

§ 1.367(b)-4

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than the excess earnings and profits amount to be applied against such basis, the taxpayer may choose to which specific assets in the category the basis reduction first applies.

(C) *Notification.* The exchanging shareholder shall elect to apply the rules of this paragraph (b)(4)(i) by attaching a statement of its election to its section 367(b) notice. See § 1.367(b)-1(c) For the rules concerning filing a section 367(b) notice.

(D) *Example.* The following example illustrates the rules of this paragraph (b)(4)(i):

Example. (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 \$80 in such stock. The assets of FC are one parcel of land with a value of \$60 and a basis of \$30, and tangible depreciable assets with a value of \$40 and a basis of \$80. FC has no net operating loss carryovers or capital loss carryovers. The all earnings and profits amount with respect to the FC stock owned by DC is \$30, of which \$19 is described in section 1248(a) and the remaining \$11 is not (for example, because it was earned prior to 1963). In a liquidation described in section 332, FC distributes all of its property to DC, and the FC stock held by DC is canceled. Rather than including in income as a deemed dividend the all earnings and profits amount of \$30 as provided in § 1.367(b)-3(b)(3)(i), DC instead elects taxable exchange treatment under paragraph (b)(4)(i)(A) of this section.

(ii) *Result.* DC recognizes the \$20 of gain it realizes on its stock in FC. Of this \$20 amount, \$19 is included in income by DC as a dividend pursuant to section 1248(a). (For the source of the remaining \$1 of gain recognized by DC, see section 865. For the treatment of the \$1 for purposes of the foreign tax credit limitation, see generally section 904(d)(2)(A)(i).) Because the transaction is described in section 332 and because the all earnings and profits amount with respect to the FC stock held by DC (\$30) exceeds by \$10 the income recognized by DC (\$20), the attribute reduction rules of paragraph (b)(4)(i)(B) of this section apply. Accordingly, the \$10 excess earnings and profits amount is applied to reduce the basis of the tangible depreciable assets of FC, beginning with those assets with the shortest class lives. Under section 337(a) FC does not recognize gain or loss in the assets that it distributes to DC, and under section 334(b) (which is applied taking into account the basis reduction prescribed by paragraph (b)(4)(i)(A)(3) of this section) DC takes a basis of \$30 in the land and \$70 in the tangible depreciable assets that it receives from FC.

(ii) *Effective date.* This paragraph (b)(4) applies for section 367(b) exchanges that occur between February 23, 2000, and February 23, 2001.

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

[T.D. 8863, 65 FR 3588, Jan. 24, 2000, as amended by T.D. 9243, 71 FR 4288, Jan. 26, 2006]

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

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

of this section. A foreign corporation that undergoes a reorganization described in section 368(a)(1)(E) is treated as both the foreign acquired corporation and the foreign acquiring corporation for purposes of this section. See § 1.367(a)-3(b)(2) for transactions subject to the concurrent application of sections 367(a) and (b).

(b) *Income inclusion.* If an exchange is described in paragraph (b)(1)(i), (2)(i) or (3) of this section, the exchanging shareholder shall include in income as a deemed dividend the section 1248 amount attributable to the stock that it exchanges.

(1) *Exchange that results in loss of status as section 1248 shareholder*—(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, an exchange is described in this paragraph (b)(1)(i) if—

(A) Immediately before the exchange, the exchanging shareholder is—

(1) A United States person that is a section 1248 shareholder with respect to the foreign acquired corporation; or

(2) A foreign corporation, and a United States person is a section 1248 shareholder with respect to such foreign corporation and with respect to the foreign acquired corporation; and

(B) Either of the following conditions is satisfied—

(1) Immediately after the exchange, the stock received in the exchange is not stock in a corporation that is a controlled foreign corporation as to which the United States person described in paragraph (b)(1)(i)(A) of this section is a section 1248 shareholder; or

(2) Immediately after the exchange, the foreign acquiring corporation or the foreign acquired corporation (in the case of the acquisition of the stock of a foreign acquired corporation) is not a controlled foreign corporation as to which the United States person described in paragraph (b)(1)(i)(A) of this section is a section 1248 shareholder.

