

whether there is a need for a graphics capability (beyond that currently offered by the WordPerfect 5.1 for DOS and Microsoft Word for Windows programs) to permit transmission of pictorial or graphic material included in Disclosure Documents or in other documents required to be filed with the Commission; (4) whether the Commission should specify uniform formatting requirements for electronically-filed documents (e.g., margin dimensions, type font and point size, pagination, etc.) and if so, what the appropriate requirements would be; and (5) whether the selection of word processing formats currently being considered by the Commission for use in the pilot program (WordPerfect 5.1 for DOS or Microsoft Word for Windows) is adequate, and if not, which additional word processing programs or text formats registrants should be permitted to use.

D. Unsolicited Proposal Recently Presented to the Commission

The Commission has been approached by a prospective vendor ("Vendor") with a proposal to implement a system to permit electronic filing of Disclosure Documents utilizing a computer system developed by Vendor. The Vendor's prototype system assumes use of a WordPerfect or Microsoft Word word processing system in a Microsoft Windows operating system environment. Registrants would download from the Commission's Internet website a document "packaging" program, which would prompt the registrant to provide identifying information and facilitate secure uploading of the registrant's Disclosure Document to Vendor's system.¹¹⁷ Vendor has offered to develop a separate program for Commission staff handling and tracking of filed Disclosure Documents during the review process. Vendor's system, if implemented, may be designed to accommodate other required Commission filings, including CPO annual reports to pool participants. Under one variation of Vendor's system, filed Disclosure Documents would "reside" electronically on a server located at Vendor's offices, rather than at the Commission's headquarters.

The Commission plans to publish in *Commerce Business Daily* a notice seeking information and indications of interest on the part of proprietary vendors and developers of data

processing and telecommunication systems with respect to developing and implementing a system to accept, track and control electronically-filed documents, as well as incoming and outgoing correspondence in connection with such documents.

Comment is sought regarding the advisability of the Commission's selecting and entering into a contractual relationship with one or more independent vendors to facilitate electronic filing of documents on behalf of the Commission, and/or to serve as a repository or dissemination point to provide public access to electronically-filed documents. Finally, to the extent that a filing fee would be necessary to cover the operating and development costs of Vendor's system, the Commission seeks comment on the willingness of registrants to bear such costs and suggestions concerning how such fees should be calculated.

E. Future Releases

The Commission invites comment not only on the specific issues discussed in this release, but also on any other approaches or issues that should be considered in connection with facilitating the use of electronic media. In the future, the Commission may issue further releases, as may be suitable to expand or provide additional guidance regarding the pilot program; to propose and adopt rules and amendments to existing rules to implement electronic filing procedures; or to give guidance generally with respect to the use of electronic media in the context of the Commission's regulatory program.

Issued in Washington, DC, on May 8, 1996, by the Commission.

Catherine D. Dixon,

Assistant to the Secretary of the Commission.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8682]

RIN 1545-AU23

Treatment of Section 355 Distributions by U.S. Corporations to Foreign Persons

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: These temporary regulations amend the Income Tax Regulations

relating to the distribution of stock and securities under section 355 of the Internal Revenue Code of 1986 by a domestic corporation to a person that is not a United States person. These regulations are necessary to implement section 367(e)(1) as added by the Tax Reform Act of 1986. The text of these regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register.

EFFECTIVE DATE: These regulations are effective September 13, 1996.

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

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1487. Responses to this collection of information are required in order for a U.S. corporation that distributes domestic stock or securities to a foreign person to qualify for an exception to the general rule of taxation provided by the regulations under section 367(e)(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.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

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 January 16, 1990, temporary regulations under section 367(e)(1) and 367(e)(2) were published in the Federal

¹¹⁷ The document packaging software includes a scrambling or encryption function enabling transmission of the document over phone lines without permitting unauthorized persons to read or alter the text.

Register (55 FR 1406). A cross-referenced Notice of Proposed Rulemaking was published on that same date (55 FR 1472). These regulations were proposed to implement section 367(e) of the Internal Revenue Code of 1986 (Code), as revised by sections 631(d)(1) and 1810(g) of the Tax Reform Act of 1986 (100 Stat. 2085, 2272, Public Law 99-514 [1986-3 C.B. (Vol. 1) 1, 189, 745]). On January 15, 1993, final regulations under section 367(e)(1) were published in the Federal Register.

Need for Temporary Regulations

Under the current regulations, in certain circumstances the gain recognition exception may be dependent on the form rather than the substance of a taxpayer's transaction. As a result, certain taxpayers may be subject to strict restrictions under this exception, while other taxpayers arguably may avoid the restrictions by structuring their transactions in a different fashion (even though the substance of the transactions is similar). Based on these considerations, it is determined that immediate regulatory guidance will ensure the efficient administration of the tax laws and that it would be impracticable and contrary to the public interest to issue this Treasury decision with prior notice under section 553(b).

Explanation of Provisions

Section 355 provides that, if certain requirements are met, a distributing corporation (Distributing) does not recognize gain or loss on the distribution of the stock or securities of a controlled corporation (Controlled) to Distributing's shareholder or shareholders (Distributee(s)). However, section 367(e)(1) provides that, in the case of any distribution described in section 355 (or so much of section 356 as relates to section 355) by a domestic corporation to a Distributee who is not a United States person (an outbound section 355 distribution), to the extent provided in regulations, gain shall be recognized under principles similar to the principles of section 367.

The existing regulations under section 367(e)(1) provide different tax treatment to Distributing in an outbound section 355 distribution depending upon whether Controlled is a foreign corporation or a domestic corporation. If Controlled is a foreign corporation, an outbound section 355 distribution by Distributing is taxable, with no exceptions. If Controlled is a domestic corporation, however, the existing regulations provide that the distribution is taxable, but permit three exceptions: (i) a FIRPTA exception in cases where

both Distributing and Controlled are U.S. real property holding corporations (as defined in section 897(c)(2)) at the time of the distribution, (ii) a publicly traded exception in certain cases where Distributing is publicly traded in the United States at the time of the distribution, and (iii) a gain recognition agreement (GRA) exception described in detail below.

The new temporary regulations retain the general framework of the existing regulations by permitting no exceptions in the case of an outbound section 355 distribution of foreign stock and the same three exceptions in the case of an outbound section 355 distribution of domestic stock. However, the new temporary regulations substantially modify the GRA exception.

The temporary regulations retain many of the provisions from the existing regulations. However, the IRS and Treasury have decided to reissue all of the regulations under section 367(e)(1) as temporary regulations to obtain a uniform set of regulations.

GRA Exception Under the Existing Regulations

The GRA exception in the existing regulations contains a number of specific requirements, all of which must be satisfied for the distributing corporation to defer taxation under the exception.

In general, if Distributee is a resident of a country that has an income tax treaty with the United States and meets certain other requirements, Distributing can defer its gain by entering into a GRA. Under the GRA, if a (foreign) Distributee sells all or a portion of the stock of either Distributing or Controlled within 60 months after the close of the taxable year in which the distribution occurs, Distributing agrees to amend its return and include the deferred gain in income based upon the proportion of the stock that is sold by Distributee. Thus, for example, if Distributee sells 10 percent of its stock of Distributing or Controlled, Distributing is required to amend its return to include 10 percent of the deferred gain. There is no special rule (i.e., no full trigger of the deferred gain) if Distributee sells a substantial amount of its stock of either company. In addition, there is no special rule that triggers gain in the case of a nonrecognition transaction (such as the issuance of additional stock by either Distributing or Controlled to third parties through a public offering) that results in a substantial reduction of the percentage of stock owned by Distributee(s).

The existing regulations generally provide that the GRA will not be

triggered if Distributee transfers the stock of either Distributing or Controlled in certain nonrecognition transactions (permitted transactions). The transfer of the stock of either company in a (second) section 355 distribution, however, is not permitted.

In the case of a permitted transaction, the existing regulations provide special successor-in-interest rules under which the deferred gain generally will be taxable unless Distributee maintains a direct or indirect 80 percent interest in the stock of Distributing and Controlled that it owned immediately after the distribution. For example, if Distributing distributed the stock of Controlled in an outbound section 355 distribution that qualified for the GRA exception and, within the term of the GRA, Distributee then contributed the stock of Distributing to a new company (Newco) in a section 351 exchange and received 100 percent of Newco, the successor-in-interest rules apply. Thus, Distributee generally would be required to maintain an 80 percent indirect interest in Distributing. Under these rules, (i) Distributee's sale of up to 20 percent of the stock of Newco, or (ii) Newco's sale of up to 20 percent of the stock of Distributing would result in a corresponding trigger of the deferred gain. The issuance of new stock by Newco or Distributing of up to 20 percent to unrelated persons, however, would not result in any trigger of the GRA. If, however, Newco (or Distributing) issued more than 20 percent of its stock to unrelated persons (or any other nonrecognition transaction reduced Distributee's indirect interest in Distributing to below 80 percent as a result of a nonrecognition transaction), the entire gain would be triggered.

Reasons for Change/Overview of Temporary Regulations

The treatment of non pro rata outbound section 355 distributions is not adequately addressed in the existing regulations. For example, assume that a foreign parent (FP) owns all of the stock of Distributing, a domestic corporation, which, in turn, owns all of the stock of Controlled, also a domestic corporation. Assume that the distribution of Controlled by Distributing to FP qualifies for the GRA exception. If FP then contributes all of the stock of Distributing to a newly formed foreign corporation (Newco), the successor rules would apply, and FP would be required to maintain a direct or indirect 80 percent interest in Distributing.

The outcome under the existing regulations arguably is substantially different, however, if the corporations structured the distribution as a non pro

rata distribution. For example, assume that FP first forms Newco and transfers to Newco a percentage of the Distributing stock (the percentage equal to the value of Distributing (without the Controlled stock) divided by the combined value of Distributing and Controlled) in an exchange under section 351. Distributing then distributes the stock of Controlled to FP in exchange for FP's stock of Distributing (a non pro rata section 355 distribution). After the distribution, FP owns all of the stock of Controlled and all of the stock of Newco; Newco owns all of the stock of Distributing. Under the existing regulations, FP is a Distributee. However, because FP has no direct interest in Distributing after the distribution, the regulations effectively treat FP as a Distributee only with respect to Controlled. Moreover, because Newco does not actually receive stock of Controlled in the distribution (even though its percentage ownership interest in Distributing increases as a result of the distribution), it is arguably not a Distributee with respect to the Distributing stock. As a result, because the taxpayer structures the transaction in this manner (rather than a section 355 distribution followed by a section 351 exchange as in the first hypothetical), if the steps of the transaction are respected and in the absence of the application of other sections of the Code, Distributing could take the position that there are no restrictions in the existing regulations with respect to (i) the sale by FP of Newco stock, or (ii) the sale by Newco of Distributing stock.

