Issued: June 9, 1998.

Kenneth R. Wykle,

Federal Highway Administrator.

[FR Doc. 98–15882 Filed 6–18–98; 8:45 am]

BILLING CODE 4910–22–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 7, and 602

[TD 8770]

RIN Nos. 1545–AP81 and 1545–AI32

Certain Transfers of Stock or Securities by U.S. Persons to Foreign Corporations and Related Reporting Requirements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations relating to certain transfers of stock or securities by U.S. persons to foreign corporations pursuant to the corporate organization and reorganization provisions of the Internal Revenue Code, and the reporting requirements related to such transfers. The regulations provide the public with guidance necessary to comply with the Tax Reform Act of 1984.

DATES: These regulations are effective July 20, 1998.

FOR FURTHER INFORMATION CONTACT: Philip L. Tretiak at (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1271. Responses to these collections of information are required in order for certain U.S. shareholders that transfer stock or securities in section 367(a) exchanges to qualify for an exception to the general rule of taxation under section 367(a)(1).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated burden per respondent varies from .5 to 8 hours, depending upon individual circumstances, with an estimated average of 4 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, *Attn:* IRS Reports Clearance Officer, T:FS:FP, Washington, DC 20224, and to the Office of Management and Budget, *Attn:* Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On May 16, 1986, temporary and proposed regulations under sections 367 (a) and (d), and 6038B were published in the **Federal Register** (51 FR 17936). These regulations, which addressed transfers of stock or securities and other assets, as well as related reporting requirements, were published to provide the public with guidance necessary to comply with changes made to the Internal Revenue Code by the Tax Reform Act of 1984. The IRS and the Treasury Department later issued Notice 87–85 (1987–2 C.B. 395), which set forth substantial changes to the 1986 regulations, effective with respect to transfers of domestic or foreign stock or securities occurring after December 16, 1987. A further notice of proposed rulemaking containing rules under section 367(a) with respect to transfers of domestic or foreign stock or securities, as well as section 367(b), was published in the **Federal Register** on August 26, 1991 (56 FR 41993). The section 367(a) portion of the 1991 proposed regulations was generally based upon the positions announced in Notice 87–85, but the regulations proposed certain modifications to Notice 87–85, particularly with respect to transfers of stock or securities of foreign corporations.

Subsequently, the IRS and the Treasury Department have issued guidance focusing on the transfers of stock or securities of domestic corporations. Notice 94–46 (1994–1 C.B. 356) announced modifications to the positions set forth in Notice 87–85 (and the 1991 proposed regulations) with respect to transfers of stock or securities of domestic corporations occurring after April 17, 1994. Temporary and proposed regulations (referred to as the inversion regulations) implementing Notice 94–46 (with certain modifications) were published in the **Federal Register** on December 26, 1995 (60 FR 66739 and 66771). Final inversion regulations, published in the **Federal Register** on December 27, 1996 (61 FR 61849), generally followed the rules contained in the temporary regulations, with modifications.

The final regulations herein address transfers of foreign stock or securities, and other matters addressed in the 1991 proposed regulations under section 367(a) that were not addressed in the 1996 final inversion regulations.

In addition, these final regulations address those portions of the 1991 proposed section 367(b) regulations that relate to transactions that are subject to both sections 367 (a) and (b). The remainder of the 1991 proposed section 367(b) regulations will be finalized at a later date.

This document also contains final regulations under section 6038B with respect to reporting requirements applicable to transfers of stock or securities described under section 367(a). Rules regarding outbound transfers to corporations of assets other than stock (including intangibles), and outbound transfers to foreign partnerships will be addressed in separate guidance.

Finally, these final regulations contain a clarification with respect to the scope of certain outbound transfers of intangibles that are subject to section 367(d).

Explanation of Provisions

Sections 367 (a) and (b): Introduction

Section 367(a)(1) generally treats a transfer of property (including stock or securities) by a U.S. person to a foreign corporation (an outbound transfer) in an exchange described in section 332, 351, 354, 356 or 361 as a taxable exchange unless the transfer qualifies for an exception to this general rule.

Section 367(a)(2) provides that, except as provided by regulations, section 367(a)(1) shall not apply to the transfer of stock or securities of a foreign corporation which is a party to the exchange or a party to the reorganization. Section 367(a)(3) contains an exception to section 367(a)(1) for certain outbound transfers of tangible assets other than stock or securities. Section 367(a)(5) contains limitations on any exceptions to section 367(a)(1) in certain instances.

Section 367(b) provides that, with respect to certain nonrecognition transfers in connection with which there is no transfer of property described in section 367(a)(1), a foreign corporation will retain its status as a corporation unless regulations provide otherwise.

These final regulations address transactions described in both sections

367 (a) and (b), and are prescribed under the authority of both sections 367 (a) and (b).

Stock Transfers Under Sections 367 (a) and (b): Scope

Outbound transfers of stock that are subject to section 367(a) may be either direct (such as an outbound transfer of stock described under section 351), indirect (as described below with respect to certain transfers) or constructive (such as an outbound stock transfer that may occur pursuant to a change in an entity's classification). See § 1.367(a)–3(a) (as amended) for the general rules regarding the scope of stock transfers that are subject to section 367(a).

Indirect Stock Transfers: in General

The current temporary regulations contain illustrative examples of certain transactions, including triangular reorganizations described under section 368(a)(1)(A) and either section 368(a)(2)(D) or (E), section 368(a)(1)(B) or (C), that are treated as indirect stock transfers subject to section 367(a) where the acquired company and the acquiring company are domestic corporations and the shareholders of the acquired company receive stock of the acquiring company's foreign parent in the exchange. (Under the terminology used in the proposed and final regulations, in the case of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E), U.S. shareholders exchange their stock for stock of the *acquired* company's foreign parent.)

The proposed regulations clarified the treatment of indirect stock transfers, and provided extensive examples of the rules. The proposed regulations provided that transactions that are treated as indirect stock transfers include: (i) successive section 351 exchanges, and (ii) section 368(a)(1)(C) reorganizations followed by section 368(a)(2)(C) exchanges. In addition, the reorganizations illustrated under the existing temporary regulations are also treated as indirect stock transfers under the proposed regulations where the acquired and/or acquiring corporations are foreign corporations.

The proposed regulations requested comments as to the scope of the indirect stock transfer rules. The IRS and the Treasury Department carefully considered comments received with respect to the scope of the indirect stock transfer rules and have decided to retain the rules set forth in the proposed regulations. These rules are contained in § 1.367(a)–3(d), and additional examples are provided in the final regulations.

Indirect Stock Transfer Rules and Section 367(d)

In the case of a triangular section 368(a)(1)(C) reorganization in which a U.S. target company (UST) transfers its assets to a foreign acquiring company (FA) and UST's U.S. parent company (USP) receives stock of FA's foreign parent (the transferee foreign corporation or TFC) in exchange for the UST stock, the indirect stock transfer rules and the asset transfer rules will apply contemporaneously.

If UST is taxable under section 367(a) with respect to its outbound (section 361) transfer of all or a portion of its tangible assets (because such assets do not qualify for an exception to section 367(a)(1)), USP will receive a step up in the basis of its stock in UST, provided that USP and UST file a consolidated Federal income tax return. See § 1.1502–32. USP will also be deemed to make an indirect transfer of the stock of UST for TFC stock. See § 1.367(a)–3(d)(1)(iv). Thus, if USP receives at least five percent of either the total value or the total voting power of the stock of TFC (i.e., USP is a 5-percent shareholder (which is also referred to as a 5-percent transferee shareholder in § 1.367(a)–3(c)(5)(ii)) and the value of the UST stock exceeds USP's basis in UST (taking into account basis adjustments relating to the asset transfer), USP may qualify for nonrecognition treatment by entering into a gain recognition agreement (GRA), described below, provided that the requirements of § 1.367(a)–3(c)(1) are satisfied. See, e.g., § 1.367(a)–3(d)(3), *Example 7* through *Example 7C*.

If the asset transfer involves tangible assets and the transfer is fully taxable (so that USP's basis in its UST stock equals the value of the UST stock), the indirect stock transfer would not be taxable under section 367(a), and, hence, no GRA would be required. In contrast, if the assets transferred by UST include intangibles that are taxable under section 367(d), the exact manner in which section 367(d) operates is less certain.

The regulations under section 367(d) do not address the tax consequences when the U.S. transferor goes out of existence pursuant to the transaction. The IRS and the Treasury Department are studying the manner in which the rules under section 367(d) should operate when the U.S. transferor goes out of existence contemporaneously with (or subsequent to) its outbound transfer of an intangible. Comments are requested with respect to this issue.

Transactions Subject to Sections 367(a) and (b)

An outbound transfer of foreign stock or securities can be subject to both sections 367(a) and (b). Pursuant to section 367(a)(2), § 1.367(a)–3T(b) of the current temporary regulations provides that, if an exchange is described in section 354 or 361, an outbound transfer of stock or securities of a foreign corporation that is a party to the reorganization is not subject to section 367(a). Thus, for example, an outbound transfer in which a U.S. person exchanges stock in one controlled foreign corporation (CFC) for another CFC that qualifies as a reorganization under section 368(a)(1)(B) (a B reorganization), including a transfer that qualifies as both a B reorganization and a section 351 exchange, is subject only to section 367(b), not section 367(a). In such case, no GRA, described below, is required under the current temporary regulations to preserve nonrecognition treatment. In contrast, an outbound transfer of foreign stock that qualifies as a section 351 exchange but not a B reorganization is currently subject to only section 367(a), not section 367(b), and, thus, a GRA may be required to preserve nonrecognition treatment.

The IRS and the Treasury Department believe that substantially similar transactions, such as these, should not be treated in markedly different manners. Thus, these final regulations adopt the approach contained in the proposed regulations: that all outbound transfers of foreign stock will be subject to sections 367(a) and (b) concurrently, except to the extent that the exchange is fully taxable under section 367(a)(1). See § 1.367(a)–3(b)(2).

Sections 367(a) and (b): Exceptions to Taxation

Once a determination is made that a particular outbound transfer of stock or securities is subject to section 367(a), the next determination is the tax treatment of such transfer. In general, the current rules regarding the outbound transfer of stock or securities under section 367(a) provide for three different tax consequences depending upon the particular facts: (i) certain transfers retain nonrecognition treatment without condition, (ii) certain transfers retain nonrecognition treatment only if the U.S. transferor enters into a GRA, and (iii) certain transfers of stock are taxable to the U.S. transferor under section 367(a)(1) with no option to file a GRA to secure nonrecognition treatment. These final regulations retain this general framework.

The current rules governing whether a taxpayer may qualify for an exception under section 367(a) in the case of an outbound transfer of stock are described in § 1.367(a)–3(c) of the final inversion regulations (in the case of domestic stock or securities) and Notice 87–85 (in the case of foreign stock or securities).

Notice 87–85 provides that in the case of an outbound transfer of foreign stock or securities to which section 367(a) applies, a U.S. transferor may generally qualify for nonrecognition treatment if it either (i) is not a 5-percent shareholder, or (ii) is a 5-percent shareholder but enters into a GRA for a term of 5 or 10 years, depending upon the TFC stock owned by all U.S. transferors. Under current law, a 5-percent shareholder that qualifies for nonrecognition treatment under section 367(a) by filing a GRA agrees that if the TFC disposes of the stock of the transferred corporation in a taxable transaction during the term of the GRA, the 5-percent shareholder must amend its return for the year of the transfer and include in income the amount that it realized but did not recognize with respect to the stock of the transferred corporation, and pay the tax due, plus interest, on this amount. (Under Notice 87–85, the term of the GRA is 5 years if all U.S. transferors, in the aggregate, own less than 50 percent of both the total voting power and the total value of the TFC immediately after the transfer, or 10 years if all U.S. transferors, in the aggregate, own 50 percent or more of either the total voting power or the total value of the TFC immediately after the transfer.) Although GRAs are currently used solely with respect to outbound transfers of stock or securities, the IRS and the Treasury Department may, at a later date, permit taxpayers to secure nonrecognition treatment under section 367(a) with respect to other types of assets by entering into GRAs.

Notice 87–85, however, provides no exception to section 367(a)(1) if a U.S. transferor transfers stock in a CFC in which it is a United States shareholder (as defined in § 7.367(b)–2(b) or section 953(c)) but does not receive back stock in a CFC in which it is a United States shareholder.

The final regulations, following the proposed regulations on this point, provide that a transfer described in the preceding paragraph, such as a section 351 exchange in which a U.S. transferor exchanges stock of a CFC in which it is a United States shareholder for stock of a non-CFC, is not automatically taxable. Instead, both sections 367(a) and (b) apply to the exchange. If the U.S. transferor is required under section 367(a) to enter into a GRA to preserve nonrecognition treatment and fails to do so, the transaction is fully taxable under section 367(a) (and, as a consequence, the section 1248 amount that would be included as a dividend under section 367(b) had a GRA been filed is instead treated as a dividend under section 1248). If the U.S. transferor is required to enter into a GRA and properly does so, the U.S. transferor is required under section 367(b) to include in income the section 1248 amount attributable to the stock exchanged. The amount of the GRA equals the gain realized on the transfer less the inclusion under section 367(b). See § 1.367(a)–3(b)(2).

As noted above, Notice 87–85 addressed outbound transfers of both domestic and foreign stock. The (1996) final inversion regulations superseded Notice 87–85 with respect to outbound transfers of domestic stock. The rules in Notice 87–85 with respect to outbound transfers of foreign stock have been incorporated into these final regulations with respect to transfers that occur prior to July 20, 1998. See § 1.367(a)–3(g). Notice 87–85 will be obsolete when these final regulations are effective.

Section 367(a): Post-GRA Transactions

Section 1.367(a)–8 provides general rules regarding terms and conditions relating to GRAs, and the manner in which post-GRA transactions impact the GRA. The general terms and conditions for GRAs have not changed significantly from the terms and conditions set forth in § 1.367(a)–3T(g) of the current temporary regulations, except that the final regulations contain an election (the GRA election), described below, to permit the taxpayer to include the GRA amount in income in the year of the triggering event (with interest on the tax due from the year of the transfer) rather than on an amended return for the year of the initial transfer. In addition, the final regulations generally follow the proposed regulations by providing a more comprehensive explanation of the manner in which the GRA is affected by both taxable and nontaxable dispositions by the U.S. transferor, the TFC, and the transferred corporation.