(ii) *Special rules*—(A) *Receipt of foreign stock in an exchange to which § 1.367(a)-7(c) applies.* If an exchanging shareholder is a domestic corporation that transfers stock of a foreign acquired corporation in an exchange under section 361(a) or (b) (section 361 exchange) to which the exception to section 367(a)(5) in § 1.367(a)-7(c) applies, and

the exchanging shareholder receives stock in either the foreign acquiring corporation or foreign controlling corporation (in the case of a triangular reorganization), such exchange will not be described in paragraph (b)(1)(i) of this section only if immediately after the exchanging shareholder's receipt of the foreign stock in the section 361 exchange, but prior to, and without taking into account, the exchanging shareholder's distribution of the foreign stock under section 361(c)(1), the foreign acquired corporation, foreign acquiring corporation, and foreign controlling corporation (in the case of a triangular reorganization) are controlled foreign corporations as to which the exchanging shareholder is a section 1248 shareholder. See paragraph (b)(1)(iii) of this section, *Example 4*, for an illustration of this rule. If an exchange is not described in paragraph (b)(1)(i) of this section as a result of the application of this paragraph, see §§ 1.1248(f)-1(b)(3) and 1.1248(f)-2(c), as applicable. For adjustments to the basis of stock of the foreign surviving corporation in certain triangular reorganizations, see paragraph (b)(1)(ii)(B)(2)(i) of this section.

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

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

(ii) The foreign surviving corporation, in the case of a section 354 or section 356 exchange of the stock of the foreign acquired corporation pursuant to a forward triangular merger, triangular C reorganization, reverse triangular merger, or triangular G reorganization. See paragraph (b)(1)(iii) of

this section, *Example 3B* for an illustration of this rule.

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

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

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

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

(iii) *Examples.* The following examples illustrate the rules of this paragraph (b)(1):

Example 1. (i) *Facts.* FC1 is a foreign corporation that is owned, directly and indirectly (applying the ownership rules of section 958), solely by foreign persons. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation. Thus, under § 1.367(b)-2(a) and (b), DC is a section 1248 shareholder with respect to FC2, and FC2 is a controlled foreign corporation. Under § 1.367(b)-2(c)(1), the section 1248 amount attributable to the stock of FC2 held by DC is \$20. In a reorganization described in section 368(a)(1)(C), FC1 acquires all of the assets and assumes all of the liabilities of FC2 in exchange for FC1 voting stock. The FC1 voting stock received does not represent more than 50 percent of the voting power or value of FC1's stock. FC2 distributes the FC1 stock to DC, and the FC2 stock held by DC is canceled.

(ii) *Result.* FC1 is not a controlled foreign corporation immediately after the exchange. As a result, the exchange is described in paragraph (b)(1)(i) of this section. Under paragraph (b) of this section, DC must include in income, as a deemed dividend from FC2, the section 1248 amount (\$20) attributable to the FC2 stock that DC exchanged.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that the voting stock of FC1, which is received by FC2 in exchange for its assets and distributed by FC2 to DC, represents more than 50 percent of the voting power of FC1's stock under the rules of section 957(a).

(ii) *Result.* Paragraph (b)(1)(i) of this section does not apply to require inclusion in income of the section 1248 amount, because FC1 is a controlled foreign corporation as to which DC is a section 1248 shareholder immediately after the exchange.

Example 3. (i) *Facts.* The facts are the same as in *Example 1*, except that FC2 receives and distributes voting stock of FP, a foreign corporation that is in control (within the meaning of section 368(c)) of FC1, instead of receiving and distributing voting stock of FC1.

