stock of a subsidiary on or before January 26, 2006, see §1.1502–32(b)(5)(ii) *Example 6* as contained in the 26 CFR part 1 edition revised as of April 1, 2005.

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: January 17, 2006.

Eric Solomon,

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9243]

RIN 1545–BA65

Revision of Income Tax Regulations Under Sections 367, 884, and 6038B Dealing With Statutory Mergers or Consolidations Under Section 368(a)(1)(A) Involving One or More Foreign Corporations, and Guidance Necessary To Facilitate Business Electronic Filing Under Section 6038B

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations amending the income tax regulations under various provisions of the Internal Revenue Code (Code) to account for statutory mergers and consolidations under section 368(a)(1)(A) (including such reorganizations described in section 368(a)(2)(D) or (E)) involving one or more foreign corporations. These final regulations are issued concurrently with final regulations (TD 9242) that define a reorganization under section 368(a)(1)(A) to include certain statutory mergers or consolidations effected pursuant to foreign law. This document also contains final regulations under section 6038B which facilitate the electronic filing of Form 926 ''Return by a U.S. Transferor of Property to a Foreign Corporation.''

DATES: *Effective Date:* These regulations are effective on January 23, 2006.

Applicability Dates: For dates of applicability, see § 1.367(a)–3(e); § 1.367(b)–6(a)(1); § 1.367(b)–13(f); § 1.884–2(g); and § 1.6038B–1(b)(1)(i) and (g).

FOR FURTHER INFORMATION CONTACT: Robert W. Lorence, Jr., (202) 622–3918 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(d)) under control numbers 1545–1478 and 1545–1617.

The collection of information in these final regulations is in § 1.367(a)–3(d)(2)(vi)(B)(*1*)(*ii*) and § 1.6038B–1(b)(1)(i). The information under § 1.367(a)–3(d)(2)(vi)(B)(*1*)(*ii*) is required to inform the IRS of a domestic corporation (domestic acquired corporation) that is claiming an exception from the application of section 367(a) and (d) for certain transfers of property to a foreign corporation that is re-transferred by the foreign corporation to a domestic corporation controlled by the foreign corporation (domestic controlled corporation). The information is in the form of a statement attached to the domestic acquired corporation's U.S. income tax return for the year of the transfer certifying that if the foreign corporation disposes of the stock of the domestic controlled corporation with a tax avoidance purpose, the domestic acquired corporation will file an income tax return (or amended return, as the case may be) reporting gain. The collection of information is mandatory.

The information under § 1.6038B–1(b)(1)(i) is required to inform the IRS of transfers described in section 6038B(a)(1)(A) or section 367(d) or (e) by filing Form 926 ''Return by a U.S. Transferor of Property to a Foreign Corporation'' and any information attached to the form with the U.S. transferor's income tax return for the taxable year of the transfer. The collection of information is mandatory.

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

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 24, 2003, the IRS and Treasury issued proposed regulations (REG–126485–01, 2003–1 C.B. 542, 68 FR 3477) and temporary regulations (TD 9038, 2003–1 C.B. 524, 68 FR 3384), that would revise the definition of a statutory merger or consolidation under section 368(a)(1)(A). On January 5, 2005, the IRS and Treasury issued proposed regulations (REG–117969–00, 2005–7 I.R.B. 533, 70 FR 746) that would revise the definition of a section 368(a)(1)(A) reorganization to include transactions effected pursuant to foreign law and transactions involving entities organized under foreign law. Final regulations incorporating the temporary regulations and both sets of proposed regulations, as modified to reflect comments, are being published concurrently with this document.

On January 5, 2005, the IRS and Treasury also issued proposed regulations under sections 358, 367 and 884 (the 2005 proposed regulations) that would account for section 368(a)(1)(A) reorganizations involving one or more foreign corporations. The regulations also proposed changes to other aspects of the section 367(a) and (b) regulations that would address additional issues. This document contains final regulations that incorporate the 2005 proposed regulations amending sections 358, 367, and 884.

The public hearing with respect to the 2005 proposed regulations was cancelled because no request to speak was received. However, the IRS and Treasury received several written comments, which are discussed below.

On December 19, 2003, the IRS and Treasury issued temporary and final regulations (TD 9100, 2004–1 C.B. 297, 68 FR 70701) modifying regulations under section 6038B to eliminate regulatory impediments to the electronic submission of Form 926 ''Return by a U.S. Transferor of Property to a Foreign Corporation.'' In the same issue of the **Federal Register**, the IRS and Treasury issued a notice of proposed rulemaking (REG–116664–01, 2004–1 C.B. 319, 68 FR 70747) cross-referencing the temporary regulations under section 6038B. This document contains final regulations incorporating certain provisions of the temporary regulations under section 6038B. No public hearing regarding the notice of proposed rulemaking was requested or held and no comments were received.

Summary of Comments and Explanation of Provisions

A. Basis and Holding Period Rules

1. Section 354 Exchanges

On May 3, 2004, the IRS and Treasury published a notice of proposed rulemaking (REG–116564–03) in the **Federal Register** (69 FR 24107) that included regulations under section 358 that would provide guidance regarding the determination of the basis of stock or securities received in either a reorganization described in section 368 (*e.g.*, in a section 354 exchange) or a distribution to which section 355 applies. The proposed section 358 regulations would adopt a tracing regime for determining the basis of each share of stock or security received in an exchange under section 354 (or section 356). Related provisions in the 2005 proposed regulations followed that general tracing regime, with modifications. See Prop. Treas. Reg. § 1.367(b)–13(b). Comments were received in response to the proposed regulations under section 358. The IRS and Treasury have issued final regulations under section 358 that adopted the section 358 proposed regulations, with modifications to reflect the comments received. See TD 9244.

The final section 358 regulations retained the general tracing regime for determining basis in an exchange under section 354 (or section 356). This tracing regime is consistent with the policies and requirements underlying the international provisions of the Code, including those under section 1248. As a result, these final regulations do not include the rules set forth in § 1.367(b)–13(b) of the 2005 proposed regulations that would determine the basis and holding period in stock as a result of certain exchanges under section 354 (or section 356) involving foreign corporations. Instead, the final regulations cross-reference the regulations under section 358 to determine the exchanging shareholder's basis in stock or securities received in an exchange under section 354 (and section 356). Special rules for certain triangular reorganizations are discussed below.

2. Triangular Asset Reorganizations

In contrast to the above, the application of the stock basis rules of § 1.358–6 in certain triangular asset reorganizations involving foreign corporations does not accurately preserve a shareholder's section 1248 amount (within the meaning of § 1.367(b)–2(c)). Therefore, the 2005 proposed regulations would provide special basis and holding period rules for certain triangular asset reorganizations involving foreign corporations that have section 1248 shareholders (within the meaning of § 1.367(b)–2(b)). See Prop. Treas. Reg. § 1.367(b)–13(c) through (e). These rules would apply to certain reorganizations described in section 368(a)(1)(A) and (a)(2)(D) (forward triangular merger), triangular reorganizations described in section 368(a)(1)(C), and reorganizations described in section 368(a)(1)(A) and (a)(2)(E) (reverse triangular merger).

The 2005 proposed regulations would provide that, in determining the stock basis of the surviving corporation in certain triangular asset reorganizations, the exchanging shareholder's basis in the stock of the target corporation will be taken into account, rather than target corporation's basis in its assets. Further, where applicable, the 2005 proposed regulations would provide for a divided basis and holding period in each share of stock in the surviving corporation to reflect the relevant section 1248 amounts, if any, in the stock of the target corporation and the surviving corporation. If there are two or more blocks of stock in the target corporation with section 1248 amounts, then each share of the surviving corporation would be further divided to account for each block of stock. If two or more blocks of stock are held by one or more shareholders that are not section 1248 shareholders, then shares in these blocks would be aggregated into one divided portion for basis purposes. If none of the shareholders is a section 1248 shareholder, then the asset basis rules of § 1.358–6 would apply.

Commentators stated that the application of the special basis rules would cause unjustified complexity. One commentator stated that such complexity arises in cases where the shares of the target corporation are widely held or where section 1248 shareholders hold less than 50 percent of the target corporation. The commentator recommended that if the special basis rules are retained, § 1.358–6 should continue to apply where section 1248 shareholders hold less than 50 percent of the stock of the target corporation. The commentator further recommended that the controlling corporation be allowed to elect to apply the rules under § 1.358–6 in return for all exchanging section 1248 shareholders including in income the section 1248 amounts with respect to their stock. The IRS and Treasury have considered these comments. On balance, the IRS and Treasury have concluded that creating exceptions to the application of the special basis rules (*e.g.*, by election) would create significant uncertainty for the IRS and would not meaningfully reduce administrative complexity. While the IRS and Treasury recognize the complexity of the rules, the IRS and Treasury nevertheless believe it is important to preserve section 1248 amounts and avoid unnecessary income inclusions that might otherwise be required. As a result, the final regulations do not adopt this recommendation. However, the IRS and Treasury will continue to study alternative methods for preserving the section 1248 amounts in such transactions.

One commentator suggested that the IRS and Treasury consider applying the special basis rules to section 368(a) asset reorganizations followed by asset transfers to a corporation controlled (within the meaning of section 368(c)) by the acquiring corporation pursuant to the same transaction (controlled asset transfer), because these transactions are similar to triangular reorganizations under section 368(a)(1)(C) and section 368(a)(1)(A) and (a)(2)(D). If this suggestion were adopted, the basis in the stock of the controlled subsidiary would reflect the basis in the stock of the target corporation and not the basis of the contributed assets. Because the IRS and Treasury are continuing to study the application of section 358 to such transactions, and because such controlled asset transfers may involve only a portion of the acquired assets, this comment is not adopted at this time.

Finally, commentators noted that the special basis rules of § 1.367(b)–13(c) of the 2005 proposed regulations would not apply, by their terms, to a forward triangular merger or a triangular section 368(a)(1)(C) reorganization where no shareholder of the target corporation is a section 1248 shareholder, but the parent of the acquiring corporation is either a domestic corporation that is a section 1248 shareholder of the acquiring corporation or a foreign corporation that has a section 1248 shareholder that is also a section 1248 shareholder of the acquiring corporation. This result was not intended, as illustrated by *Example 3* of § 1.367(b)–13(e) of the 2005 proposed regulations, which applies the special basis rules of § 1.367(b)–13(c) of the 2005 proposed regulations to such a transaction. As a result, the text of the final regulations has been modified to apply the special basis rules to this type of transaction.

B. Exceptions to the Application of Section 367(a)

1. Exchanges of Stock or Securities in Certain Triangular Asset Reorganizations

A U.S. person recognizes gain under section 367(a) on the transfer of property to a foreign corporation in an exchange described in section 351, 354, 356, or 361, unless an exception applies. Under § 1.367(a)–3(a), section 367(a) does not apply if, pursuant to a section 354 exchange, a U.S. person transfers stock of a domestic or foreign corporation ''for stock of a foreign corporation'' in an asset reorganization described in section 368(a)(1) that is not treated as an indirect stock transfer.

Notwithstanding the language in the current regulations, this exception is intended to apply to any section 354 (or section 356) exchange made pursuant to an asset reorganization under section 368(a)(1) that is not treated as an indirect stock transfer under § 1.367(a)–3(d). However, commentators noted that in certain triangular asset reorganizations where a U.S. person transfers stock of a foreign acquired corporation to such foreign corporation in a section 354 (or section 356) exchange, but receives stock of the domestic parent of the foreign acquiring corporation pursuant to such exchange, the transfer by the U.S. person might be subject to section 367(a). This would be the case because, under § 1.367(a)–3(a), the U.S. person does not receive ''stock of a foreign corporation.'' This result was not intended. Accordingly, the final regulations clarify the application of this rule by removing the phrase ''for stock of a foreign corporation.'' Thus, section 367(a) will not apply to any section 354 (or section 356) exchange of stock or securities of a domestic or foreign corporation pursuant to an asset reorganization under section 368(a)(1), unless the exchange is considered an indirect stock transfer pursuant to § 1.367(a)–3(d). A conforming change also is made to the section 6038B reporting rules (see part J. of this preamble).

2. Exchanges of Securities in Certain Recapitalizations and Other Reorganizations

Prior to the issuance of the 2005 proposed regulations, several commentators noted that the exception to the application of section 367(a) contained in § 1.367(a)–3(a) applied to exchanges of stock, but not exchanges of securities, in section 368(a)(1)(E) reorganizations and certain asset reorganizations. In response, the IRS and Treasury issued Notice 2005–6 (2005–5 I.R.B. 448) concurrently with the 2005 proposed regulations, and announced the plan to amend § 1.367(a)–3(a) to apply the exception to exchanges of stock or securities. These final regulations incorporate the rule announced in Notice 2005–6, including the dates of applicability as discussed below in part K.3. of this preamble.