The current temporary regulations provide that the GRA is triggered if (i) the TFC disposes of all or a portion of the stock of the transferred corporation, or (ii) the transferred corporation disposes of a substantial portion of its assets. The term *substantial portion* was not defined in the regulations.

Both the final and the proposed regulations use the rule from the current temporary regulations that a GRA is triggered to the extent that the TFC disposes of all or a portion of the stock of the transferred corporation. The final regulations also adopt the rule contained in the proposed regulations that a GRA is triggered if the transferred corporation disposes of substantially all of its assets (within the meaning of section 368(a)(1)(C)). In addition, the final regulations provide that a GRA will be triggered if the U.S. transferor is either a U.S. citizen or long-term resident (as defined in section 877(e)(2)) at the time of the initial transfer and such person ceases to be a U.S. citizen or long-term resident during the GRA term.

Under the current temporary regulations, if a GRA is triggered, the U.S. transferor must amend its tax return for the year of the initial transfer, include in income the gain that was realized but not recognized, and pay the tax due thereon with interest. The proposed regulations would have maintained the amended return/interest charge requirement, but requested comments as to (i) the amount of gain to be recognized by the U.S. transferor upon a triggering event, (ii) the year in which the gain should be included in the income of the U.S. transferor, and (iii) whether an interest charge is appropriate.

A number of commentators have suggested that the 10-year GRA term under Notice 87–85 in certain instances is too restrictive because a disposition of the stock of the transferred corporation in year 8, for example, would likely not be a tax avoidance transfer but the interest charges would be burdensome in such case. Other commentators suggested a deferred income approach similar to that applicable in the consolidated return deferred intercompany context.

In response to these comments, these final regulations contain two significant modifications to the current temporary regulations. First, in conformity with the final inversion regulations, these regulations provide that the GRA term will be 5 years in all cases involving outbound transfers of foreign stock. (Moreover, taxpayers may elect to apply these final regulations to past transactions so that any 10-year GRA that is in existence (i.e., has not been triggered) on July 20, 1998 will be a 5-year GRA. Thus, the 10-year GRA will be considered to be a 5-year GRA by the IRS, and, such GRA will terminate on the fifth full taxable year following the close of the taxable year of the initial transfer.) Second, because the IRS and the Treasury Department are concerned that the amended return requirement can be burdensome to taxpayers in the event that a GRA is triggered, the final regulations contain an election (the GRA election), which must be filed with the

U.S. transferor's tax return that includes the date of the initial transfer, that permits taxpayers to report a triggering event in the year of the triggering event rather than on an amended return for the year of the initial transfer. (No such election is available with respect to GRAs that are in existence when these final regulations become effective.)

Even if a transferor makes a GRA election, such person is still required to extend the statute of limitations, comply with all of the applicable GRA reporting requirements (such as filing annual certifications) and, in the case of a triggering event, include in income the GRA amount plus interest in the same manner as under the current temporary regulations, except that (i) the GRA amount and interest would be included on the U.S. transferor's tax return for the year that includes the triggering event, and (ii) other computations, such as the section 1248 amount (if any) attributable to the transferred stock, will be determined on the triggering date rather than the date of the initial transfer.

Consistent with the proposed regulations, the final regulations clarify that post-GRA nonrecognition transactions (e.g., nonrecognition transactions in which the U.S. transferor transfers the stock of the TFC, the TFC transfers the stock of the transferred corporation, or the transferred corporation transfers substantially all of its assets) generally do not trigger the GRA, provided that the U.S. transferor reports the transaction and amends the GRA to reflect the post-GRA transaction.

The current temporary regulations do not provide instances that would cause the GRA to be terminated (i.e., extinguished). The proposed regulations would have provided that the GRA would be terminated if either (i) the U.S. transferor disposed of all of its TFC stock in a taxable transaction, or (ii) the transferred company is a U.S. company that sold substantially all of its assets in a taxable transaction (but only if the transferred company was affiliated with the U.S. transferor under section 1504(a)(2) prior to the initial transfer).

The final regulations retain these two rules. In addition, the final regulations also provide that a GRA will be terminated if (i) the TFC distributes the stock of the transferred corporation back to the U.S. transferor in a section 355 exchange, or (ii) the TFC liquidates into the U.S. transferor under section 332, provided that, immediately after the section 355 distribution or section 332 liquidation, the U.S. transferor's basis in the transferred stock is less than or equal to the basis that it had in the transferred stock immediately prior to the initial transfer of such stock.

Finally, the current temporary regulations provide (and the 1991 proposed regulations would have provided) certain restrictions on taxpayers' ability to use net operating losses and credits to offset the amount of gain recognized upon the trigger of a GRA. In response to suggestions from commentators, the final regulations remove these restrictions.

Section 367(a) and ''Check-the-Box'' Rules

The IRS and the Treasury Department are aware that taxpayers may attempt to use the entity classification (i.e., check-the-box) regulations to avoid entering into GRAs. For example, assume that a U.S. transferor (USP) owns all of the stock of two CFCs, CFC1 and CFC2. USP transfers the stock of CFC2 to CFC1 in an exchange otherwise described as both a section 351 exchange and a B reorganization. USP elects under § 301.7701–3(c) to treat CFC2 as a disregarded entity, and such election is effective immediately prior to the transfer.

Provided that the election is respected, USP would, for Federal income tax purposes, transfer the assets (and not the stock) of CFC2 to CFC1 in a section 351 exchange. If the assets will be used by CFC1 in the active conduct of a trade or business outside the United States, the transfer of the assets by USP will qualify for the exception contained in section 367(a)(3) and § 1.367(a)–2T (as limited by certain provisions, including §§ 1.367(a)–4T through 1.367(a)–6T). If the assets are disposed of (either directly by CFC2 or because the stock of CFC2 is disposed of by CFC1) in connection with the transfer to CFC1, the step transaction doctrine may apply to deny nonrecognition treatment to the outbound transfer to the extent it is treated as an asset transfer. In addition, the active trade or business exception under § 1.367(a)–2T is inapplicable if, as part of the same transaction in which the TFC received the assets, it disposes of such assets. See § 1.367(a)–2T(c). Thus, if USP intended to sell CFC2 or its business at the time of the election or the asset transfer, the transfer would be treated as a taxable exchange under section 367(a)(1). If the step transaction doctrine and the active trade or business anti-avoidance rule do not apply, however, the use of the ''check-the-box'' regulations in this context will not be viewed as inconsistent with the purposes of section 367(a), and, therefore, the transaction will be respected as an asset transfer.

Section 367(a) and Tax-Motivated Transactions

The IRS and the Treasury Department are aware that certain taxpayers have entered into (or are contemplating) transactions that are designed to avoid the inversion regulations under § 1.367(a)–3(c). In these transactions (where a foreign corporation acquires the stock of a domestic corporation), one or more U.S. transferors attempt to avoid taxation under the inversion regulations by retaining an equity interest (or receiving a modified equity interest) in the domestic target corporation. Such interest, however, is typically coupled with an interest in the foreign acquirer, or a right to convert the interest in the domestic target into stock of the foreign acquirer.

The IRS and the Treasury Department are currently scrutinizing these transactions on a case-by-case basis using substance over form (or other) principles, and are studying whether it is appropriate to issue specific guidance with respect to these transactions. Comments are requested as to the instances in which a U.S. transferor that receives (or maintains) a stock interest in the domestic target in circumstances similar to those described above should not be treated as having received stock in the foreign acquirer for purposes of section 367(a).

Section 367(b)

This document finalizes the 1991 proposed section 367(b) regulations to the extent necessary to address those transfers of foreign stock subject to both sections 367(a) and (b) under the 1991 proposed regulations.

In addition, this document contains a number of other miscellaneous provisions, at the request of commentators.

First, under current law, if a United States shareholder (defined under § 7.367(b)–2(b) as a 10 percent shareholder of a CFC within the past 5 years) exchanges, under section 351, stock of a foreign corporation for stock of a domestic corporation, the U.S. transferor is not taxable under section 367(b). However, if the transaction constitutes a section 354 exchange, under § 7.367(b)–7(c)(1) the United States shareholder must include in income the section 1248 amount attributable to the stock exchanged. Consistent with the 1991 proposed regulations as well as the purpose of these final regulations to harmonize the Federal income tax consequences of substantially similar transactions, the final section 367(b) regulations provide that a section 1248 inclusion generally

is not required in the case of the section 354 exchange described above. (This result is accomplished by excluding domestic stock from the categories of nonqualifying consideration described in § 1.367(b)–4(b)(1). Thus, these transfers will generally be respected as nonrecognition exchanges under 367(b).)

Second, consistent with the principles of section 367(b), in cases where the final regulations do not require that the section 1248 amount be included in income, the regulations clarify the appropriate treatment of post-reorganization exchanges under section 1248 or 367(b). See § 1.367(b)–4(b)(5).

Third, in an effort to reduce the reporting burdens of U.S. persons that make outbound transfers of foreign stock or securities, the section 367(b) regulations are amended to provide that, to the extent that a transaction is described in both sections 367(a) and (b), and the exchanging shareholder is not a United States shareholder of the corporation whose stock is exchanged, reporting under section 367(b) is not required. See § 1.367(b)–1(c).

Finally, the proposed section 367(b) regulations provided that final regulations generally would be effective for exchanges that occur on or after 30 days after the final regulations were published in the **Federal Register**. However, § 1.367(b)–2(d) (relating to the definition of the all earnings and profits amount) was proposed to be effective for transfers occurring on or after August 26, 1991. In response to comments regarding this provision and its effective date, a separate notice of proposed rulemaking is issued with these final regulations to delete the August 26, 1991, effective date with respect to the all earnings and profits amount. Thus, the definition of the all earnings and profits amount that will be included in forthcoming section 367(b) final regulations will apply to exchanges that occur on or after 30 days after the issuance of those final regulations.

The IRS and the Treasury Department will issue guidance at a later date to address section 367(b) provisions described in the 1991 proposed regulations that are not addressed herein.

Section 6038B: In General

Section 6038B, as enacted under the Deficit Reduction Act of 1984 (Public Law 98–369), provided that U.S. persons that made certain outbound transfers of property to foreign corporations were required to report those transfers in the manner prescribed by regulations. The penalty for failure to comply with the regulations was 25 percent of the gain realized on the exchange, unless the failure was due to reasonable cause and not to willful neglect. (The penalty was modified by the Taxpayer Relief Act of 1997 (TRA '97).)

Section 1.6038B–1T, promulgated on May 15, 1986, by TD 8087 (together with regulations under sections 367(a) and (d)), provided rules concerning the information that was required to be reported under section 6038B with respect to transfers of property to foreign corporations.

Section 6038B: Transfers of Stock or Securities

Section 1.6038B–1T(b)(2)(i) of the current temporary regulations provides, inter alia, that no notice is required under section 6038B with respect to a transfer of stock or securities described in § 1.367(a)–3T(f)(1) of the current temporary regulations. Section 1.367(a)–3T(f)(1) had provided that an outbound transfer of stock or securities of a domestic or foreign corporation was not taxable under section 367(a)(1) if immediately after the transfer (i) all U.S. transferors owned in the aggregate less than 20 percent of both the total voting power and the total value of the stock of the TFC, or (ii) all U.S. transferors owned in the aggregate 20 percent or more of either the total voting power or the total value of the stock of the TFC, but less than 50 percent of that total voting power and total value and the subject U.S. transferor was not a 5-percent shareholder.

Notice 87–85 superseded the 1986 temporary regulations under section 367(a) (including § 1.367(a)–3T(f)(1)) with respect to the exceptions available for outbound stock transfers. Notice 87–85 provided that final regulations would incorporate the rules contained in the Notice, for transfers occurring after December 16, 1987. The exceptions in the 1986 temporary regulations, including § 1.367(a)–3T(f)(1) of the current temporary regulations, were removed as deadwood (for transfers occurring after December 16, 1987) by the 1995 temporary inversion regulations (TD 8638).

Prior to the issuance of these final regulations, however, section 6038B had not been amended with respect to outbound transfers of stock or securities. Thus, there was uncertainty whether a U.S. transferor that qualified under the inversion regulations or Notice 87–85 for nonrecognition treatment without filing a GRA (i.e., such U.S. transferor was not a 5-percent shareholder) was required to comply with section 6038B.

To reduce the reporting burdens on U.S. taxpayers that make outbound transfers of stock subject to section 6038B, the final section 6038B regulations provide that, with respect to transfers occurring after December 16, 1987, and before these final regulations are generally effective, a U.S. transferor that makes an outbound transfer subject to section 367(a) will not be subject to section 6038B with respect to such transfer if (i) such person was not a 5-percent shareholder and the transfer qualified for nonrecognition treatment under section 367(a), or (ii) such person was not a 5-percent shareholder in the case of a taxable transaction but such person included the gain on its Federal income tax return for the taxable year that included the date of the transfer.

With respect to transfers occurring after these final regulations are effective, these regulations contain the two exceptions described above. In addition, a 5-percent shareholder that is required to file a GRA is not subject to section 6038B provided that a GRA is properly filed. Moreover, U.S. transferors that are taxable on their outbound transfers of stock or securities (such as under the inversion regulations or because a 5-percent shareholder that was eligible to qualify for nonrecognition treatment chose not to file a GRA) are not subject to section 6038B if they properly report the gain recognized on the transfer on their tax returns that include the date of the transfer.

Thus, a U.S. transferor that does not properly report the gain recognized on its outbound stock transfer has not met its section 6038B filing obligation with respect to such transfer, and will be subject to the penalty under section 6038B, unless the transferor's failure to report the gain from the outbound transfer was due to reasonable cause and not willful neglect. Such person will also be subject to the extended statute of limitations under section 6501(c)(8).

Section 6038B: Transfers of Cash and Unappreciated Property

As noted above, prior to the enactment of TRA '97, the penalty for failure to comply with section 6038B was 25 percent of the gain realized on the outbound transfer. Thus, in the case of an outbound transfer of cash or unappreciated property required to be reported under section 6038B, no penalty was imposed upon the failure to report the transfer.

