfer of the CFC1 stock, CFC2 stock, and Asset A to FA in exchange for the

60 shares of FA stock qualifies as a section 361 exchange. UST distributes the FA stock received in the section 361 exchange to US1, US2, and X pursuant to section 361(c)(1). US1, US2, and X exchange their UST stock for 30, 18, and 12 shares, respectively, of FA stock pursuant to section 354. Immediately after the reorganization, FA has 100 shares of stock outstanding, and US1 and US2 are each a section 1248 shareholder with respect to FA.

(ii) *Result.* (A) UST's transfer of the CFC1 stock and CFC2 stock to FA in the section 361 exchange is subject to the provisions of this paragraph (e), and this paragraph (e) applies to the transfer of the CFC1 stock and CFC2 stock prior to the application of any other provision of section 367 to such transfer. See paragraphs (e)(1)(i) and (e)(1)(ii) of this section. Pursuant to the general rule of paragraph (e)(2) of this section, UST must recognize the gain realized of \$20x on the transfer of the CFC1 stock (the excess of \$40x fair market value over \$20x basis) and the gain realized of \$130x on the transfer of the CFC2 stock (the excess of \$160x fair market value over \$30x basis), subject to the application of section 1248(a), unless the requirements for the exception provided in paragraph (e)(3) of this section are satisfied. In this case, the requirement of paragraph (e)(3)(i) of this section is satisfied because the control requirement of §1.367(a)-7(c)(1) is satisfied, and a stated assumption is that the requirements of §§1.367(a)-7(c)(2) through 1.367(a)-7(c)(5) will be satisfied. The control requirement is satisfied because US1 and US2, each a control group member, own in the aggregate 80% of the UST stock immediately before the reorganization. The requirement of paragraph (e)(3)(ii) of this section is not applicable because that paragraph applies to the transfer of stock of a domestic corporation, and CFC1 and CFC2 are foreign corporations. UST owns 5% or more of the total voting power or value of the stock of FA (60%, or 60 of the 100 shares of FA stock outstanding) immediately after the transfer of the CFC1 stock and CFC2 stock in the section 361 exchange, but prior to and without taking into account UST's distribution of the FA stock under section 361(c)(1). As a result, paragraph (e)(3)(iii) of this section is applicable to the section 361 exchange of the CFC1 stock and CFC2 stock. US1, US2, and X each own (applying the attribution rules of section 318, as modified by section 958(b)) 5% or more of the total voting power or value of the FA stock immediately after the reorganization, or 30%, 18%, and 12%, respectively. Accordingly, in order to meet the requirements of paragraph (e)(3)(iii)(A) of this section, US1 and US2 must enter into gain recognition agreements with respect to the CFC1 stock and CFC2 stock that satisfy the requirements of paragraph (e)(6) of this section and §1.367(a)-8. X is not required to

enter into a gain recognition agreement because the amount of gain that would be subject to the gain recognition agreement is zero. See paragraph (ii)(J) of this *Example 3* for the computation of the amount of gain subject to each gain recognition agreement. Assuming US1 and US2 enter into the gain recognitions agreements described above, the requirements of paragraph (e)(3) are satisfied and accordingly, UST does not recognize the gain realized of \$20x in the stock of CFC1 or the gain realized of \$130x in the stock of CFC2 pursuant to this section.

(B) UST's transfer of the CFC1 stock and CFC2 stock to FA pursuant to the section 361 exchange is subject to §1.367(b)-4(b)(1)(i), which applies prior to the application of §1.367(a)-7(c). See paragraph (e)(1) of this section. UST (the exchanging shareholder) is a U.S. person and a section 1248 shareholder with respect to CFC1 and CFC2 (each a foreign acquired corporation). However, UST is not required to include in income as a deemed dividend the section 1248 amount with respect to the CFC1 stock (\$20x) or CFC2 stock (\$130x) under §1.367(b)-4(b)(1)(i) because, immediately after UST's section 361 exchange of the CFC1 stock and CFC2 stock for FA stock (and before the distribution of the FA stock to US1, US2, and X under section 361(c)(1), FA, CFC1, and CFC2 are controlled foreign corporations as to which UST is a section 1248 shareholder. See §1.367(b)-4(b)(1)(ii)(A). However, if UST were required to include in income as a deemed dividend the section 1248 amount with respect to the CFC1 stock or CFC2 stock (for example, if FA were not a controlled foreign corporation), such deemed dividend would be taken into account prior to the application of §1.367(a)-7(c). Furthermore, because US1, US2, and X are all persons described in paragraph (e)(3)(iii)(A) of this section, any such deemed dividend would increase inside basis. See §1.367(a)-7(f)(4).