Consistent with these changes, these final regulations also amend the indirect stock transfer rules of § 1.367(a)–3(d) to provide that exchanges by a U.S. person of stock or securities of an acquired corporation for stock or securities of the corporation that controls the acquiring corporation in a triangular section 368(a)(1)(B) reorganization will be treated as an indirect transfer of such stock or securities subject to the rules of section 367(a). This amendment conforms the treatment of triangular section 368(a)(1)(B) reorganizations with the other indirect stock transfers described in § 1.367(a)–3(d). Although this amendment has a prospective effective date, no inference is intended as to the application of current law to such exchanges.

Other provisions of the section 367 regulations also contain references to exchanges of stock but not to securities. See, *e.g.*, § 1.367(a)–8(e)(1)(i). The IRS and Treasury are studying these references and intend to amend these provisions if these omissions are not appropriate.

C. Concurrent Application of Section 367(a) and (b)

The 2005 proposed regulations would modify the concurrent application of section 367(a) and (b) to exchanges that require the inclusion in income of the exchanging United States shareholder's all earnings and profits amount under section 367(b). The 2005 proposed regulations would provide that the rules of section 367(b), and not section 367(a), apply to such exchanges in cases where the all earnings and profits amount attributable to the stock of an exchanging shareholder is greater than the amount of gain in such stock subject to section 367(a) pursuant to the indirect stock transfer rules. In such a case, the shareholder would be required to include in income as a deemed dividend the all earnings and profits amount pursuant to § 1.367(b)–3, without regard to whether the exchanging shareholder files a gain recognition agreement as provided under §§ 1.367(a)–3(b) and 1.367(a)–8. This change was proposed because the IRS and Treasury determined that it was contrary to the policy of section 367(b) to allow a shareholder effectively to elect to be taxed on the lesser amount of gain under section 367(a) simply by failing to file a gain recognition agreement.

Two comments were received with respect to this overlap rule. One commentator questioned, as a general matter, the application of § 1.367(b)–3 and the all earnings and profits rule to inbound asset acquisitions and, more specifically, the broadening of the circumstances under the 2005 proposed regulations where a taxpayer would be required to include in income as a deemed dividend the all earnings and profits amount. The commentator suggested an alternative means to taxing the earnings and profits of the foreign acquired corporation, such as reducing the basis of assets brought into the United States to the extent of any previously untaxed earnings and profits. The IRS and Treasury, at this time, do not believe that a comprehensive revision of the all earnings and profits rule is necessary or appropriate. Alternative approaches to the all earnings and profits rule are beyond the scope of this regulation project, because, for example, any such revision would have to take into account recently enacted section 362(e). As a result, this comment is not adopted.

The second comment stated that the overlap rule adds unnecessary complexity to the section 367 regulations, because it is unlikely that a transaction will occur that would invoke the rule (*i.e.*, where a foreign acquired corporation transfers its assets to a domestic subsidiary of a foreign parent corporation in a triangular reorganization). The overlap rule in the 2005 proposed regulations was intended to address cases that are affected by this rule. The IRS and Treasury continue to believe that the rule is necessary to preserve the policies of section 367(b), and that the rule as applied in these contexts does not create undue complexity. For this reason, the comment is not adopted.

D. Triangular Section 368(a)(1)(B) Reorganizations

In a triangular section 368(a)(1)(B) reorganization, if a U.S. person exchanges stock of an acquired corporation for voting stock of a foreign corporation that controls (within the meaning of section 368(c)) the acquiring corporation, the U.S. person is treated as making an indirect transfer of stock of the acquired corporation to the foreign controlling corporation in a transfer subject to section 367(a). § 1.367(a)–3(d)(1)(iii). The current regulations do not, however, treat as an indirect stock transfer a triangular section 368(a)(1)(B) reorganization where the acquiring

corporation is foreign and the controlling corporation is domestic. The 2005 proposed regulations would extend the indirect stock transfer rules to include triangular section 368(a)(1)(B) reorganizations in which a U.S. person exchanges stock of the acquired corporation for voting stock of a domestic corporation that controls the foreign acquiring corporation. In such a case, the 2005 proposed regulations would provide that a gain recognition agreement filed pursuant to such transaction is triggered if the domestic controlling corporation disposes of the stock of the foreign acquiring corporation, or the foreign acquiring corporation disposes of the stock of the acquired corporation.

Commentators stated that because any built-in gain in the stock of the acquired corporation is reflected in the stock of the foreign acquiring corporation held by the domestic controlling corporation under § 1.358–6(c)(3), a gain recognition agreement should not be triggered if the domestic controlling corporation disposes of the stock of the foreign acquiring corporation. The IRS and Treasury agree, in part, with this comment. Accordingly, the final regulations provide that, in certain cases, the disposition of the stock of the foreign acquiring corporation is not a triggering event. For example, the gain recognition agreement terminates in such a case if the domestic controlling corporation disposes of the stock of the foreign acquiring corporation in a taxable exchange. See § 1.367(a)–8(h)(1).

E. Identifying the Stock Transferred in Indirect Stock Transfers Involving a Change in Domestic or Foreign Status of the Acquired Corporation

Under the current section 367(a) regulations, if a U.S. person exchanges stock or securities of an acquired corporation for stock or securities of a foreign acquiring corporation in, for example, a section 368(a)(1)(C) reorganization, and the foreign acquiring corporation transfers all or part of the assets of the acquired corporation to a corporation in a controlled asset transfer, the U.S. person is treated, for purposes of section 367(a), as transferring the stock or securities of the acquired corporation to the foreign acquiring corporation to the extent of the assets transferred to the controlled subsidiary. § 1.367(a)–3(d)(1)(v); see also § 1.367(a)–3(d)(3), *Example 5A.*

A commentator stated that the indirect stock transfer rules should apply to such a transaction based on the status of the controlled subsidiary, rather than the status of the acquired corporation. Under this approach, if the acquired corporation were domestic and the controlled subsidiary were foreign, U.S. persons that exchange stock or securities of the domestic acquired corporation would be treated as having made an indirect stock transfer of stock or securities of a foreign corporation to a foreign corporation subject to § 1.367(a)–3(b), rather than of stock or securities of a domestic corporation that would be subject to the more restrictive rules of § 1.367(a)–3(c).

The IRS and Treasury agree, in part, with this comment and believe that § 1.367(a)–3(c) should not apply to certain indirect stock transfers that occur by reason of transactions involving a subsidiary member of a consolidated group to the extent that the assets of the domestic acquired corporation are ultimately transferred to a foreign corporation. Accordingly, the final regulations provide that where a subsidiary member of a consolidated group transfers its assets to a foreign corporation pursuant to an asset reorganization, and an indirect stock transfer described in § 1.367(a)–3(d)(1)(i) (mergers described in section 368(a)(1)(A) and (a)(2)(D) and reorganizations described in section 368(a)(1)(G) and (a)(2)(D)), (iv) (triangular reorganizations described in section 368(a)(1)(C)), or (v) (asset reorganizations followed by a controlled asset transfer) occurs in connection with such transfer, the U.S. persons that exchange stock or securities in the domestic acquired corporation pursuant to section 354 (or section 356) will be treated for purposes of § 1.367(a)–3 as having made an indirect transfer of foreign stock or securities subject to the rules of § 1.367(a)–3(b) (and not domestic stock or securities subject to § 1.367(a)–3(c)). In the case where the foreign acquiring corporation transfers assets in a controlled asset transfer to a foreign corporation, the exception applies only to the extent of the assets transferred to the foreign corporation. Further, the exception does not apply to the extent that the assets of the domestic acquired corporation are ultimately transferred in one or more successive controlled asset transfers to a domestic corporation. Thus, in such a case, the indirect stock transfer remains subject to § 1.367(a)–3(c). The rules relating to foreign acquired corporations remain the same as under current law (that is, the indirect stock transfer rules are based on the status of the foreign acquired corporation).

The IRS and Treasury are studying in a separate project the interaction of section 7874 and § 1.367(a)–3(c). In connection with this study, the IRS and Treasury will continue to examine whether the recommended change should also apply to other transactions. The results of this study may be addressed in a future regulations project. At this time, however, the final regulation will continue to apply to other transactions based on the stock that is owned and exchanged by the U.S. person in the transaction (rather than based on stock of the corporation in which the assets of the acquired corporation are ultimately transferred). Comments are requested as to whether the exception, described above, should be expanded to other ownership structures (*e.g.*, where the domestic target corporation is an affiliated but not consolidated group member).

F. Coordination of the Indirect Stock Transfer Rules and the Asset Transfer Rules

Under the current regulations, when an indirect stock transfer also involves a transfer of assets by a domestic corporation to a foreign corporation, section 367(a) and (d) apply to the domestic corporation's transfer of assets prior to the application of the indirect stock transfer rules. However, section 367(a) and (d) do not apply to the domestic corporation's transfer to the extent that the foreign acquiring corporation re-transfers the assets received in the asset transfer to a controlled domestic corporation, provided that the controlled domestic corporation's basis in the assets is no greater than the basis that the domestic acquired corporation had in such assets.

The 2005 proposed regulations would modify the scope of the coordination rule as it applies to asset reorganizations such that section 367(a) and (d) generally would apply to the domestic corporation's transfer of assets to the foreign corporation, even if the foreign corporation re-transfers all or part of the assets received to a domestic corporation in a controlled asset transfer. However, the 2005 proposed regulations would provide two exceptions to this general rule. The first exception generally would apply if the domestic acquired corporation is controlled (within the meaning of section 368(c)) by 5 or fewer domestic corporations, appropriate basis adjustments as provided in section 367(a)(5) are made to the stock of the foreign acquiring corporation, and any other conditions as provided in regulations under section 367(a)(5) are satisfied.

The second exception would apply if the controlled domestic corporation's basis in the assets is no greater than the domestic acquired corporation's basis in such assets and the following two

conditions are satisfied: (1) The indirect transfer of stock of the domestic acquired corporation satisfies the requirements of § 1.367(a)–3(c)(1)(i), (ii), and (iv), and (c)(6); and (2) the domestic acquired corporation attaches a statement to its tax return for the taxable year of the transfer. The statement must certify that the domestic acquired corporation will recognize gain (as described below) if the foreign acquiring corporation disposes of any stock of the domestic controlled corporation with a principal purpose of avoiding the U.S. tax that would have been imposed on the domestic acquired corporation had it disposed of the re-transferred assets. The 2005 proposed regulations contain a rebuttable presumption that the disposition of stock has a principal purpose of tax avoidance if the disposition occurs within 2 years of the transfer.

When applicable, under this second exception, the domestic acquired corporation would be required to recognize gain as if, immediately prior to the exchange, it had transferred the re-transferred assets, including any intangible assets, directly to a domestic corporation in an exchange qualifying under section 351, and immediately sold the stock to an unrelated party for its fair market value in a transaction in which it recognizes gain, if any (but not loss). The 2005 proposed regulations would provide that the basis that the foreign acquiring corporation has in the stock of the domestic controlled corporation is increased immediately prior to its disposition by the amount of gain recognized by the domestic acquired corporation. However, the basis of the re-transferred assets held by the domestic controlled corporation would not be increased by such gain.

Several comments were received with respect to the second exception. Commentators stated that the final regulations should provide that the amount of gain recognized by the domestic acquired corporation under the second exception should also increase the basis of the re-transferred assets held by the domestic controlled corporation. As stated in the preamble to the 2005 proposed regulations, the IRS and Treasury believe that the concerns raised by the construct that results from a controlled asset transfer to a domestic subsidiary after an outbound asset transfer are analogous to the concerns raised in other divisive transactions where gain is recognized on the stock of a corporation without a corresponding increase in the basis of the assets of such corporation. See section 355(e) and § 1.367(e)–2(b)(2)(iii). The tax consequences set forth in the final regulations are intended to be consistent with the tax consequences that result in these other transactions. As a result, the final regulations do not adopt this comment.

Commentators also questioned whether the proposed modification to the coordination rule is necessary in light of the enactment of section 7874 and whether any new limitations to the rule should await an analysis of how section 7874 affects the rules of § 1.367(a)–3(c). Because of the divisive concerns present in these types of transactions, the IRS and Treasury believe that the modifications to the coordination rule continue to be necessary and therefore are retained. Nevertheless, the IRS and Treasury are studying the effect of section 7874 on the coordination rule, as well as the direct and indirect transfer of domestic stock under § 1.367(a)–3(c). The results of this study may be addressed in a future regulation project.

Finally, in light of the enactment of section 7874, *Example 6D* of § 1.367(a)–3(d)(3) of the 2005 proposed regulations has not been retained. Compare § 1.367(a)–3(d)(3) *Example 6B.*

G. Treatment of a Controlled Asset Transfer Following a Section 368(a)(1)(F) Reorganization as an Indirect Stock Transfer

The 2005 proposed regulations would revise § 1.367(a)–3(d)(1)(v) so that any non-triangular asset reorganization followed by a controlled asset transfer will be considered an indirect stock transfer under § 1.367(a)–3(d)(1).