(ii) *Result.* For purposes of section 367(a), the transfer is an indirect stock transfer subject to section 367(a). See § 1.367(a)-3(d)(1)(iv). Accordingly, DC's exchange of FC2 stock for FP stock under section 354 will be taxable under section 367(a) (and section 1248 will be applicable) if DC fails to enter into a gain

recognition agreement in accordance with §1.367(a)-8. Under §1.367(a)-3(b)(2), if DC enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder, as well as section 367(a). If FP and FC1 are controlled foreign corporations as to which DC is a (direct or indirect) section 1248 shareholder immediately after the reorganization, then the section 367(b) result is the same as in *Example 2*—that is, paragraph (b)(1)(i) of this section does not apply to require inclusion in income of the section 1248 amount. Under these circumstances, the amount of the gain recognition agreement would equal the amount of the gain realized on the indirect stock transfer. If FP or FC1 is not a controlled foreign corporation as to which DC is a (direct or indirect) section 1248 shareholder immediately after the exchange, then the section 367(b) result is the same as in *Example 1*—that is, DC must include in income, as a deemed dividend from FC2, the section 1248 amount (\$20) attributable to the FC2 stock that DC exchanged. Under these circumstances, the amount of the gain recognition agreement would equal the amount of the gain realized on the indirect stock transfer, less the \$20 section 1248 amount inclusion.

Example 3A. (i) *Facts.* The facts are the same as in *Example 3*, except that FC1 merges into FC2 in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E). Pursuant to the reorganization, DC exchanges its FC2 stock for stock of FP.

(ii) *Result.* The result is similar to the result in *Example 3*. The transfer is an indirect stock transfer subject to section 367(a). See §1.367(a)-3(d)(1)(ii). Accordingly, DC's exchange of FC2 stock for FP stock will be taxable under section 367(a) (and section 1248 will be applicable) if DC fails to enter into a gain recognition agreement. If DC enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder, as well as section 367(a). If FP and FC2 are controlled foreign corporations as to which DC is a section 1248 shareholder immediately after the reorganization, then paragraph (b)(1)(i) of this section does not apply to require DC to include in income the section 1248 amount attributable to the FC2 stock that was exchanged and the amount of the gain recognition agreement is the amount of gain realized on the indirect stock transfer. If FP or FC2 is not a controlled foreign corporation as to which DC is a section 1248 shareholder immediately after the exchange, then DC must include in income as a deemed dividend from FC2 the section 1248 amount (\$20) attributable to the FC2 stock that DC exchanged. Under these circumstances, the gain recognition agreement would be the amount of gain realized on the

indirect transfer, less the \$20 section 1248 amount inclusion.

Example 3B. (i) *Facts.* The facts are the same as *Example 3*, except that USP, a domestic corporation, owns the controlling interest (within the meaning of section 368(c)) in FC1 stock. In addition, FC2 merges into FC1 in a reorganization described in sections 368(a)(1)(A) and (a)(2)(D). Pursuant to the reorganization, DC exchanges its FC2 stock for USP stock.

(ii) *Result.* Because DC receives stock of a domestic corporation, USP, in the section 354 exchange, the transfer is not an indirect stock transfer subject to section 367(a). Accordingly, the exchange will be subject only to the provisions of section 367(b) and the regulations thereunder. Under paragraph (b)(1)(ii) of this section, because the stock received is stock of a domestic corporation (USP) and, immediately after the exchange, USP is a section 1248 shareholder of FC1 (the surviving corporation) and FC1 is a controlled foreign corporation, the exchange is not described in paragraph (b)(1)(i) of this section and DC is not required to include in income the section 1248 amount attributable to the FC2 stock that was exchanged. See §1.367(b)-13(c) for the basis and holding period rules applicable to this transaction, which cause USP's adjusted basis and holding period in the stock of FC1 after the transaction to reflect the basis and holding period that DC had in its FC2 stock.

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

(ii) *Result.* DC2, the exchanging shareholder, is a U.S. person and a section 1248