To remedy this potential disparity in treatment between pro rata and non pro rata distributions, the temporary regulations expand the definition of Distributee in the GRA exception (referred to as Foreign Distributee under such exception) to include all persons that were shareholders of Distributing immediately prior to the distribution. Thus, for example, in the second hypothetical above, Newco and FP would both be Foreign Distributees. Provided that nonrecognition treatment is claimed under the GRA exception with respect to Newco and FP (referred to as Qualified Foreign Distributees in the case of Foreign Distributees for which nonrecognition may be claimed), the GRA would be triggered by either (i) the sale by FP of Newco stock, or (ii) the sale by Newco of Distributing stock.

Second, even in the case of pro rata distributions, the IRS and Treasury believe that the results obtained under the existing regulations are too dependent upon the form of the transaction. This is principally because

taxpayers could be subject to the stricter successor-in-interest rules if their transactions were structured in a particular way, but might be subject to the more liberal distributee rules if the order of the steps of the particular transaction are reversed.

In the preamble to the existing regulations, the IRS and Treasury stated that the successor-in-interest rules were "designed to provide taxpayers with flexibility to restructure their operations, without imposing undue administrative burdens on the Service." The IRS solicited taxpayer comments on the scope of these rules. A number of commentators have stated that the rules are overly restrictive.

The temporary regulations harmonize the treatment of the distributee and successor-in-interest rules in order to minimize the importance of the form of a particular transaction. In addition, as discussed below, the temporary regulations liberalize the strict successor rules by replacing the 80-percent threshold (computed on an individual Distributee basis) with a 50-percent threshold (computed with reference to all Qualified Foreign Distributees as a group).

The temporary regulations follow the existing regulations by providing that a sale by a Qualified Foreign Distributee of the stock of either Controlled or Distributing triggers gain in the same proportion as the percentage of stock that is sold. However, the temporary regulations provide that a sale by Qualified Foreign Distributee(s) of either Distributing or Controlled that results in a substantial transformation results in a trigger of the full amount of the deferred gain. A substantial transformation is defined as a greater than 50-percent (direct or indirect) reduction, on an aggregate basis, in either the total voting power or the total value of the stock of Controlled or Distributing held by Qualified Foreign Distributee(s) immediately after the distribution. The new temporary regulations also provide that a nonrecognition transaction that results in a substantial transformation (such as the issuance of stock by Distributing or Controlled in a public offering) generally causes a trigger of the full amount of the deferred gain. No gain will be triggered if a nonrecognition transaction does not result in a substantial transformation.

The temporary regulations also expand the types of post-distribution nonrecognition transactions that are permitted transactions to include section 355 distributions. A post-distribution section 355 transaction may qualify for nonrecognition treatment if the foreign distributee (referred to as a

Substitute Distributee) that receives stock of Distributing and/or Controlled qualifies as a Qualified Foreign Distributee. In such case, the Substitute Distributee will replace the initial Qualified Foreign Distributee as the person whose ownership interest is considered for purposes of determining whether a disposition or substantial transformation has occurred (on a cumulative, aggregate basis) with respect to such stock.

In addition, the temporary regulations provide that foreign persons that owned stock or securities of Distributing within two years prior to the distribution and that own (directly, indirectly, or constructively) 50 percent or more of the stock of Distributing or Controlled immediately after the distribution will also be considered Foreign Distributees. Thus, for example, if F1, a foreign corporation, transfers the stock of US1 to F2 in exchange for all of the stock of F2 in a section 351 exchange and, within two years after the transfer, US1 distributes all of the stock of US2, its wholly owned subsidiary, to F2 in a section 355 exchange, F1 is also treated as a Foreign Distributee under this rule. (F1 would have been treated as a Foreign Distributee without the operation of this rule if the section 355 distribution occurred prior to the section 351 exchange.)

The IRS and the Treasury also believe that certain procedural aspects of the GRA exception need modification. The temporary regulations enhance reporting and security requirements, extend the term of the GRA from 5 to 10 years, and delete other requirements that are believed to be unnecessary in light of the modifications herein.

To address the security concerns of the IRS resulting from the liberalization of the successor-in-interest rules and the expansion of permissible post-distribution nonrecognition transactions to include section 355 distributions, the assets of Distributing are more closely monitored to insure that such corporation has sufficient funds to pay a potential tax on the deferred gain. In addition, Controlled must agree to be secondarily liable (after Distributing) for the tax on the deferred gain.

Moreover, the new temporary regulations extend the term of the GRA from 5 to 10 years in order to conform the GRA term under section 367(e)(1) to the GRA term under section 367(a). Under section 367(a), the GRA term in the case of outbound stock transfers is 10 years when U.S. transferors own at least 50 percent of the stock of a foreign transferee company. See § 1.367(a)-3T(c)(3) and Notice 87-85 (1987-2 C.B. 395). The IRS and Treasury believe that

the GRA term under section 367(e)(1) should be no less than the term under section 367(a) when U.S. transferors control the transferee because, once the GRA under section 367(e)(1) expires, the sale of Distributing or Controlled stock by a Qualified Foreign Distributee likely will not be subject to Federal income taxation. In contrast, under section 367(a), even if the GRA lapses, an amount approximating the deferred gain likely will be subject to Federal income taxation if the U.S. transferor later sells the stock of the transferee foreign corporation.

Finally, the IRS and Treasury believe that section 367(e)(1) distributions should be subject to some form of section 6038B reporting, as are transfers described under sections 367(a) and 367(d). Thus, the temporary regulations extend limited section 6038B reporting to section 367(e)(1) transactions. The reporting requirements under section 6038B will be deemed satisfied in the case of a taxpayer that qualifies for one of the three exceptions to taxation under the regulations if the taxpayer complies with the applicable reporting requirements relating to the relevant exception. This change is also intended to extend the statute of limitations under section 6501(c)(8) in cases where distributing corporations do not properly report their outbound section 355 distributions. Separately, the temporary regulations provide new notice and reporting rules in cases where Distributing qualifies for either the FIRPTA or publicly traded exception.

Specific changes to GRA Exception in Temporary Regulations

The specific requirements of the GRA exception, as amended, are as follows:

(A) Ten or Fewer Qualified Foreign Distributees

The existing regulations provide that Distributing is permitted to claim nonrecognition with respect to 10 or fewer individual or corporate foreign distributees. A ruling is required in the case of a foreign distributee that holds its interest in Distributing through a partnership, trust, or estate (whether foreign or domestic). This requirement is unchanged in the temporary regulations.

(B) Active Trade or Business

The existing regulations provide that, if Distributee is a foreign corporation, it must be engaged in an active trade or business. This requirement is removed in the temporary regulations.

(C) Value of Distributing

The existing regulations provide that, immediately after the distribution, the value of Distributing must be at least equal to the value of the distributed stock and securities. This requirement is waived by the existing regulations if Distributing and Controlled are members of the same consolidated group at the time of the distribution. This requirement is revised in the temporary regulations to provide that the value of Distributing (the value of its assets less all of its liabilities) must be at least equal to the amount of the deferred gain on all testing dates during the GRA period. (Alternatively, Distributing may satisfy this test using the adjusted basis of its assets instead of fair market value.) A testing date is the last day of each taxable year of Distributing and any day in which Distributing distributes money or property to its shareholders (regardless of whether such distribution is treated as a dividend). The waiver in the existing regulations if Distributing and Controlled are members of the same consolidated group is eliminated in the temporary regulations.

(D) Treaty Residence

The existing regulations provide that all Distributees are required to be residents of a country that maintains a comprehensive income tax treaty with the United States that contains an exchange of information provision. This requirement is not changed in the temporary regulations.

(E) Continuity of Interest Rule

The existing regulations provide that the Distributee is required to continue to own, for a 60-month period, all of the stock of Distributing and Controlled that it owns at the time of the distribution. This requirement is maintained, but the period is increased to 120 months.

(F) Distributing Must Remain in Existence

The existing regulations provide that Distributing cannot go out of existence pursuant to the distribution. This requirement is maintained in the temporary regulations.

(G) GRA

The existing regulations provide that Distributing is required to enter into a 5-year GRA and receive annual certifications from Distributees, stating that they continue to own the stock that they held immediately after the distribution. The temporary regulations increase the GRA term to 10 years.

(H) Annual Certifications

The existing regulations provide that Distributees must provide their certifications directly to Distributing. Under the temporary regulations, Controlled also must provide an annual statement to Distributing, containing information regarding whether any of its Qualified Foreign Distributees have disposed of their stock in Controlled during the relevant taxable year.

Special Analyses

It has been determined that this temporary regulation is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that this regulation does not have a significant impact on a substantial number of small entities. This certification is based on the fact that the number of corporations that distribute stock or securities to foreign persons in transactions that qualify under section 355, and thus become subject to the collection of information contained in these regulations, is estimated to be only 260 per year. Moreover, because these regulations will primarily affect large multinational corporations with foreign shareholders, it is estimated that out of the 260 annual transactions subject to reporting, very few, if any, will involve small entities. Therefore, the regulations do not significantly alter the reporting or recordkeeping duties of small entities. Thus, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

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 Part 1

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 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for § 1.367(e)-1 and adding an entry in numerical order to read as follows:

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

Section 1.367(e)-1T also issued under 26 U.S.C. 367(e)(1) * * *

§ 1.367 [Amended]

Par. 2. Sections 1.367(e)-0 and 1.367(e)-1 are removed.

Par. 3. Sections 1.367(e)-0T and 1.367(e)-1T are added to read as follows:

§ 1.367(e)-0T Treatment of section 355 distributions by U.S. corporations to foreign persons; table of contents.

This section lists captioned paragraphs contained in § 1.367(e)-1T.

§ 1.367(e)-1T Treatment of section 355 distributions by U.S. corporations to foreign persons.