Commentators stated, however, that a section 368(a)(1)(F) reorganization followed by a controlled asset transfer should not be treated as an indirect stock transfer. According to the commentators, because a section 368(a)(1)(F) reorganization involves only a ''single'' corporation, it should be treated in effect as a ''non-event'' for purposes of the indirect stock transfer rules. As a result, the commentators believe that the transaction should be treated as a mere section 351 transfer of assets to the controlled subsidiary and not as an indirect stock transfer.

In response to this comment, the final regulations exclude from the application of the indirect stock transfer rules *same-country 368(a)(1)(F) reorganizations* followed by controlled asset transfers. For this purpose, a same-country section 368(a)(1)(F) reorganization is a reorganization described in section 368(a)(1)(F) in which both the acquired corporation and the acquiring corporation are foreign corporations and are created or organized under the laws of the same foreign country. This would include, for example, situations where the foreign corporation changes its name, changes its location within the foreign country, or changes its form within the foreign country. The IRS and Treasury will continue to examine whether other foreign-to-foreign section 368(a)(1)(F) reorganizations followed by controlled asset transfers should be treated as indirect stock transfers, however, as the general treatment of section 368(a)(1)(F) reorganizations is further considered. Outbound reorganizations under section 368(a)(1)(F) followed by controlled asset transfers are treated as indirect stock transfers under the final regulations. See § 1.367(a)–1T(f).

H. Treatment of Reorganizations Described in Section 368(a)(1)(G) and (a)(2)(D) as Indirect Stock Transfers

Section 368(a)(2)(D) provides that the acquisition by one corporation, in exchange for stock of a corporation which is in control of the acquiring corporation, of substantially all the properties of another corporation does not disqualify a transaction from qualifying as a reorganization under section 368(a)(1)(A) or 368(a)(1)(G), provided certain conditions are satisfied.

Section 1.367(a)–3(d)(1)(i) and (iv) of the 2005 proposed regulations would treat certain reorganizations described in section 368(a)(1)(A) and (a)(2)(D), and certain triangular reorganizations described in section 368(a)(1)(C), respectively, as indirect stock transfers. Moreover, section 1.367(a)–3(d)(1)(v) of the 2005 proposed regulations would include certain reorganizations described in section 368(a)(1)(G), followed by controlled asset transfers, as indirect stock transfers. The 2005 proposed regulations would not explicitly treat reorganizations described in section 368(a)(1)(G) and (a)(2)(D) as indirect stock transfers, even though they have the same effect as these other reorganizations. As a result, the final regulations modify § 1.367(a)–3(d)(1)(i), and related provisions, to include as indirect stock transfers certain reorganizations described in section 368(a)(1)(G) and (a)(2)(D). Similar modifications are made in other sections of the final regulations to take into account reorganizations described in section 368(a)(1)(G) and (a)(2)(D).

I. General Operation of Section 367 Regulations and the Effect of Section 7874

Comments were received regarding the scope of certain portions of the section 367 regulations in light of the enactment of section 7874. In response

to the potential overlap of these two provisions, the IRS and Treasury are considering possible changes to § 1.367(a)–3(c). Comments are requested as to the interaction of section 7874 and § 1.367(a)–3(c), as well as to other aspects of the section 367 regulations.

J. Section 6038B Reporting

Section 6038B provides for reporting by U.S. persons that transfer property to foreign corporations in an exchange described in section 332, 351, 354, 355, 356, or 361. Temporary regulations under section 6038B provide an exception from reporting for certain transactions described in § 1.367(a)–3(a). Section 1.367(a)–3(a) provides an exception to section 367(a) for certain exchanges under section 354 or 356 of stock or securities in section 368(a)(1)(E) reorganizations or in asset reorganizations that are not indirect stock transfers. These exceptions from reporting under section 6038B have been amended to conform to the amendments to § 1.367(a)–3(a). These exceptions are incorporated in the final regulations. See Part B. of this preamble.

Section 6038B and the regulations thereunder provide for reporting by filing Form 926 ''Return by a U.S. Transferor of Property to a Foreign Corporation'' and any attachments with the income tax return for the year of the transfer. Temporary regulations under section 6038B eliminate the requirement to sign Form 926, thus permitting the electronic filing of the form with the U.S. transferor's federal income tax return. The temporary regulations provide that Form 926 and any attachments are verified by signing the income tax return with which the form and attachments are filed. These temporary regulations are incorporated in these final regulations, except with respect to certain filings by corporations which will be addressed as part of a larger final regulation dealing with electronic filing.

K. Effective Dates

1. General Rule

Except as provided below, the final regulations apply to transactions occurring on or after January 23, 2006.

2. Retroactive Application of § 1.367(b)–4(b)(1)(ii) of the Proposed Regulations

Under § 1.367(b)–4(b), certain shareholders of a foreign acquired corporation are required to include in income as a deemed dividend the section 1248 amount with respect to the stock of the foreign acquired corporation if such exchange results in the loss of section 1248 shareholder status. This may occur, for example, if the exchanging shareholder receives domestic stock in exchange for the stock of an acquired foreign corporation in a triangular reorganization where a domestic issuing corporation controls the foreign acquiring corporation.

The current regulations consider the section 1248 shareholder status to be lost in this case because the domestic acquiring corporation's basis in the foreign acquiring corporation is generally determined by reference to the assets of the foreign acquired corporation, rather than by reference to the stock of the foreign acquired corporation. See § 1.358–6. Under the 2005 proposed regulations, however, such an exchanging shareholder would not be required to include in income as a deemed dividend the section 1248 amount under § 1.367(b)–4(b), provided that the domestic issuing corporation, immediately after the exchange, is a section 1248 shareholder of the acquired corporation (in the case of a triangular section 368(a)(1)(B) reorganization) or the surviving corporation (in the case of a triangular section 368(a)(1)(C) reorganization, a forward triangular merger, a reorganization described in section 368(a)(1)(G) and (a)(2)(D), or a reverse triangular merger) and such acquired or surviving corporation is a controlled foreign corporation. This change was made in the case of triangular asset reorganizations because the special basis rules in § 1.367(b)–13(c) of the 2005 proposed regulations would preserve the section 1248 amounts attributable to the stock of the foreign acquired corporation in the stock of the foreign acquiring (or surviving) corporation held by the domestic issuing corporation. The special basis rules would not apply to triangular reorganizations under section 368(a)(1)(B). The special basis rules are not needed for these transactions because section 1248 amounts are preserved under the general rules of § 1.358–6.

Commentators requested that the modification to § 1.367(b)–4 relating to triangular section 368(a)(1)(B) reorganizations be made retroactive to February 23, 2000, the date on which § 1.367(b)–4 was promulgated, because the basis rules of § 1.358–6 were in effect at that time and the transactions never raised concerns about preserving section 1248 amounts. The IRS and Treasury agree with this comment and therefore the final regulations allow taxpayers to apply the modification to § 1.367(b)–4 to a triangular section 368(a)(1)(B) reorganization occurring on or after February 23, 2000, and during any taxable year which is not closed by the period of limitations. Taxpayers applying this rule, however, must do so consistently with respect to all such transactions.

Commentators also requested that the modification to § 1.367(b)–4 apply to other triangular reorganizations on a retroactive basis, on the condition that taxpayers also apply the special basis rules of § 1.367(b)–13(c) of the 2005 proposed regulations retroactively to these transactions. The IRS and Treasury only intend for the § 1.367(b)–13(c) basis rules to apply on a prospective basis. Elective application of these rules to prior years would be complex and difficult to administer. Accordingly, the IRS and Treasury have not adopted this comment for other triangular reorganizations.

3. Exchanges of Securities in Certain Recapitalizations and Reorganizations

As stated above in part B.2. of this preamble, the final regulations provide an exception to the application of section 367(a) to transfers of securities by U.S. persons in a section 354 or 356 exchange pursuant to a section 368(a)(1)(E) reorganization, or a section 368(a)(1) asset reorganization that is not treated as an indirect stock transfer. This rule applies to transfers occurring after January 5, 2005, although taxpayers may apply the rule to transfers of securities occurring on or after July 20, 1998, and on or before January 5, 2005, if done consistently to all transactions.

4. Asset Reorganizations Followed by Controlled Asset Transfers

Commentators stated that because the 2005 proposed regulations did not provide an effective date for the rule that treats a section 368(a)(1)(F) reorganization followed by a controlled asset transfer as an indirect stock transfer, such rule could be interpreted as applying to transactions occurring on or after July 20, 1998, which is the general effective date of § 1.367(a)–3(d). The final regulations clarify that a section 368(a)(1)(F) reorganization followed by a controlled asset transfer is treated as an indirect stock transfer subject to section 367(a) only if the reorganization occurs on or after January 23, 2006.

In general, section 368(a)(1)(D) reorganizations followed by controlled asset transfers are treated as indirect stock transfers subject to section 367(a) if the reorganization occurs after December 9, 2002. However, see Rev. Rul. 2002–85 (2002–2 C.B. 986), for special retroactive applicability dates.

5. Electronic Filing Under Section 6038B

These final regulations provide that Form 926 and any attachments will be verified by signing the income tax return with which the form and attachments are filed, in order to facilitate the electronic filing of Form 926 with the transferor's income tax return. This rule applies to taxable years beginning after December 31, 2002. For taxable years beginning before January 1, 2003, Form 926 must be signed under penalties of perjury declaring that the information submitted is true, correct and complete to the best of the transferor's knowledge and belief.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Robert W. Lorence, Jr., of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury 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 continues to read, in part, as follows:

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

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

§ 1.367(b)–13 also issued under 26 U.S.C. 367(b) * * *

■ **Par. 2.** In § 1.358–6, paragraph (e) is amended by adding a sentence at the end of the paragraph to read as follows:

§ 1.358–6 Stock basis in certain triangular reorganizations

* * * * *

(e) * * * For certain triangular reorganizations where the surviving corporation (S or T) is foreign, see § 1.367(b)–13.

* * * * *

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

■ 1. In paragraph (a), remove the third and fourth sentences, and add five sentences in their place.

■ 2. In paragraph (a), add a sentence at the end of the paragraph.

■ 3. Revise paragraph (b)(2)(i).

■ 4. Revise paragraph (c)(5)(vi).

■ 5. Revise paragraph (d)(1), introductory text.

■ 6. Revise paragraph (d)(1)(i).

■ 7. In paragraph (d)(1)(ii), add a sentence at the end of the paragraph.

■ 8. Revise paragraph (d)(1)(iii).

■ 9. In paragraph (d)(1)(iv), remove the language ''*Example 5*'' and add ''*Example 6*'' in its place, remove ''*Example 7*'' and add ''*Example 8*'' in its place, and remove ''*Example 11*'' and add ''*Example 14*'' in its place.

■ 10. Revise paragraph (d)(1)(v).

■ 11. In paragraph (d)(1)(vi), remove the language ''*Example 10* and *Example 10A*'' and add ''*Example 13* and *Example 13A*'' in its place.

■ 12. Revise paragraphs (d)(2)(i), (ii), and (iv).

■ 13. Revise paragraph (d)(2)(v)(A) and (C).

■ 14. Redesignate paragraph (d)(2)(v)(D) as paragraph (d)(2)(v)(F).

■ 15. Add new paragraphs (d)(2)(v)(D) and (E).

■ 16. Revise paragraph (d)(2)(vi).

■ 17. Add new paragraph (d)(2)(vii).

■ 18. In paragraph (d)(3), remove the first sentence, and add two sentences in its place.

■ 19. In paragraph (d)(3), redesignate the examples as follows and add the following new examples:

Redesignate	As	Add
Example 12 ..	*Example 16.*	
		Example 15.
Examples 11 and *11A.*	*Examples 14* and *14A.*	
Examples 10 and *10A.*	*Examples 13* and *13A.*	
Example 9	*Example 12.*	
		Examples 10 and 11.
Example 8	*Example 9.*	
Examples 7, 7A, 7B, and *7C.*	*Examples 8, 8A, 8B,* and *8C.*	
Examples 6 and *6A.*	*Examples 7* and *7A.*	
		Example 6C.
Examples 5, 5A, and *5B.*	*Examples 6, 6A,* and *6B.*	
		Example 5A.
Example 4	*Example 5.*	
Example 3	*Example 4.*	
Example 2	*Example 3.*	
		Example 2.

■ 20. In paragraph (d)(3), newly designated *Example 3,* the heading and paragraph (i) are revised.

■ 21. In paragraph (d)(3), newly designated *Example 5,* paragraph (i), remove the language ''paragraph (d)(1)(iii)'' and add ''paragraph (d)(1)(iii)(A)'' in its place.