Pursuant to the TRA '97, the penalty for failure to report under section 6038B is revised from 25 percent of the gain realized in the property transferred to 10 percent of the fair market value of the property transferred, but limited to $100,000 unless the failure to report the

exchange was due to intentional disregard. (The final regulations reflect the modification to the penalty provision under section 6038B.)

In response to the TRA '97 change to the penalty structure under section 6038B, these final regulations clarify that transfers of unappreciated property are required to be reported, or the 10 percent penalty will apply. These final regulations, however, do not require outbound transfers of cash to be reported. Rules regarding outbound transfers of cash will be provided in future regulations.

Section 6038B: Other Transfers

Pursuant to TRA '97, certain outbound transfers to foreign partnerships are required to be reported under section 6038B. Rules regarding outbound transfers to foreign corporations of assets not covered in these final regulations (such as intangibles), and outbound transfers to foreign partnerships, will be addressed in separate guidance.

Section 367(d) and Other TRA '97 Matters

A clarification provides that certain rules under section 367(a) will also apply under section 367(d) for purposes of determining the identity of the transferor that makes an outbound transfer of an intangible subject to section 367(d). Section 367(a)(4) and § 1.367(a)–1T(c)(5) provide that, for purposes of section 367(a), a partnership is treated as an aggregate in cases where a U.S. person transfers a partnership interest or a partnership makes an outbound transfer of stock (or other assets).

The IRS and the Treasury Department believe that the identity of the transferor has been and must be consistent under both sections 367(a) and (d). Consequently, a U.S. person may not attempt the use of a foreign partnership as an intermediary (in light of the repeal of section 1491) for an outbound transfer of an intangible by a U.S. person to a foreign corporation to avoid section 367(d). In the case of a transfer of an intangible by a partnership to a foreign corporation that qualifies as a section 351 exchange, each partner that is a U.S. person is treated as transferring its share of the intangible in a transfer that is subject to section 367(d).

Guidance under TRA '97 relating to the repeal of section 1491 may address situations in which inappropriate results can be achieved through transactions facilitated by such repeal. For example, guidance may address the appropriate tax consequences when a U.S. person who is a United States shareholder of a CFC transfers stock in the CFC to a foreign partnership, and immediately after the transfer the foreign corporation loses its status as a CFC. Guidance is generally not, however, expected to require gain recognition under section 721(c) in cases where gain is not inappropriately shifted to foreign persons.

Effective Dates

The final regulations contained herein are generally effective for transfers occurring on or after July 20, 1998. However, taxpayers generally may elect to apply the final regulations under § 1.367(a)–3(b) and (d) to transfers of foreign stock or securities occurring after December 17, 1987. A taxpayer that makes the election must apply section 367(b) and the regulations thereunder to such transfers. In the case of a transfer described in section 351, an electing transferor must apply section 367(b) and the regulations thereunder as if the exchange was described in § 7.367(b)–7. Thus, for example, in a case of a section 351 exchange in which a U.S. person exchanges stock of a CFC in which it is a United States shareholder but does receive back stock of a CFC in which it is a United States shareholder, the electing transferor must include in income the section 1248 amount with respect to the transferred stock.

Special Analyses

It has been determined that this regulation is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information contained in this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that these final regulations generally reduce the reporting requirements in comparison with the requirements contained under current law and the proposed sections 367(a) and (b) regulations. For example, the maximum term of the GRA under section 367(a) is reduced from 10 to 5 years, thus eliminating the need for annual certifications in years 5 through 9. Moreover, the requirements under section 6038B have been substantially revised for outbound transfers of stock described in section 367(a) so that the amount of filing required under that section will be significantly reduced. In addition, as a general matter, these regulations will primarily affect large shareholders and U.S. multinational corporations with foreign operations. Thus, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Drafting Information

The principal author of these regulations is Philip L. Tretiak of the Office of Associate Chief Counsel (International), within the Office of Chief Counsel, IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Parts 1 and 7

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 7 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entry for section 1.367(b)–7 and adding new entries to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.367(a)–3 also issued under 26 U.S.C. 367(a) and (b).

Section 1.367(a)–8 also issued under 26 U.S.C. 367(a) and (b).

Section 1.367(b)–1 also issued under 26 U.S.C. 367(a) and (b). * * *

Section 1.367(b)–4 also issued under 26 U.S.C. 367(a) and (b).

Section 1.367(b)–7 also issued under 26 U.S.C. 367(a) and (b). * * *

Par. 2. Section 1.367(a)–1T is amended as follows:

1. Paragraph (a), fourth sentence is amended by removing the reference ''§ 1.367(a)–3T'' and adding ''§ 1.367(a)–3'' in its place.

2. Paragraph (a), last sentence is amended by removing the reference ''§ 1.6038B–1T'' and adding ''§§ 1.6038B–1 and 1.6038B–1T'' in its place.

3. Paragraph (b)(2)(i) is removed and reserved.

4. Paragraph (b), the concluding text immediately following paragraph (b)(2)(iii) is removed.

5. Paragraph (c)(1), the last sentence is removed.

6. Paragraph (c)(2) is revised to read as set forth below.

7. Paragraph (c)(3)(ii)(C), the second sentence of the concluding text immediately following paragraph (c)(3)(ii)(C)(*2*) is amended by removing the language ''§ 1.367(a)–3T'' and adding ''§ 1.367(a)–3'' in its place.

§ 1.367(a)–1T Transfers to foreign corporations subject to section 367(a): in general (temporary).

* * * * *

(c) * * *

(2) *Indirect transfers in certain reorganizations.* [Reserved] For further guidance, see § 1.367(a)–3(d).

* * * * *

Par. 3. Section 1.367(a)–3 is amended as follows:

1. Paragraphs (a) and (b) are revised.
2. Paragraph (c)(1)(iii)(B) is amended by removing the reference ''§ 1.367(a)–3T(g)'' and adding ''§ 1.367(a)–8'' in its place.
3. Revising paragraph (d).
4. Removing paragraphs (e) through (h) and adding paragraphs (e), (f) and (g).

The revisions and additions read as follows:

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

(a) *In general.* This section provides rules concerning the transfer of stock or securities by a U.S. person to a foreign corporation in an exchange described in section 367(a). In general, a transfer of stock or securities by a U.S. person to a foreign corporation that is described in section 351, 354 (including a reorganization described in section 368(a)(1)(B) and including an indirect stock transfer described in paragraph (d) of this section), 356 or section 361(a) or (b) is subject to section 367(a)(1) and, therefore, is treated as a taxable exchange, unless one of the exceptions set forth in paragraph (b) of this section (regarding transfers of foreign stock or securities) or paragraph (c) of this section (regarding transfers of domestic stock or securities) applies. However, if in an exchange described in section 354, a U.S. person exchanges stock of one foreign corporation for stock of another foreign corporation in a reorganization described in section 368(a)(1)(E), or a U.S. person exchanges stock of a domestic corporation for stock of a foreign corporation pursuant to an asset reorganization described in section 368(a)(1)(C), (D) or (F) that is not treated as an indirect stock transfer under paragraph (d) of this section, such section 354 exchange is not a transfer to a foreign corporation subject to section 367(a). See, e.g., paragraph (d)(3) *Example 12.* For rules regarding other indirect or constructive transfers of stock or securities subject to section 367(a), see § 1.367(a)–1T(c). For additional rules relating to an exchange involving a foreign corporation in connection with which there is a transfer of stock, see section 367(b) and the regulations under that section. For additional rules regarding a transfer of stock or securities in an exchange described in section 361(a) or (b), see section 367(a)(5) and any regulations under that section. For rules regarding reporting requirements with respect to transfers described under section 367(a), see section 6038B and the regulations thereunder.

(b) *Transfers by U.S. persons of stock or securities of foreign corporations to foreign corporations*—(1) *General rule.* Except as provided in section 367(a)(5), a transfer of stock or securities of a foreign corporation by a U.S. person to a foreign corporation that would otherwise be subject to section 367(a)(1) under paragraph (a) of this section shall not be subject to section 367(a)(1) if either—

(i) *Less than 5-percent shareholder.* The U.S. person owns less than five percent (applying the attribution rules of section 318, as modified by section 958(b)) of both the total voting power and the total value of the stock of the transferee foreign corporation immediately after the transfer; or

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

(2) *Certain transfers subject to sections 367(a) and (b)*—(i) *In general.* A transfer of foreign stock or securities described in section 367(a) or any regulations thereunder as well as in section 367(b) or any regulations thereunder shall be concurrently subject to sections 367(a) and (b) and the regulations thereunder, except to the extent that the transferee foreign corporation is not treated as a corporation under section 367(a)(1). The example in paragraph (b)(2)(ii) of this section illustrates the rules of this paragraph (b)(2). For an illustration of the interaction of the indirect stock transfer rules under section 367(a) (described under paragraph (d) of this section) and the rules of section 367(b), see paragraph (d)(3) *Example 11* of this section.

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

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

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

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

* * * * *

(d) *Indirect stock transfers in certain nonrecognition transfers*—(1) *In general.* For purposes of this section, a U.S. person who exchanges, under section 354 (or section 356) stock or securities in a domestic or foreign corporation for stock or securities in a foreign corporation in connection with one of the following transactions described in paragraphs (d)(1)(i) through (v) of this section (or who is deemed to make such an exchange under paragraph (d)(1)(vi) of this section) shall be treated as having made an indirect transfer of such stock or securities to a foreign corporation that is subject to the rules of this section, including, for example, the requirement, where applicable, that the U.S. transferor enter into a gain recognition agreement to preserve nonrecognition treatment under section 367(a). If the U.S. person exchanges stock or securities of a foreign corporation, see also section 367(b) and the regulations thereunder. For an example of the concurrent application of the indirect stock transfer rules under section 367(a) and the rules of section 367(b), see, e.g., paragraph (d)(3) *Example 11* of this section.

(i) *Mergers described in sections 368(a)(1)(A) and (a)(2)(D).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation)

for stock or securities of a foreign corporation that controls the acquiring corporation in a reorganization described in sections 368(a)(1)(A) and (a)(2)(D). See, e.g., paragraph (d)(3) *Example 1* of this section.

(ii) *Mergers described in sections 368(a)(1)(A) and (a)(2)(E).* A U.S. person exchanges stock or securities of a corporation (the acquiring corporation) for stock or securities in a foreign corporation that controls the acquired corporation in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E).

(iii) *Triangular reorganizations described in section 368(a)(1)(B).* A U.S. person exchanges stock of the acquired corporation for voting stock of a foreign corporation that is in control (as defined in section 368(c)) of the acquiring corporation in connection with a reorganization described in section 368(a)(1)(B). See, e.g., paragraph (d)(3) *Example 4* of this section.

(iv) *Triangular reorganizations described in section 368(a)(1)(C).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for voting stock or securities of a foreign corporation that controls the acquiring corporation in a reorganization described in section 368(a)(1)(C). See, e.g., paragraph (d)(3) *Example 5* of this section (for an example of a triangular section 368(a)(1)(C) reorganization involving domestic acquired and acquiring corporations), and paragraph (d)(3) *Example 7* of this section (for an example involving a domestic acquired corporation and a foreign acquiring corporation). If the acquired corporation is a foreign corporation, see paragraph (d)(3) *Example 11* of this section, and section 367(b) and the regulations thereunder.

(v) *Reorganizations described in sections 368(a)(1)(C) and (a)(2)(C).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for voting stock or securities of a foreign acquiring corporation in a reorganization described in sections 368(a)(1)(C) and (a)(2)(C) (other than a triangular section 368(a)(1)(C) reorganization described in paragraph (d)(1)(iv) of this section). In the case of a reorganization in which some but not all of the assets of the acquired corporation are transferred pursuant to section 368(a)(2)(C), the transaction shall be considered to be an indirect transfer of stock or securities subject to this paragraph (d) only to the extent of the assets so transferred. (Other assets shall be treated as having been transferred in an asset transfer rather than an indirect stock transfer, and such asset transfer would be subject to the other provisions of section 367, including sections 367(a)(1), (3), (5) and (d) if the acquired corporation is a domestic corporation). See, e.g., paragraph (d)(3) *Example 5B* of this section.

(vi) *Successive transfers of property to which section 351 applies.* A U.S. person transfers property (other than stock or securities) to a foreign corporation in an exchange described in section 351, and all or a portion of such assets transferred to the foreign corporation by such person are, in connection with the same transaction, transferred to a second corporation that is controlled by the foreign corporation in one or more exchanges described in section 351. For purposes of this paragraph (d)(1) and § 1.367(a)–8, the initial transfer by the U.S. person shall be deemed to be a transfer of stock described in section 354. (Any assets transferred to the foreign corporation that are not transferred by the foreign corporation to a second corporation shall be treated as a transfer of assets subject to the general rules of section 367, including sections 367(a)(1), (3), (5) and (d), and not as an indirect stock transfer under the rules of this paragraph (d).) See, e.g., paragraph (d)(3) *Example 10* and *Example 10A* of this section.

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

(i) *Transferee foreign corporation.* The transferee foreign corporation shall be the foreign corporation that issues stock or securities to the U.S. person in the exchange.

(ii) *Transferred corporation.* The transferred corporation shall be the acquiring corporation, except that in the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii) of this section, the transferred corporation shall be the acquired corporation; in the case of a triangular section 368(a)(1)(C) reorganization described in paragraph (d)(1)(iv) of this section followed by a section 368(a)(2)(C) transfer or a section 368(a)(1)(C) reorganization followed by a section 368(a)(2)(C) transfer described in paragraph (d)(1)(v) of this section, the transferred corporation shall be the transferee corporation; and in the case of successive section 351 transfers described in paragraph (d)(1)(vi) of this section, the transferred corporation shall be the transferee corporation in the final section 351 transfer. The transferred property shall be the stock or securities of the transferred corporation, as appropriate in the circumstances.

(iii) *Amount of gain.* The amount of gain that a U.S. person is required to include in income in the event of a disposition (or a deemed disposition) of some or all of the stock or securities of the transferred corporation shall be the proportionate share (as determined under § 1.367(a)–8(e)) of the U.S. person's gain realized but not recognized in the initial exchange (or deemed exchange) of stock or securities under section 354.