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shareholder with respect to FC2, the foreign acquired corporation. Whether DC2 is required to include in income the section 1248 amount attributable to the FC2 stock under paragraph (b)(1)(i) of this section depends on whether, immediately after DC2's section 361 exchange of the FC2 stock for FC1 stock (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)), FC1 and FC2 are controlled foreign corporations as to which DC2 is a section 1248 shareholder. See paragraph (b)(1)(ii)(A) of this section. If, immediately after the section 361 exchange (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)), FC1 and FC2 are both controlled foreign corporations as to which DC2 is a section 1248 shareholder, then DC2 is not required to include in income the section 1248 amount attributable to the FC2 stock under paragraph (b)(1)(i) of this section because neither condition in paragraph (b)(1)(i)(B) of this section is satisfied. Alternatively, if immediately after the section 361 exchange (and before the distribution of the FC1 stock to DC1 under section 361(c)(1)) either FC1 or FC2 is not a controlled foreign corporation as to which DC2 is a section 1248 shareholder, then, pursuant to paragraph (b)(1)(i) of this section, DC2 must include in income the section 1248 amount attributable to the FC2 stock. For the treatment of DC2's transfer of assets other than the FC2 stock to FC1, see section 367(a)(1) and (a)(3) and the regulations under that section. Furthermore, because DC2's transfer of any other assets to FC1 is pursuant to a section 361 exchange, see section 367(a)(5) and § 1.367(a)-7. If any of the assets transferred are intangible assets for purposes of section 367(d), see section 367(d). With respect to DC2's distribution of the FC1 stock to DC1 under section 361(c)(1), see section 1248(f)(1), and §§ 1.1248(f)-1 and 1.1248(f)-2.

Example 5. (i) *Facts.* DC1, a domestic corporation, wholly owns DC2, a domestic corporation. The DC2 stock has a \$100x fair market value, and DC1 has a basis of \$30x in the stock. DC2's only asset is all of the outstanding stock of FC2, a foreign corporation. The FC2 stock has a \$100x fair market value, and DC2 has a basis of \$30x in the stock. There are \$20x of earnings and profits attributable to the FC2 stock for purposes of section 1248. USP, a domestic corporation unrelated to DC1, DC2, and FC2, wholly owns FC1, a foreign corporation. In a triangular reorganization described in section 368(a)(1)(C), DC2 transfers all the FC2 stock to FC1 in exchange solely for voting stock of USP, and distributes the USP stock to DC1 under section 361(c)(1). DC1 exchanges its DC2 stock for the USP stock under section 354. DC2's transfer of the FC2 stock to FC1 is described in section 361(a) and therefore, under section 367(a)(5) and § 1.367(a)-7, is generally subject to section 367(a)(1). However, the exception to section 367(a)(5) provided in § 1.367(a)-7(c)

applies to the section 361 exchange. In addition, DC1 is not required to adjust the basis of its USP stock (determined under section 358) under section 367(a)(5) and § 1.367(a)-7(c)(3). DC1 properly files a gain recognition agreement that satisfies the conditions of §§ 1.367(a)-3T(e)(6) and 1.367(a)-8 to qualify for nonrecognition treatment under section 367(a) with respect to DC2's transfer of the FC2 stock to FC1. See § 1.367(a)-3T(e).

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

(2) *Receipt by exchanging shareholder of preferred or other stock in certain instances—(i) Rule.* An exchange is described in this paragraph (b)(2)(i) if—

(A) Immediately before the exchange, the foreign acquired corporation and the foreign acquiring corporations are not members of the same affiliated group (within the meaning of section 1504(a), but without regard to the exceptions set forth in section 1504(b), and substituting the words “more than 50” in place of the words “at least 80” in sections 1504(a)(2)(A) and (B));

(B) Immediately after the exchange, a domestic corporation meets the ownership threshold specified by section 902(a) or (b) such that it may qualify for a deemed paid foreign tax credit if

it receives a distribution from the foreign acquiring corporation (directly or through tiers); and

(C) The exchanging shareholder receives preferred stock (other than preferred stock that is fully participating with respect to dividends, redemptions and corporate growth) in consideration for common stock or preferred stock that is fully participating with respect to dividends, redemptions and corporate growth, or, in the discretion of the Commissioner or the Commissioner's delegate (and without regard to whether the stock exchanged is common stock or preferred stock), receives stock that entitles it to participate (through dividends, redemption payments or otherwise) disproportionately in the earnings generated by particular assets of the foreign acquired corporation or foreign acquiring corporation.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (b)(2):