■ 22. In paragraph (d)(3), newly designated *Example 5,* paragraph (ii), last sentence, remove the language '', or if S sold all or a portion of the stock of Y''.

■ 23. In paragraph (d)(3), newly designated *Example 6A,* paragraph (i), the first and last sentences, and paragraph (ii), the first, fourth, and fifth sentences are revised.

■ 24. In paragraph (d)(3), newly designated *Example 6B* is revised.

■ 25. In paragraph (d)(3), newly designated *Example 8,* paragraph (ii), the fourth sentence is revised.

■ 26. In paragraph (d)(3), newly designated *Example 9* is revised.

■ 27. In paragraph (d)(3), newly designated *Example 12,* paragraph (ii), the fifth sentence is revised.

■ 28. In paragraph (d)(3), revise newly designated *Example 16.*

■ 29. In paragraph (d)(3), for each of the newly designated examples listed in the first column, replace the language in the second column with the language in the third column:

Redesignated examples	Remove	Add
Example 7, paragraph (i).	*Example 5*	*Example 6.*
Example 7A, paragraph (i) and paragraph (ii), penultimate sentence.	*Example 6*	*Example 7.*
Example 8, paragraph (i).	*Example 5*	*Example 6.*
Example 8A, paragraph (i).	*Example 7*	*Example 8.*

Redesignated examples	Remove	Add
Example 8B, paragraph (i).	*Example 7*	*Example 8.*
Example 8C, paragraph (i).	*Example 7*	*Example 8.*
Example 12, paragraph (i), third sentence.	*Example 9*	*Example 12.*
Example 13A, paragraph (i) and paragraph (ii), first sentence.	*Example 10* ..	*Example 13.*
Example 14A, paragraph (i).	*Example 11* ..	*Example 14.*

■ 30. Paragraph (e)(1) is revised.

The revisions and additions are as follows:

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

* * * * *

(a) * * * However, if, in an exchange described in section 354 or 356, a U.S. person exchanges stock or securities of a foreign corporation in a reorganization described in section 368(a)(1)(E), or a U.S. person exchanges stock or securities of a domestic or foreign corporation pursuant to an asset reorganization that is not treated as an indirect stock transfer under paragraph (d) of this section, such section 354 or 356 exchange is not a transfer to a foreign corporation subject to section 367(a). See paragraph (d)(3) *Example 16* of this section. For purposes of this section, an asset reorganization is defined as a reorganization described in section 368(a)(1) involving a transfer of assets under section 361. If, in a transfer described in section 361, a domestic merging corporation transfers stock of a controlling corporation to a foreign surviving corporation in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E), such section 361 transfer is not subject to section 367(a) if the stock of the controlling corporation is provided to the merging corporation by the controlling corporation pursuant to the plan of reorganization; a section 361 transfer of other property, including stock of the controlling corporation not provided by the controlling corporation pursuant to the plan of reorganization, by the domestic merging corporation to the foreign surviving corporation pursuant to such a reorganization is subject to section 367(a). For special basis and holding period rules involving foreign corporations that are parties to certain triangular reorganizations under section 368(a)(1), see § 1.367(b)–13. * * * For rules related to expatriated entities, see section 7874 and the regulations thereunder.

(b) * * *

(2) * * *

(i) *In general.* A transfer of foreign stock or securities described in section 367(a) or the regulations thereunder as well as in section 367(b) or the regulations thereunder shall be subject concurrently to sections 367(a) and (b) and the regulations thereunder, except as provided in paragraph (b)(2)(i)(A) or (B) of this section. See paragraph (d)(3) *Examples 11* and *14* of this section.

(A) Section 367(b) and the regulations thereunder shall not apply if a foreign corporation is not treated as a corporation under section 367(a)(1). See the example in paragraph (b)(2)(ii) of this section and paragraph (d)(3) *Example 14* of this section.

(B) If a foreign corporation transfers assets to a domestic corporation in a transaction to which § 1.367(b)–3(a) and (b) and the indirect stock transfer rules of paragraph (d) of this section apply, and all the earnings and profits amount attributable to the stock of an exchanging shareholder under § 1.367(b)–3(b) is greater than the amount of gain in such stock subject to section 367(a) pursuant to the indirect stock transfer rules of paragraph (d) of this section, then the rules of section 367(b), and not the rules of section 367(a), shall apply to the exchange. See paragraph (d)(3) *Example 15* of this section.

* * * * *

(c) * * *

(5) * * *

(vi) *Transferee foreign corporation.* Except as provided in paragraph (d)(2)(i)(B) of this section, a transferee foreign corporation is the foreign corporation whose stock is received in the exchange by U.S. persons.

* * * * *

(d) * * *

(1) *In general.* For purposes of this section, a U.S. person who exchanges, under section 354 (or section 356) stock or securities in a domestic or foreign corporation for stock or securities in a foreign corporation (or in a domestic corporation in control of a foreign acquiring corporation in a triangular section 368(a)(1)(B) reorganization) in connection with a transaction described in paragraphs (d)(1)(i) through (v) of this section (or who is deemed to make such an exchange under paragraph (d)(1)(vi) of this section) shall, except as provided in paragraph (d)(2)(vii) of this section, be treated as having made an indirect transfer of such stock or securities to a foreign corporation that is subject to the rules of this section, including, for example, the requirement, where applicable, that the U.S. transferor enter into a gain recognition agreement to preserve nonrecognition treatment under section 367(a). If the U.S. person exchanges stock or securities of a foreign corporation, see also section 367(b) and the regulations thereunder. For examples of the concurrent application of the indirect stock transfer rules under section 367(a) and the rules of section 367(b), see paragraph (d)(3) *Examples 14* and *15* of this section. For purposes of this paragraph (d), if a corporation acquiring assets in an asset reorganization transfers all or a portion of such assets to a corporation controlled (within the meaning of section 368(c)) by the acquiring corporation as part of the same transaction, the subsequent transfer of assets to the controlled corporation will be referred to as a controlled asset transfer. See section 368(a)(2)(C).

(i) *Mergers described in sections 368(a)(1)(A) and (a)(2)(D) and reorganizations described in sections 368(a)(1)(G) and (a)(2)(D).* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for stock or securities of a foreign corporation that controls the acquiring corporation in a reorganization described in either sections 368(a)(1)(A) and (a)(2)(D), or in sections 368(a)(1)(G) and (a)(2)(D). See paragraph (d)(3) *Example 1* of this section for an example of a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) involving domestic acquired and acquiring corporations, and see paragraph (d)(3) *Example 10* of this section for an example involving a domestic acquired corporation and a foreign acquiring corporation.

(ii) * * * See paragraph (d)(3) *Example 2* of this section for an example of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) involving domestic acquired and acquiring corporations, and see paragraph (d)(3) *Example 11* of this section for an example involving a domestic acquired corporation and a foreign acquiring corporation.

(iii) *Triangular reorganizations described in section 368(a)(1)(B)*—(A) A U.S. person exchanges stock or securities of the acquired corporation for voting stock or securities of a foreign corporation that is in control (as defined in section 368(c)) of the acquiring corporation in a reorganization described in section 368(a)(1)(B). See paragraph (d)(3) *Example 5* of this section.

(B) A U.S. person exchanges stock or securities of the acquired corporation for voting stock or securities of a domestic corporation that is in control (as defined in section 368(c)) of a foreign acquiring corporation in a reorganization described in section 368(a)(1)(B). See paragraph (d)(3) *Example 5A* of this section.

* * * * *

(v) *Transfers of assets to subsidiaries in certain section 368(a)(1) reorganizations.* A U.S. person exchanges stock or securities of a corporation (the acquired corporation) for stock or securities of a foreign acquiring corporation in an asset reorganization (other than a triangular section 368(a)(1)(C) reorganization described in paragraph (d)(1)(iv) of this section, a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) or sections 368(a)(1)(G) and (a)(2)(D) described in paragraph (d)(1)(i) of this section, a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) described in paragraph (d)(1)(ii) of this section, or a same-country section 368(a)(1)(F) reorganization) that is followed by a controlled asset transfer. For purposes of this section, a same-country section 368(a)(1)(F) reorganization is a reorganization described in section 368(a)(1)(F) in which both the acquired corporation and the acquiring corporation are foreign corporations and are created or organized under the laws of the same foreign country. In the case of a transaction described in this paragraph (d)(1)(v) in which some but not all of the assets of the acquired corporation are transferred in a controlled asset transfer, the transaction shall be considered to be an indirect transfer of stock or securities subject to this paragraph (d) only to the extent of the assets so transferred. The remaining assets shall be treated as having been transferred by the acquired corporation in an asset transfer rather than an indirect stock transfer, and, if the acquired corporation is a domestic corporation, such asset transfer shall be subject to the other provisions of section 367, including sections 367(a)(1), (3), and (5), and (d). See paragraph (d)(3) *Examples 6A* and *6B* of this section.

* * * * *

(2) * * *

(i) *Transferee foreign corporation*—(A) *General rule.* Except as provided in paragraph (d)(2)(i)(B) of this section, the transferee foreign corporation shall be the foreign corporation that issues stock or securities to the U.S. person in the exchange.

(B) *Special rule for triangular reorganizations described in paragraph (d)(1)(iii)(B) of this section.* In the case of a triangular reorganization described in paragraph (d)(1)(iii)(B) of this section, the transferee foreign corporation shall be the foreign acquiring corporation. See paragraph (d)(3) *Example 5A* of this section.

(ii) *Transferred corporation.* The transferred corporation shall be the acquiring corporation, except as provided in this paragraph (d)(2)(ii). In the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii) of this section, the transferred corporation shall be the acquired corporation. In the case of an indirect stock transfer described in paragraph (d)(1)(i), (ii), or (iv) of this section followed by a controlled asset transfer, or an indirect stock transfer described in paragraph (d)(1)(v) of this section, the transferred corporation shall be the controlled corporation to which the assets are transferred. In the case of successive section 351 transfers described in paragraph (d)(1)(vi) of this section, the transferred corporation shall be the corporation to which the assets are transferred in the final section 351 transfer. The transferred property shall be the stock or securities of the transferred corporation, as appropriate under the circumstances.

* * * * *

(iv) *Gain recognition agreements involving multiple parties.* The U.S. transferor's agreement to recognize gain, as provided in § 1.367(a)–8, shall include appropriate provisions consistent with the principles of these rules, including a requirement that the transferor recognize gain in the event of a direct or indirect disposition of the stock or assets of the transferred corporation. For example, in the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii)(A) of this section, a disposition of the transferred stock or securities requiring the U.S. transferor to recognize gain shall include a direct or indirect disposition of such stock or securities by the transferee foreign corporation, such as a disposition of such stock or securities by a foreign acquiring corporation or a disposition of the stock of the acquiring corporation (either foreign or domestic) by the transferee foreign corporation. In the case of a triangular section 368(a)(1)(B) reorganization described in paragraph (d)(1)(iii)(B) of this section, a disposition of the transferred stock or securities requiring the U.S. transferor to recognize gain shall occur, for example, upon the disposition of such stock or securities by the acquiring corporation. Moreover, a disposition of the stock of the acquiring corporation by the domestic issuing corporation in a taxable transaction shall, for example, terminate the gain recognition agreement. See § 1.367(a)–8(h)(1) and paragraph (d)(3) *Examples 5* and *5A* of this section.

(v) * * *

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

* * * * *

(C) In the case of an asset reorganization followed by a controlled asset transfer, as described in paragraph (d)(1)(v) of this section, the assets of the acquired corporation that are transferred to the corporation controlled by the acquiring corporation;

(D) In the case of a triangular reorganization described in section 368(a)(1)(C) followed by a controlled asset transfer, a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) followed by a controlled asset transfer, or a reorganization described in sections 368(a)(1)(G) and (a)(2)(D) followed by a controlled asset transfer, the assets of the acquired corporation including those transferred to the corporation controlled by the acquiring corporation;

(E) In the case of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E) followed by a controlled asset transfer, the assets of the acquiring corporation including those transferred to the corporation controlled by the acquiring corporation; and

* * * * *

(vi) *Coordination between asset transfer rules and indirect stock transfer rules*—(A) *General rule.* Except as otherwise provided in this paragraph (d)(2)(vi), if, pursuant to any of the transactions described in paragraph (d)(1) of this section, a U.S. person transfers (or is deemed to transfer) assets to a foreign corporation in an exchange described in section 351 or section 361, the rules of section 367, including sections 367(a)(1), (a)(3), and (a)(5), as well as section 367(d), and the regulations thereunder shall apply prior to the application of the rules of this section.