- (a) Purpose and scope.
- (b) Recognition of gain required.
- (1) In general.
- (2) Computation of gain of the distributing corporation.
- (3) Treatment of foreign distributee.
- (4) Nonapplication of section 367(a) principles that provide for exceptions to gain recognition.
- (5) Partnerships, trusts, and estates.
 - (i) In general.
 - (ii) Written statement.
- (6) Anti-abuse rule.
- (c) Nonrecognition of gain.
- (1) Distribution by a U.S. real property holding corporation of stock in a second U.S. real property holding corporation.
- (2) Distribution by a publicly traded corporation.
- (i) Conditions for nonrecognition.
- (ii) Recognition of gain if foreign distributee owns 5 percent of distributing corporation.
- (iii) Reporting requirements.
- (iv) Timely filed return.
- (v) Relation to other nonrecognition provisions.
- (3) Distribution of certain domestic stock to 10 or fewer qualified foreign distributees.
 - (i) In general.
 - (ii) Conditions for nonrecognition.
 - (iii) Agreement to recognize gain.
 - (iv) Waiver of period of limitation.
 - (v) Annual certifications and other reporting requirements.
 - (vi) Special rule for nonrecognition transactions.
 - (vii) Recognition of gain.
 - (viii) Failure to comply.
 - (d) Other consequences.
 - (1) Exchange under section 897(e)(1).
 - (2) Dividend treatment under section 1248.

- (3) Distribution of stock of a passive foreign investment company. [Reserved]
- (4) Reporting under section 6038B.
- (e) Examples.
- (f) Effective date.

§ 1.367(e)-1T Treatment of section 355 distributions by U.S. corporations to foreign persons (temporary).

(a) *Purpose and scope.* This section provides rules concerning the recognition of gain by a domestic corporation on a distribution that qualifies for nonrecognition under section 355 of stock or securities of a domestic or foreign corporation to a person who is not a U.S. person. Paragraph (b) of this section states as a general rule that gain recognition is required on the distribution. Paragraph (c) of this section provides exceptions to the gain recognition rule for certain distributions of stock or securities of a domestic corporation. Paragraph (d) of this section refers to other consequences of distributions described in this section. Paragraph (e) of this section provides examples of these rules. Finally, paragraph (f) of this section specifies the effective date of this section.

(b) *Recognition of gain required—(1) In general.* (i) If a domestic corporation (distributing corporation) makes a distribution that qualifies for nonrecognition under section 355 of stock or securities of a domestic or foreign corporation (controlled corporation) to a person who is not a qualified U.S. person, then, except as provided in paragraph (c) of this section, the distributing corporation shall recognize gain (but not loss) on the distribution under section 367(e)(1). No gain is required to be recognized under this section with respect to a distribution to a qualified U.S. person of stock or securities that qualifies for nonrecognition under section 355. For purposes of this section, a qualified U.S. person is—

(A) A citizen or resident of the United States; and

(B) A domestic corporation.

(ii) In the case of stock or securities owned through a partnership, trust, or estate, see paragraph (b)(5) of this section.

(2) *Computation of gain of the distributing corporation.* The gain recognized by the distributing corporation under paragraph (b)(1) of this section shall be equal to the excess of the fair market value of the stock or securities distributed to persons who are not qualified U.S. persons (determined as of the time of the distribution) over the distributing corporation's adjusted basis in the stock or securities distributed to such distributees. For

purposes of the preceding sentence, the distributing corporation's adjusted basis in each unit of each class of stock or securities distributed to a distributee shall be equal to the distributing corporation's total adjusted basis in all of the units of the respective class of stock or securities owned immediately before the distribution, divided by the total number of units of the class of stock or securities owned immediately before the distribution.

(3) *Treatment of distributee.* If the distribution otherwise qualifies for nonrecognition under section 355, each distributee shall be considered to have received stock or securities in a distribution qualifying for nonrecognition under section 355, even though the distributing corporation may recognize gain on the distribution under this section. Thus, the distributee shall not be considered to have received a distribution described in section 301 or a distribution in an exchange described in section 302(b) upon the receipt of the stock or securities of the controlled corporation. Except where section 897(e)(1) and the regulations thereunder cause gain to be recognized by the distributee, the basis of the distributed domestic or foreign corporation stock in the hands of the foreign distributee shall be the basis of the distributed stock determined under section 358 without any increase for any gain recognized by the domestic corporation on the distribution.

(4) *Nonapplication of section 367(a) principles that provide for exceptions to gain recognition.* Paragraph (b)(1) of this section requires recognition of gain notwithstanding the application of any principles contained in section 367(a) or the regulations thereunder. The only exceptions to paragraph (b)(1) of this section are contained in paragraph (c) of this section. None of these exceptions applies to distributions of stock or securities of a foreign corporation.

(5) *Partnerships, trusts, and estates—(i) In general.*

For purposes of this section, stock or securities owned by or for a partnership (whether foreign or domestic) shall be considered to be owned proportionately by its partners. In applying this principle, the proportionate share of the stock or securities of the distributing corporation considered to be owned by a partner of the partnership at the time of the distribution shall equal the partner's distributive share of gain that would be realized by the partnership from a sale of stock of the distributing corporation considered to be owned by a partner of the partnership at the time of the distribution (without regard to whether, under the particular facts, any gain would actually be realized on the sale

for U.S. tax purposes), determined under the rules and principles of sections 701 through 761 and the regulations thereunder. For purposes of this section, stock or securities owned by or for a trust or estate (whether foreign or domestic) shall be considered to be owned proportionately by the persons who would be treated as owning such stock or securities under sections 318(a)(2)(A) and (B). In applying section 318(a)(2)(B), if a trust includes interests that are not actuarially ascertainable and a principal purpose of the inclusion of the interests is the avoidance of section 367(e)(1), all such interests shall be considered to be owned by foreign persons. In a case where an interest holder in a partnership, trust, or estate that owns stock of the distributing corporation is itself a partnership, trust, or estate, the rules of this paragraph (b)(5) apply to individuals or corporations that own (direct or indirect) interests in the upper-tier partnership, trust or estate.

(ii) *Written statement.* If, prior to the date on which the distributing corporation must file its income tax return for the year of the distribution, the corporation obtains a written statement, signed under penalties of perjury by an interest holder in a partnership, trust, or estate that receives a distribution described in paragraph (b)(1) of this section from the corporation, which statement certifies that the interest holder is a qualified U.S. person (as defined in paragraph (b)(1)(i) of this section), no liability shall be imposed under paragraph (b)(1) of this section with respect to the distribution to the partnership, trust, or estate to the extent of the interest holder's interest in the partnership, trust, or estate, unless the distributing corporation knows or has reason to know that the statement is false, or it is subsequently determined that the interest holder, in fact, was not a qualified U.S. person at the time of the distribution. The written statement must set forth the amount of the interest holder's proportionate interest in the partnership, trust, or estate as determined under paragraph (b)(5)(i) of this section and must set forth the amount of such entity's proportionate interest in the distributing and controlled corporation, as well as the interest holder's name, taxpayer identification number, home address (in the case of an individual) or office address and place of incorporation (in the case of a corporation). The written statement must be retained by the distributing corporation with its books and records for a period of three

calendar years following the close of the last calendar year in which the corporation relied upon the statement.

(6) *Anti-abuse rule.* If a domestic corporation is directly or indirectly formed or availed of by one or more foreign persons to hold the stock of a second domestic corporation for a principal purpose of avoiding the application of section 367(e)(1) and the requirements of this section, any distribution of stock or securities to which section 355 applies by such second domestic corporation shall be treated for Federal income tax purposes as a distribution to such foreign person or persons, followed by a transfer of the stock or securities to the first domestic corporation. The qualification of the distribution to the foreign person for an exception to the general gain recognition rule of paragraph (b)(1) of this section, and the consequences of the transfer to the first domestic corporation under this section, shall be determined in accordance with all of the facts and circumstances.

(c) *Nonrecognition of gain—(1) Distribution by a U.S. real property holding corporation of stock in a second U.S. real property holding corporation.* Gain shall not be recognized under paragraph (b) of this section by a domestic corporation making a distribution that qualifies for nonrecognition under section 355 of stock or securities of a domestic controlled corporation to a person who is not a qualified U.S. person (as defined in paragraph (b)(1)(i) of this section) if the conditions specified in paragraphs (c)(1) (i) and (ii) of this section are both satisfied:

(i) Immediately after the distribution, both the distributing and controlled corporations are U.S. real property holding corporations (as defined in section 897(c)(2)). For the treatment of the distribution under section 897, see section 897(e)(1) and the regulations thereunder.

(ii) The distributing corporation attaches to its timely filed Federal income tax return for the taxable year in which the distribution occurs a statement titled "Section 367(e)(1)—Reporting of Section 355 Distribution by U.S. Real Property Holding Corporation", signed under penalties of perjury by an officer of the corporation, disclosing the following information—

(A) A statement that the distribution is one to which paragraph (c)(1) of this section applies; and

(B) A description of the transaction in which one U.S. real property holding corporation distributes the stock of another U.S. real property holding

corporation in a transaction that is described under section 355.

(iii) For purposes of this paragraph (c)(1), an income tax return (including an amended return) will be considered a timely filed Federal income tax return if it is filed prior to the time that the Internal Revenue Service discovers that the reporting requirements of this paragraph have not been satisfied.

(2) *Distribution by a publicly traded corporation—(i) Conditions for nonrecognition.* Except as provided by paragraph (c)(2)(ii) of this section, gain shall not be recognized under paragraph (b) of this section by a domestic corporation making a distribution that qualifies for nonrecognition under section 355 of stock or securities of a domestic controlled corporation to a person who is not a qualified U.S. person (as defined in paragraph (b)(1)(i) of this section) if both of the following conditions are satisfied:

(A) Stock of the domestic controlled corporation with a value of more than 80 percent of the outstanding stock of the corporation is distributed with respect to one or more classes of the outstanding stock of the distributing corporation that are regularly traded on an established securities market, as defined in § 1.897-1(m) (1) and (3), located in the United States. Stock is considered to be regularly traded if it is regularly quoted by brokers or dealers making a market in such interests. A broker or dealer is considered to make a market only if the broker or dealer holds himself out to buy or sell interests in the stock at the quoted price.

(B) The distributing corporation satisfies the reporting requirements contained in paragraph (c)(2)(iii) of this section.