Example 1. (i) *Facts.* FC1 is a foreign corporation. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation, and FC2 has no outstanding preferred stock. The value of FC2 is \$100 and DC has a basis of \$50 in the stock of FC2. Under § 1.367(b)-2(c)(1), the section 1248 amount attributable to the stock of FC2 held by DC is \$20. In a reorganization described in section 368(a)(1)(B), FC1 acquires all of the stock of FC2 and, in exchange, DC receives FC1 voting preferred stock that constitutes 10 percent of the voting stock of FC1 for purposes of section 902(a). Immediately after the exchange, FC1 and FC2 are controlled foreign corporations and DC is a section 1248 shareholder of FC1 and FC2, so paragraph (b)(1)(i) of this section does not require inclusion in income of the section 1248 amount.

(ii) *Result.* Pursuant to § 1.367(a)-3(b)(2), the transfer is subject to both section 367(a) and section 367(b). Under § 1.367(a)-3(b)(1), DC will not be subject to tax under section 367(a)(1) if it enters into a gain recognition agreement in accordance with § 1.367(a)-8. Even though paragraph (b)(1)(i) of this section does not apply to require inclusion in income by DC of the section 1248 amount, DC must nevertheless include the \$20 section 1248 amount in income as a deemed dividend from FC2 under paragraph (b)(2)(i) of this section. Thus, if DC enters into a gain recognition agreement, the amount is \$30 (the \$50 gain realized less the \$20 recognized under section 367(b)). If DC fails to enter into a gain recognition agreement, it must include in income under section 367(a)(1) the \$50 of gain

realized (\$20 of which is treated as a dividend under section 1248). Section 367(b) does not apply in such case.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that DC owns all of the outstanding stock of FC1 immediately before the transaction.

(ii) *Result.* Both section 367(a) and section 367(b) apply to the transfer. Paragraph (b)(2)(i) of this section does not apply to require inclusion of the section 1248 amount. Under paragraph (b)(2)(i)(A) of this section, the transaction is outside the scope of paragraph (b)(2)(i) of this section because FC1 and FC2 are, immediately before the transaction, members of the same affiliated group (within the meaning of such paragraph). Thus, if DC enters into a gain recognition agreement in accordance with § 1.367(a)-8, the amount of such agreement is \$50. As in *Example 1*, if DC fails to enter into a gain recognition agreement, it must include in income \$50, \$20 of which will be treated as a dividend under section 1248.

Example 3. (i) *Facts.* FC1 is a foreign corporation. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation. The section 1248 amount attributable to the stock of FC2 held by DC is \$20. In a reorganization described in section 368(a)(1)(B), FC1 acquires all of the stock of FC2 in exchange for FC1 voting stock that constitutes 10 percent of the voting stock of FC1 for purposes of section 902(a). The FC1 voting stock received by DC in the exchange carries voting rights in FC1, but by agreement of the parties the shares entitle the holder to dividends, amounts to be paid on redemption, and amounts to be paid on liquidation, that are to be determined by reference to the earnings or value of FC2 as of the date of such event, and that are affected by the earnings or value of FC1 only if FC1 becomes insolvent or has insufficient capital surplus to pay dividends.

(ii) *Result.* Under § 1.367(a)-3(b)(1), DC will not be subject to tax under section 367(a)(1) if it enters into a gain recognition agreement with respect to the transfer of FC2 stock to FC1. Under § 1.367(a)-3(b)(2), the exchange will be subject to the provisions of section 367(b) and the regulations thereunder to the extent that it is not subject to tax under section 367(a)(1). Furthermore, even if DC would not otherwise be required to recognize income under this section, the Commissioner or the Commissioner's delegate may nevertheless require that DC include the \$20 section 1248 amount in income as a deemed dividend from FC2 under paragraph (b)(2)(i) of this section.

(3) *Certain recapitalizations.* An exchange pursuant to a recapitalization under section 368(a)(1)(E) shall be deemed to be an exchange described in

this paragraph (b)(3) if the following conditions are satisfied—

(i) During the 24-month period immediately preceding or following the date of the recapitalization, the corporation that undergoes the recapitalization (or a predecessor of, or successor to, such corporation) also engages in a transaction that would be described in paragraph (b)(2)(i) of this section but for paragraph (b)(2)(i)(C) of this section, either as the foreign acquired corporation or the foreign acquiring corporation; and

(ii) The exchange in the recapitalization is described in paragraph (b)(2)(i)(C) of this section.