(iv) *Gain recognition agreements involving multiple parties.* The U.S. transferor's agreement to recognize gain, as provided in § 1.367(a)–8, shall include appropriate provisions, consistent with the principles of these rules, requiring the transferor to recognize gain in the event of a direct or indirect disposition of the stock or assets of the transferred corporation. For example, in the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii) of this section, a disposition of the transferred stock shall include an indirect disposition of such stock by the transferee foreign corporation, such as a disposition of such stock by the acquiring corporation or a disposition of the stock of the acquiring corporation by the transferee foreign corporation. See, e.g., paragraph (d)(3) *Example 4* of this section.

(v) *Determination of whether the transferred corporation disposed of substantially all of its assets.* For purposes of applying § 1.367(a)–8(e)(3)(i) to determine whether the transferred corporation has disposed of substantially all of its assets, the following assets shall be taken into account (but only if such assets are not fully taxable under section 367 in the taxable year that includes the indirect transfer)—

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

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

(C) In the case of a sections 368(a)(1)(C) and (a)(2)(C) reorganization described in paragraph (d)(1)(v) of this section, the assets of the acquired corporation that are subject to a transfer described in section 368(a)(2)(C); and

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

(vi) *Coordination between asset transfer rules and indirect stock transfer rules.* If, pursuant to any of the transactions described in paragraph (d)(1) of this section, a domestic corporation transfers (or is deemed to transfer) assets to a foreign corporation (other than in an exchange described in section 354), the rules of section 367, including sections 367(a)(1), (a)(3) and (a)(5), as well as section 367(d), and the regulations thereunder shall apply prior to the application of the rules of this section. However, if a transaction is described in this paragraph (d), section 367(a) shall not apply in the case of a domestic acquired corporation that transfers its assets to a foreign acquiring corporation, to the extent that such assets are re-transferred to a domestic corporation in a transfer described in section 368(a)(2)(C) or paragraph (d)(1)(vi) of this section, but only if the domestic transferee's basis in the assets is no greater than the basis that the domestic acquired company had in such assets. See, e.g., paragraph (d)(3) *Example 8* and *Example 10A* of this section.

(3) *Examples.* The rules of this paragraph (d) and § 1.367(a)–8 are illustrated by the following examples:

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

(ii) *Result.* Pursuant to paragraph (d)(1)(i) of this section, the reorganization is subject to the indirect stock transfer rules. F is treated as the transferee foreign corporation, and Newco is treated as the transferred corporation. Provided that the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that A enter into a five-year gain recognition agreement as described in § 1.367(a)–8, A's exchange of W stock for F stock under section 354 will not be subject to section 367(a)(1). If F disposes (within the meaning of § 1.367(a)–8(e)) of all (or a portion) of Newco's stock within the five-year term of the agreement (and A has not made a valid election under § 1.367(a)–8(b)(1)(vii)), A is required to file an amended return for the year of the transfer and include in income, with interest, the gain realized but not recognized on the initial section 354 exchange. If A has made a valid election under § 1.367(a)–8(b)(1)(vii) to include the amount subject to the gain recognition agreement in the year of the triggering event, A would instead include the gain on its tax return for the taxable year that includes the triggering event, together with interest.

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

(ii) *Result.* Even though A is the U.S. transferor, P is required under § 1.367(a)–8(a)(3) to enter into the gain recognition agreement and comply with the requirements under § 1.367(a)–8. In the event that A leaves the P group, A would make the annual certifications required under § 1.367(a)–8(b)(5)(ii). P would remain liable with A under the gain recognition agreement.

Example 2. Taxable inversion pursuant to indirect stock transfer rules—(i) *Facts.* The facts are the same as in *Example 1,* except that A receives more than fifty percent of either the total voting power or the total value of the stock of F in the transaction.

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

Example 3. Disposition by U.S. transferred corporation of substantially all of its assets—(i) *Facts.* The facts are the same as in *Example 1,* except that, during the third year of the gain recognition agreement, Newco disposes of substantially all (as described in § 1.367(a)–8(e)(3)(i)) of the assets described in paragraph (d)(2)(v)(A) of this section for cash and recognizes currently all of the gain realized on the disposition.

(ii) *Result.* Under § 1.367(a)–8(e)(3)(i), the gain recognition agreement is generally triggered when the transferred corporation disposes of substantially all of its assets. However, under the special rule contained in § 1.367(a)–8(h)(2), because A and W filed a consolidated Federal income tax return prior to the transaction, and Newco, the transferred corporation, is a domestic corporation, the gain recognition agreement is terminated and has no further effect.

Example 4. Triangular section 368(a)(1)(B) reorganization—(i) *Facts.* F, a foreign corporation, owns all the stock of S, a domestic corporation. U, a domestic corporation, owns all of the stock of Y, also a domestic corporation. U does not own any of the stock of F (applying the attribution rules of section 318, as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(B) and paragraph (d)(1)(iii) of this section, S acquires all the stock of Y, and U receives 10% of the voting stock of F.

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

Example 5. Triangular section 368(a)(1)(C) reorganization—(i) *Facts.* F, a foreign corporation, owns all of the stock of R, a domestic corporation that operates an historical business. V, a domestic corporation, owns all of the stock of Z, also a domestic corporation. V does not own any of the stock of F (applying the attribution rules of section 318 as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(C) (and paragraph (d)(1)(iv) of this section), R acquires all of the assets of Z, and V receives 30% of the voting stock of F.

(ii) *Result.* The consequences of the transfer are similar to those described in *Example 1*; V is required to enter into a 5-year gain recognition agreement under § 1.367(a)–8 to secure nonrecognition treatment under section 367(a). Under paragraphs (d)(2)(i) and (ii) of this section, F is treated as the transferee foreign corporation and R is treated as the transferred corporation. In determining whether, in a later transaction, R has disposed of substantially all of its assets under § 1.367(a)–8(e)(3)(i), see paragraph (d)(2)(v)(A) of this section.

Example 5A. Section 368(a)(1)(C) reorganization followed by section 368(a)(2)(C) exchange—(i) *Facts.* The facts are the same as in *Example 5,* except that the transaction is structured as a section 368(a)(1)(C) reorganization, followed by a section 368(a)(2)(C) exchange, and R is a foreign corporation. The following additional facts are present. Z has 3 businesses: Business A with a basis of $10 and a value of $50, Business B with a basis of $10 and a value of $40, and Business C with a basis of $10 and a value of $30. V and Z file a consolidated Federal income tax return and V has a basis of $30 in the Z stock, which has a value of $120. Assume that Businesses A and B consist solely of assets that will satisfy the section 367(a)(3) active trade or business exception; none of Business C's assets will satisfy the exception. Z transfers all 3 businesses to F in exchange for 30 percent of the F stock, which Z distributes to V pursuant to a section 368(a)(1)(C) reorganization. F then contributes Businesses B and C to R pursuant to section 368(a)(2)(C).

(ii) *Result.* The transfer of the Business A assets by Z to F is subject to the general rules under section 367, as such transfer does not constitute an indirect stock transfer. The transfer by Z of the Business B and C assets to F must first be tested under sections 367(a)(1), (3) and (5). Z recognizes $20 of gain on the outbound transfer of the Business C

assets, as such assets do not qualify for an exception to section 367(a)(1). The Business B assets, which will be used by R in an active trade or business outside the United States, qualify for the exception under section 367(a)(3) and § 1.367(a)–2T(c)(2). V is deemed to transfer the stock of Z to F in a section 354 exchange subject to the rules of paragraph (d). V must enter into the gain recognition agreement in the amount of $30 to preserve Z's nonrecognition treatment with respect to its transfer of Business B assets. Under paragraphs (d)(2)(i) and (ii) of this section, F is the transferee foreign corporation and R is the transferred corporation.

Example 5B. Section 368(a)(1)(C) reorganization followed by section 368(a)(2)(C) exchange with U.S. transferee—(i) *Facts.* The facts are the same as in *Example 5A*, except that R is a U.S. corporation.

(ii) *Result.* As in *Example 5A*, the outbound transfer of Business A assets to F is subject to section 367(a) and is not affected by the rules of this paragraph (d). The Business B assets qualified for nonrecognition treatment; the Business C assets did not. However, pursuant to paragraph (d)(2)(vi) of this section, the Business C assets are not subject to section 367(a)(1), provided that the basis of the assets in the hands of R is no greater than the basis of the assets in the hands of Z. V is deemed to make an indirect transfer under the rules of this paragraph (d). To preserve nonrecognition treatment under section 367(a), V must enter into a 5-year gain recognition agreement in the amount of $50, the amount of the appreciation in the Business B and C assets, as the transfer of such assets by Z were not taxable under section 367(a)(1) but were treated as an indirect stock transfer.

Example 6. Triangular section 368(a)(1)(C) reorganization followed by 351 exchange—(i) *Facts.* The facts are the same as in *Example 5*, except that, during the fourth year of the gain recognition agreement, R transfers substantially all of the assets received from Z to K, a wholly-owned domestic subsidiary of R, in an exchange described in section 351.

(ii) *Result.* The disposition by R, the transferred corporation, of substantially all of its assets would trigger the gain recognition agreement if the assets were disposed of in a taxable transaction. However, because the assets were transferred in a nonrecognition transaction, such transfer does not trigger the gain recognition agreement if V satisfies the reporting requirements contained in § 1.367(a)–8(g)(3)(i) (which includes the requirement that V amend its gain recognition agreement to reflect the transaction). See also paragraph (d)(2)(iv) of this section. To determine whether substantially all of the assets are disposed of, any assets of Z that were transferred by Z to R and then contributed by R to K are taken into account.

Example 6A. Triangular section 368(a)(1)(C) reorganization followed by section 351 exchange with foreign transferee—(i) *Facts.* The facts are the same as in *Example 6* except that K is a foreign corporation.

(ii) *Result.* This transfer of assets by R to K must be analyzed to determine its effect upon the gain recognition agreement, and such transfer is also an outbound transfer of assets that is taxable under section 367(a)(1) unless the active trade or business exception under section 367(a)(3) applies. If the transfer is fully taxable under section 367(a)(1), the transfer is treated as if the transferred company, R, sold substantially all of its assets. Thus, the gain recognition agreement would be triggered (but see § 1.367(a)–8(b)(3)(ii) for potential offsets to the gain to be recognized). If each asset transferred qualifies for nonrecognition treatment under section 367(a)(3) and the regulations thereunder (which require, under § 1.367(a)–2T(a)(2), the transferor to comply with the reporting requirements under section 6038B), the result is the same as in *Example 6*. If a portion of the assets transferred qualify for nonrecognition treatment under section 367(a)(3) and a portion are taxable under section 367(a)(1) (but such portion does not result in the disposition of substantially all of the assets), the gain recognition agreement will not be triggered if such information is reported as required under § 1.367(a)–8(b)(5) and (e)(3)(i).

Example 7. Concurrent application of asset transfer and indirect stock transfer rules in consolidated return setting—(i) *Facts.* Assume the same facts as in *Example 5*, except that R is a foreign corporation and V and Z file a consolidated return for Federal income tax purposes. The properties of Z consist of Business A assets, with an adjusted basis of $50 and fair market value of $90, and Business B assets, with an adjusted basis of $50 and a fair market value of $110. Assume that the Business A assets do not qualify for the active trade or business exception under section 367(a)(3), but that the Business B assets do qualify for the exception. V's basis in the Z stock is $100, and the value of such stock is $200.

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

Example 7A. Concurrent application without consolidated returns—(i) *Facts.* The facts are the same as in *Example 7*, except that V and Z do not file consolidated income tax returns.

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

Example 7B. Concurrent application with individual U.S. shareholder—(i) Facts. The facts are the same as in *Example 7*, except that V is an individual U.S. citizen.

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

Example 7C. Concurrent application with nonresident alien shareholder—(i) *Facts.* The facts are the same as in *Example 7*, except that V is a nonresident alien.

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

Example 8. Concurrent application with section 368(a)(2)(C) Exchange—(i) *Facts.* The facts are the same as in *Example 7*, except that R transfers the Business A assets to M, a wholly-owned domestic subsidiary of R, in an exchange described in section 368(a)(2)(C).

(ii) *Result.* Pursuant to paragraph (d)(2)(vi) of this section, section 367(a)(1) does not apply to Z's transfer of Business A assets to

R, because such assets are transferred to M, a domestic corporation. Sections 367(a)(1), (3) and (5), as well as section 367(d), apply to Z's transfer of assets to R to the extent that such assets are not transferred to M. However, the Business B assets qualify for an exception to taxation under section 367(a)(3). Thus, if the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that V enter into a 5-year gain recognition agreement and comply with the requirements of § 1.367(a)–8 with respect to the gain realized on the Z stock, $100, the entire transaction qualifies for nonrecognition treatment under section 367(a)(1). See also section 367(a)(5) and any regulations issued thereunder. Under paragraphs (d)(2)(i) and (ii) of this section, the transferee foreign corporation is F and the transferred corporation is M. Pursuant to paragraph (d)(2)(iv) of this section, a disposition by F of the stock of R, or a disposition by R of the stock of M, will trigger the gain recognition agreement. To determine whether substantially all of the assets have been disposed of (as described under § 1.367(a)–8(e)(3)(i)), the Business A assets in M and the Business B assets in R must both be considered.

Example 9. Concurrent application of direct and indirect stock transfer rules—(i) *Facts.* F, a foreign corporation, owns all of the stock of O, also a foreign corporation. D, a domestic corporation, owns all of the stock of E, also a domestic corporation, which owns all of the stock of N, also a domestic corporation. Prior to the transactions described in this *Example 9,* D, E and N filed a consolidated income tax return. D has a basis of $100 in the stock of E, which has a fair market value of $160. The N stock has a fair market value of $100, and E has a basis of $60 in such stock. In addition to the stock of N, E owns the assets of Business X. The assets of Business X have a fair market value of $60, and E has a basis of $50 in such assets. Assume that the Business X assets qualify for nonrecognition treatment under section 367(a)(3). D does not own any stock in F (applying the attribution rules of section 318 as modified by section 958(b)). In a triangular reorganization described in section 368(a)(1)(C) and paragraph (d)(1)(iv) of this section, O acquires all of the assets of E, and D exchanges its stock in E for 40% of the voting stock of F.