(ii) *Recognition of gain if distributee owns 5 percent of distributing corporation.* If, at the time of the distribution, the distributing corporation knows or has reason to know that any distributee who is not a qualified U.S. person (as defined in paragraph (b)(1)(i) of this section) owns, directly, indirectly, or constructively (using the rules of sections 897(c)(3) and (c)(6)(C), but subject to the rules of paragraph (b)(5) of this section), more than 5 percent (by value) of a class of stock or securities of the distributing corporation with respect to which the stock or securities of the controlled corporation is distributed (a 5-percent shareholder), the distributing corporation will qualify for nonrecognition under paragraph (c)(2)(i) of this section if, with respect to such 5-percent shareholder, either—

(A) The distribution qualifies for nonrecognition under paragraph (c)(3) of this section; or

(B) The distributing corporation recognizes gain (but not loss) on the distribution under paragraph (b) of this section.

(iii) *Reporting Requirements.* To qualify for nonrecognition treatment under paragraph (c)(2)(i) of this section, the distributing corporation must attach to its timely filed Federal income tax return, for the taxable year in which the distribution occurs a statement titled "Section 367(e)(1)—Reporting of Section 355 Distribution by U.S. Publicly Traded Corporation to Foreign Persons," signed under penalties of perjury by an officer of the corporation, disclosing the following information:

(A) A statement that the distribution is one to which paragraph (c)(2) of this section applies.

(B) A description of the transaction in which the distributing corporation that is publicly traded on a U.S. securities market distributed stock or securities of a domestic controlled corporation.

(C) The U.S. securities market on which the stock of the distributing corporation is publicly traded.

(D) A statement that, at the time of the distribution, either—

(1) The distributing corporation does not know or have reason to know that any distributee who is not a qualified U.S. shareholder (as defined in paragraph (b)(1)(i) of this section) is a 5-percent shareholder; or

(2) The distributing corporation knows or has reason to know that one or more distributees who are not qualified U.S. persons are 5-percent shareholders, and, that with respect to each such 5-percent shareholder, either—

(i) Gain will not be recognized because the requirements of paragraph (c)(3) of this section are satisfied; or

(ii) Gain (but not loss) will be recognized in accordance with paragraph (b) of this section.

(iv) *Timely filed return.* For purposes of this paragraph (c)(2), an income tax return (including an amended return) will be considered a timely filed Federal income tax return if it was received prior to the time that the Internal Revenue Service discovers that the reporting requirements of this paragraph (c)(2) have not been satisfied.

(v) *Relation to other nonrecognition provisions.* If the distribution of the stock and securities of the controlled corporation also qualifies for nonrecognition under paragraph (c)(1) of this section, the distributing corporation shall be entitled to nonrecognition under paragraph (c)(1)

of this section and not this paragraph (c)(2).

(3) *Distribution of certain domestic stock to 10 or fewer qualified foreign distributees—(i) In general.* (A) Gain shall not be recognized under paragraph (b) of this section by a domestic corporation making a distribution that qualifies for nonrecognition under section 355 of stock or securities of a domestic controlled corporation with respect to a foreign distributee (defined in paragraph (c)(3)(i)(B) of this section) that is a qualified foreign distributee (defined in paragraph (c)(3)(i)(C) of this section), provided that each of the conditions contained in paragraph (c)(3)(ii) of this section is satisfied. If one or more foreign distributees are not treated as qualified foreign distributees, the distributing corporation shall recognize a percentage of the gain realized on the distribution, equal to the percentage of its stock owned immediately before the distribution, directly or indirectly, by foreign distributees who are not qualified foreign distributees. See paragraph (b)(5) of this section for rules regarding the ownership of stock held by a partnership, trust, or estate.

(B) For purposes of this paragraph (c)(3), the term *foreign distributee* is any person who is not a qualified U.S. person (as defined in paragraph (b)(1)(i) of this section) if such person—

(1) Owned stock or securities of the distributing corporation immediately prior to the distribution;

(2) Owned stock or securities of the distributing corporation within two years prior to the distribution and directly, indirectly, or constructively (using the rules of section 318) owns 50 percent or more of either the total voting power or the total value of the stock of the distributing or controlled corporation immediately after the distribution; or

(3) Is a transferee or substitute distributee, as defined in paragraph (c)(3)(vi) (C) or (D) of this section.

(C) For purposes of this section, except as provided by paragraph (c)(3)(i)(D) of this section, the term *qualified foreign distributee* is a foreign distributee that, during the entire period for which the agreement to recognize gain (described in paragraph (c)(3)(iii) of this section) is in effect with respect to the distributee, is either an individual or a corporation (as defined in section 7701(a)(3)), resident of a foreign country that maintains a comprehensive income tax treaty with the United States which contains an information exchange provision. However, no more than ten foreign distributees in total may be current or former qualified foreign

distributees (including any transferee or substitute distributees as defined in paragraph (c)(3)(vi) (C) or (D) of this section) during the entire term of the gain recognition agreement. See, however, paragraph (c)(3)(vi)(G) of this section for special rules applicable to substitute distributees.

(D) Unless the distributing corporation obtains a ruling from the Internal Revenue Service to the contrary, no foreign distributee shall be treated as a qualified foreign distributee if it holds its interest in the distributing corporation through a partnership, trust or estate, characterized as such under the taxation laws of the United States or any entity that is treated as fiscally transparent under the taxation laws of the foreign country in which it is a resident if such country maintains a comprehensive income tax treaty with the United States which contains an information exchange provision.

(ii) *Conditions for nonrecognition.* A distribution of stock or securities described in paragraph (c)(3)(i) of this section to a qualified foreign distributee shall not result in the recognition of gain if each of the following conditions is satisfied:

(A) If more than ten foreign distributees, at any time during the entire term of the gain recognition agreement, are eligible to be qualified foreign distributees, the distributing corporation shall designate the foreign distributees to be considered qualified foreign distributees for which nonrecognition is claimed under this paragraph (c)(3).

(B) Immediately after the distribution and on each testing date beginning after the distribution and during the period that the agreement to recognize gain (described in paragraph (c)(3)(iii) of this section) is in effect, the value of the distributing corporation (that is, the fair market value of the assets of the distributing corporation, less all liabilities of the distributing corporation) must exceed the amount of gain that the distributing corporation realized, but did not recognize (on or after the distribution) under this paragraph (c)(3), as a consequence of the distribution with respect to qualified foreign distributees. This requirement will be deemed satisfied for any testing date upon which the adjusted basis of the distributing corporation's assets, less all liabilities of the distributing corporation, exceeds the amount of the deferred gain. A testing date is—

(1) The last day of any taxable year of the distributing corporation during which the agreement to recognize gain is in effect; and

(2) Any date upon which the distributing corporation distributes property to its shareholders under section 301(a).

(C) At all times until the close of the 120-month period following the end of the taxable year of the distributing corporation in which the distribution was made, except under the circumstances and subject to the consequences prescribed in paragraphs (c)(3) (vi) and (vii) of this section, all qualified foreign distributees must continue to own, directly or indirectly, all of the stock and securities of the distributing and controlled corporations that the qualified foreign distributee owned, directly or indirectly, immediately after the distribution (including any stock and securities of the distributing or controlled corporation later acquired from the distributing or controlled corporation for which the distributee has a holding period determined under section 1223 by reference to the stock or securities).

(D) The distribution of stock or securities described in paragraph (c)(3)(i) of this section must not be a distribution pursuant to which the distributing corporation goes out of existence.

(E) The distributing corporation must file an agreement to recognize gain, and the controlled corporation must agree to be secondarily liable in the event that the distributing corporation does not pay the tax due upon a recognition event described in paragraph (c)(3)(vii) of this section. The agreement is described in paragraph (c)(3)(iii) of this section and filed by the distributing corporation with its Federal income tax return for its taxable year in which the distribution is made.

(F) For each of the taxable years of the distributing corporation, beginning with the taxable year of the distribution and ending with the taxable year that includes the close of the 120-month period following the end of the taxable year of the distributing corporation in which the distribution was made, all qualified foreign distributees and the controlled corporation must provide to the distributing corporation the annual certifications described in paragraph (c)(3)(v) of this section, and the distributing corporation must file the certifications with its tax return.

(iii) *Agreement to recognize gain.* The agreement to recognize gain required by this paragraph (c)(3)(iii) shall be prepared by or on behalf of the distributing corporation and signed under penalties of perjury by an authorized officer of the distributing corporation. An authorized officer of the controlled corporation must also sign

the agreement under penalties of perjury, agreeing to extend the statute of limitations and accept liability for the tax in the event that the distributing corporation fails to pay the tax upon a recognition event. The agreement provided by the distributing corporation shall set forth the following items, under the heading "GAIN RECOGNITION AGREEMENT UNDER § 1.367(e)-1T(c)(3)(iii)", with paragraphs labeled to correspond with such items:

(A) A declaration that the distribution is one to which paragraph (c)(3) of this section applies.

(B) A description of each qualified foreign distributee, which shall include the qualified foreign distributee's—

(1) Name;

(2) Address;

(3) Taxpayer identification number (if any); and

(4) Residence and citizenship (in the case of an individual) or place of incorporation and country of residence (in the case of a qualified foreign distributee that is a corporation for Federal income tax purposes under section 7701(a)(3)).

(C) A description of the stock and securities of the distributing and controlled corporations owned (directly or indirectly) by each qualified foreign distributee, including—

(1) The number or amount of shares;

(2) The type of stock or securities;

(3) The fair market values of the stock and securities of the controlled corporation owned (directly or indirectly) by the qualified foreign distributee(s), determined immediately before and immediately after the distribution;

(4) The distributing corporation's adjusted basis (immediately before the distribution) in the stock and securities of the controlled corporation distributed to the qualified foreign distributees;

(5) The fair market value of the distributing corporation (fair market value of its assets, less all liabilities of the distributing corporation) immediately after the distribution. Such amount must exceed the amount of gain that the distributing corporation realized, but did not recognize under this paragraph (c)(3), on the distribution to qualified foreign distributees. Alternatively, the fair market value standard will be deemed satisfied if the adjusted basis of the assets of the distributing corporation, less all liabilities of the distributing corporation, exceeds the amount of the deferred gain.

(6) For each applicable valuation, a summary of the method (including appraisals, if any) used for determining

the fair market values required by this paragraph (c)(3)(iii).