(C) In order to meet the requirements of §1.367(a)-7(c)(2)(i), UST must recognize gain equal to the portion of the inside gain attributable to non-control group members (X), or \$68x. The \$68x of gain is computed as the product of the inside gain (\$340x) multiplied by X's ownership interest percentage in UST (20%), reduced (but not below zero) by \$0x, the sum of the amounts described in §1.367(a)-7(c)(2)(i)(A) through (c)(2)(i)(C). Pursuant to §1.367(a)-7(f)(5), the \$340x of inside gain is the amount by which the aggregate fair market value (\$400x) of the section 367(a) property (Asset A, CFC1 stock, and CFC2 stock) exceeds the sum of the inside basis (\$60x) and \$0x (the product of the section 367(a) percentage (100%) multiplied by UST's deductible liabilities (\$0x)). Pursuant to §1.367(a)-7(f)(4), the inside basis equals the aggregate basis of the section 367(a) property transferred in the section 361 exchange (\$60x), increased by any gain or deemed divi-

dends recognized by UST with respect to the section 367(a) property under section 367 (\$0x), but not including the \$68x of gain recognized by UST under §1.367(a)-7(c)(2)(i). Under §1.367(a)-7(e)(1), the \$68x gain recognized is treated as being with respect to the CFC1 stock, CFC2 stock, and Asset A in proportion to the amount of gain realized by UST on the transfer of the property. The amount treated as recognized with respect to the CFC1 stock is \$4x (\$68x gain multiplied by $\frac{20x}{\$340x}$). The amount treated as recognized with respect to the CFC2 stock is \$26x (\$68x gain multiplied by $\frac{130x}{\$340x}$). The amount treated as recognized with respect to Asset A is \$38x (\$68x gain multiplied by $\frac{190x}{\$340x}$). Under section 1248(a), UST must include in gross income as a dividend the \$4x gain recognized with respect to the CFC1 stock and the \$26x gain recognized with respect to CFC2 stock. Furthermore, FA's basis in the CFC1 stock, CFC2 stock, and Asset A, as determined under section 362, is increased by the amount of gain recognized by UST with respect to such property. See §1.367(a)-1(b)(4)(i)(B). Thus, FA's basis in the CFC1 stock is \$24x (\$20x increased by \$4x of gain), the CFC2 stock is \$56x (\$30x increased by \$26x of gain), and Asset A is \$48x (\$10x increased by \$38x of gain).

(D) The requirement to recognize gain under §1.367(a)-7(c)(2)(ii) is not applicable because the portion of the inside gain attributable to US1 and US2 (control group members) can be preserved in the stock received by each such shareholder. As described in paragraph (ii)(C) of this *Example 3*, the inside gain is \$340x. US1's attributable inside gain of \$170x (equal to the product of \$340x inside gain multiplied by US1's 50% ownership interest percentage, reduced by \$0x, the sum of the amounts described in §1.367(a)-7(c)(2)(i)(A)(1) through (c)(2)(ii)(A)(3)) does not exceed \$200x (equal to the product of the section 367(a) percentage of 100% multiplied by \$200x fair market value of FA stock received by US1). Similarly, US2's attributable inside gain of \$102x (equal to the product of \$340x inside gain multiplied by US2's 30% ownership interest percentage, reduced by \$0x, the sum of the amounts described in §1.367(a)-7(c)(2)(i)(A)(1) through (c)(2)(ii)(A)(3)) does not exceed \$120x (equal to the product of the section 367(a) percentage of 100% multiplied by \$120x fair market value of FA stock received by US2).