(ii) *Result.* E's transfer of its assets, including the N stock, must be tested under the general rules of section 367(a) before consideration of D's indirect transfer of the stock of E. E's transfer of the assets of Business X qualify for nonrecognition under section 367(a)(3). E could qualify for nonrecognition treatment with respect to its transfer of N stock if it enters into a gain recognition agreement (and all of the requirements of paragraph (c)(1)(i) of this section are satisfied); however under § 1.367(a)–8(f)(2)(i), D, the parent of the consolidated group, must enter into the agreement. O is the transferee foreign corporation; N is the transferred corporation. D may also qualify for nonrecognition with respect to its indirect transfer of the stock of E if it enters into a separate gain recognition agreement with respect to the E stock (and all of the requirements of paragraph (c)(1)(i) of this section are satisfied). As to this transfer, F is the transferee foreign corporation; O is the transferred corporation. The amount of the gain recognition agreement is $60. See also section 367(a)(5) and any regulations issued thereunder.

Example 10. Successive section 351 exchanges—(i) *Facts.* D, a domestic corporation, owns all the stock of X, a controlled foreign corporation that operates an historical business, which owns all the stock of Y, a controlled foreign corporation that also operates an historical business. The properties of D consist of Business A assets, with an adjusted basis of $50 and a fair market value of $90, and Business B assets, with an adjusted basis of $50 and a fair market value of $110. Assume that the Business B assets qualify for the exception under section 367(a)(3) and § 1.367(a)–2T(c)(2), but that the Business A assets do not qualify for the exception. In an exchange described in section 351, D transfers the assets of Businesses A and B to X, and, in connection with the same transaction, X transfers the assets of Business B to Y in another exchange described in section 351.

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

Example 10A. Successive section 351 exchanges with ultimate domestic transferee—(i) *Facts.* The facts are the same as in *Example 10,* except that Y is a domestic corporation.

(ii) *Result.* As in *Example 10,* D must recognize $40 of income on the outbound transfer of the Business A assets. Although the Business B assets qualify for the exception under section 367(a)(3) (and end up in U.S. corporate solution, in Y), the $60 of gain realized on the Business B assets is nevertheless taxable under paragraphs (c)(1) and (d)(1)(vi) of this section because the transaction is considered to be a transfer by D of stock of a domestic corporation, Y, in which D receives more than 50 percent of the stock of the transferee foreign corporation, X. A gain recognition agreement is not permitted.

Example 11. Concurrent application of indirect stock transfer rules and section 367(b)—(i) *Facts.* F, a foreign corporation, owns all of the stock of Newco, which is also a foreign corporation. P, a domestic corporation, owns all of the stock of S, a foreign corporation that is a controlled foreign corporation within the meaning of section 957(a). P's basis in the stock of S is $50 and the value of S is $100. The section 1248 amount with respect to S stock is $30. In a reorganization described in section 368(a)(1)(C) (and paragraph (d)(1)(iv) of this section), Newco acquires all of the properties of S, and P exchanges its stock in S for 49 percent of the stock of F.

(ii) *Result.* P's exchange of S stock for F stock under section 354 will be taxable under section 367(a) (and section 1248 will be applicable) if P fails to enter into a 5-year gain recognition agreement in accordance with § 1.367(a)–8. Under paragraph (b)(2) of this section, if P enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder as well as section 367(a). Under § 7.367(b)–7(c)(1)(i) of this chapter, P must recognize the section 1248 amount of $30 because P exchanged stock of a controlled foreign corporation, S, for stock of a foreign corporation that is not a controlled foreign corporation, F. The indirect stock transfer rules do not apply with respect to section 367(b). The deemed dividend of $30 recognized by P will increase P's basis in the F stock received in the transaction, and F's basis in the Newco stock. Thus, the amount of the gain recognition agreement is $20 ($50 gain realized on the transfer less the $30 inclusion under section 367(b)). Under paragraphs (d)(2)(i) and (ii) of this section, F is treated as the transferee foreign corporation and Newco is the transferred corporation.

Example 11A. Triangular section 368(a)(1)(C) reorganization involving foreign acquired corporation—(i) *Facts.* Assume the same facts as in Example 11, except that P receives 51 percent of the stock of F.

(ii) *Result.* P may still enter into a gain recognition agreement to avoid taxation under section 367(a). There is, however, no inclusion under section 367(b) because P would be exchanging stock in one controlled foreign corporation for another. The amount of the gain recognition agreement is $50. See, also, § 1.367(b)–4(b)(4).

Example 12. Direct asset reorganization not subject to stock transfer rules—(i) *Facts.* D is a publicly traded domestic corporation. D's assets consist of tangible assets, including stock or securities. In a reorganization described in section 368(a)(1)(F), D becomes a foreign corporation, F.

(ii) *Result.* The reorganization is characterized under § 1.367(a)–1T(f). D's outbound transfer of assets is taxable under section 367(a)(1). Even if any of D's assets would have otherwise qualified for an exception to section 367(a)(1), section 367(a)(5) provides that no exception can

apply. The section 368(a)(1)(F) reorganization is not an indirect stock transfer described in paragraph (d) of this section. Moreover, the exchange by D's shareholders of D stock for F stock in an exchange described under section 354 is not an exchange described under section 367(a). See paragraph (a) of this section.

(e) *Effective dates*—(1) *In general.* The rules in paragraphs (a), (b) and (d) of this section apply to transfers occurring on or after July 20, 1998. The rules in paragraph (c) of this section with respect to transfers of domestic stock or securities are generally applicable for transfers occurring after January 29, 1997. See § 1.367(a)–3(c)(11). For rules regarding transfers of domestic stock or securities after December 16, 1987, and before January 30, 1997, and transfers of foreign stock or securities after December 16, 1987, and before July 20, 1998, see paragraph (g) of this section.

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

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

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

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

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

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

(iv) *Loss of United States shareholder status in the case of a transfer of foreign stock.* Notwithstanding the provisions of paragraphs (g)(2)(i) and (ii) of this section, in no event will any exception to section 367(a)(1) apply to the transfer of stock of a foreign corporation in which the U.S. transferor is a United States shareholder (as defined in § 7.367(b)–2(b) of this chapter or section 953(c)) unless the U.S. transferor receives back stock in a controlled foreign corporation (as defined in section 953(c), section 957(a) or section 957(b)) as to which the U.S. transferor is a United States shareholder immediately after the transfer.

§ 1.367(a)–3T [Removed]

Par. 4. Section 1.367(a)–3T is removed.

Par. 5. Section 1.367(a)–8 is added to read as follows:

§ 1.367(a)–8 Gain recognition agreement requirements.

(a) *In general.* This section specifies the general terms and conditions for an agreement to recognize gain entered into pursuant to § 1.367(a)–3(b) or (c) to qualify for nonrecognition treatment under section 367(a).

(1) *Filing requirements.* A transferor's agreement to recognize gain (described in paragraph (b) of this section) must be attached to, and filed by the due date (including extensions) of, the transferor's income tax return for the taxable year that includes the date of the transfer.

(2) *Gain recognition agreement forms.* Any agreement, certification, or other document required to be filed pursuant to the provisions of this section shall be submitted on such forms as may be prescribed therefor by the Commissioner (or similar statements providing the same information that is required on such forms). Until such time as forms are prescribed, all necessary filings may be accomplished by providing the required information to the Internal Revenue Service in accordance with the rules of this section.

(3) *Who must sign.* The agreement to recognize gain must be signed under penalties of perjury by a responsible officer in the case of a corporate transferor, except that if the transferor is a member but not the parent of an affiliated group (within the meaning of section 1504(a)(1)), that files a consolidated Federal income tax return for the taxable year in which the transfer was made, the agreement must be entered into by the parent corporation and signed by a responsible officer of such parent corporation; by the individual, in the case of an individual transferor (including a partner who is treated as a transferor by virtue of § 1.367(a)–1T(c)(3)); by a trustee, executor, or equivalent fiduciary in the case of a transferor that is a trust or estate; and by a debtor in possession or trustee in a bankruptcy case under Title 11, United States Code. An agreement may also be signed by an agent authorized to do so under a general or specific power of attorney.

(b) *Agreement to recognize gain*—(1) *Contents.* The agreement must set forth the following information, with the heading ''GAIN RECOGNITION AGREEMENT UNDER § 1.367(a)–8'', and with paragraphs labeled to correspond with the numbers set forth as follows—

(i) A statement that the document submitted constitutes the transferor's agreement to recognize gain in accordance with the requirements of this section;

(ii) A description of the property transferred as described in paragraph (b)(2) of this section;

(iii) The transferor's agreement to recognize gain, as described in paragraph (b)(3) of this section;

(iv) A waiver of the period of limitations as described in paragraph (b)(4) of this section;

(v) An agreement to file with the transferor's tax returns for the 5 full taxable years following the year of the transfer a certification as described in paragraph (b)(5) of this section;

(vi) A statement that arrangements have been made in connection with the transferred property to ensure that the transferor will be informed of any subsequent disposition of any property that would require the recognition of gain under the agreement; and

(vii) A statement as to whether, in the event all or a portion of the gain recognition agreement is triggered under paragraph (e) of this section, the taxpayer elects to include the required amount in the year of the triggering event rather than in the year of the initial transfer. If the taxpayer elects to include the required amount in the year of the triggering event, such statement must be included with all of the other information required under this paragraph (b), and filed by the due date (including extensions) of the transferor's income tax return for the taxable year that includes the date of the transfer.

(2) *Description of property transferred*—(i) The agreement shall include a description of each property transferred by the transferor, an estimate of the fair market value of the property as of the date of the transfer, a statement of the cost or other basis of the property and any adjustments thereto, and the date on which the property was acquired by the transferor.

(ii) If the transferred property is stock or securities, the transferor must provide the information contained in paragraphs (b)(2)(ii)(A) through (F) of this section as follows—

(A) The type or class, amount, and characteristics of the stock or securities transferred, as well as the name, address, and place of incorporation of the issuer of the stock or securities, and the percentage (by voting power and value) that the stock (if any) represents of the total stock outstanding of the issuing corporation;

(B) The name, address and place of incorporation of the transferee foreign corporation, and the percentage of stock (by voting power and value) that the U.S. transferor received or will receive in the transaction;

(C) If stock or securities are transferred in an exchange described in section 361(a) or (b), a statement that the conditions set forth in the second sentence of section 367(a)(5) and any regulations under that section have been satisfied, and an explanation of any basis or other adjustments made pursuant to section 367(a)(5) and any regulations thereunder;

(D) If the property transferred is stock or securities of a domestic corporation, the taxpayer identification number of the domestic corporation whose stock or securities were transferred, together with a statement that all of the requirements of § 1.367(a)–3(c)(1) are satisfied;

(E) If the property transferred is stock or securities of a foreign corporation, a statement as to whether the U.S. transferor was a United States shareholder (a U.S. transferor that satisfies the ownership requirements of section 1248(a)(2) or (c)(2)) of the corporation whose stock was exchanged, and, if so, a statement as to whether the U.S. transferor is a United States shareholder with respect to the stock received, and whether any reporting requirements contained in regulations under section 367(b) are applicable, and, if so, whether they have been satisfied; and

(F) If the transaction involved the transfer of assets other than stock or securities and the transaction was subject to the indirect stock transfer rules of § 1.367(a)–3(d), a statement as to whether the reporting requirements under section 6038B have been satisfied with respect to the transfer of property other than stock or securities, and an explanation of whether gain was recognized under section 367(a)(1) and whether section 367(d) was applicable to the transfer of such assets, or whether any tangible assets qualified for nonrecognition treatment under section 367(a)(3) (as limited by section 367(a)(5) and §§ 1.367(a)–4T, 1.367(a)–5T and 1.367(a)–6T).

(3) *Terms of agreement*—(i) *General rule.* If prior to the close of the fifth full taxable year (i.e., not less than 60 months) following the close of the taxable year of the initial transfer, the transferee foreign corporation disposes of the transferred property in whole or in part (as described in paragraphs (e)(1) and (2) of this section), or is deemed to have disposed of the transferred property (under paragraph (e)(3) of this section), then, unless an election is made in paragraph (b)(1)(vii) of this section, by the 90th day thereafter the U.S. transferor must file an amended return for the year of the transfer and recognize thereon the gain realized but

not recognized upon the initial transfer, with interest. If an election under paragraph (b)(1)(vii) of this section was made, then, if a disposition occurs, the U.S. transferor must include the gain realized but not recognized on the initial transfer in income on its Federal income tax return for the period that includes the date of the triggering event. In accordance with paragraph (b)(3)(iii) of this section, interest must be paid on any additional tax due. (If a taxpayer properly makes the election under paragraph (b)(1)(vii) of this section but later fails to include the gain realized in income, the Commissioner may, in his discretion, include the gain in the taxpayer's income in the year of the initial transfer.)

(ii) *Offsets.* No special limitations apply with respect to net operating losses, capital losses, credits against tax, or similar items.

(iii) *Interest.* If additional tax is required to be paid, then interest must be paid on that amount at the rates determined under section 6621 with respect to the period between the date that was prescribed for filing the transferor's income tax return for the year of the initial transfer and the date on which the additional tax for that year is paid. If the election in paragraph (b)(1)(vii) of this section is made, taxpayers should enter the amount of interest due, labelled as ''sec. 367 interest'' at the bottom right margin of page 1 of the Federal income tax return for the period that includes the date of the triggering event (page 2 if the taxpayer files a Form 1040), and include the amount of interest in their payment (or reduce the amount of any refund due by the amount of the interest). If the election in paragraph (b)(1)(vii) of this section is made, taxpayers should, as a matter of course, include the amount of gain as taxable income on their Federal income tax returns (together with other income or loss items). The amount of tax relating to the gain should be separately stated at the bottom right margin of page 1 of the Federal income tax return (page 2 if the taxpayer files a Form 1040), labelled as ''sec. 367 tax.''