(D) The distributing corporation's agreement to recognize gain in accordance with paragraph (c)(3)(vii) of this section.

(E) The controlled corporation's agreement to be secondarily liable for the distributing corporation's tax liability, pursuant to the gain recognition agreement described in this paragraph (c)(3)(iii).

(F) A waiver of the period of limitations by both the distributing and controlled corporation as described in paragraph (c)(3)(iv) of this section.

(G) An attached statement from each qualified foreign distributee declaring that the qualified foreign distributee will provide to the distributing corporation the annual certifications described in paragraph (c)(3)(v)(A) of this section for each of the taxable years of the distributing corporation, beginning with the taxable year of the distribution and ending with the taxable year that includes the close of the 120-month period following the taxable year of the distributing corporation in which the distribution was made. The attached statements shall be signed under penalties of perjury by an authorized officer in the case of any qualified foreign distributee that is a corporation for Federal income tax purposes or by the individual in the case of a qualified foreign distributee that is an individual.

(H) An attached statement from the controlled corporation declaring that it will provide to the distributing corporation the annual certifications described in paragraph (c)(3)(v)(B) of this section.

(I) An agreement by the distributing corporation to attach to its tax returns the annual certifications of the qualified foreign distributees and the controlled corporation described in paragraphs (c)(3)(v)(A) and (B) of this section, respectively, and to meet any other reporting requirement in accordance with paragraph (c)(3)(v) of this section.

(iv) *Waiver of period of limitation.* The distributing corporation and the controlled corporation must file, with the gain recognition agreement described in paragraph (c)(3)(iii) of this section, a waiver of the period of limitation on the assessment of tax upon the gain realized on the distribution to the qualified foreign distributee(s). The waiver shall be executed on Form 8838, substitute form, or such other form as may be prescribed by the Commissioner for this purpose and shall extend the period for assessment of such tax to a date not earlier than the close of the thirteenth full year following the taxable year that includes the distribution. A

properly executed Form 8838, substitute form, or such other form authorized by this paragraph (c)(3)(iv) shall be deemed to be consented to and signed by a Service Center Director or the Assistant Commissioner (International) for purposes of § 301.6501(c)-1(d) of this chapter.

(v) *Annual certifications and other reporting requirements.* For each of the taxable years of the distributing corporation, beginning with the taxable year of the distribution and ending with the taxable year that includes the close of the 120-month period following the end of the taxable year of the distributing corporation in which the distribution was made, the distributing corporation must file with its Federal income tax return the annual certifications for that year described in this paragraph (c)(3)(v).

(A) Each current qualified foreign distributee must provide to the distributing corporation an annual certification, signed under penalties of perjury by an authorized officer of the qualified foreign distributee that is a corporation or by the qualified foreign distributee that is an individual (as the case may be). Each annual certification must identify the distribution with respect to which it is given by setting forth the date and a summary description of the distribution. In the annual certification, the qualified foreign distributee must declare that—

(1) The qualified foreign distributee continues to satisfy paragraph (c)(3)(i)(C) of this section; and

(2) The qualified foreign distributee continues to own, directly or indirectly, without interruption, the stock and securities of the distributing and controlled corporations (except to the extent the stock or securities have been disposed of in a transfer described in paragraph (c)(3)(vi) of this section).

(B) The controlled corporation must provide a certification to the distributing corporation, signed under penalties of perjury by an authorized officer of the corporation, that lists each current qualified foreign distributee holding (directly or indirectly) stock of the controlled corporation and its direct or indirect ownership interest in the controlled corporation at both the first day and the last day of the taxable year for which the distributing corporation files its Federal income tax return, and certifies the accuracy of that list.

(C) The distributing corporation must attach to the annual certifications described in paragraphs (c)(3)(v)(A) and (B) of this section, a statement signed under penalties of perjury by an authorized officer of the corporation, in which the corporation declares that, to

the best of its knowledge, the annual certifications are true.

(D) The distributing corporation must also attach to the annual certifications a separate statement indicating—

(1) The names and addresses of each current and each former qualified foreign distributee;

(2) The percentage of direct or indirect ownership that the qualified foreign distributees retain in the distributing corporation at year-end; and

(3) A certification that the value of the distributing corporation (or the adjusted basis of its assets), less all of the liabilities of the distributing corporation on all testing dates, exceeded the amount of the gain deferred as of the testing date.

(vi) *Special rule for nonrecognition transactions.* (A) Gain shall not be recognized under paragraph (c)(3)(vii) of this section if the distributing or controlled corporation is acquired by a successor-in-interest (described in paragraph (c)(3)(vi)(B) of this section), or upon a direct or indirect disposition by a qualified foreign distributee of stock or securities of a distributing or controlled corporation (or a successor-in-interest) that is subject to a gain recognition agreement described in paragraph (c)(3)(iii) of this section, if the requirements of this paragraph (c)(3)(vi) are satisfied and the disposition consists of a transfer described in section 332, 337, 351, 354, 355, 356, or 361 that does not result in a substantial transformation (as defined in paragraph (c)(3)(vii)(B) of this section). For special rules regarding transfers described in section 355, see paragraph (c)(3)(vi)(G) of this section.

(B) For purposes of this section, the term *successor-in-interest* refers to any domestic corporation that acquires the assets of the distributing or controlled corporation in a transaction described in section 381(a) to which this paragraph (c)(3)(vi) applies.

(C) For purposes of this section, the term *transferee distributee* refers to:

(1) Any corporation whose stock or securities are exchanged for the stock or securities of the distributing or controlled corporation (or a successor-in-interest), or of another transferee distributee, in a transaction described in section 351, 354, or sections 361 and 381(a)(2), to which this paragraph (c)(3)(vi) applies.

(2) Any corporation that acquires the assets of any qualified foreign distributee, transferee distributee or substitute distributee in a transaction described in section 381(a).

(D) For purposes of this section, the term *substitute distributee* refers to any person that acquires the stock or

securities of the distributing or controlled corporation (or a successor-in-interest), or of a qualified foreign distributee, in a section 355 distribution.

(E) Gain shall not be recognized under paragraph (c)(3)(vii) of this section in a transaction involving a transfer of the assets of the distributing or controlled corporation to a successor-in-interest, only if the following information and agreements are included with the first annual certification thereafter filed under paragraph (c)(3)(v) of this section:

(1) A description of the transaction (including a statement of applicable Internal Revenue Code provisions, and a description of stock or securities transferred, exchanged, or received in the transaction).

(2) A description of the successor-in-interest (including the name, address, taxpayer identification number, and place of incorporation of the successor in interest).

(3) An agreement of the successor-in-interest, signed under penalties of perjury by an authorized officer of the successor-in-interest corporation, to succeed to all of the responsibilities and duties of the distributing corporation or the controlled corporation (as the case may be) under this paragraph (c)(3) as if the successor-in-interest were the distributing or controlled corporation.

(F) Gain shall not be recognized under paragraph (c)(3)(vii) of this section in a transaction described in paragraph (c)(3)(vi)(A) of this section in which a qualified foreign distributee, directly or indirectly, disposes of, and a transferee distributee acquires, stock or securities of the distributing or controlled corporation (or a successor-in-interest), or another transferee distributee, only if the transferee distributee is either a qualified U.S. person or qualifies as a qualified foreign distributee under this paragraph (c)(3) and the following information and agreements are included with the first annual certification thereafter filed under paragraph (c)(3)(v) of this section:

(1) A description of the transaction (including a statement of applicable Internal Revenue Code provisions, and a description of the stock or securities of the distributing or controlled corporation (or a successor-in-interest) owned, directly or indirectly, by qualified foreign distributees immediately after the transaction).

(2) An agreement of the distributing corporation and the controlled corporation (amending the agreement described in paragraph (c)(3)(iii) of this section), signed under penalties of perjury by an authorized officer of the corporation, to recognize gain (in the

case of the distributing corporation) and to be secondarily liable (in the case of the controlled corporation) in accordance with the provisions of this paragraph (c)(3) upon the occurrence of a disposition, directly or indirectly, by the foreign transferee distributee of any stock or securities of the distributing or controlled corporation (or a successor-in-interest) (other than a disposition that itself satisfies the requirements of this paragraph (c)(3)(vi)).

(3) An agreement of each foreign transferee distributee, signed under penalties of perjury by the individual or an authorized officer of the corporation, to comply with all of the responsibilities, qualifications and duties of a qualified foreign distributee under this paragraph (c)(3), with respect to the stock or securities of the distributing or controlled corporation (or a successor-in-interest) owned, directly or indirectly, by the transferee distributee.

(G) Gain shall not be recognized under paragraph (c)(3)(vii) of this section in the case of a section 355 distribution by a qualified foreign distributee of stock or securities of the distributing or controlled corporation (or a successor-in-interest), or of another qualified foreign distributee. The qualified foreign distributee that distributed the stock or securities is no longer required to comply with the rules of this section applicable to qualified foreign distributees, provided such person no longer has any interest, directly or indirectly, in the distributing and controlled corporation. Thus, for example, such person is not counted as a qualified foreign distributee for purposes of limiting gain recognition to 10 or fewer foreign distributees. In order for this provision to apply, the substitute distributee must either be a qualified U.S. person or satisfy the requirements applicable to qualified foreign distributees contained in this paragraph (c)(3) and must include with the first annual certification thereafter filed under paragraph (c)(3)(v) of this section the following information and agreements:

(1) A description of the transaction (including a statement of applicable Internal Revenue Code sections, and a description of the stock or securities distributed in the transaction).

(2) An agreement of the distributing corporation and the controlled corporation (amending the agreement described in paragraph (c)(3)(iii) of this section), signed under penalties of perjury by an authorized officer of the corporation, to recognize gain (in the case of the distributing corporation) and to be secondarily liable (in the case of

the controlled corporation) in accordance with the provisions of this paragraph (c)(3) upon the occurrence of a disposition, directly or indirectly, by a foreign substitute distributee of any stock or securities received by the substitute distributee in the transaction.

(3) An agreement of each foreign substitute distributee, signed under penalties of perjury by the individual or authorized officer of the corporation, to succeed to all of the responsibilities, qualifications and duties of a qualified foreign distributee under this paragraph (c)(3), with respect to the stock or securities of the distributing or controlled corporation (or a successor-in-interest) received by such substitute distributee.