(E) Each control group member (US1 and US2) separately computes any required adjustment to stock basis under §1.367(a)-7(c)(3). US1's section 358 basis in the FA stock received of \$180x (equal to US1's basis in the UST stock exchanged) is reduced to preserve the attributable inside gain with respect to US1, less any gain recognized with respect to US1 under §1.367(a)-7(c)(2)(ii). Because UST does not recognize gain on the section 361 exchange with respect to US1

under § 1.367(a)-7(c)(2)(ii) (as determined in paragraph (ii)(D) of this *Example 3*), the attributable inside gain of \$170x with respect to US1 is not reduced under § 1.367(a)-7(c)(3)(i)(A). US1's outside gain (as defined in § 1.367(a)-7(f)(6)) in the FA stock is \$20x, the product of the section 367(a) percentage (100%) multiplied by the \$20x gain (equal to the difference between \$200x fair market value and \$180x section 358 basis in the FA stock). Thus, US1's \$180x section 358 basis in the FA stock must be reduced by \$150x (the excess of \$170x attributable inside gain, reduced by \$0x, over \$20x outside gain) to \$30x. Similarly, US2's section 358 basis in the FA stock received of \$100x (equal to US2's basis in the UST stock exchanged) is reduced to preserve the attributable inside gain with respect to US2, less any gain recognized with respect to US2 under § 1.367(a)-7(c)(2)(ii). Because UST does not recognize gain on the section 361 exchange with respect to US2 under § 1.367(a)-7(c)(2)(ii) (as determined in paragraph (ii)(D) of this *Example 3*), the attributable inside gain of \$102x with respect to US2 is not reduced under § 1.367(a)-7(c)(3)(i)(A). US2's outside gain in the FA stock is \$20x, the product of the section 367(a) percentage (100%) multiplied by the \$20x gain (equal to the difference between \$120x fair market value and \$100x section 358 basis in FA stock). Thus, US2's \$100x section 358 basis in the FA stock must be reduced by \$82x (the excess of \$102x attributable inside gain, reduced by \$0x, over \$20x outside gain) to \$18x.

(F) UST's distribution of the FA stock to US1, US2, and X under section 361(c)(1) (new stock distribution) is subject to § 1.1248(f)-1(b)(3). Except as provided in § 1.1248(f)-2(c), under § 1.1248(f)-1(b)(3) UST must include in gross income as a dividend the total section 1248(f) amount (as defined in § 1.1248(f)-1(c)(14)). The total section 1248(f) amount is \$120x, the sum of the section 1248(f) amount (as defined in § 1.1248(f)-1(c)(10)) with respect to the CFC1 stock (\$16x) and CFC2 stock (\$104x). The \$16x section 1248(f) amount with respect to the CFC1 stock is the amount that UST would have included in income as a dividend under § 1.367(b)-4(b)(1)(i) with respect to the CFC1 stock if the requirements of § 1.367(b)-4(b)(1)(ii)(A) had not been satisfied (\$20x), reduced by the amount of gain recognized by UST under § 1.367(a)-7(c)(2) allocable to the CFC1 stock and treated as a dividend under section 1248(a) (\$4x, as described in paragraph (ii)(C) of this *Example 3*). Similarly, the section 1248(f) amount with respect to the CFC2 stock is \$104x (\$130x reduced by \$26x).

(G) If, however, UST along with US1 and US2 (each a section 1248 shareholder of FA immediately after the distribution) elect to apply the provisions of § 1.1248(f)-2(c) (as provided in § 1.1248(f)-2(c)(1)), the amount that UST is required to include in income as a

dividend under § 1.1248(f)-1(b)(3) (\$120x total section 1248(f) amount as computed in paragraph (ii)(F) of this *Example 3*) is reduced by the sum of the portions of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock that is attributable (under the rules of § 1.1248(f)-2(d)) to the FA stock distributed to US1 and US2. Assume that the election is made to apply § 1.1248(f)-2(c).