(B) *Exceptions.* (*1*) If a transaction is described in paragraph (d)(2)(vi)(A) of this section, sections 367(a) and (d) shall not apply to the extent a domestic corporation (domestic acquired corporation) transfers its assets to a foreign corporation (foreign acquiring

corporation) in an asset reorganization, and such assets (re-transferred assets) are transferred to a domestic corporation (domestic controlled corporation) in a controlled asset transfer, provided that the domestic controlled corporation's basis in such assets is no greater than the basis that the domestic acquired corporation had in such assets and the conditions contained in either of the following paragraphs are satisfied:

(*i*) The domestic acquired corporation is controlled (within the meaning of section 368(c)) by 5 or fewer domestic corporations, appropriate basis adjustments as provided in section 367(a)(5) are made to the stock of the foreign acquiring corporation, and any other conditions as provided in regulations under section 367(a)(5) are satisfied. For purposes of determining whether the domestic acquired corporation is controlled by 5 or fewer domestic corporations, all members of the same affiliated group within the meaning of section 1504 shall be treated as 1 corporation.

(*ii*) The requirements of paragraphs (c)(1)(i), (ii), and (iv), and (c)(6) of this section are satisfied with respect to the indirect transfer of stock in the domestic acquired corporation, and the domestic acquired corporation attaches a statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer.

(*2*) Sections 367(a) and (d) shall not apply to transfers described in paragraph (d)(1)(vi) of this section where a U.S. person transfers assets to a foreign corporation in a section 351 exchange, to the extent that such assets are transferred by such foreign corporation to a domestic corporation in another section 351 exchange, but only if the domestic transferee's basis in the assets is no greater than the basis that the U.S. transferor had in such assets.

(C) *Required statement.* The statement required by paragraph (d)(2)(vi)(B)(*1*)(*ii*) of this section shall be entitled ''Required Statement under § 1.367(a)–3(d) for Assets Transferred to a Domestic Corporation'' and shall be signed under penalties of perjury by an authorized officer of the domestic acquired corporation and by an authorized officer of the foreign acquiring corporation. The required statement shall contain a certification that, if the foreign acquiring corporation disposes of any stock of the domestic controlled corporation in a transaction described in paragraph (d)(2)(vi)(D) of this section, the domestic acquired corporation shall recognize gain as described in paragraph (d)(2)(vi)(E) of this section. The domestic acquired corporation (or the foreign acquiring corporation on behalf of the domestic acquired corporation) shall file a U.S. income tax return (or an amended U.S. tax return, as the case may be) for the year of the transfer reporting such gain.

(D) *Gain recognition transaction.* (*1*) A transaction described in this paragraph (d)(2)(vi)(D) is one where a principal purpose of the transfer by the domestic acquired corporation is the avoidance of U.S. tax that would have been imposed on the domestic acquired corporation on the disposition of the re-transferred assets. A transfer may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes when taken together.

(*2*) For purposes of paragraph (d)(2)(vi)(D)(*1*) of this section, a transaction is deemed to have a principal purpose of tax avoidance if the foreign acquiring corporation disposes of any stock of the domestic controlled corporation (whether in a recognition or non-recognition transaction) within 2 years of the transfer described in paragraph (d)(2)(vi)(A) of this section. The rule in this paragraph (d)(2)(vi)(D)(*2*) shall not apply if the domestic acquired corporation (or the foreign acquiring corporation on behalf of the domestic acquired corporation) demonstrates to the satisfaction of the Commissioner that the avoidance of U.S. tax was not a principal purpose of the transaction.

(E) *Amount of gain recognized and other matters.* (*1*) In the case of a transaction described in paragraph (d)(2)(vi)(D) of this section, solely for purposes of this paragraph (d)(2)(vi)(E), the domestic acquired corporation shall be treated as if, immediately prior to the transfer described in paragraph (d)(2)(vi)(A) of this section, it transferred the re-transferred assets, including any intangible assets, directly to a domestic corporation in exchange for stock of such domestic corporation in a transaction that is treated as a section 351 exchange, and immediately sold such stock to an unrelated party for its fair market value in a sale in which it shall recognize gain, if any (but not loss). Any gain recognized by the domestic acquired corporation pursuant to this paragraph (d)(2)(vi)(E) will increase the basis that the foreign acquiring corporation has in the stock of the domestic controlled corporation immediately before the transaction described in paragraph (d)(2)(vi)(D) of this section, but will not increase the basis of the re-transferred assets held by the domestic controlled corporation. Section 1.367(d)–1T(g)(6) shall not apply with respect to any intangible property included in the re-transferred assets described in this paragraph.

(*2*) If additional tax is required to be paid as a result of a transaction described in paragraph (d)(2)(vi)(D) of this section, then interest must be paid on that amount at rates determined under section 6621 with respect to the period between the date prescribed for filing the domestic acquired corporation's income tax return for the year of the transfer and the date on which the additional tax for that year is paid.

(F) *Examples.* For illustrations of the rules in paragraph (d)(2)(vi) of this section, see paragraph (d)(3) *Examples 6B, 6C, 9,* and *13A* of this section.

(vii) *Change in status of a domestic acquired corporation to a foreign corporation.* (A) A U.S. person that exchanges stock or securities of a domestic corporation for stock or securities of a foreign corporation under section 354 (or section 356) will be treated for purposes of this section as having made an indirect stock transfer of the stock or securities of a foreign corporation (and not of a domestic corporation) to a foreign corporation under paragraph (b) of this section (but not paragraph (c) of this section), if the acquired domestic corporation is a subsidiary member (within the meaning of § 1.1502–1(c)) of a consolidated group (within the meaning of § 1.1502–1(h)) immediately before the transaction, and if the transaction is either of the following:

(*1*) Described in paragraph (d)(1)(i) or (iv) of this section, but only if the acquiring corporation is foreign. See paragraph (d)(3) *Examples 8, 9, 10* and *12* of this section.

(*2*) Described in paragraph (d)(1)(v) of this section, but only to the extent the controlled asset transfer is to a foreign corporation. See paragraph (d)(3) *Example 6A* of this section.

(B) The rules of paragraph (d)(2)(vii)(A) of this section will not apply to the extent assets transferred to the foreign acquiring corporation in a transaction described in paragraph (d)(2)(vii)(A)(*1*) of this section, or assets transferred to a foreign corporation in a controlled asset transfer in a transaction described in paragraph (d)(2)(vii)(A)(*2*) of this section, are retransferred to a domestic controlled corporation in one or more successive transfers as part of the same transaction. See paragraph (d)(3) *Example 9* of this section.

(3) * * * The rules of this paragraph (d) and § 1.367(a)–8 are illustrated by the following examples. For purposes of these examples, assume section 7874 does not apply.

* * * * *

Example 2. Section 368(a)(1)(A)/(a)(2)(E) reorganization—(i) *Facts.* The facts are the same as in *Example 1,* except that Newco merges into W and Newco receives stock of W which it distributes to F in a reorganization described in sections 368(a)(1)(A) and (a)(2)(E). Pursuant to the reorganization, A receives 40 percent of the stock of F in an exchange described in section 354.

(ii) *Result.* The consequences of the transfer are similar to those described in *Example 1.* Pursuant to paragraph (d)(1)(ii) of this section, A is considered to have transferred its W stock to F pursuant to the indirect stock transfer rules. F is treated as the transferee foreign corporation, and W is treated as the transferred corporation. Provided that the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that A enter into a five-year gain recognition agreement as described in § 1.367(a)–8, A's exchange of W stock for F stock under section 354 will not be subject to section 367(a)(1).

Example 3. Taxable transaction pursuant to indirect stock transfer rules—(i) *Facts.* The facts are the same as in *Example 1*, except that A receives 55 percent of either the total voting power or the total value of the stock of F in the transaction.

* * * * *

Example 5A. Triangular section 368(a)(1)(B) reorganization—(i) *Facts.* The facts are the same as in *Example 5*, except that F is a domestic corporation and S is a foreign corporation.

(ii) *Result.* U's exchange of Y stock for stock of F, a domestic corporation in control of S, the foreign acquiring corporation, is treated as an indirect transfer of Y stock to a foreign corporation under paragraph (d)(1)(iii)(B) of this section. U's exchange of Y stock for F stock will not be subject to section 367(a)(1) provided that all of the requirements of paragraph (c)(1) of this section are satisfied, including the requirement that U enter into a five-year gain recognition agreement. In satisfying the 50 percent or less ownership requirements of paragraphs (c)(1)(i) and (ii) of this section, U's indirect ownership of S stock (through its direct ownership of F) will determine whether the requirement of paragraph (c)(1)(i) of this section is satisfied and will be taken into account in determining whether the requirement of paragraph (c)(1)(ii) of this section is satisfied. See paragraph (c)(4)(iv) of this section. For purposes of this section, S is treated as the transferee foreign corporation (see paragraph (d)(2)(i)(B) of this section). The gain recognition agreement would be triggered, for example, if S sold all or a portion of the stock of Y, or if Y sold substantially all of its assets (within the meaning of section 368(a)(1)(C)). In addition, if F disposed of the stock of S in a taxable transaction the gain recognition agreement would be terminated.

* * * * *

Example 6A. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer—(i) *Facts.* The facts are the same as in *Example 6*, except that the transaction is structured as a section 368(a)(1)(C) reorganization with Z transferring its assets to F, followed by a controlled asset transfer, and R is a foreign corporation. * * * F then contributes Businesses B and C to R in a controlled asset transfer.

(ii) *Result.* The transfer of the Business A assets by Z to F does not constitute an indirect stock transfer under paragraph (d) of this section, and, subject to section 367(a)(5), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a). * * * Subject to section 367(a)(5), the Business B assets may qualify for the exception under section 367(a)(3) and § 1.367(a)–2T(c)(2) for assets that will be used by R in an active trade or business outside the United States. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(2) of this section, V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section. * * *

* * * * *

Example 6B. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts.* The facts are the same as in *Example 6A,* except that R is a domestic corporation.

(ii) *Result.* As in *Example 6A,* the outbound transfer of the Business A assets to F is not affected by the rules of this paragraph (d) and is subject to the general rules under section 367. However, subject to section 367(a)(5), the Business A assets qualify for the section 367(a)(3) active trade or business exception and are not subject to section 367(a). The Business B and C assets are part of an indirect stock transfer under this paragraph (d) but must first be tested under section 367(a) and (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3); the Business C assets do not. However, pursuant to paragraph (d)(2)(vi)(B) of this section, the Business B and C assets are not subject to section 367(a) or (d), provided that the basis of the Business B and C assets in the hands of R is no greater than the basis of the assets in the hands of Z, and appropriate basis adjustments are made pursuant to section 367(a)(5) to the stock of F held by V. V also is deemed to make an indirect transfer of Z stock under the rules of paragraph (d) of this section to the extent the assets are transferred to R. To preserve non-recognition treatment under section 367(a), and assuming the other requirements of paragraph (c) of this section are satisfied, V must enter into a 5-year gain recognition agreement in the amount of $50, the amount of the appreciation in the Business B and C assets, as the transfer of such assets by Z was not taxable under section 367(a)(1) and constituted an indirect stock transfer.

Example 6C. Section 368(a)(1)(C) reorganization followed by a controlled asset transfer to a domestic controlled corporation—(i) *Facts.* The facts are the same as in *Example 6B*, except that Z is owned by U.S. individuals, none of whom qualify as five-percent target shareholders with respect to Z within the meaning of paragraph (c)(5)(iii) of this section. The following additional facts are present. No U.S. persons that are either officers or directors of Z own any stock of F immediately after the transfer. F is engaged in an active trade or business outside the United States that satisfies the test set forth in paragraph (c)(3) of this section.

(ii) *Result.* The Business A assets transferred to F are not re-transferred to R and therefore Z's transfer of these assets is not subject to the rules of paragraph (d) of this section. However, the transfer of such assets is subject to gain recognition under section 367(a)(1), because the section 367(a)(3) active trade or business exception is inapplicable pursuant to section 367(a)(5). The Business B and C assets are part of an indirect stock transfer under this paragraph (d) but must first be tested with respect to Z under section 367(a) and (d), as provided in paragraph (d)(2)(vi) of this section. The transfer of the Business B assets (which otherwise would satisfy the section 367(a)(3) active trade or business exception) generally is subject to section 367(a)(1) pursuant to section 367(a)(5). The transfer of the Business C assets generally is subject to section 367(a)(1) because these assets do not qualify for the active trade or business exception under section 367(a)(3). However, pursuant to paragraph (d)(2)(vi)(B) of this section, the transfer of the Business B and C assets is not subject to sections 367(a)(1) and (d), provided the basis of the Business B and C assets in the hands of R is no greater than the basis in the hands of Z and certain other requirements are satisfied. Even though Z is not controlled within the meaning of section 368(c) by 5 or fewer domestic corporations, Z may avoid immediate gain recognition under section 367(a) and (d) on the transfers of the Business B and Business C assets to F if, pursuant to paragraph (d)(3)(vi)(B) of this section, the indirect transfer of Z stock satisfies the requirements of paragraphs (c)(1)(i), (ii), and (iv), and (c)(6) of this section, and Z attaches a statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return for the taxable year of the transfer. In general, the statement must contain a certification that, if F disposes of the stock of R (in a recognition or nonrecognition transaction) and a principal purpose of the transfer is the avoidance of U.S. tax that would have been imposed on Z on the disposition of the Business B and C assets transferred to R, then Z (or F on behalf of Z) will file a return (or amended return as the case may be) recognizing gain ($50), as if, immediately prior to the reorganization, Z transferred the Business B and C assets to a domestic corporation in exchange for stock in a transaction treated as a section 351 exchange and immediately sold such stock to an unrelated party for its fair market value. A transaction is deemed to have a principal purpose of U.S. tax avoidance if F disposes of R stock within two years of the transfer, unless Z (or F on behalf of Z) can rebut the presumption to the satisfaction of the Commissioner. See paragraph (d)(2)(vi)(D)(*2*) of this section. With respect to the indirect transfer of Z stock, assume the requirements of paragraphs (c)(1)(i), (ii), and (iv) of this section are satisfied. Thus, assuming Z attaches the statement described in paragraph (d)(2)(vi)(C) of this section to its U.S. income tax return and satisfies the reporting

requirements of (c)(6) of this section, the transfer of Business B and C assets is not subject to immediate gain recognition under section 367(a) or (d).