(vii) *Recognition of gain.* (A) (1) The distributing corporation must file, within 90 days of a transaction described in this paragraph (c)(3)(vii)(A), an amended return for the year of the distribution and recognize gain realized but not recognized upon such distribution, if, prior to the close of the 120-month period following the end of the taxable year of the distributing corporation in which the distribution was made, either—

(i) A qualified foreign distributee sells (or otherwise disposes of) the stock or securities of the distributing or controlled corporation that the qualified foreign distributee owned (directly or indirectly) (other than pursuant to a transfer described in paragraph (c)(3)(vi) of this section); or

(ii) Any other transaction (e.g., a public offering or reorganization) results in a substantial transformation (as defined in paragraph (c)(3)(vii)(B) of this section) in either the distributing or controlled corporation (or both).

(2) For purposes of this paragraph (c)(3)(vii)(A), a disposition includes, but is not limited to, any disposition treated as a sale or exchange under this subtitle (e.g., section 301(c)(3)(A), 302(a), 351(b) or 356(a)(1)). For the computation of gain in the case of a sale (or similar disposition), see paragraph (c)(3)(vii)(C) of this section. For the computation of gain in the case of other transactions, see paragraphs (c)(3)(vii)(D) and (F) of this section. For special rules regarding substitute distributees, see paragraph (c)(3)(vii)(E) of this section.

(B) A transaction is treated as a substantial transformation if, as a result of such transaction, the qualified foreign distributees, transferee distributees and substitute distributees own, in the aggregate, less than 50 percent of either the total voting power or the total value of the stock of the distributing or the controlled corporation, directly or indirectly, that the qualified foreign

distributees owned immediately after the distribution.

(C) In the case of a sale (or similar disposition), directly or indirectly, by a qualified foreign distributee of the stock or securities of the distributing or controlled corporation (or a successor-in-interest) that does not result in a substantial transformation, the distributing corporation shall be required to recognize a proportionate amount of the gain realized but not recognized under this paragraph (c)(3), equal to the percentage of stock of the distributing or controlled corporation, as the case may be, sold (or otherwise disposed of), directly or indirectly, by the qualified foreign distributee. However, if the sale (or other disposition) of stock or securities by a qualified foreign distributee results in a substantial transformation, the distributing corporation (or its successor-in-interest) must recognize the entire deferred gain that has not already been recognized under paragraph (c)(3)(vii) of this section.

(D) In the case of a nonrecognition transaction that results in a substantial transformation, the distributing corporation must recognize the entire deferred gain that has not already been recognized under paragraph (c)(3)(vii) of this section. If a nonrecognition transaction does not result in a substantial transformation, the distributing corporation does not recognize any gain provided that the requirements of paragraph (c)(3)(vi) of this section are satisfied.

(E) A sale (or other disposition), directly or indirectly, by a substitute distributee, of all or a portion of the stock or securities of the distributing or controlled corporation (or a successor-in-interest) that the substitute distributee received in the section 355 distribution shall be treated as a disposition of such stock or securities by a qualified foreign distributee (in accordance with paragraph (c)(3)(vii)(C) of this section) for purposes of computing gain under this paragraph (c)(3)(vii).

(F) Other transactions or events shall trigger gain under this paragraph (c)(3)(vii) as follows:

(1) If a qualified foreign distributee ceases to satisfy the requirements for a qualified foreign distributee contained in paragraph (c)(3)(i)(C) of this section (or any other specified requirements in paragraph (c)(3) of this section), the qualified foreign distributee shall be treated as if it sold all of the stock and securities that it owned, directly or indirectly, in the distributing and controlled corporation (or a successor-

in-interest), on the date that such person ceased to meet the requirements.

(2) If a substitute distributee ceases to satisfy the requirements for a qualified foreign distributee contained in paragraph (c)(3)(i)(C) of this section (or any other specified requirements in paragraph (c)(3) of this section), the substitute distributee shall be treated as if it sold all of the stock and securities of the distributing or controlled corporation (or a successor-in-interest) that it received in the distribution, on the date that it ceased to meet the requirements.

(3) If the distributing corporation (or a successor-in-interest) fails to satisfy the requirement contained in paragraph (c)(3)(ii)(B) of this section on any testing date during which the agreement to recognize gain is in effect, such failure will be treated as if a substantial transformation has occurred on such date.

(4) If either the distributing or controlled corporation (or a successor-in-interest) is acquired in a section 381(a) exchange and the acquirer is not a successor-in-interest that satisfies the requirements of paragraph (c)(3)(vi)(E), such acquisition will be treated as if a substantial transformation has occurred on the date of the acquisition.

(G) A qualified foreign distributee that sells (or otherwise disposes of) all of its interest, directly or indirectly, in the distributing and controlled corporation ceases thereafter to be a qualified foreign distributee. In addition, where one qualified foreign distributee owns all of the stock of another qualified foreign distributee, and both persons have identical direct or indirect interests in the distributing or controlled corporation, the direct or indirect sale (or other disposition) by one qualified foreign distributee of all of its interest in the distributing or controlled corporation (under paragraph (c)(3)(vii) of this section) will terminate the qualified foreign distributee status for the second qualified foreign distributee. The principles of this paragraph (c)(3)(vii) shall generally be applied so that any gain relating to the same stock of the distributing or controlled corporation by more than one person is not taxed more than once under this paragraph (c)(3)(vii). In any event, gain recognized pursuant to this paragraph (c)(3)(vii), on a cumulative basis, shall not exceed the amount of gain that the distributing corporation would have recognized under section 367(e)(1) if its initial distribution of the stock or securities of the controlled corporation was fully taxable under paragraph (b) of this section.

(H) If additional tax is required to be paid by the distributing corporation (or a successor-in-interest) for the year of the distribution, interest must be paid by the distributing corporation (or the controlled corporation if the distributing corporation fails to pay the tax due) on that amount at the rates determined under section 6621(a)(2) with respect to the period between the date that was prescribed for filing the distributing corporation's original income tax return for the year of the distribution and the date on which the additional tax for that year is paid.

(I) Net operating losses, capital losses, or credits against tax that were available in the year of the distribution and that are unused (whether or not they have expired since the distribution) at the time of gain recognition described in this paragraph (c)(3)(vii) may be applied (respectively) by the distributing corporation against any gain recognized or tax owed by reason of this provision, but no other adjustments shall be made with respect to any other items of income or deduction in the year of distribution or other years.

(viii) *Failure to comply.* (A) Except as otherwise provided in paragraph (c)(3)(viii)(B) of this section, if the distributing corporation or the controlled corporation fails to comply in any material respect with the requirements of this paragraph (c)(3) or with the terms of an agreement submitted pursuant hereto, or if the distributing corporation knows or has reason to know of any failure of another person to so comply, the distributing corporation shall treat the initial distribution of the stock or securities of the controlled corporation as a taxable exchange in the year of the distribution. In such event, the period for assessment of tax shall be extended until three years after the date on which the Internal Revenue Service receives actual notice of such failure to comply.

(B) If a person fails to comply in any material respect with the requirements of this paragraph or with the terms of an agreement submitted pursuant thereto, the provisions of paragraph (c)(3)(viii)(A) 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, provided that the person achieves compliance as soon as the person becomes aware of the failure. Whether a failure to materially comply was due to reasonable cause shall be determined by the district director under all the facts and circumstances.

(d) *Other consequences—(1) Exchange under section 897(e)(1).* With respect to the treatment under section

897(e)(1) of a foreign distributee on the receipt of stock or securities of a domestic or foreign corporation where the foreign distributee's interest in the distributing domestic corporation is a United States real property interest, see section 897(e)(1) and the regulations thereunder.

(2) *Dividend treatment under section 1248.* With respect to the treatment as a dividend of a portion of the gain recognized by the domestic corporation on the distribution of the stock of certain foreign corporations, see sections 1248(a) and (f) and the regulations thereunder.

(3) *Distribution of stock of a passive foreign investment company.* [Reserved]

(4) *Reporting under section 6038B.* Notice shall be required under section 6038B with respect to a distribution described in this section. See § 1.6038B-1T(e).

(e) *Examples.* The rules of paragraphs (b), (c), and (d) of this section are illustrated by the examples below. In all examples, assume that all foreign companies are treated as corporations for Federal income tax purposes and are not treated as fiscally transparent under the taxation laws of the relevant foreign country.

Example 1. (i) FC, a Country Z company, owns all of the outstanding stock of DC1, a domestic corporation. DC1 owns all of the outstanding stock of DC2, another domestic corporation. The fair market value of the DC1 stock is 300x, and FC has a 100x basis in the DC1 stock. The fair market value of the DC2 stock is 180x, and DC1 has a 80x basis in the DC2 stock. Neither DC1 nor DC2 is a U.S. real property holding corporation. Country Z does not maintain an income tax treaty with the United States.

(ii) In a transaction qualifying for nonrecognition under section 355, DC1 distributes all of the stock of DC2 to FC. After the distribution, the DC1 stock has a fair market value of 120x.

(iii) Under paragraphs (b) (1) and (2) of this section, DC1 recognizes gain of 100x, which is the difference between the fair market value (180x) and the adjusted basis (80x) of the stock distributed. Under paragraph (d)(1) of this section and section 358, FC takes a basis of 40x in the DC1 stock, and a basis of 60x in the DC2 stock.

Example 2. (i) C, a citizen and resident of Country F, owns all of the stock of DC1, a domestic corporation. DC1, in turn, owns all of the stock of DC2, also a domestic corporation. The fair market value of the DC1 stock is 500x, and C has a 100x basis in the DC1 stock. The DC2 stock has a fair market value of 200x, and DC1 has a 180x basis in the DC2 stock.

(ii) In a transaction qualifying for nonrecognition under section 355, DC1 distributes to C all of the stock of DC2. DC1 and DC2 are U.S. real property holding corporations immediately after the distribution. After the distribution, the DC1 stock has a fair market value of 300x.

(iii) Under paragraph (c)(1) of this section, provided that DC1 complies with the reporting requirements contained in paragraph (c)(1)(ii) of this section, DC1 does not recognize gain on the distribution of the DC2 stock because DC1 and DC2 are U.S. real property holding corporations immediately after the distribution.