(I) Under § 1.1248(f)-2(d)(1), the portion of the section 1248(f) amount with respect to the CFC1 stock that is attributed to the 30 shares of FA stock distributed to US1 is equal to the hypothetical section 1248 amount (as defined in § 1.1248(f)-1(c)(4)) with respect to the CFC1 stock that is attributable to US1's ownership interest percentage in UST. US1's hypothetical section 1248 amount with respect to the CFC1 stock is the amount that UST would have included in income as a deemed dividend under § 1.367(b)-4(b)(1)(i) with respect to the CFC1 stock if the requirements of § 1.367(b)-4(b)(1)(ii)(A) had not been satisfied (\$20x) and that would be attributable to US1's ownership interest percentage in UST (50%), reduced by the amount of gain recognized by UST under § 1.367(a)-7(c)(2) attributable to US1 and allocable to the CFC1 stock, but only to the extent such gain is treated as a dividend under section 1248(a) (\$0x, as described in paragraphs (ii)(C) and (D) of this *Example 3*). Thus, US1's hypothetical section 1248 amount with respect to the CFC1 stock is \$10x (\$20x multiplied by 50%, reduced by \$0x). The \$10x hypothetical section 1248 amount is attributed pro rata (based on relative values) among the 30 shares of FA stock distributed to US1, and the attributable share amount (as defined in § 1.1248(f)-2(d)(1)) is \$.33x (\$10x/30 shares). Similarly, US1's hypothetical section 1248 amount with respect to the CFC2 stock is \$65x (\$130x multiplied by 50%, reduced by \$0x), and the attributable share amount is \$2.17x (\$65x/30 shares). Similarly, US2's hypothetical section 1248 amount with respect to the CFC1 stock is \$6x (\$20x multiplied by 30%, reduced by \$0x), and the attributable share amount is also \$.33x (\$6x/18 shares). Finally, US2's hypothetical section 1248 amount with respect to the CFC2 stock is \$39x (\$130x multiplied by 30%, reduced by \$0x), and the attributable share amount is also \$2.17x (\$39x/18 shares). Thus, the sum of the portion of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock attributable to shares of stock of FA distributed to US1 and US2 is \$120x (\$10x plus \$65x plus \$6x plus \$39x).

(2) If the shares of FA stock are divided into portions, § 1.1248(f)-2(d)(2) applies to attribute the attributable share amount to portions of shares of FA stock distributed to US1 and US2. Under § 1.1248(f)-2(c)(2) each share of FA stock received by US1 (30 shares) and US2 (18 shares) is divided into three portions, one attributable to the single block of

stock of CFC1, one attributable to the single block of stock of CFC2, and one attributable to Asset A. Thus, the attributable share amount of \$.33x with respect to the CFC1 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC1 stock. Similarly, the attributable share amount of \$.17x with respect to the CFC2 stock is attributed to the portion of each of the 30 shares and 18 shares of FA stock received by US1 and US2, respectively, that relates to the CFC2 stock.

(3) The total section 1248(f) amount (\$120x) that UST is otherwise required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) is reduced by \$120x, the sum of the portions of the section 1248(f) amount with respect to the CFC1 stock and CFC2 stock that are attributable to the shares of FA stock distributed to US1 and US2. Thus, the amount DC is required to include in gross income as a dividend under § 1.1248(f)-1(b)(3) is \$0x (\$120x reduced by \$120x).

(H) As stated in paragraph (ii)(G)(2) of this *Example 3*, under § 1.1248(f)-2(c)(2) each share of FA stock received by US1 (30 shares) and US2 (18 shares) is divided into three portions, one attributable to the CFC1 stock, one attributable to the CFC2 stock, and one attributable to Asset A. Under § 1.1248(f)-2(c)(4)(i), the basis of each portion is the product of US1's and US2's section 358 basis in the share of FA stock multiplied by the ratio of the section 362 basis of the property (CFC1 stock, CFC2 stock, or Asset A, as applicable) received by FA in the section 361 exchange to which the portion relates, to the aggregate section 362 basis of all property received by FA in the section 361 exchange. Under § 1.1248(f)-2(c)(4)(ii), the fair market value of each portion is the product of the fair market value of the share of FA stock multiplied by the ratio of the fair market value of the property (CFC1 stock, CFC2 stock, or Asset A, as applicable) to which the portion relates, to the aggregate fair market value of all property received by FA in the section 361 exchange. The section 362 basis of the CFC1 stock, CFC2 stock, and Asset A is \$24x, \$56x, and \$48x, respectively, for an aggregate section 362 basis of \$128x. See paragraph (ii)(C) of this *Example 3*. The fair market value of the CFC1 stock, CFC2 stock, and Asset A is \$40x, \$160x, and \$200x, for an aggregate fair market value of \$400x. Furthermore, US1's 30 shares of FA stock have an aggregate fair market value of \$200x and section 358 basis of \$30x (resulting in aggregate gain of \$170x), and US2's 18 shares of FA stock have an aggregate fair market value of \$120x and section 358 basis of \$18x (resulting in aggregate gain of \$102x). See paragraph (ii)(E) of this *Example 3*.