* * * * *

Example 8. Concurrent application of asset transfer and indirect stock transfer rules in consolidated return setting—(i) *Facts.* * * *

(ii) * * * Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section, and therefore must enter into a gain recognition agreement in the amount of $60 (the gain realized but not recognized by V in the stock of Z after the $40 basis adjustment).

* * * * *

Example 9. Indirect stock transfer by reason of a controlled asset transfer—(i) *Facts.* The facts are the same as in *Example 8,* except that R transfers the Business A assets to M, a wholly owned domestic subsidiary of R, in a controlled asset transfer. In addition, V's basis in its Z stock is $90.

(ii) *Result.* Pursuant to paragraph (d)(2)(vi)(B) of this section, sections 367(a) and (d) do not apply to Z's transfer of the Business A assets to R, because such assets are re-transferred to M, a domestic corporation, provided that the basis of the Business A assets in the hands of M is no greater than the basis of the assets in the hands of Z, and certain other requirements are satisfied. Because Z is controlled (within the meaning of section 368(c)) by V, a domestic corporation, appropriate basis adjustments must be made pursuant to section 367(a)(5) to the stock of F held by V. Section 367(a)(1) does not apply to Z's transfer of its Business B assets to R (which are not re-transferred to M) because such assets qualify for an exception to gain recognition under section 367(a)(3), subject to section 367(a)(5). Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, V is generally deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section, including the requirement that V enter into a 5-year gain recognition agreement and comply with the requirements of § 1.367(a)–8. However, pursuant to paragraph (d)(2)(vii)(B) of this section, paragraph (d)(2)(vii)(A)(1) of this section does not apply to the extent of the transfer of business A assets by R to M, a domestic corporation. As a result, to the extent of the business A assets transferred by R to M, V is deemed to transfer the stock of Z (a domestic corporation) to F in a section 354 exchange subject to the rules of paragraphs (c) and (d) of this section. Thus, with respect to V's indirect transfer of Z stock to F, such transfer is not subject to gain recognition under section 367(a)(1) if the requirements of paragraph (c) of this section are satisfied, including the requirement that V enter into a 5-year gain recognition agreement and comply with the requirements of § 1.367(a)–8. Under paragraphs (d)(2)(i) and (ii) of this section, the transferee foreign corporation is F and the transferred corporation is M. Pursuant to paragraph (d)(2)(iv) of this section, a disposition by F of the stock of R, or a disposition by R of the stock of M, will trigger the gain recognition agreement. To determine whether an asset disposition constitutes a deemed disposition of the transferred corporation's stock under the rules of § 1.367(a)–8(e)(3)(i), both the Business A assets in M and the Business B assets in R must be considered.

Example 10. Concurrent application of direct stock transfer and indirect stock transfer rules in section 368(a)(1)(A)/(a)(2)(D) reorganization—(i) *Facts.* The facts are the same as in Example 8, except that R acquires all of the assets of Z in a reorganization described in sections 368(a)(1)(A) and (a)(2)(D). Pursuant to the reorganization, V receives 30 percent of the stock of F in a section 354 exchange.

(ii) *Result.* The consequences of the transaction are similar to those in *Example 8.* The assets of Businesses A and B that are transferred to R must be tested under section 367(a) and (d) prior to the consideration of the indirect stock transfer rules of this paragraph (d). The Business B assets qualify for the active trade or business exception under section 367(a)(3), subject to section 367(a)(5). Because the Business A assets do not qualify for the exception, Z must recognize $40 of gain under section 367(a) on the transfer of Business A assets to R. Further, because V and Z file a consolidated return, V's basis in the stock of Z is increased from $100 to $140 as a result of Z's $40 gain. Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, V is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section. V's indirect transfer of foreign stock will be taxable under section 367(a) unless V enters into a gain recognition agreement in the amount of $60 ($200 value of Z stock less $140 adjusted basis).

Example 11. Concurrent application of section 367(a) and (b) in section 368(a)(1)(A)/(a)(2)(E) reorganization—(i) *Facts.* F, a foreign corporation, owns all the stock of D, a domestic corporation. V, a domestic corporation, owns all the stock of Z, a foreign corporation. V has a basis of $100 in the stock of Z which has a fair market value of $200. D is an operating corporation with assets valued at $100 with a basis of $60. In a reorganization described in sections 368(a)(1)(A) and (a)(2)(E), D merges into Z, and V exchanges its Z stock for 55 percent of the outstanding F stock.

(ii) *Result.* Under paragraph (d)(1)(ii) of this section, V is treated as making an indirect transfer of Z stock to F. V's exchange of Z stock for F stock will be taxable under section 367(a) (and section 1248 will be applicable) if V fails to enter into a 5-year gain recognition agreement in accordance with the requirements of § 1.367(a)–8. Under paragraph (b)(2) of this section, if V enters into a gain recognition agreement, the exchange will be subject to the provisions of section 367(b) and the regulations thereunder as well as section 367(a). Under § 1.367(b)–4(b), however, no income inclusion is required because both F and Z are controlled foreign corporations with respect to which V is a section 1248 shareholder immediately after the exchange. Under paragraphs (d)(2)(i) and (ii) of this section, the transferee foreign corporation is F, and the transferred corporation is Z (the acquiring corporation). If F disposes (within the meaning of § 1.367(a)–8(e)) of all (or a portion) of Z stock within the 5-year term of the agreement (and V has not made a valid election under § 1.367(a)–8(b)(1)(vii)), V is required to file an amended return for the year of the transfer and include in income, with interest, the gain realized but not recognized on the initial section 354 exchange. To determine whether Z (the transferred corporation) disposes of substantially all of its assets, only the assets of Z immediately prior to the transaction are taken into account, pursuant to paragraph (d)(2)(v)(B) of this section. Because D is owned by F, a foreign corporation, section 367(a)(5) precludes any assets of D from qualifying for nonrecognition under section 367(a)(3). Thus, D recognizes $40 of gain on the transfer of its assets to Z under section 367(a)(1).

Example 12. Concurrent application of direct and indirect stock transfer rules—(i) *Facts.* * * *

(ii) * * * Pursuant to paragraphs (d)(1) and (d)(2)(vii)(A)(*1*) of this section, D is deemed to transfer the stock of a foreign corporation to F in a section 354 exchange subject to the rules of paragraphs (b) and (d) of this section, and therefore may enter into a gain recognition agreement for such indirect stock transfer as provided in paragraph (b) of this section and § 1.367(a)–8. * * *

* * * * *

Example 15. Concurrent application of indirect stock transfer rules and section 367(b)—(i) *Facts.* F, a foreign corporation, owns all of the stock of Newco, a domestic corporation. P, a domestic corporation, owns all of the stock of FC, a foreign corporation. P's basis in the stock of FC is $50 and the value of FC stock is $100. The all earnings and profits amount with respect to the FC stock held by P is $60. See § 1.367(b)–2(d). In a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) (and paragraph (d)(1)(i) of this section), Newco acquires all of the properties of FC, and P exchanges its stock in FC for 20 percent of the stock in F.

(ii) *Result.* P's section 354 exchange is considered an indirect stock transfer under paragraph (d)(1)(i) of this section. Further, because the assets of FC were acquired by Newco, a domestic corporation, in an asset reorganization, the transaction is within § 1.367(b)–3(a) and (b). Because the transaction is subject to § 1.367(b)–3 and the indirect stock rules of paragraph (d) of this section, and because the all earnings and profits amount with respect to the FC stock exchanged by P ($60) is greater than the gain in such stock subject to section 367(a) ($50), the section 367(b) rules (and not the section 367(a) rules) apply to the exchange. See § 1.367(a)–3(b)(2)(i)(B). Under the rules of section 367(b), P must include in income the all earnings and profits amount of $60 with respect to its FC stock. See § 1.367(b)–3. Alternatively, if P's all earnings and profits amount with respect to its FC stock were $30 (which is less than the gain in such stock subject to section 367(a) ($50)), section 367(b) and the regulations thereunder would not

apply if there is gain recognition under section 367(a). Thus, if P failed to enter into a 5-year gain recognition agreement in accordance with § 1.367(a)–8, then P would recognize $50 of gain under section 367(a) and there would be no income inclusion under section 367(b). If, instead, P enters into a 5-year gain recognition agreement under § 1.367(a)–8, thereby avoiding immediate gain recognition on the entire $50 of section 367(a) gain, P is required to include in income the all earnings and profits amount of $30. In such a case, P will adjust its basis in the FC stock pursuant to § 1.367(b)–2(e)(3)(ii) and enter into a gain recognition agreement in the amount of $20.

Example 16. Direct asset reorganization not subject to stock transfer rules—(i) *Facts.* D is a domestic corporation that owns all the stock of F1 and F2, both foreign corporations. In a reorganization described in section 368(a)(1)(D), F2 acquires all of the assets of F1, and D receives 30 percent of the stock of F2 in an exchange described in section 354.

(ii) *Result.* The section 368(a)(1)(D) reorganization is not an indirect stock transfer described in paragraph (d) of this section. Moreover, the section 354 exchange by D of F1 stock for F2 stock is not an exchange described under section 367(a). See paragraph (a) of this section.

(e) * * *

(1) *Rules of applicability*—(A) Except as otherwise provided in this paragraph (e), the rules in paragraphs (a), (b), and (d) of this section apply to transfers occurring on or after July 20, 1998.

(B) The following rules apply to transactions occurring on or after January 23, 2006—

(*1*) The rules in paragraphs (a) and (d) of this section, as they apply to section 368(a)(1)(A) reorganizations (including reorganizations described in section 368(a)(2)(D) or (E)) involving a foreign acquiring or foreign acquired corporation;

(*2*) The rules in paragraph (b)(2)(i)(B) of this section;

(*3*) The rules in paragraph (d) of this section, as they apply to section 368(a)(1)(G) reorganizations (including reorganizations described in section 368(a)(2)(D));

(*4*) The rules of paragraph (d)(1) and (d)(2)(iv), as they relate to exchanges by a U.S. person of securities of an acquired corporation for voting stock or securities of a foreign corporation in control of the acquiring corporation in a triangular section 368(a)(1)(B) reorganization;

(*5*) The rules in paragraph (d)(1) and (d)(2)(iv) of this section, as they relate to exchanges by a U.S. person of stock or securities of an acquired corporation for voting stock or securities of a domestic corporation in control of the foreign acquiring corporation in a triangular section 368(a)(1)(B) reorganization; and

(*6*) The rules in paragraph (d)(2)(vii) of this section.

(C) The rules of paragraph (a) of this section that apply to transfers of securities in a section 354 or 356 exchange (pursuant to a section 368(a)(1)(E) reorganization or an asset reorganization that is not treated as an indirect stock transfer) that is not subject to section 367(a) apply only to transfers occurring after January 5, 2005 (although taxpayers may apply such provision to transfers of securities occurring on or after July 20, 1998, and on or before January 5, 2005, if done consistently to all transactions).

(D) The rules in paragraph (d)(1)(v) of this section apply to:

(*1*) A reorganization described in section 368(a)(1)(C) followed by a controlled asset transfer if such reorganization occurs on or after July 20, 1998;

(*2*) A reorganization described in section 368(a)(1)(D) followed by a controlled asset transfer if such reorganization occurs after December 9, 2002 (for additional guidance concerning such reorganizations that occur on or after July 20, 1998 and on or before December 9, 2002, see Rev. Rul. 2002–85 (2002–2 C.B. 986) and § 601.601(d)(2) of this chapter); and

(*3*) A reorganization described in section 368(a)(1)(A), (F), or (G) followed by a controlled asset transfer if such reorganization occurs on or after January 23, 2006.