(iv) *Basis adjustments*—(A) *Transferee.* If a U.S. transferor is required to recognize gain under this section on the disposition by the transferee foreign corporation of the transferred property, then in determining for U.S. income tax purposes any gain or loss recognized by the transferee foreign corporation upon its disposition of such property, the transferee foreign corporation's basis in such property shall be increased (as of the date of the initial transfer) by the amount of gain required to be recognized (but not by any tax or interest required to be paid on such amount) by the U.S. transferor. In the case of a deemed disposition of the stock of the transferred corporation described in paragraph (e)(3)(i) of this section, the transferee foreign corporation's basis in the transferred stock deemed disposed of shall be increased by the amount of gain required to be recognized by the U.S. transferor.

(B) *Transferor.* If a U.S. transferor is required to recognize gain under this section, then the U.S. transferor's basis in the stock of the transferee foreign corporation shall be increased by the amount of gain required to be recognized (but not by any tax or interest required to be paid on such amount).

(C) *Other adjustments.* Other appropriate adjustments to basis that are consistent with the principles of this paragraph (b)(3)(iv) may be made if the U.S. transferor is required to recognize gain under this section.

(D) *Example.* The principles of this paragraph (b)(3) are illustrated by the following example:

Example—(i) *Facts.* D, a domestic corporation owning 100 percent of the stock of S, a foreign corporation, transfers all of the S stock to F, a foreign corporation, in an exchange described in section 368(a)(1)(B). The section 1248 amount with respect to the S stock is $0. In the exchange, D receives 20 percent of the voting stock of F. All of the requirements of § 1.367(a)–3(c)(1) are satisfied, and D enters into a five-year gain recognition agreement to qualify for nonrecognition treatment and does not make the election contained in paragraph (b)(1)(vii) of this section. One year after the initial transfer, F transfers all of the S stock to F1 in an exchange described in section 351, and D complies with the requirements of paragraph (g)(2) of this section. Two years after the initial transfer, D transfers its entire 20 percent interest in F's voting stock to a domestic partnership in exchange for an interest in the partnership. Three years after the initial exchange, S disposes of substantially all (as described in paragraph (e)(3)(i) of this section) of its assets in a transaction that would be taxable under U.S. income tax principles, and D is required by the terms of the gain recognition agreement to recognize all the gain that it realized on the initial transfer of the stock of S.

(ii) *Result.* As a result of this gain recognition and paragraph (b)(3)(iv) of this section, D is permitted to increase its basis in the partnership interest by the amount of gain required to be recognized (but not by any tax or interest required to be paid on such amount), the partnership is permitted to increase its basis in the 20 percent voting stock of F, F is permitted to increase its basis in the stock of F1, and F1 is permitted to increase its basis in the stock of S. S, however, is not permitted to increase its basis in its assets for purposes of determining the direct or indirect U.S. tax results, if any, on the sale of its assets.

(4) *Waiver of period of limitation.* The U.S. transferor must file, with the agreement to recognize gain, a waiver of the period of limitation on assessment of tax upon the gain realized on the transfer. The waiver shall be executed on Form 8838 (Consent to Extend the Time to Assess Tax Under Section 367—Gain Recognition Agreement) and shall extend the period for assessment of such tax to a date not earlier than the eighth full taxable year following the taxable year of the transfer. Such waiver shall also contain such other terms with respect to assessment as may be considered necessary by the Commissioner to ensure the assessment and collection of the correct tax liability for each year for which the waiver is required. The waiver must be signed by a person who would be authorized to sign the agreement pursuant to the provisions of paragraph (a)(3) of this section.

(5) *Annual certification*—(i) *In general.* The U.S. transferor must file with its income tax return for each of the five full taxable years following the taxable year of the transfer a certification that the property transferred has not been disposed of by the transferee in a transaction that is considered to be a disposition for purposes of this section, including a disposition described in paragraph (e)(3) of this section. The U.S. transferor must include with its annual certification a statement describing any taxable dispositions of assets by the transferred corporation that are not in the ordinary course of business. The annual certification pursuant to this paragraph (b)(5) must be signed under penalties of perjury by a person who would be authorized to sign the agreement pursuant to the provisions of paragraph (a)(3) of this section.

(ii) *Special rule when U.S. transferor leaves its affiliated group.* If, at the time of the initial transfer, the U.S. transferor was a member of an affiliated group (within the meaning of section 1504(a)(1)) filing a consolidated Federal income tax return but not the parent of such group, the U.S. transferor will file the annual certification (and provide a copy to the parent corporation) if it leaves the group during the term of the gain recognition agreement, notwithstanding the fact that the parent entered into the gain recognition agreement, extended the statute of limitations pursuant to this section, and remains liable (with other corporations that were members of the group at the time of the initial transfer) under the

gain recognition agreement in the case of a triggering event.

(c) *Failure to comply*—(1) *General rule.* If a person that is required to file an agreement under paragraph (b) of this section fails to file the agreement in a timely manner, or if a person that has entered into an agreement under paragraph (b) of this section fails at any time to comply in any material respect with the requirements of this section or with the terms of an agreement submitted pursuant hereto, then the initial transfer of property is described in section 367(a)(1) (unless otherwise excepted under the rules of this section) and will be treated as a taxable exchange in the year of the initial transfer (or in the year of the failure to comply if the agreement was filed with a timely-filed (including extensions) original (not amended) return and an election under paragraph (b)(1)(vii) of this section was made). Such a material failure to comply shall extend the period for assessment of tax until three years after the date on which the Internal Revenue Service receives actual notice of the failure to comply.

(2) *Reasonable cause exception.* If a person that is permitted under § 1.367(a)–3(b) or (c) to enter into an agreement (described in paragraph (b) of this section) fails to file the agreement in a timely manner, as provided in paragraph (a)(1) of this section, or fails to comply in any material respect with the requirements of this section or with the terms of an agreement submitted pursuant hereto, the provisions of paragraph (c)(1) of this section shall not apply if the person is able to show that such failure was due to reasonable cause and not willful neglect and if the person files the agreement or reaches compliance as soon as he becomes aware of the failure. Whether a failure to file in a timely manner, or materially comply, was due to reasonable cause shall be determined by the district director under all the facts and circumstances.

(d) *Use of security.* The U.S. transferor may be required to furnish a bond or other security that satisfies the requirements of § 301.7101–1 of this chapter if the district director determines that such security is necessary to ensure the payment of any tax on the gain realized but not recognized upon the initial transfer. Such bond or security will generally be required only if the stock or securities transferred are a principal asset of the transferor and the director has reason to believe that a disposition of the stock or securities may be contemplated.

(e) *Disposition (in whole or in part) of stock of transferred corporation*—(1) *In general*—(i) *Definition of disposition.* For purposes of this section, a disposition of the stock of the transferred corporation that triggers gain under the gain recognition agreement includes any taxable sale or any disposition treated as an exchange under this subtitle, (e.g., under sections 301(c)(3)(A), 302(a), 311, 336, 351(b) or section 356(a)(1)), as well as any deemed disposition described under paragraph (e)(3) of this section. It does not include a disposition that is not treated as an exchange, (e.g., under section 302(d) or 356(a)(2)). A disposition of all or a portion of the stock of the transferred corporation by installment sale is treated as a disposition of such stock in the year of the installment sale. A disposition of the stock of the transferred corporation does not include certain transfers treated as nonrecognition transfers (under paragraph (g) of this section) in which the gain recognition agreement is retained but modified, or certain transfers (under paragraph (h) of this section) in which the gain recognition agreement is terminated and has no further effect.

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

Example. Interaction between trigger of gain recognition agreement and subpart F rules—(i) *Facts.* A U.S. corporation (USP) owns all of the stock of two foreign corporations, CFC1 and CFC2. USP's section 1248 amount with respect to CFC2 is $30. USP has a basis of $50 in its stock of CFC2; CFC2 has a value of $100. In a transaction described in section 351 and 368(a)(1)(B), USP transfers the stock of CFC2 in exchange for additional stock of CFC1. The transaction is subject to both sections 367 (a) and (b). See §§ 1.367(a)–3(b) and 1.367(b)–1(a). To qualify for nonrecognition treatment under section 367(a), USP enters into a 5-year gain recognition agreement for $50 under this section. No election under paragraph 8(b)(1)(vii) of this section is made. USP also complies with the notice requirement under § 1.367(b)–1(c).

(ii) *Trigger of gain recognition agreement with no election.* Assume that in year 2, CFC1 sells the stock of CFC2 for $120, and that there were no distributions by CFC2 prior to the sale. USP must amend its return for the year of the initial transfer and include $50 in income (with interest), $30 of which will be recharacterized as a dividend pursuant to section 1248. As a result, CFC1 has a basis of $100 in CFC2. As a result of the sale of CFC2 stock by CFC1, USP will have $20 of subpart F foreign personal holding company income. See section 951, et. seq., and the regulations thereunder.

(iii) *Trigger of gain recognition agreement with election.* Assume the same facts as in paragraphs (i) and (ii) of this *Example,* except that when USP attached the gain recognition agreement to its timely filed Federal income tax return for the year of the initial transfer, it elected under paragraph (b)(1)(vii) of this section to include the amount of gain realized but not recognized on the initial transfer, $50, in the year of the triggering event rather than in the year of the initial transfer. In such case, the result is the same as in paragraph (e)(1)(ii)(B) of this section, except that USP will include the $50 of gain on its year 2 return, together with interest. For purposes of determining the dividend component, if any, of the $50 inclusion, USP will take into account the section 1248 amount of CFC2 at the time of the disposition in Year 2.

(2) *Partial disposition.* If the transferee foreign corporation disposes of (or is deemed to dispose of) only a portion of the transferred stock or securities, then the U.S. transferor is required to recognize only a proportionate amount of the gain realized but not recognized upon the initial transfer of the transferred property. The proportion required to be recognized shall be determined by reference to the relative fair market values of the transferred stock or securities disposed of and retained. Solely for purposes of determining whether the U.S. transferor must recognize income under the agreement described in paragraph (b) of this section, in the case of transferred property (including stock or securities) that is fungible with other property owned by the transferee foreign corporation, a disposition by such corporation of any such property shall be deemed to be a disposition of no less than a ratable portion of the transferred property.

(3) *Deemed dispositions of stock of transferred corporation*—(i) *Disposition by transferred corporation of substantially all of its assets*—(A) *In general.* Unless an exception applies (as described in paragraph (e)(3)(i)(B) of this section), a transferee foreign corporation will be treated as having disposed of the stock or securities of the transferred corporation if, within the term of the gain recognition agreement, the transferred corporation makes a disposition of substantially all (within the meaning of section 368(a)(1)(C)) of its assets (including stock in a subsidiary corporation or an interest in a partnership). If the initial transfer that necessitated the gain recognition agreement was an indirect stock transfer, see § 1.367(a)–3(d)(2)(v). If the transferred corporation is a U.S. corporation, see paragraph (h)(2) of this section.

(B) The transferee foreign corporation will not be deemed to have disposed of the stock of the transferred corporation if the transferred corporation is liquidated into the transferee foreign corporation under sections 337 and 332,

provided that the transferee foreign corporation does not dispose of substantially all of the assets formerly held by the transferred corporation (and considered for purposes of the substantially all determination) within the remaining period during which the gain recognition agreement is in effect. A nonrecognition transfer is not counted for purposes of the substantially all determination as a disposition if the transfer satisfies the requirements of paragraph (g)(3) of this section. A disposition does not include a compulsory transfer as described in § 1.367(a)–4T(f) that was not reasonably forseeable by the U.S. transferor at the time of the initial transfer.

(ii) *U.S. transferor becomes a non-citizen nonresident. If a U.S. transferor loses U.S. citizenship or a long-term resident ceases to be taxed as a lawful permanent resident (as defined in section 877(e)(2)), then immediately prior to the date that the U.S. transferor loses U.S. citizenship or ceases to be taxed as a long-term resident, the gain recognition agreement will be triggered as if the transferee foreign corporation disposed of all of the stock of the transferred corporation in a taxable transaction on such date. No additional inclusion is required under section 877, and a gain recognition agreement under section 877 may not be used to avoid taxation under section 367(a) resulting from the trigger of the section 367(a) gain recognition agreement.*

(f) *Effect on gain recognition agreement if U.S. transferor goes out of existence*—(1) *In general.* If an individual transferor that has entered into an agreement under under paragraph (b) of this section dies, or if a U.S. trust or estate that has entered into an agreement under paragraph (b) of this section goes out of existence and is not required to recognize gain as a consequence thereof with respect to all of the stock of the transferee foreign corporation received in the initial transfer and not previously disposed of, then the gain recognition agreement will be triggered unless one of the following requirements is met—

(i) The person winding up the affairs of the transferor retains, for the duration of the waiver of the statute of limitations relating to the gain recognition agreement, assets to meet any possible liability of the transferor under the duration of the agreement;

(ii) The person winding up the affairs of the transferor provides security as provided under paragraph (d) of this section for any possible liability of the transferor under the agreement; or

(iii) The transferor obtains a ruling from the Internal Revenue Service providing for successors to the transferor under the gain recognition agreement.

(2) *Special rule when U.S. transferor is a corporation*—(i) *U.S. transferor goes out of existence pursuant to the transaction.* If the transferor is a U.S. corporation that goes out of existence in a transaction in which the transferor's gain would have qualified for nonrecognition treatment under § 1.367(a)–3(b) or (c) had the U.S. transferor remained in existence and entered into a gain recognition agreement, then the gain may generally qualify for nonrecognition treatment only if the U.S. transferor is owned by a single U.S. parent corporation and the U.S. transferor and its parent corporation file a consolidated Federal income tax return for the taxable year that includes the transfer, and the parent of the consolidated group enters into the gain recognition agreement. However, notwithstanding the preceding sentence, a U.S. transferor that was controlled (within the meaning of section 368(c)) by five or fewer domestic corporations may request a ruling that, if certain conditions prescribed by the Internal Revenue Service are satisfied, the transaction may qualify for nonrecognition treatment.

(ii) *U.S. corporate transferor is liquidated after gain recognition agreement is filed.* If a U.S. transferor files a gain recognition agreement but is liquidated during the term of the gain recognition agreement, such agreement will be terminated if the liquidation does not qualify as a tax-free liquidation under sections 337 and 332 and the U.S. transferor includes in income any gain from the liquidation. If the liquidation qualifies for nonrecognition treatment under sections 337 and 332, the gain recognition agreement will be triggered unless the U.S. parent corporation and the U.S. transferor file a consolidated Federal income tax return for the taxable year that includes the dates of the initial transfer and the liquidation of the U.S. transferor, and the U.S. parent enters into a new gain recognition agreement and complies with reporting requirements similar to those contained in paragraph (g)(2) of this section.