(I) With respect to US1's 30 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of \$5.63x (\$30x

multiplied by \$24x/\$128x) and fair market value of \$20x (\$200x multiplied by \$40x/\$400x), resulting in aggregate gain in such portions of \$14.38x (or \$.48x gain in each such portion of the 30 shares). The portions attributable to the CFC2 stock have an aggregate basis of \$13.13x (\$30x multiplied by \$56x/\$128x) and fair market value of \$80x (\$200x multiplied by \$160x/\$400x), resulting in aggregate gain in such portions of \$66.88x (or \$2.23x in each such portion of the 30 shares). The portions attributable to Asset A have an aggregate basis of \$11.25x (\$30x multiplied by \$48x/\$128x) and fair market value of \$100x (\$200x multiplied by \$200x/\$400x), resulting in aggregate gain in such portions of \$88.75x (or \$2.96x in each such portion of the 30 shares). Thus, the aggregate gain in all the portions of the 30 shares is \$170x (\$14.38x plus \$66.88x plus \$88.75x).

(2) With respect to US2's 18 shares of FA stock, the portions attributable to the CFC1 stock have an aggregate basis of \$3.38x (\$18x multiplied by \$24x/\$128x) and fair market value of \$12x (\$120x multiplied by \$40x/\$400x), resulting in aggregate gain in such portions of \$8.63x (or \$.48x in each such portion of the 18 shares). The portions attributable to the CFC2 stock have an aggregate basis of \$7.88x (\$18x multiplied by \$56x/\$128x) and fair market value of \$48x (\$120x multiplied by \$160x/\$400x), resulting in aggregate gain of \$40.13x (or \$2.23x in each such portion of the 18 shares). The portions attributable to Asset A have an aggregate basis of \$6.75x (\$18x multiplied by \$48x/\$128x) and fair market value of \$60x (\$120x multiplied by \$200x/\$400x), resulting in aggregate gain of \$53.25x (or \$2.96x in each such portion of the 18 shares). Thus, the aggregate gain in all the portions of the 18 shares is \$102x (\$8.63x plus \$40.13x plus \$53.25x).

(3) Under § 1.1248-8(b)(2)(iv), the earnings and profits of CFC1 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC1 stock is \$15x (the product of US1's 50% ownership interest percentage in UST multiplied by \$30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by \$0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US1). The earnings and profits of CFC2 attributable to the portions of US1's 30 shares of FA stock that relate to the CFC2 stock is \$75x (the product of US1's 50% ownership interest percentage in UST multiplied by \$150x of earnings and profits attributable to the CFC2 stock before the section 361 exchange, reduced by \$0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US1). Similarly, the earnings and profits of CFC1 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC1 stock is \$9x (the product of US2's 30% ownership interest percentage in UST multiplied

by \$30x of earnings and profits attributable to the CFC1 stock before the section 361 exchange, reduced by \$0x of dividend included in UST's income with respect to the CFC1 stock under section 1248(a) attributable to US2). Finally, the earnings and profits of CFC2 attributable to the portions of US2's 18 shares of FA stock that relate to the CFC2 stock is \$45x (the product of US2's 30% ownership interest percentage in UST multiplied by \$150x of earnings and profits attributable to the CFC2 stock before the section 361 exchange, reduced by \$0x of dividend included in UST's income with respect to the CFC2 stock under section 1248(a) attributable to US2).