(E) The rules of paragraph (d)(2)(vi) of this section apply only to transactions occurring on or after January 23, 2006. See § 1.367(a)–3(d)(2)(vi), as contained in 26 CFR part 1 revised as of April 1, 2005, for transactions occurring on or after July 20, 1998 and before January 23, 2006.

(F) With respect to certain transfers of domestic stock or securities, the rules in paragraph (c) of this section are generally applicable for transfers occurring after January 29, 1997. See § 1.367(a)–3(c)(11). For transition rules regarding certain transfers of domestic stock or securities after December 16, 1987, and before January 30, 1997, and transfers of foreign stock or securities after December 16, 1987, and before July 20, 1998, see paragraph (g) of this section.

* * * * *

■ **Par. 4.** Section 1.367(a)–8 is amended as follows:

■ 1. In paragraphs (c)(2) and (d), remove the words ''district director'' and add ''Director of Field Operations'' in their place.

■ 2. In paragraph (e)(1)(i), a sentence is added after the first sentence.

The addition reads as follows:

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

* * * * *

(e) * * *

(1) * * *

(i) * * * It also includes an indirect disposition of the stock of the transferred corporation as described in § 1.367(a)–3(d)(2)(iv). * * *

* * * * *

■ **Par. 5.** In § 1.367(b)–1(a), remove the third and fourth sentences and add a sentence in their place to read as follows:

§ 1.367(b)–1 Other transfers.

(a) * * * For rules coordinating the concurrent application of sections 367(a) and (b), see § 1.367(a)–3(b)(2). * * *

* * * * *

■ **Par. 6.** In § 1.367(b)–3(b)(3)(ii), revise paragraph (i) of *Example 5* to read as follows:

§ 1.367(b)–3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

* * * * *

(b) * * *

(3) * * *

(ii) * * *

Example 5. (i) *Facts.* DC1, a domestic corporation, owns all of the outstanding stock of FC1, a foreign corporation. FC1 owns all of the outstanding stock of FC2, a foreign corporation. The all earnings and profits amount with respect to the FC2 stock owned by FC1 is $20. In a reorganization described in section 368(a)(1)(A), DC2, a domestic corporation unrelated to FC1 or FC2, acquires all of the assets and liabilities of FC2 pursuant to a State W merger. FC2 receives DC2 stock and distributes such stock to FC1. The FC2 stock held by FC1 is canceled, and FC2 ceases its separate legal existence.

* * * * *

■ **Par. 7.** Section 1.367(b)–4 is amended as follows.

■ 1. Paragraph (a) is revised.

■ 2. The heading and first sentence of paragraph (b)(1)(i) are revised.

■ 3. Paragraph (b)(1)(ii) is redesignated as paragraph (b)(1)(iii), and new paragraph (b)(1)(ii) is added.

■ 4. In newly designated paragraph (b)(1)(iii) *Examples 3A* and *3B* are added after *Example 3*.

The revisions and additions read as follows:

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

(a) *Scope.* This section applies to an acquisition by a foreign corporation (the foreign acquiring corporation) of the

stock or assets of a foreign corporation (the foreign acquired corporation) in an exchange described in section 351 or a reorganization described in section 368(a)(1). In the case of a reorganization described in sections 368(a)(1)(A) and (a)(2)(E), this section applies if stock of the foreign surviving corporation is exchanged for stock of a foreign corporation in control of the merging corporation; in such a case, the foreign surviving corporation is treated as a foreign acquired corporation for purposes of this section. A foreign corporation that undergoes a reorganization described in section 368(a)(1)(E) is treated as both the foreign acquired corporation and the foreign acquiring corporation for purposes of this section. See § 1.367(a)–3(b)(2) for transactions subject to the concurrent application of this section and section 367(a).

(b) * * *

(1) * * *

(i) *General rule.* Except as provided in paragraph (b)(1)(ii) of this section, an exchange is described in this paragraph (b)(1)(i) if—

* * * * *

(ii) *Exception.* In the case of a triangular reorganization described in § 1.358–6(b)(2), or a reorganization described in sections 368(a)(1)(G) and (a)(2)(D), an exchange is not described in paragraph (b)(1)(i) of this section if the stock received in the exchange is stock of a domestic corporation and, immediately after the exchange, such domestic corporation is a section 1248 shareholder of the acquired corporation (in the case of a triangular B reorganization) or the surviving corporation (in the case of a triangular C reorganization, a forward triangular merger, a reorganization described in sections 368(a)(1)(G) and (a)(2)(D), or a reverse triangular merger) and such acquired or surviving corporation is a controlled foreign corporation. See § 1.367(b)–13(c) for rules regarding such domestic corporation's basis in the stock of the surviving corporation. See paragraph (b)(1)(iii) of this section, *Example 3B* for an illustration of this rule.

(iii) * * *

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

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

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

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

* * * * *

■ **Par. 8.** In § 1.367(b)–6, paragraph (a)(1), add two sentences to the end to read as follows:

§ 1.367(b)–6 Effective dates and coordination rules.

(a) * * *

(1) * * * The rules of §§ 1.367(b)–3 and 1.367(b)–4, as they apply to reorganizations described in section 368(a)(1)(A) (including reorganizations described in section 368(a)(2)(D) or (E)) involving a foreign acquiring or foreign acquired corporation, apply only to transfers occurring on or after January 23, 2006. Section 1.367(b)–4(b)(1)(ii) applies to triangular B reorganizations occurring on or after February 23, 2000 and to all other triangular reorganizations and reorganizations described in section 368(a)(1)(G) and (a)(2)(D) occurring on or after January 23, 2006.

* * * * *

■ **Par. 9.** Section 1.367(b)–13 is added to read as follows:

§ 1.367(b)–13 Special rules for determining basis and holding period.

(a) *Scope and definitions*—(1) *Scope.* This section provides special basis and holding period rules to determine the basis and holding period of stock of certain foreign surviving corporations held by a controlling corporation whose stock is issued in an exchange under section 354 or 356 in a triangular reorganization. This section applies to transactions that are subject to section 367(b) as well as section 367(a), including transactions concurrently subject to sections 367(a) and (b).

(2) *Definitions.* For purposes of this section, the following definitions apply:

(i) A block of stock has the meaning provided in § 1.1248–2(b).

(ii) A triangular reorganization is a reorganization described in § 1.358–6(b)(2)(i), (ii), or (iii) or in sections 368(a)(1)(G) and (a)(2)(D) (a forward triangular merger, triangular C reorganization, reverse triangular merger, or triangular G reorganization, respectively). For purposes of triangular reorganizations—

(A) P is a corporation that is a party to a reorganization that is in control (within the meaning of section 368(c)) of another party to the reorganization and whose stock is transferred pursuant to the reorganization;

(B) S is a corporation that is a party to the reorganization and that is controlled by P; and

(C) T is a corporation that is another party to the reorganization.

(b) *Determination of basis for exchanges of foreign stock or securities under section 354 or 356.* For rules determining the basis of stock or securities in a foreign corporation received in a section 354 or 356 exchange, see § 1.358–2.

(c) *Determination of basis and holding period for triangular reorganizations*—(1) *Application.* In the case of a triangular reorganization described in paragraph (a)(2)(ii) of this section, this paragraph (c) applies, if—

(i)(A) Immediately before the transaction, either P is a section 1248 shareholder with respect to S, or P is a foreign corporation and a United States

person is a section 1248 shareholder with respect to both P and S; and

(B) In the case of a reverse triangular merger, P's exchange of S stock is not described in § 1.367(b)–3(a) and (b) or in § 1.367(b)–4(b)(1)(i), (2)(i), or (3); or

(ii)(A) Immediately before the transaction, a shareholder of T is a section 1248 shareholder with respect to T, or a shareholder of T is a foreign corporation and a United States person is a section 1248 shareholder with respect to both such foreign corporation and T; and

(B) With respect to at least one of the exchanging shareholders described in paragraph (c)(1)(ii)(A) of this section, the exchange of T stock is not described in § 1.367(b)–3(a) and (b) or in § 1.367(b)–4(b)(1)(i), (2)(i), or (3).

(2) *Basis and holding period rules.* In the case of a triangular reorganization described in paragraph (c)(1) of this section, each share of stock of the surviving corporation (S or T) held by P must be divided into portions attributable to the S stock and the T stock immediately before the exchange. See paragraph (e) of this section *Examples 1* through *4* for illustrations of this rule.

(i) *Portions attributable to S stock*—(A) In the case of a forward triangular merger, a triangular C reorganization, or a triangular G reorganization, the basis and holding period of the portion of each share of surviving corporation stock attributable to the S stock is the basis and holding period of such share of stock immediately before the exchange.

(B) In the case of a reverse triangular merger, the basis and holding period of the portion of each share of surviving corporation stock attributable to the S stock is the basis and the holding period immediately before the exchange of a proportionate amount of the S stock to which the portion relates. If P is a shareholder described in paragraph (c)(1)(i)(A) of this section with respect to S, and P exchanges two or more blocks of S stock pursuant to the transaction, then each share of the surviving corporation (T) attributable to the S stock must be further divided into separate portions to account for the separate blocks of stock in S.

(C) If the value of S stock immediately before the triangular reorganization is less than one percent of the value of the surviving corporation stock immediately after the triangular reorganization, then P may determine its basis in the surviving corporation stock by applying the rules of paragraph (c)(2)(ii) of this section to determine the basis and holding period of the surviving corporation stock attributable to the T stock, and then increasing the basis of each share of surviving corporation stock by the proportionate amount of P's aggregate basis in the S stock immediately before the exchange (without dividing the stock of the surviving corporation into separate portions attributable to the S stock).

(ii) *Portions attributable to T stock*—(A) If any exchanging shareholder of T stock is described in paragraph (c)(1)(ii) of this section, the basis and holding period of the portion of each share of stock in the surviving corporation attributable to the T stock is the basis and holding period immediately before the exchange of a proportionate amount of the T stock to which such portion relates. If any exchanging shareholder of T stock is described in paragraph (c)(1)(ii) of this section, and such shareholder exchanges two or more blocks of T stock pursuant to the transaction, then each share of surviving corporation stock attributable to the T stock must be further divided into separate portions to account for the separate blocks of T stock.

(B) If no exchanging shareholder of T stock is described in paragraph (c)(1)(ii) of this section, the rules of § 1.358–6 apply to determine the basis of the portion of each share of the surviving corporation attributable to T immediately before the exchange.

(d) *Special rules applicable to divided shares of stock*—(1) *In general*—(i) Shares of stock in different blocks are aggregated into one divided portion for basis purposes, if such shares immediately before the exchange are owned by one or more shareholders that are—

(A) Not section 1248 shareholders with respect to the corporation; or

(B) Foreign corporate shareholders, provided that no United States persons are section 1248 shareholders with respect to both such foreign corporate shareholders and the corporation.

(ii) For purposes of determining the amount of gain realized on the sale or exchange of stock that has a divided portion pursuant to paragraph (c) of this section, any amount realized on such sale or exchange will be allocated to each divided portion of the stock based on the relative fair market value of the stock to which the portion is attributable at the time the portions were created. See paragraph (e) *Example 5* of this section.

(iii) Shares of stock will no longer be required to be divided if section 1248 or section 964(e) would not apply to a disposition or exchange of such stock.

(2) *Pre-exchange earnings and profits.* All earnings and profits (or deficits) accumulated by a foreign corporation before the reorganization and attributable to a share (or block) of stock for purposes of section 1248 are attributable to the divided portion of stock with the basis and holding period of that share (or block). See § 1.367(b)–4(d).

(3) *Post-exchange earnings and profits.* Any earnings and profits (or deficits) accumulated by the surviving corporation subsequent to the reorganization are attributed to each divided share of stock pursuant to section 1248 and the regulations thereunder. The amount of earnings and profits (or deficits) attributable to a divided share of stock is further attributed to the divided portions of such share of stock based on the relative fair market value of each divided portion of stock. See paragraph (e) *Example 5* of this section.

(e) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. Blocks of stock exchanged in a triangular reorganization—(i) *Facts.* (A) US1, a domestic corporation, owns all the stock of F1, a foreign corporation. F1 owns all the stock of FT, a foreign corporation, with 100 shares of stock outstanding. Each share of FT stock is valued at $10x. Because F1 acquired the stock of FT at two different dates, F1 owns two blocks of FT stock for purposes of section 1248. The first block consists of 60 shares. The shares in the first block have a basis of $300x ($5x per share), a holding period of 10 years, and $240x ($4x per share) of earnings and profits attributable to the shares for purposes of section 1248. The second block consists of 40 shares. The shares in the second block have a basis of $600x ($15x per share), a holding period of 2 years, and $80x ($2x per share) of earnings and profits attributable to the shares for purposes of section 1248.