(c) *Exclusion of deemed dividend from foreign personal holding company income—(1) Rule.* In the event the section 1248 amount is included in income as a deemed dividend by a foreign corporation under paragraph (b) of this section, such deemed dividend shall not be included as foreign personal holding company income under section 954(c).

(2) *Example.* The following example illustrates the rule of this paragraph (c):

Example. (i) *Facts.* FC1 is a foreign corporation that is owned, directly and indirectly (applying the ownership rules of section 958), solely by foreign persons. DC is a domestic corporation that is unrelated to FC1. DC owns all of the outstanding stock of FC2, a foreign corporation. FC2 owns all of the outstanding stock of FC3, a foreign corporation. Under § 1.367(b)-2(c)(1), the section 1248 amount attributable to the stock of FC3 held by FC2 is \$20. In a reorganization described in section 368(a)(1)(B), FC1 acquires from FC2 all of the stock of FC3 in exchange for FC1 voting stock. The FC1 voting stock received by FC2 does not represent more than 50 percent of the voting power or value of FC1's stock.

(ii) *Result.* FC1 is not a controlled foreign corporation immediately after the exchange. Under paragraph (b)(1) of this section, FC2 must include in income, as a deemed dividend from FC3, the section 1248 amount (\$20) attributable to the FC3 stock that FC2 exchanged. 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 this paragraph (c) the deemed dividend is not foreign personal holding company income to FC2.

(d) *Rules for subsequent sales or exchanges—(1) Rule.* If an exchanging shareholder (as defined in § 1.1248-8(b)(1)(iv)) is not required to include in

income as a deemed dividend the section 1248 amount under paragraph (b) of this section in a section 367(b) exchange described in paragraph (a) of this section (non-inclusion exchange), then, for purposes of applying section 367(b) or section 1248 to subsequent sales or exchanges, and subject to the limitation of § 1.367(b)-2(d)(3)(ii) (in the case of a transaction described in § 1.367(b)-3), the determination of the earnings and profits attributable to the stock an exchanging shareholder receives in the non-inclusion exchange shall be determined pursuant to the rules of section 1248 and the regulations under that section.

(2) *Example.* The following example illustrates the rules of this section. For purposes of the example, assume that—

(i) There is no immediate gain recognition pursuant to section 367(a)(1) and the regulations under that section (either through operation of the rules or because the appropriate parties have entered into a gain recognition agreement under §§ 1.367(a)-3(b) and 1.367(a)-8);

(ii) References to earnings and profits are to earnings and profits that would be includible in income as a dividend under section 1248 and the regulations under that section if stock to which the earnings and profits are attributable were sold or exchanged by its shareholder;

(iii) Each corporation has only a single class of stock outstanding and uses the calendar year as its taxable year; and

(iv) Each transaction is unrelated to all other transactions.

Example. Acquisition of the stock of a foreign corporation that controls a foreign acquiring corporation in a reorganization described in section 368(a)(1)(C). (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC1, a controlled foreign corporation, since its formation on January 1, year 1. CFC1 has owned all the stock of CFC2, a controlled foreign corporation, since its formation on January 1, year 1. FC, a foreign corporation that is not a controlled foreign corporation, has owned all of the stock of FC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that was a triangular reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets, including the CFC2 stock, to FC2 in exchange for 80% of the voting stock of FC.

CFC1 transfers the voting stock of FC to DC1 and the CFC1 stock is cancelled. Pursuant to section 1223(1), DC1 is considered to have held the stock of FC since January 1, year 1. Under section 1223(2), FC2 is considered to have held the stock of CFC2 since January 1, year 1. On December 31, year 3, CFC1 has \$100 of earnings and profits. From January 1, year 4, until December 31, year 5, FC (a controlled foreign corporation after the restructuring transaction) accumulates an additional \$50 of earnings and profits. FC2, a controlled foreign corporation after the restructuring transaction, accumulates \$100 of earnings and profits from January 1, year 4, until December 31, year 5. On December 31, year 5, FC is liquidated into DC1 in a transaction described in section 332.