(I) Under § 1.1248(f)-2(c)(3), neither US1 nor US2 is required to reduce the aggregate section 358 basis in the portions of their respective shares of FA stock, and UST is not required to include in gross income any additional deemed dividend.

(I) US1 is not required to reduce the aggregate section 358 basis of the portions of its 30 shares of FA stock that relate to the CFC1 stock because the \$10x section 1248(f) amount with respect to the CFC1 stock attributable to the portions of the shares of FA stock received by US1 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount (as defined in § 1.1248(f)-1(c)(6), or \$14.38x) in those portions. The \$14.38x postdistribution amount equals the amount that US1 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 30 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under § 1.1248(f)-2(c)(3) (\$20x fair market value, \$5.63x basis, and \$15x earnings and profits attributable to the portions for purposes of section 1248). Similarly, US1 is not required to reduce the aggregate section 358 basis of the portions of its 30 shares of FA stock that relate to the CFC2 stock because the \$65x section 1248(f) amount with respect to the CFC2 stock attributable to the portions of the shares of FA stock received by US1 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount (\$66.88x) in those portions. The \$66.88x postdistribution amount equals the amount that US1 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 30 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under § 1.1248(f)-2(c)(3) (\$80x fair market value, \$13.13x basis, and \$75x earnings and profits attributable to the portions for purposes of section 1248).

(2) US2 is not required to reduce the aggregate section 358 basis of the portions of its 18 shares of FA stock that relate to the CFC1 stock because the \$6x section 1248(f) amount with respect to the CFC1 stock attributable to the portions of the shares of FA stock received by US2 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US2's postdistribution amount (\$8.63x) in those portions. The \$8.63x postdistribution amount equals the amount that US2 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 18 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under § 1.1248(f)-2(c)(3) (\$12x fair market value, \$3.38x basis, and \$9x earnings and profits attributable to the portions for purposes of section 1248). Similarly, US2 is not required to reduce the aggregate section 358 basis of the portions of its 18 shares of FA stock that relate to the CFC2 stock because the \$39x section 1248(f) amount with respect to the CFC2 stock attributable to the portions of the shares of FA stock received by US2 (as computed in paragraph (ii)(G) of this *Example 3*) does not exceed US1's postdistribution amount (\$40.13x) in those portions. The \$40.13x postdistribution amount equals the amount that US2 would be required to include in income as a dividend under section 1248(a) with respect to such portion if it sold the 18 shares of FA stock immediately after the distribution in a transaction in which all realized gain is recognized, without taking into account basis adjustments or income inclusions under § 1.1248(f)-2(c)(3) (\$48x fair market value, \$7.88x basis, and \$45x earnings and profits attributable to the portions for purposes of section 1248).

(J) The amount of gain subject to the gain recognition agreement filed by each of US1 and US2 is determined pursuant to paragraph (e)(6)(i) of this section. The amount of gain subject to the gain recognition agreement filed by US1 with respect to the stock of CFC1 and CFC2 is \$10x and \$65x, respectively. The \$10x and \$65x are computed as the product of US1's ownership interest percentage (50%) multiplied by the gain realized by UST in the CFC1 stock (\$20x) and CFC2 stock (\$130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A), (e)(6)(i)(B), (e)(6)(i)(C), and (e)(6)(i)(D) of this section with respect to the CFC1 stock and CFC2 stock attributable to US1 (\$0x with respect to the CFC1 stock, and \$0x with respect to the CFC2 stock). The amount of gain subject to the gain recognition agreement filed by US2 with respect to the stock of CFC1 and CFC2 is \$6x and \$39x, respectively. The \$6x and \$39x are computed