(iv) Under section 897(e) and the regulations thereunder, C is considered to have exchanged DC1 stock with a fair market value of 200x and an adjusted basis of 40x for DC2 stock with a fair market value of 200x. Because DC2 is a U.S. real property holding corporation, and its stock is a U.S. real property interest, C does not recognize any gain under section 897(e) on the distribution. C takes a basis of 40x in the DC2 stock, and its basis in the DC1 stock is reduced to 60x pursuant to section 358.

Example 3. (i) All of the outstanding common stock of DC, a domestic corporation that is not a U.S. real property holding corporation, is regularly traded on an established securities market located in the United States. None of the foreign shareholders of DC (directly, indirectly, or constructively) owns more than five percent of the common stock of DC. DC owns all of the stock of DS, a domestic corporation. The stock of DS has appreciated in the hands of DC.

(ii) In a transaction qualifying for nonrecognition under section 355, DC distributes all of the stock of DS to the common shareholders of DC.

(iii) Under paragraph (c)(2) of this section, DC does not recognize gain on the distribution of the DS stock to any foreign distributee, provided that DC complies with the reporting requirements contained in paragraph (c)(2)(iii) of this section. Each shareholder's basis in the DC and DS stock is determined pursuant to section 358.

Example 4. (i) FC, a company resident in Country X, owns all of the stock of DC1, a domestic corporation. DC1, in turn, owns all of the stock of DC2, a domestic corporation. The fair market value of the DC1 stock is 1,000x, and FC has a basis in the DC1 stock of 800x. The DC2 stock has a fair market value of 500x at the time of the distribution, and DC1 has a 100x basis in the DC2 stock. Neither DC1 nor DC2 is a U.S. real property holding corporation. Country X maintains an income tax treaty with the United States that includes an information exchange provision.

(ii) In a transaction qualifying for nonrecognition under section 355, DC1 distributes to FC all of the stock of DC2. Immediately after the distribution, the DC1 stock has a fair market value of 500x. Thus, the value of DC1 exceeds 400x, the amount of the deferred gain on the distribution.

(iii) Under paragraph (c)(3) of this section, DC1 will not recognize gain on the distribution of the DC2 stock to (foreign distributee) FC if FC is a qualified foreign distributee (as described in paragraph (c)(3)(i)(C) of this section) and DC1 enters into a gain recognition agreement (in which DC2 agrees to be secondarily liable), as described in paragraph (c)(3)(iii) of this section, and DC1, DC2 and FC otherwise comply with all of the provisions of paragraph (c)(3) of this section. Pursuant to

section 358, FC will take a 400x basis in the DC2 stock and FC's basis in the DC1 stock will be reduced to 400x.

Example 5. (i) Assume the same facts as in Example 4. In addition, two years after DC1's distribution of DC2 stock to FC, FC sells 25 percent of the DC2 stock to Y, an unrelated corporation. One year later, FC sells an additional 30 percent of its DC2 stock to Z, another unrelated corporation.

(ii) Under paragraph (c)(3)(vii) of this section, upon FC's sale of 25 percent of its DC2 stock, DC1 is required to file an amended return for the year in which the DC2 stock was distributed to FC, and recognize 100x of gain, which represents 25 percent of the gain realized but not recognized on the distribution.

(iii) Upon FC's second sale of 30 percent of its DC1 stock, DC1 is required to file another amended return for the year of the distribution and recognize the balance of the deferred gain, or 300x, because such sale results in a substantial transformation (within the meaning of paragraph (c)(3)(vii)(B) of this section).

Example 6. (i) Assume the same facts as in Example 5, except that FC did not sell an additional 30 percent of its DC2 stock. Instead, DC2 issued additional stock in a public offering that reduced FC's interest in DC2 to less than 50 percent.

(ii) The public offering caused a substantial transformation because, as a result of the public offering, the interest of FC in DC2 was reduced to less than 50 percent of the amount of stock that FC owned in DC2 immediately after the distribution. Thus, the result is the same as in Example 5.

Example 7. (i) Assume the same facts as in Example 4. In addition, one year after DC1's distribution of DC2 stock to FC, FC transfers all of the DC2 stock to FS, a company resident in Country X, in exchange for all of the FS stock, in a transaction described in section 351.

(ii) FS is described as a transferee distributee under paragraph (c)(3)(vi)(C) of this section. The transfer by FC of DC2 stock to FS is a nonrecognition transaction under paragraph (c)(3)(vi) of this section provided all of the requirements in paragraph (c)(3)(vi)(F) of this section are satisfied. (FS is counted, together with FC, for purposes of limiting nonrecognition treatment to up to ten qualified foreign distributees during the time that the gain recognition agreement is in effect.) DC1 will not recognize gain under the gain recognition agreement upon FC's transfer of the stock of DC2 to FS if DC1 enters into a new agreement, agreeing to recognize gain if FS sells DC2 stock, and the provisions of paragraph (c)(3)(vi) of this section are satisfied. A sale by FC of FS stock would be treated as a recognition event under paragraph (c)(3)(vii) because such sale would constitute an indirect disposition by FC of the DC2 stock.

Example 8. (i) P1, an entity treated as a partnership for Federal income tax purposes, owns all of the outstanding stock of DC1, a domestic corporation. DC1 owns all of the outstanding stock of DC2, another domestic corporation. The fair market value of the DC1 stock is 900x and P1 has an 900x basis in the DC1 stock. The fair market value of the DC2

stock is 600x and DC1 has a 400x basis in the DC2 stock. Neither DC1 nor DC2 is a U.S. real property holding corporation.

(ii) FC, a company resident in country X, and USP, a U.S. corporation, are the sole partners of P1. Under the rules and principles of sections 701 through 761, FC is entitled to a 60 percent, and USP is entitled to a 40 percent, distributive share of each item of P1 income and loss. Country X maintains an income tax treaty with the United States that includes an information exchange provision.

(iii) In a distribution qualifying for nonrecognition under section 355, DC1 distributes all of the stock of DC2 to P1. Paragraph (b)(5)(i) of this section provides that stock owned by a partnership is considered to be owned proportionately by its partners. Under paragraph (b)(5)(ii) of this section, if USP certifies to DC1 that it is a qualified U.S. person (and DC1 does not know or have reason to know that the certification is false), no Federal income tax shall be imposed with respect to the distribution by DC1 of DC2 to P1, to the extent of USP's 40 percent interest in P1.

(iv) Paragraph (c)(3)(i)(D) of this section provides that no foreign distributee may be treated as a qualified foreign distributee with respect to stock of the distributing corporation owned through a partnership, unless the distributing corporation receives a ruling from the Internal Revenue Service to the contrary. Thus, DC1 may not avoid recognition of the remaining 60 percent of the realized gain (relating to the interest of P1 owned by FC) by entering into a gain recognition agreement pursuant to paragraph (c)(3) of this section, unless DC1 obtains a ruling to the contrary.

Example 9. (i) DC1, a domestic corporation, owns all of the stock of DC2, also a domestic corporation. The stock of DC1 is owned equally by three shareholders: A, a domestic corporation, B, a U.S. citizen, and FB, a Country Y company.

(ii) A short time before DC1 adopted a plan to distribute the stock of DC2 to its shareholders, but after the board of directors of DC1 began contemplating the distribution, FB formed Newco, a domestic corporation, and contributed its DC1 stock to Newco in a transaction qualifying for nonrecognition under section 351. A valid business purpose existed for FB's transfer of the DC1 stock to Newco, but this purpose would have been fulfilled irrespective of whether FB transferred the DC1 stock to Newco before the distribution of DC2, or after the distribution of DC2 (in which case FB would have transferred the stock of DC1 and DC2 to Newco).

(iii) Pursuant to paragraph (b)(6) of this section, the District Director may determine that FB formed Newco for a principal purpose of avoiding section 367(e)(1). In such case, for Federal income tax purposes, FB will be treated as having received the stock of DC2 in a section 355 distribution, and then as having transferred the stock to Newco in a section 351 transaction.

(iv) If B was not a shareholder of DC1 so that A and FB were equal (50 percent) shareholders, FB would be treated as a foreign distributee within the meaning of

paragraph (c)(3)(i)(B) of this section without the application of paragraph (b)(6) of this section. In such case, DC1 would recognize 50 percent of the gain realized on the distribution of the DC2 stock, unless FB was a qualified foreign distributee within the meaning of paragraph (c)(3)(i) of this section and the conditions under paragraph (c)(3)(ii) of this section were satisfied.

Example 10. (i) DC1, a domestic corporation, owns all of the stock of DC2, also a domestic corporation. The stock of DC1 is owned by FP, a company resident in Country X. Country X maintains an income tax treaty with the United States that includes an information exchange provision. The DC2 stock has a fair market value of 500x at the time of the distribution, and DC1 has a basis of 100x in the DC2 stock. The stock of DC1 has a value of 500x (excluding DC1's investment in DC2). Neither DC1 nor DC2 is a U.S. real property holding corporation.

(ii) FP forms a holding company resident in Country X, Newco, and transfers 50 percent of its DC1 stock to Newco in an exchange described in section 351. Immediately after those transactions, DC1 distributes all of its DC2 stock to FP in exchange for FP's stock of DC1 in a transaction described in section 355. Thus, after the non pro rata distribution, FP owns all of the stock of DC2, and FP also owns all of the stock of Newco, which, in turn, owns all of the stock of DC1.

(iii) Newco and FP are foreign distributees (under paragraph (c)(3)(i)(B)(I) of this section) because they owned stock of DC1 immediately prior to the distribution. Assuming that all of the requirements of the gain recognition agreement exception under paragraph (c)(3) of this section are satisfied (so that both FP and Newco are qualified foreign distributees under paragraph (c)(3)(i)(C) of this section), DC1 will not be immediately taxable on the 400x gain realized on the distribution of the stock of DC2. Gain will be triggered under the gain recognition agreement under paragraph (c)(3)(vii) of this section if FP sells stock of Newco (because such sale would be an indirect disposition by FP of the stock of DC1), if Newco sells stock of DC1, or if FP sells stock of DC2.

Example 11. (i) Assume the same facts as in Example 10, except that Newco is a company resident of Country Z, and Country Z does not maintain an income tax treaty with the United States that includes an information exchange provision.