(g) *Effect on gain recognition agreement of certain nonrecognition transactions*—(1) *Certain nonrecognition transfers of stock or securities of the transferee foreign corporation by the U.S. transferor.* If the U.S. transferor disposes of any stock of the transferee foreign corporation in a nonrecognition transfer and the U.S. transferor complies with reporting requirements similar to those contained in paragraph (g)(2) of this section, the U.S. transferor shall continue to be subject to the terms of the gain recognition agreement in its entirety.

(2) *Certain nonrecognition transfers of stock or securities of the transferred corporation by the transferee foreign corporation.* (i) If, during the period the gain recognition agreement is in effect, the transferee foreign corporation disposes of all or a portion of the stock of the transferred corporation in a transaction in which gain or loss would not be required to be recognized by the transferee foreign corporation under U.S. income tax principles, such disposition will not be treated as a disposition within the meaning of paragraph (e) of this section if the transferee foreign corporation receives (or is deemed to receive), in exchange for the property disposed of, stock in a corporation, or an interest in a partnership, that acquired the transferred property (or receives stock in a corporation that controls the corporation acquiring the transferred property); and the U.S. transferor complies with the requirements of paragraphs (g)(2)(ii) through (iv) of this section.

(ii) The U.S. transferor must provide a notice of the transfer with its next annual certification under paragraph (b)(5) of this section, setting forth—

(A) A description of the transfer;

(B) The applicable nonrecognition provision; and

(C) The name, address, and taxpayer identification number (if any) of the new transferee of the transferred property.

(iii) The U.S. transferor must provide with its next annual certification a new agreement to recognize gain (in accordance with the rules of paragraph (b) of this section) if, prior to the close of the fifth full taxable year following the taxable year of the initial transfer, either—

(A) The initial transferee foreign corporation disposes of the interest (if any) which it received in exchange for the transferred property (other than in a disposition which itself qualifies under the rules of this paragraph (g)(2)); or

(B) The corporation or partnership that acquired the property disposes of such property (other than in a disposition which itself qualifies under the rules of this paragraph (g)(2)); or

(C) There is any other disposition that has the effect of an indirect disposition of the transferred property.

(iv) If the U.S. transferor is required to enter into a new gain recognition

agreement, as provided in paragraph (g)(2)(iii) of this section, the U.S. transferor must provide with its next annual certification (described in paragraph (b)(5) of this section) a statement that arrangements have been made, in connection with the nonrecognition transfer, ensuring that the U.S. transferor will be informed of any subsequent disposition of property with respect to which recognition of gain would be required under the agreement.

(3) *Certain nonrecognition transfers of assets by the transferred corporation*. A disposition by the transferred corporation of all or a portion of its assets in a transaction in which gain or loss would not be required to be recognized by the transferred corporation under U.S. income tax principles, will not be treated as a disposition within the meaning of paragraph (e)(3) of this section if the transferred corporation receives in exchange stock or securities in a corporation or an interest in a partnership that acquired the assets of the transferred corporation (or receives stock in a corporation that controls the corporation acquiring the assets). If the transaction would be treated as a disposition of substantially all of the transferred corporation's assets, the preceding sentence shall only apply if the U.S. transferor complies with reporting requirements comparable to those of paragraphs (g)(2)(ii) through (iv) of this section, providing for notice, an agreement to recognize gain in the case of a direct or indirect disposition of the assets previously held by the transferred corporation, and an assurance that necessary information will be provided to appropriate parties.

(h) *Transactions that terminate the gain recognition agreement*—(1) *Taxable disposition of stock or securities of transferee foreign corporation by U.S. transferor*. (i) If the U.S. transferor disposes of all of the stock of the transferee foreign corporation that it received in the initial transfer in a transaction in which all realized gain (if any) is recognized currently, then the gain recognition agreement shall terminate and have no further effect. If the transferor disposes of a portion of the stock of the transferee foreign corporation that it received in the initial transfer in a taxable transaction, then in the event that the gain recognition agreement is later triggered, the transferor shall be required to recognize only a proportionate amount of the gain subject to the gain recognition agreement that would otherwise be required to be recognized on a subsequent disposition of the transferred property under the rules of paragraph (b)(2) of this section. The proportion required to be recognized shall be determined by reference to the percentage of stock (by value) of the transferee foreign corporation received in the initial transfer that is retained by the United States transferor.

(ii) The rule of this paragraph (h) is illustrated by the following example:

Example. A, a United States citizen, owns 100 percent of the outstanding stock of foreign corporation X. In a transaction described in section 351, A exchanges his stock in X (and other assets) for 100 percent of the outstanding voting and nonvoting stock of foreign corporation Y. A submits an agreement under the rules of this section to recognize gain upon a later disposition. In the following year, A disposes of 60 percent of the fair market value of the stock of Y, thus terminating 60 percent of the gain recognition agreement. One year thereafter, Y disposes of 50 percent of the fair market value of the stock of X. A is required to include in his income in the year of the later disposition 20 percent (40 percent interest in Y multiplied by a 50 percent disposition of X) of the gain that A realized but did not recognize on his initial transfer of X stock to Y.

(2) *Certain dispositions by a domestic transferred corporation of substantially all of its assets*. If the transferred corporation is a domestic corporation and the U.S. transferor and the transferred corporation filed a consolidated Federal income tax return at the time of the transfer, the gain recognition agreement shall terminate and cease to have effect if, during the term of such agreement, the transferred corporation disposes of substantially all of its assets in a transaction in which all realized gain is recognized currently. If an indirect stock transfer necessitated the filing of the gain recognition agreement, such agreement shall terminate if, immediately prior to the indirect transfer, the U.S. transferor and the acquired corporation filed a consolidated return (or, in the case of a section 368(a)(1)(A) and (a)(2)(E) reorganization described in § 1.367(a)–3(d)(1)(ii), the U.S. transferor and the acquiring corporation filed a consolidated return) and the transferred corporation disposes of substantially all of its assets (taking into account § 1.367(a)–3(d)(2)(v)) in a transaction in which all realized gain is recognized currently.

(3) *Distribution by transferee foreign corporation of stock of transferred corporation that qualifies under section 355 or section 337*. If, during the term of the gain recognition agreement, the transferee foreign corporation distributes to the U.S. transferor, in a transaction that qualifies under section 355, or in a liquidating distribution that qualifies under sections 332 and 337, the stock that initially necessitated the filing of the gain recognition agreement (and any additional stock received after the initial transfer), the gain recognition agreement shall terminate and have no further effect, provided that immediately after the section 355 distribution or section 332 liquidation, the U.S. transferor's basis in the transferred stock is less than or equal to the basis that it had in the transferred stock immediately prior to the initial transfer that necessitated the GRA.

(i) *Effective date*. The rules of this section shall apply to transfers that occur on or after July 20, 1998. For matters covered in this section for periods before July 20, 1998, the corresponding rules of § 1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) and Notice 87–85 ((1987–2 C.B. 395); see § 601.601(d)(2)(ii) of this chapter) apply. In addition, if a U.S. transferor entered into a gain recognition agreement for transfers prior to July 20, 1998, then the rules of § 1.367(a)–3T(g) (see 26 CFR part 1, revised April 1, 1998) shall continue to apply in lieu of this section in the event of any direct or indirect nonrecognition transfer of the same property. See, also, § 1.367(a)–3(f).

Par. 6. Section 1.367(b)–1 is added to read as follows:

§ 1.367(b)–1 Other transfers.

(a) *Scope*. Section 367(b) and the regulations thereunder set forth certain rules regarding the extent to which a foreign corporation shall be considered to be a corporation in connection with an exchange to which section 367(b) applies. An exchange to which section 367(b) applies is any exchange described in section 332, 351, 354, 355, 356 or 361, with respect to which the status of a foreign corporation as a corporation is relevant for determining the extent to which income shall be recognized or for determining the effect of the transaction on earnings and profits, basis of stock or securities, or basis of assets. Notwithstanding the preceding sentence, a section 367(b) exchange does not include a transfer to the extent that the foreign corporation fails to be treated as a corporation by reason of section 367(a)(1). See § 1.367(a)–3(b)(2)(ii) for an illustration of the interaction of sections 367 (a) and (b). This paragraph applies for transfers occurring on or after July 20, 1998.

(b) [Reserved]. For further guidance, see § 7.367(b)–1(b) of this chapter.

(c) *Notice required*—(1) *In general*. If any person referred to in section 6012

(relating to the requirement to make returns of income) realized gain or other income (whether or not recognized) on account of any exchange to which section 367(b) applies, such person must file a notice of such exchange on or before the last date for filing a Federal income tax return (taking into account any extensions of time therefor) for the person's taxable year in which such gain or other income is realized. This notice must be filed with the district director with whom the person would be required to file a Federal income tax return for the taxable year in which the exchange occurs. Notwithstanding anything in this paragraph (c)(1) to the contrary, no notice under this paragraph (c)(1) is required to the extent a transaction is described in both section 367(a) and (b), and the exchanging person is not a United States shareholder of the corporation whose stock is exchanged. This paragraph applies to transfers occurring on or after July 20, 1998.

(c)(2) through (f) [Reserved]. For further guidance, see § 7.367(b)–1(c)(2) through (f) of this chapter.

Par. 6a. Section 1.367(b)–4 is added to read as follows:

§ 1.367(b)–4 Certain exchanges of stock described in section 354, 351, or sections 354 and 351.

(a) *In general.* This section applies to an exchange of stock in a foreign corporation by a United States shareholder if the exchange is described in section 351, or is described in section 354 and is made pursuant to a reorganization described in section 368(a)(1)(B) (including an exchange that is also described in section 351), without regard to whether the exchange may also be described in section 361.

(b) *Recognition of income.* If an exchange is described in paragraph (b)(1), (2) 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. See, also, § 1.367(a)–3(b)(2). However, in the case of a recapitalization described in paragraph (b)(3) of this section that occurred prior to July 20, 1998, the exchanging shareholder shall include the section 1248 amount on its tax return for the taxable year that includes the exchange described in paragraph (b)(2)(iii) of this section (and not in the taxable year of the recapitalization), except that no inclusion is required if both the recapitalization and the exchange described in paragraph (b)(2)(iii) of this section occurred prior to July 20, 1998.

(1) *Loss of United States shareholder or controlled foreign corporation status.* An exchange is described in this paragraph (b)(1) if—

(i) An exchanging shareholder receives stock of a foreign corporation that is not a controlled foreign corporation;

(ii) An exchanging shareholder receives stock of a controlled foreign corporation as to which the exchanging United States shareholder is not a United States shareholder; or

(iii) The corporation whose stock is exchanged is not a controlled foreign corporation immediately after the transfer.

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

(i) 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));

(ii) 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 from the foreign acquiring corporation a distribution (directly or through tiers) of its earnings and profits; and

(iii) 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 District Director (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. See, e.g., paragraph (b)(4) *Example 1* through *Example 3* of this section.

(3) *Certain exchanges involving 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) of this section but for paragraph (b)(2)(iii) 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)(iii) of this section.

(4) *Examples.* The rules of paragraph (b)(2) of this section are illustrated by the following examples:

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. 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 outstanding 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 United States shareholder of FC1, so paragraph (b)(1) 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. The amount of the gain recognition agreement is $50 less any inclusion under section 367(b). Even though paragraph (b)(1) 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) 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. 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) of this section does not apply to require inclusion of the section 1248 amount. Under paragraph (b)(2)(i) of this section, the transaction is outside the scope of paragraph (b)(2) 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.

Example 3—(i) *Facts.* FC1 is a foreign corporation. DC is a domestic corporation that is unrelated to FC1. DC owns all of the 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 outstanding 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, which are to be determined by reference to the earnings or value of FC2 as of the date of such event, and which 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 District Director may nevertheless require that DC include the $20 section 1248 amount in income as a deemed dividend from FC2 under paragraph (b)(2) of this section.

(5) *Special rules for applying section 1248 to subsequent exchanges.* (i) If income is not required to be recognized under paragraph (b) of this section in a transaction described in paragraph (b)(1) of this section involving a foreign acquiring corporation, then, for purposes of applying section 1248 or 367(b) to subsequent exchanges, the earnings and profits attributable to an exchanging shareholder's stock received in the transaction shall be determined by reference to the exchanging shareholder's pro rata interest in the earnings and profits of the foreign acquiring corporation and foreign acquired corporation that accrue after the transaction, as well as its pro rata interest in the earnings and profits of the foreign acquired corporation that accrued prior to the transaction. See also section 1248(c)(2)(D)(ii). The earnings and profits attributable to an exchanging shareholder's stock received in the transaction shall not include any earnings and profits of the foreign acquiring corporation that accrued prior to the transaction.

(ii) The following example illustrates this paragraph (b)(5):

Example. (i) *Facts.* DC1, a domestic corporation, owns all of the stock of FC1, a foreign corporation. DC1 has owned all of the stock of FC1 since FC1's formation. DC2, a domestic corporation, owns all of the stock of FC2, a foreign corporation. DC2 has owned all of the stock of FC2 since FC2's formation. DC1 and DC2 are unrelated. In a reorganization described in section 368(a)(1)(B), DC1 transfers all of the stock of FC1 to FC2 in exchange for 40 percent of FC2. DC1 enters into a five-year gain recognition agreement under the provisions of §§ 1.367(a)–3(b) and 1.367(a)–8 with respect to the transfer of FC1 stock to FC2.

(ii) *Result.* DC1's transfer of FC1 to FC2 is an exchange described in paragraph (b) of this section. Because the transfer is not described in paragraph (b)(1), 2) or (3) of this section, DC1 is not required to include in income the section 1248 amount attributable to the exchanged FC1 stock and the special rule of this paragraph (b)(5) applies. Thus, for purposes of applying section 1248 or section 367(b) to subsequent exchanges, the earnings and profits attributable to DC1's interest in FC2 will be determined by reference to 40 percent of the post-reorganization earnings and profits of FC1 and FC2, and by reference to 100 percent of the pre-reorganization earnings and profits of FC1. The earnings and profits attributable to DC1's interest in FC2 do not include any earnings and profits accrued by FC2 prior to the transaction. Those earnings and profits are attributed to DC2 under section 1248.