as the product of US2's ownership interest percentage (30%) multiplied by the gain realized by UST in the CFC1 stock (\$20x) and CFC2 stock (\$130x), respectively, as determined prior to taking into account the application of any other provision of section 367, reduced by the sum of the amounts described in paragraphs (e)(6)(i)(A), (e)(6)(i)(B), (e)(6)(i)(C), and (e)(6)(i)(D) of this section with respect to the CFC1 stock and CFC2 stock attributable to US2 (\$0x with respect to the CFC1 stock, and \$0x with respect to the CFC2 stock). X is not required to enter into a gain recognition agreement because the amount of gain that would be subject to the gain recognition agreement is \$0x with respect to the CFC1 stock, and \$0x with respect to the CFC2 stock, computed as X's ownership percentage (20%) multiplied by the gain realized in the stock of CFC1 (\$20x multiplied by 20%, or \$4x) and CFC2 (\$130x multiplied by 20%, or \$26x), reduced the amount of gain recognized by UST with respect to the stock of CFC1 and CFC2 that is attributable to X pursuant to § 1.367(a)-7(c)(2) (\$4x and \$26x, respectively, as determined in paragraph (ii)(C) of this *Example 3*). Pursuant to paragraph (e)(6)(ii) of this section, each gain recognition agreement must include the election described in § 1.367(a)-8(c)(2)(vi). Furthermore, pursuant to paragraph (e)(6)(iii) of this section, US1 and US2 must be designated as the U.S. transferor on their respective gain recognition agreements for purposes of § 1.367(a)-8.

(9) *Illustration of rules.* For rules relating to certain distributions of stock of a foreign corporation by a domestic corporation, see section 1248(f) and §§ 1.1248(f)-1 through 1.1248(f)-3.

(f) through (g)(1)(vi) [Reserved] For further guidance, see §§ 1.367(a)-3(f) through (g)(1)(vi).

(vii)(A) Except as provided in this paragraph (g)(1)(vii), the rules of paragraph (e) of this section apply to transfers of stock or securities occurring on or after April 17, 2013. For matters covered in this section for periods before April 17, 2013, but on or after March 13, 2009, see § 1.367(a)-3(e) as contained in 26 CFR part 1 revised as of April 1, 2012. For matters covered in this section for periods before March 13, 2009, but on or after March 7, 2007, see § 1.367(a)-3T(e) as contained in 26 CFR part 1 revised as of April 1, 2007. For matters covered in this section for periods before March 7, 2007, but on or after July 20, 1998, see § 1.367(a)-8(f)(2)(i) as contained in 26 CFR part 1 revised as of April 1, 2006.

(g)(1)(vii)(B) through (g)(1)(viii) [Reserved] For further guidance see § 1.367(a)-3(g)(vii)(B) through (g)(viii).

(ix) Paragraphs (d)(2)(vi)(B) and (d)(3), *Example 6B*, *Example 6C*, and *Example 9* of this section apply to transfers that occur on or after March 18, 2013. See paragraphs (d)(2)(vi)(B) and (d)(3), *Example 6B*, *Example 6C*, and *Example 9* of this section, as contained in 26 CFR part 1 revised as of April 1, 2012, for transfers that occur on or after January 23, 2006, and before March 18, 2013.

(g)(2) through (j) [Reserved] For further guidance, see § 1.367(a)-3(g)(2) through (j).

(k) *Expiration date.* Paragraphs (d)(2)(vi)(B), (d)(3), *Example 6B*, *Example 6C*, and *Example 9*, and paragraph (e) of this section expire on March 18, 2016.

[T.D. 9615, 78 FR 17056, Mar. 19, 2013]

§ 1.367(a)-4 Special rules applicable to specified transfers of property.

(a) through (c)(2) [Reserved] For further guidance, see § 1.367(a)-4T(a) through (c)(2).

(3) *Aircraft and vessels leased in foreign commerce.* For purposes of satisfying § 1.367-4T(c)(1), aircraft or vessels, including component parts such as engines leased separately from aircraft or vessels, transferred to a foreign corporation and leased to other persons by the foreign corporation shall be considered to be transferred for use in the active conduct of a trade or business if—

(i) The employees of the foreign corporation perform substantial managerial and operational activities of leasing aircraft or vessels outside the United States; and

(ii) The leased tangible personal property is predominantly used outside the United States, as determined under § 1.954-2(c)(2)(v).

(d) through (h) [Reserved] For further guidance, see § 1.367-4T(d) through (h).

(i) *Effective/applicability date.* The rules of paragraph (c)(3) of this section apply for transfers of property occurring on or after May 2, 2006. Transferees may elect to apply these provisions to transfers occurring on or after October 22, 2004, by citing the provisions of paragraph (c)(3) of this section