(ii) *Result.* Generally, this paragraph (d) requires that DC1 include in income the earnings and profits attributable to its stock in FC as determined under § 1.1248-8. However, since the liquidation of FC into DC1 is a transaction described in § 1.367(b)-3, the earnings and profits attributable to the stock of FC are limited by § 1.367(b)-2(d)(3)(ii) to that portion of the earnings and profits accumulated by FC itself before or after the restructuring transaction, and do not include the earnings and profits of FC's subsidiaries accumulated before or after the restructuring transaction. Thus, DC1 will include \$40 of earnings and profits in income (80% of the \$50 of earnings and profits accumulated by FC after the restructuring transaction).

(e) [Reserved] For further guidance, see § 1.367(b)-4T(e).

(f) [Reserved] For further guidance, see § 1.367(b)-4T(f).

(g) [Reserved] For further guidance, see § 1.367(b)-4T(g).

[T.D. 8862, 65 FR 3603, Jan. 24, 2000; 65 FR 66501, Nov. 6, 2000, as amended by T.D. 9243, 71 FR 4288, Jan. 26, 2006; T.D. 9250, 71 FR 8804, Feb. 21, 2006; T.D. 9311, 72 FR 5183, Feb. 5, 2007; T.D. 9345, 72 FR 41444, July 30, 2007; T.D. 9444, 74 FR 6826, Feb. 11, 2009; T.D. 9446, 74 FR 6958, Feb. 11, 2009; T.D. 9614, 78 FR 17039, Mar. 19, 2013]

§ 1.367(b)-4T Acquisition of foreign corporate stock or assets by a foreign corporation in certain non-recognition transactions (temporary).

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

(e) Application of section 367(b) to transactions described in section 304(a)(1)—(1) *Scope and general rule.* This section applies to the extent that, pursuant to section 304(a)(1), an exchanging shareholder is treated as

transferring the stock of a foreign acquired corporation to a foreign acquiring corporation in a transaction to which section 351(a) applies (deemed section 351 exchange). Except to the extent provided in paragraph (e)(2) of this section, a transfer of stock of a foreign acquired corporation by an exchanging shareholder in a deemed section 351 exchange shall not be subject to paragraph (b) of this section.

(2) *Special rule.* Notwithstanding paragraph (e)(1) of this section, a transfer of stock of a foreign acquired corporation by an exchanging shareholder to a foreign acquiring corporation in a deemed section 351 exchange shall be subject to paragraph (b) of this section to the extent the distribution received by the exchanging shareholder in redemption of the stock of the foreign acquiring corporation is applied against and reduces, pursuant to section 301(c)(2), the basis of stock of the foreign acquiring corporation held by the exchanging shareholder other than the stock deemed issued by the foreign acquiring corporation in the deemed section 351 exchange.

(3) *Allocation of income inclusion.* If the income inclusion resulting from the application of paragraph (e)(2) of this section is less than the section 1248 amount attributable to the shares of stock of the foreign acquired corporation transferred by the exchanging shareholder in the deemed section 351 exchange, the amount of the income inclusion attributable to each share of stock transferred in the deemed section 351 exchange shall be determined by multiplying the income inclusion by the percentage that the section 1248 amount attributable to such share of stock bears to the aggregate section 1248 amount attributable to all of the shares of stock transferred in the deemed section 351 exchange.

(4) *Example.* The rules of this paragraph (e) are illustrated by the following example:

Example. (i) *Facts.* (A) FP, a foreign corporation, wholly owns USP, a domestic corporation. USP wholly owns CFC1, and CFC1 wholly owns CFC2. CFC2 wholly owns CFC3. CFC1, CFC2 and CFC3 are controlled foreign corporations within the meaning of section 957(a). USP, CFC1, CFC2 and CFC3 use a calendar taxable year. CFC1 owns 30% of the