(6) *Effective date.* This section applies to transfers occurring on or after July 20, 1998.

(c) and (d) [Reserved]. For further guidance, see § 7.367(b)–4(c) and (d) of this chapter.

Par. 7. In § 1.367(b)–7, paragraphs (a) and (b) are added to read as follows:

§ 1.367(b)–7 Exchange of stock described in section 354.

(a) Scope. (1) This section applies to an exchange of stock in a foreign corporation (other than a foreign investment company as defined in section 1246(b)) occurring on or after July 20, 1998.

(i) The exchange is described in section 354 or 356 and is made pursuant to a reorganization described in section 368(a)(1)(B) through (F); and

(ii) The exchanging person is either a United States shareholder or a foreign corporation having a United States shareholder who is also a United States shareholder of the corporation whose stock is exchanged.

(2) However, this section shall not apply if a United States shareholder exchanges stock of a foreign corporation in an exchange described in section 368(a)(1)(B). For further guidance, see § 1.367(b)–4.

(b) [Reserved]. For further guidance, see § 7.367(b)–7(b) of this chapter.

* * * * *

Par. 8. Section 1.367(d)–1T is amended by adding a sentence at the end of paragraph (a) to read as follows:

§ 1.367(d)–1T Transfers of intangible property to foreign corporations (temporary).

(a) * * * For purposes of determining whether a U.S. person has made a transfer of intangible property that is subject to the rules of section 367(d), the rules of § 1.367(a)–1T(c) shall apply.

* * * * *

Par. 9. Section 1.6038B–1 is added to read as follows:

§ 1.6038B–1 Reporting of certain transactions.

(a) *Purpose and scope.* This section sets forth information reporting requirements under section 6038B concerning certain transfers of property to foreign corporations. Paragraph (b) of this section provides general rules explaining when and how to carry out the reporting required under section 6038B with respect to the transfers to foreign corporations. Paragraph (c) of this section and § 1.6038B–1T(d) specify the information that is required to be reported with respect to certain transfers of property that are described in section 6038B(a)(1)(A) and 367(d), respectively. Section 1.6038B–1T(e) specifies the limited reporting that is required with respect to transfers of property described in section 367(e)(1). Paragraph (f) of this section sets forth the consequences of a failure to comply with the requirements of section 6038B and this section. For effective dates, see paragraph (g) of this section. For rules regarding transfers to foreign partnerships, see section 6038B(a)(1)(B) and any regulations thereunder.

(b) *Time and manner of reporting*—(1) *In general*—(i) *Reporting procedure.* Except for stock or securities qualifying under the special reporting rule of paragraph (b)(2) of this section, or cash, which is currently not required to be reported, any U.S. person that makes a transfer described in section 6038B(a)(1)(A), 367(d) or (e)(1) is required to report pursuant to section 6038B and the rules of this section and must attach the required information to Form 926 (Return by Transferor of Property to a Foreign Corporation, Foreign Estate or Trust, or Foreign Partnership). For purposes of determining a U.S. transferor that is subject to section 6038B, the rules of § 1.367(a)–1T(c) and § 1.367(a)–3(d) shall apply with respect to a transfer described in section 367(a), and the rules of § 1.367(a)–1T(c) shall apply with respect to a transfer described in section 367(d). Notwithstanding any

statement to the contrary on Form 926, the form and attachments must be attached to, and filed by the due date (including extensions) of, the transferor's income tax return for the taxable year that includes the date of the transfer (as defined in § 1.6038B–1T(b)(4)). Any attachment to Form 926 required under the rules of this section is filed subject to the transferor's declaration under penalties of perjury on Form 926 that the information submitted is true, correct, and complete to the best of the transferor's knowledge and belief.

(ii) *Reporting by corporate transferor.* If the transferor is a corporation, Form 926 must be signed by an authorized officer of the corporation. If, however, the transferor is a member of an affiliated group under section 1504(a)(1) that files a consolidated Federal income tax return, but the transferor is not the common parent corporation, an authorized officer of the common parent corporation must sign Form 926.

(iii) *Transfers of jointly-owned property.* If two or more persons transfer jointly-owned property to a foreign corporation in a transfer with respect to which a notice is required under this section, then each person must report with respect to the particular interest transferred, specifying the nature and extent of the interest. However, a husband and wife who jointly file a single Federal income tax return may file a single Form 926 with their tax return.

(2) *Exceptions and special rules for transfers of stock or securities under section 367(a)*—(i) *Transfers on or after July 20, 1998.* A U.S. person that transfers stock or securities on or after July 20, 1998 in a transaction described in section 6038(a)(1)(A) will be considered to have satisfied the reporting requirement under section 6038B and paragraph (b)(1) of this section if either—

(A) The U.S. transferor owned less than 5 percent of both the total voting power and the total value of the transferee foreign corporation immediately after the transfer (taking into account the attribution rules of section 318 as modified by section 958(b)), and either:

(*1*) The U.S. transferor qualified for nonrecognition treatment with respect to the transfer (i.e., the transfer was not taxable under §§ 1.367(a)–3(b) or (c)); or

(*2*) The U.S. transferor is a tax-exempt entity and the income was not unrelated business income; or

(*3*) The transfer was taxable to the U.S. transferor under § 1.367(a)–3(c), and such person properly reported the income from the transfer on its timely-filed (including extensions) Federal income tax return for the taxable year that includes the date of the transfer; or

(B) The U.S. transferor owned 5 percent or more of the total voting power or the total value of the transferee foreign corporation immediately after the transfer (taking into account the attribution rules of section 318 as modified by section 958(b)) and either:

(*1*) The transferor (or one or more successors) properly entered into a gain recognition agreement under § 1.367(a)–8; or

(*2*) The transferor is a tax-exempt entity and the income was not unrelated business income; or

(*3*) The transferor properly reported the income from the transfer on its timely-filed (including extensions) Federal income tax return for the taxable year that includes the date of the transfer.

(ii) *Transfers before July 20, 1998.* With respect to transfers occurring after December 16, 1987, and prior to July 20, 1998, a U.S. transferor that transferred U.S. or foreign stock or securities in a transfer described in section 367(a) is not subject to section 6038B if such person is described in paragraph (b)(2)(i)(A) of this section.

(3) *Special rule for transfers of cash.* [Reserved].

(4) [Reserved]. For further guidance, see § 1.6038B–1T(b)(4).

(c) *Information required with respect to transfers described in section 6038B(a)(1)(A).* A U.S. person that transfers property to a foreign corporation in an exchange described in section 6038B(a)(1)(A) (including unappreciated property other than cash) must provide the following information, in paragraphs labelled to correspond with the number or letter set forth in this paragraph (c) and § 1.6038B–1T(c)(1) through (5). If a particular item is not applicable to the subject transfer, the taxpayer must list its heading and state that it is not applicable. For special rules applicable to transfers of stock or securities, see paragraph (b)(2)(ii) of this section.

(1) through (5) [Reserved]. For further guidance, see § 1.6038B–1T(c)(1) through (5).

(6) *Application of section 367(a)(5).* If the asset is transferred in an exchange described in section 361(a) or (b), a statement that the conditions set forth in the second sentence of section 367(a)(5) and any regulations under that section have been satisfied, and an explanation of any basis or other adjustments made pursuant to section 367(a)(5) and any regulations thereunder.

(d) and (e) [Reserved]. For further guidance, see § 1.6038B–1T(d) and (e).

(f) *Failure to comply with reporting requirements*—(1) *Consequences of failure.* If a U.S. person is required to file a notice (or otherwise comply) under paragraph (b) of this section and fails to comply with the applicable requirements of section 6038B and this section, then with respect to the particular property as to which there was a failure to comply—

(i) That property shall not be considered to have been transferred for use in the active conduct of a trade or business outside of the United States for purposes of section 367(a) and the regulations thereunder;

(ii) The U.S. person shall pay a penalty under section 6038B(b)(1) equal to 10 percent of the fair market value of the transferred property at the time of the exchange, but in no event shall the penalty exceed $100,000 unless the failure with respect to such exchange was due to intentional disregard (described under paragraph (g)(4) of this section); and

(iii) The period of limitations on assessment of tax upon the transfer of that property does not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under this section. See section 6501(c)(8) and any regulations thereunder.

(2) *Failure to comply.* A failure to comply with the requirements of section 6038B is—

(i) The failure to report at the proper time and in the proper manner any material information required to be reported under the rules of this section; or

(ii) The provision of false or inaccurate information in purported compliance with the requirements of this section. Thus, a transferor that timely files Form 926 with the attachments required under the rules of this section shall, nevertheless, have failed to comply if, for example, the transferor reports therein that property will be used in the active conduct of a trade or business outside of the United States, but in fact the property continues to be used in a trade or business within the United States.

(3) *Reasonable cause exception.* The provisions of paragraph (f)(1) of this section shall not apply if the transferor shows that a failure to comply was due to reasonable cause and not willful neglect. The transferor may do so by providing a written statement to the district director having jurisdiction of the taxpayer's return for the year of the transfer, setting forth the reasons for the failure to comply. Whether a failure to comply was due to reasonable cause

shall be determined by the district director under all the facts and circumstances.

(4) *Definition of intentional disregard.* If the transferor fails to qualify for the exception under paragraph (f)(3) of this section and if the taxpayer knew of the rule or regulation that was disregarded, the failure will be considered an intentional disregard of section 6038B, and the monetary penalty under paragraph (f)(1)(ii) of this section will not be limited to $100,000. See § 1.6662–3(b)(2).

(g) *Effective date.* This section applies to transfers occurring on or after July 20, 1998. See § 1.6038B–1T for transfers occurring prior to July 20, 1998.

Par. 10. Section 1.6038B–1T is amended as follows:

1. The section heading is revised.
2. Paragraphs (a) through (b)(2) are revised.
3. Paragraph (b)(3) is redesignated as paragraph (b)(4).
4. New paragraph (b)(3) is added and reserved.
5. Paragraph (c) introductory text is revised and paragraph (c)(6) is added.
6. Paragraph (f) is revised.
7. Paragraph (g) is added.

The revisions and additions read as follows:

§ 1.6038B–1T Reporting of certain transactions (temporary).

(a) through (b)(2) [Reserved]. For further guidance, see § 1.6038B–1(a) through (b)(2).

(b)(3) [Reserved].

* * * * *

(c) Introductory text [Reserved]. For further guidance, see § 1.6038B–1(c).

* * * * *

(6) [Reserved]. For further guidance, see § 1.6038B–1(c)(6).

* * * * *

(f) [Reserved]. For further guidance, see § 1.6038B–1(f).

(g) *Effective date.* This section applies to transfers occurring after December 31, 1984, except paragraph (e)(1) applies to transfers occurring on or after September 13, 1996. See § 1.6038B–1T(a) through (b)(2), (c) introductory text, and (f) (26 CFR part 1, revised April 1, 1998) for transfers occurring prior to July 20, 1998. See § 1.6038B–1 for transfers occurring on or after July 20, 1998.

PART 7—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

Par. 11. The authority citation for part 7 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 12. Section 7.367(b)–1 is amended as follows:

1. Paragraphs (a) and (c)(1) are revised.
2. The authority citation at the end of the section is removed.

The revisions read as follows:

§ 7.367(b)–1 Other transfers.

(a) [Reserved] For guidance relating to transfers occurring on or after July 20, 1998, see § 1.367(b)–1(a) of this chapter.

* * * * *

(c)(1) [Reserved] For guidance relating to transfers occurring on or after July 20, 1998, see § 1.367(b)–1(c) of this chapter.

* * * * *

Par. 13. Section 7.367(b)–4 is amended as follows:

1. Paragraphs (a) and (b) are revised.
2. The authority citation at the end of the section is removed.

The revision reads as follows:

§ 7.367(b)–4 Certain changes described in more than one Code provision.

(a) and (b) [Reserved]. For guidance relating to transfers occurring on or after July 20, 1998, see § 1.367(b)–4(a) and (b) of this chapter.

* * * * *

Par 14. Section 7.367(b)–7 is amended as follows:

1. Paragraph (a) is revised.
2. The authority citation at the end of the section is removed.

The revision reads as follows:

§ 7.367(b)–7 Exchange of stock described in section 354.

* * * * *

(a) [Reserved] For guidance relating to transfers occurring on or after July 20, 1998, see § 1.367(b)–7(a) of this chapter.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par 15. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par 16. In § 602.101, paragraph (c) is amended by:

1. Removing the following entry from the table:

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.367(a)–3T	1545–0026
* * * * *	

2. Adding the following entry to the table in numerical order to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.367(a)–8	1545–1271
* * * * *	

Michael P. Dolan,

Deputy Commissioner of Internal Revenue.

Approved: May 13, 1998.

Donald C. Lubick,

Assistant Secretary of the Treasury.

[FR Doc. 98–15454 Filed 6–18–98; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF TRANSPORTATION

Coast Guard

33 CFR Parts 62 and 66

[USCG 97–3112; CGD 97–018]

RIN 2115–AF45

Merger of the Uniform States Waterway Marking System With the United States Aids to Navigation

AGENCY: Coast Guard, DOT.

ACTION: Final rule.

SUMMARY: The Coast Guard commences a five year phased-in merger of the Uniform State Waterway Marking System with the United States Aids to Navigation System. This merger eliminates distinctions between the two systems and creates safer, less confusing waterways.

DATES: This final rule is effective July 20, 1998.

ADDRESSES: Documents as indicated in this preamble are available for inspection or copying at the Docket Management Facility, [USCG–97–3112], U.S. Department of Transportation, room PL–401, 400 Seventh Street SW., Washington, DC 20590–0001.

FOR FURTHER INFORMATION CONTACT: For questions on this rule contact Dan Andrusiak, OPN–2 Short Range Aids to Navigation Division, USCG Headquarters, telephone (202) 267–0327, For questions on viewing material in the docket, contact Carol Kelley, Coast Guard Dockets Team Leader, or