(ii) DC1 may still enter into a gain recognition agreement under paragraph (c)(3) of this section. Both FP and Newco are foreign distributees, but Newco is not a qualified foreign distributee. Thus, DC1 must recognize 50 percent, or 200x, of the 400x deferred gain on the distribution of DC2 stock. Such (50 percent) portion equals the percentage of the DC1 stock owned by foreign distributees that are not qualified foreign distributees (the 50 percent of the stock owned by Newco). DC1 may defer 50 percent of the gain, with respect to the portion of its stock owned by FP, a qualified foreign distributee, provided that it meets the requirements of paragraph (c)(3) of this section.

Example 12. (i) FC, a company resident in Country X, owns all of the stock of DC1, a domestic corporation (and has owned DC1 for many years). Country X maintains an income tax treaty with the United States that includes an information exchange provision. DC1, in turn, owns all of the stock of DC2, a domestic corporation. DC1 has a basis of 200x in the DC2 stock, and the DC2 stock has a value of 500x. Immediately after the distribution of DC2 described below, DC1 has a value of more than 300x.

(ii) DC1 distributes all of the stock of DC2 to FC (a qualified foreign distributee) in a transaction described under section 355, and satisfies all of the requirements of paragraph (c)(3) of this section to qualify for an exception to the general rule of taxation under section 367(e)(1). Two years after the initial distribution, FC distributes all of the stock of DC2 to its sole shareholder, FP, a resident of Country X, in a transaction described under section 355.

(iii) Under paragraph (c)(3)(vi)(D) of this section, FP is a substitute distributee with respect to the DC2 stock. Provided that the requirements of paragraph (c)(3)(vi)(G) of this section are satisfied, FP replaces FC as a qualified foreign distributee with respect to the DC2 stock (although FC is still a qualified foreign distributee with respect to the DC1 stock). FC is no longer required to maintain an interest in DC2 for purposes of determining whether a substantial transformation occurs. Thus, a sale by FP of the stock of FC would not trigger gain under paragraph (c)(3)(vii) of this section.

Example 13. (i) DC1, a domestic corporation, owns all of the stock of DC2, also a domestic corporation. The stock of DC1 is owned by two shareholders: FP and FX. FP, a company resident in Country Z, owns 25 percent of the stock of DC1. FX, a company resident in Country X, owns 75 percent of the stock of DC1. Country X maintains an income tax treaty with the United States that includes an information exchange provision; Country Z does not. The fair market value of DC2 is 500x and DC1 has a basis of 100x in the DC2 stock. Immediately after the distribution described below, DC1 has a value in excess of 400x.

(ii) FP formed FS, a company resident in Country X, and transferred its 25 percent interest in DC1 to FS in exchange for all of the stock of FS in an exchange described in section 351. Within two years of the exchange, DC1 distributed all of the stock of DC2 to its shareholders.

(iii) Under paragraph (c)(3) of this section, DC1 may defer a portion of its gain realized on the distribution of DC2. DC1 must immediately recognize 25 percent of the realized gain, or 100x, because FP, a 25 percent (indirect) shareholder is a foreign distributee (within the meaning of paragraph (c)(3)(i)(B) of this section), but may not be treated as a qualified foreign distributee (within the meaning of paragraph (c)(3)(i)(C) of this section). DC1 may defer 75 percent of its realized gain if FX is a qualified foreign distributee and DC1 enters into a gain recognition agreement (in which DC2 agrees to be secondarily liable), and the provisions of paragraph (c)(3) of this section are otherwise met. DC1 need not include FS as

a qualified foreign distributee because FP and FS had identical 25 percent ownership interests in DC1, and DC1 is taxable with respect to such 25 percent interest. Thus, under paragraph (c)(3)(vii)(G) of this section, a sale by FS of its DC1 or DC2 stock will not result in an additional trigger of the gain recognition agreement under paragraph (c)(3)(vii) of this section.

(iv) If FP was instead a resident of Country X, DC1 could defer its entire realized gain if both FP and FS were qualified foreign distributees. In such case, DC1 would have three qualified foreign distributees. (DC1 is limited to ten qualified foreign distributees, including transferee and substitute distributees during the term of the gain recognition agreement.) If FS sold its entire interest in either DC1 or DC2, DC1 would be required to amend its Federal income tax return for the year of the transfer and include 100x in income. In such case, neither FP nor FS would be considered a qualified foreign distributee immediately after the sale (and, as a result, FP's sale of its FS stock would not trigger additional gain under paragraph (c)(3)(vii)(G) of this section). The result would be the same if FP sold all of the stock of FS (as such sale is an indirect disposition by FP of all its stock of DC1 and DC2). (In such case, the sale by FS of its stock of DC1 or DC2 would not trigger additional gain under paragraph (c)(3)(vii)(G) of this section.)

(f) *Effective date.* This section shall be effective with respect to distributions occurring on or after September 13, 1996. However, taxpayers may elect to apply the rules of this section with respect to distributions occurring on or after December 31, 1995.

Par. 4. Section 1.6038B-1T is amended by revising the second sentence of paragraph (b)(2)(i) and adding the text of paragraph (e) to read as follows:

§ 1.6038B-1T Reporting of transfers described in section 367 (temporary).

* * * * *

(b) * * *

(2) * * * (i) * * * For special reporting rules applicable to transfers described under section 367(e)(1), see paragraph (e) of this section; no reporting is required for transfers described in section 367(e)(2). * * *

* * * * *

(e) * * * (1) *In general.* If a domestic corporation (distributing corporation) makes a distribution described in section 367(e)(1), the distributing corporation must comply with the reporting requirements under this paragraph (e)(1). Form 926 and other requirements described in this section need not be met by the distributing corporation in the case of a distribution described in section 367(e)(1).

(2) *Reporting requirements if transaction is taxable under section 367(e)(1).* If the distribution is taxable to the distributing corporation under

section 367(e)(1) and the regulations thereunder, the distributing corporation must attach to its Federal income tax return for the taxable year that includes the date of the transfer a statement titled "Section 367(e)(1) Reporting—Compliance With Section 6038B", signed under penalties of perjury by an officer of the corporation, disclosing the following information:

- (i) A description of the transaction in which the U.S. distributing corporation distributed stock or securities of a controlled corporation (whether domestic or foreign) to one or more foreign distributees.
 - (ii) The basis and fair market value of the stock and securities that were distributed by the distributing corporation in the transaction.
 - (3) *Reporting requirements if transaction qualifies for an exception to section 367(e)(1).* If the distributing corporation qualifies for an exception under § 1.367(e)–1T(c)(1), the requirements of section 6038B are satisfied if the distributing corporation complies with the reporting requirements contained in § 1.367(e)–1T(c)(1)(ii). If the distributing corporation qualifies for an exception under § 1.367(e)–1T(c)(2), the requirements of section 6038B are satisfied if the distributing corporation complies with the reporting requirements contained in § 1.367(e)–1T(c)(2)(iii). If the distributing corporation qualifies for an exception under § 1.367(e)–1T(c)(3), the requirements of section 6038B are satisfied if the distributing corporation complies with the reporting requirements contained in § 1.367(e)–1T(c)(3).
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PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority for citation for part 602 continues to read as follows:
Authority: 26 U.S.C. 7805.

Par. 6. In § 602.101, paragraph (c) is amended by removing the entry for "1.367(e)-1" and adding an entry 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(e)–1T	1545–1487
* * * * *	

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved:
Donald C. Lubick,
Acting Assistant Secretary of the Treasury.
[FR Doc. 96–20663 Filed 8–09–96; 12:19 pm]
BILLING CODE 4830–01–U

26 CFR Part 301

[TD 8681]
RIN 1545–AT22

Time for Performance of Acts Where Last Day Falls on Saturday, Sunday, or Legal Holiday

AGENCY: Internal Revenue Service (IRS), Treasury.
ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the time for performance of acts by taxpayers and by the Commissioner, a district director, or the director of a regional service center, when the last day for performance falls on a Saturday, Sunday, or legal holiday. In particular, these regulations replace the list of legal holidays with a citation to the District of Columbia law that is the source of the list.

EFFECTIVE DATE: These regulations are effective August 14, 1996.
FOR FURTHER INFORMATION CONTACT: Judith A. Lintz (202) 622–6232 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 25, 1995, the IRS published in the Federal Register (60 FR 49356) a notice of proposed rulemaking (IA–36–91 [1995–2 C.B. 470]) relating to the time for performance of acts when the last day for performance falls on a Saturday, Sunday, or legal holiday. When the last day for performance of an act by a taxpayer or an employee or administrator of the IRS falls on a Saturday, Sunday, or legal holiday, section 7503 of the Internal Revenue Code (Code) extends the time for performing the act. Under the extension, the act must be performed by the next day that is not a Saturday, Sunday, or legal holiday. The current regulations explain and supplement section 7503. This document contains final regulations that simplify and update the current regulations. In particular, the final regulations replace the list of holidays, which are determined by reference to the law in the District of Columbia, with a citation to that law.

The IRS received oral and written comments on the notice of proposed rulemaking. No public hearing was held

or requested. After consideration of the comments, which are addressed below, the proposed regulations under section 7503 are adopted as published in the notice.

Explanation of Provisions and Summary of Comments

In response to the notice of proposed rulemaking for the regulations under section 7503, three categories of comments were received. First, there was some concern that replacing the list of legal holidays with a citation to the law in the District of Columbia would mean the list of holidays would no longer be accessible. It was suggested that the IRS annually publish the holidays by announcement or some other method. The final regulations do not retain the list of holidays because such a list requires regulatory revision whenever a change in the law occurs with respect to the holidays. However, a tax calendar that lists the legal holidays is annually made available through IRS Publication 509. This free publication can be obtained by calling the toll free telephone number 1–800–TAX-FORM (1–800–829–3676), or by contacting an IRS Forms Distribution Center.

Second, it was requested that the IRS address the impact of a federal government shutdown on the time for performance of acts when the last day for performance is a day when the government is closed. Section 7503 of the Code is limited to extending the time for performance of acts when the last day for performance falls on a Saturday, Sunday, or legal holiday. Therefore, the regulations for section 7503 are not appropriate for clarifying the effect of a federal government shutdown on the time allowed for performance of an act.

Third and last, it was requested that the regulations outline the kinds of acts to which the extension of time provided under section 7503 applies. The final regulations do not include this information. The purpose of the current regulatory project is to replace the list of holidays and revise other outdated material in the regulations. Outlining the kinds of acts to which section 7503 applies is not within the scope of the current project.