(B) US2, a domestic corporation, owns all of the stock of FP, a foreign corporation, which owns all of the stock of FS, a foreign corporation. FP owns two blocks of FS stock. Each block consists of 10 shares with a value of $200x ($20x per share). The shares in the first block have a basis of $50x ($5x per share), a holding period of 10 years, and $50x ($5x per share) of earnings and profits attributable to such shares for purposes of section 1248. The shares in the second block had a basis of $100x ($10x per share), a holding period of 5 years, and $20x ($2x per share) of earnings and profits attributable to such shares for purposes of section 1248.

(C) FT merges into FS, with FS surviving, and F1 receives 50 shares of FP stock with a value of $1,000x in exchange for its FT stock. The merger of FT into FS qualifies as forward triangular merger, and immediately after the exchange US1 is a section 1248 shareholder with respect to F1, the exchanging shareholder, FP and FS, all of which are controlled foreign corporations.

(ii) *Basis and holding period determination.* (*1*) US1 is a section 1248 shareholder of F1, the exchanging

shareholder, and FT (both of which are controlled foreign corporations) immediately before the transaction. Moreover, F1 is not required to include amounts in income under § 1.367(b)–3(b) or 1.367(b)–4(b) as described in paragraph (c)(1)(ii)(B) of this section. Accordingly, the basis and holding period of the FS stock held by FP immediately after the triangular reorganization is determined pursuant to paragraph (c) of this section.

(*2*) Pursuant to paragraph (c) of this section, each share of FS stock is divided into portions attributable to the basis and holding period of the FS stock held by FP immediately before the exchange (the FS portion) and the FT stock held by F1 immediately before the exchange (the FT portion). The basis and holding period of the FS portion is the basis and holding period of the FS stock held by FP immediately before the exchange. Thus, each share of FS stock in the first block has a portion with a basis of $5x, a value of $20x, a holding period of 10 years, and $5x of earnings and profits attributable to such portion for purposes of section 1248. Each share of FS stock in the second block has a portion with a basis of $10x, a value of $20x, a holding period of 5 years, and $2x of earnings and profits attributable to such portion for purposes of section 1248.

(*3*) Because the exchanging shareholder of FT stock (F1) has a section 1248 shareholder (US1), the holding period and basis of the FT portion is the holding period and the proportionate amount of the basis of the FT stock immediately before the exchange to which such portion relates. Further, because F1 exchanged two blocks of FT stock, the FT portion must be divided into two separate portions attributable to the two blocks of FT stock. Thus, each share of FS stock will have a second portion with a basis of $15x ($300x basis / 20 shares), a value of $30x ($600x value / 20 shares), a holding period of 10 years, and $12x of earnings and profits ($240x / 20 shares) attributable to such portion for purposes of section 1248. Each share of FS stock will have a third portion with a basis of $30x ($600x basis / 20 shares), a value of $20x ($400x value / 20 shares), a holding period of 2 years, and $4x of earnings and profits ($80x / 20 shares) attributable to such portion for purposes of section 1248.

(iii) *Subsequent disposition—first block.* Assume, immediately after the transaction, FP disposes of a share of FS stock from the first block. When FP disposes of any share of its FS stock, it is treated as disposing of each divided portion of such share. With respect to the first portion (attributable to the FS stock), FP recognizes a gain of $15x ($20x value − $5x basis), $5x of which is treated as a dividend under section 1248. With respect to the second portion (attributable to the first block of FT stock), FP recognizes a gain of $15x ($30x value − $15x basis), $12x of which is treated as a dividend under section 1248. With respect to the third portion (attributable to the second block of FT stock), FP recognizes a capital loss of $10x ($20x value − $30x basis).

(iv) *Subsequent disposition—second block.* Assume further, immediately after the transaction, FP also disposes of a share of stock from the second block of FS stock. With respect to the first portion (attributable to the FS stock), FP recognizes a gain of $10x ($20x value − $10x basis), $2x of which is treated as a dividend under section 1248. With respect to the second portion (attributable to the first block of FT stock), FP recognizes a gain of $15x ($30x value − $15x basis), $12x of which is treated as a dividend under section 1248. With respect to the third portion (attributable to the second block of FT stock), FP recognizes a capital loss of $10x ($20x value − $30x basis).

Example 2. (i) *Facts.* The facts are the same as in *Example 1,* except that FS merges into FT with FT surviving in a reverse triangular merger. Pursuant to the merger, F1 receives FP stock with a value of $1,000x in exchange for its FT stock, and FP receives 10 shares of FT stock with a value of $1,000x in exchange for its FS stock. Immediately after the exchange, US1 is a section 1248 shareholder with respect to F1, the exchanging shareholder, FP, and FT, all of which are controlled foreign corporations.

(ii) *Basis and holding period determination*—(A) The basis and holding period of the stock of the surviving corporation held by FP are the same as in *Example 1,* except that each share of the surviving corporation (FT, instead of FS) will be divided into four portions instead of three portions. Because FP exchanges two blocks of FS stock, the FS portion must be divided into two separate portions attributable to the two blocks of FS stock. Because F1 exchanges two blocks of FT stock, the FT portion must be divided into two separate portions attributable to the two blocks of FT stock.

(B) Thus, each share of the surviving corporation (FT) will have a first portion (attributable to the first block of FS stock) with a basis of $5x ($50x / 10 shares), a value of $20x ($200x / 10 shares), a holding period of 10 years, and $5x of earnings and profits ($50x / 10 shares) attributable to such portion for purposes of section 1248. Each share of FT stock will have a second portion (attributable to the second block of FS stock) with a basis of $10x ($100x / 10 shares), a value of $20x ($200x / 10 shares), a holding period of 5 years, and $2x of earnings and profits ($20x / 10 shares) attributable to such portion for purposes of section 1248. Moreover, each share of FT stock will have a third portion (attributable to the first block of FT stock) with a basis of $30x ($300x basis / 10 shares), a value of $60x ($600x value / 10 shares), a holding period of 10 years, and $24x of earnings and profits ($240x / 10 shares) attributable to such portion for purposes of section 1248. Lastly, each share of FT stock will have a fourth portion (attributable to the second block of FT stock) with a basis of $60x ($600x basis / 10 shares), a value of $40x ($400x value / 10 shares), a holding period of 2 years, and $8x of earnings and profits ($80x / 10 shares) attributable to such portion for purposes of section 1248.

Example 3. (i) *Facts.* USP, a domestic corporation, owns all the stock of FS, a foreign corporation with 10 shares of stock outstanding. Each share of FS stock has a value of $10x, a basis of $5x, a holding period of 10 years, and $7x of earnings and profits attributable to such share for purposes of section 1248. FP, a foreign corporation, owns the stock of FT, another foreign corporation. FP and FT do not have any section 1248 shareholders. FT has assets with a value of $100x, a basis of $50x, and no liabilities. The FT stock held by FP has a value of $100x and a basis of $75x. FT merges into FS with FS surviving in a forward triangular merger. Pursuant to the reorganization, FP receives USP stock with a value of $100x in exchange for its FT stock.

(ii) *Basis and holding period determination*—(A) Because USP is a section 1248 shareholder of FS immediately before the transaction, the basis and holding period of the FS stock held by USP immediately after the triangular reorganization is determined pursuant to paragraph (c) of this section.

(B) Pursuant to paragraph (c) of this section, each share of FS stock is divided into portions attributable to the basis and holding period of the FS stock held by USP immediately before the exchange (the FS portion) and the FT portion immediately before the exchange. Because FT does not have a section 1248 shareholder immediately before the transaction, the rules of § 1.358–6 apply to determine the basis of the FT portion of each share of FS stock. Those rules determine the basis of FS stock held by USP by reference to the basis of FT's net assets. The basis and holding period of the FS portion is the basis and holding period of the FS stock held by USP immediately before the exchange. Thus, each share of FS stock has a portion with a basis of $5x, a value of $10x, a holding period of 10 years, and $7x of earnings and profits attributable to such portion for section 1248 purposes. The basis of the FT portion is the basis of the FT assets to which such portion relates. Thus, each share of FS stock has a second portion with a basis of $5x ($50x basis in FT's assets / 10 shares) and a value of $10x ($100x value of FT's assets / 10 shares). All of FS's earnings and profits prior to the transaction ($70x) is attributed solely to the FS portion in each share of FS stock. As a result of each share of stock being divided into portions, the basis of the FS stock is not averaged with the basis of the FT assets to increase the section 1248 amount with respect to the stock of the surviving corporation (FS).

Example 4. (i) *Facts.* US, a domestic corporation, owns all of the stock of FT, a foreign corporation. The FT stock held by US constitutes a single block of stock with a value of $1,000x, a basis of $600x, and holding period of 5 years. USP, a domestic corporation, forms FS, a foreign corporation, pursuant to the plan of reorganization and capitalizes it with $10x of cash. FS merges into FT with FT surviving in a reverse triangular merger and a reorganization described in section 368(a)(1)(B). Pursuant to the reorganization, US receives USP stock with a value of $1,000x in exchange for its FT stock, and USP receives 10 shares of FT stock with a value of $1,010x in exchange for its FS stock.

(ii) *Basis and holding period determination.* (A) US and USP are section 1248 shareholders of FT and FS, respectively, immediately before the transaction. Neither

US nor USP is required to include amounts in income under § 1.367(b)–3(b) or 1.367(b)–4(b) as described in paragraph (c)(1)(i)(B) or (c)(1)(ii)(B) of this section. The basis and holding period of the FT stock held by USP is determined pursuant to paragraph (c) of this section.

(B) Pursuant to paragraph (c) of this section, because the exchanging shareholder of FT stock (US) is a section 1248 shareholder of FT, each share of the surviving corporation (FT) has a proportionate amount of the basis and holding period of the FT stock immediately before the exchange to which such share relates. Thus, the portion of each share of FT stock attributable to the FT stock has a basis of $60x ($600x basis / 10 shares), a value of $100x ($1,000x value / 10 shares), and a holding period of 5 years. Because the value of FS stock immediately before the triangular reorganization ($10x) is less than one percent of the value of the surviving corporation (FT) immediately after the triangular reorganization ($1,010x), USP may determine its basis in the stock of the surviving corporation (FT) attributable to its FS stock basis held prior to the reorganization by increasing the basis of each share of FT stock by the proportionate amount of USP's aggregate basis in the FS stock immediately before the exchange (without dividing each share of FT stock into separate portions to account for FS and FT). If USP so elects, USP's basis in each share of FT stock is increased by $1x ($10x basis in FS stock / 10 shares). As a result, each share of FT stock has a basis of $61x, a value of $101x, and a holding period of 5 years.

Example 5. (i) *Facts.* US, a domestic corporation, owns all of the stock of F1, a foreign corporation, which owns all the stock of FT, a foreign corporation. The FT stock held by F1 constitutes one block of stock with a basis of $170x, a value of $200x, a holding period of 5 years, and $10x of earnings and profits attributable to such stock for purposes of section 1248. FP, a foreign corporation, owns all the stock of FS, a foreign corporation. FS has 10 shares of stock outstanding. No United States person is a section 1248 shareholder with respect to FP or FS. The FS stock held by FP has a value of $100x and a basis of $50x ($5x per share). FT merges into FS with FS surviving in a forward triangular merger. Pursuant to the merger, F1 receives FP stock with a value of $200x for its FT stock in an exchange that qualifies for non-recognition under section 354. US is a section 1248 shareholder with respect to F1, the exchanging shareholder, FP, and FS (all of which are controlled foreign corporations) immediately after the exchange.

(ii) *Basis and holding period determination.* (A) Because US is a section 1248 shareholder of F1, the exchanging shareholder, and FT immediately before the transaction, and US is a section 1248 shareholder of F1, FP, and FS immediately after the transactions, F1 is not required to include amounts in income under §§ 1.367(b)–3(b) and 1.367(b)–4(b) as described in paragraph (c)(1)(ii)(B) of this section. Thus, the basis and holding period of the FS stock held by FP immediately after the triangular reorganization is determined pursuant to paragraph (c) of this section.

(B) Pursuant to paragraph (c) of this section, each share of FS stock is divided into portions attributable to the basis and holding period of the FS stock held by FP immediately before the exchange (the FS portion) and the FT stock held by F1 immediately before the exchange (the FT portion). The basis and holding period of the FS portion is the basis and holding period of the FS stock held by FP immediately before the exchange. Thus, each share of FS stock has a portion with a basis of $5x and a value of $10x. Because the exchanging shareholder of FT stock (F1) has a section 1248 shareholder of both F1 and FT, the basis and holding period of the FT portion is the proportionate amount of the basis and the holding period of the FT stock immediately before the exchange to which such portion relates. Thus, each share of FS stock will have a second portion with a basis of $17x ($170x basis / 10 shares), a value of $20x ($200x value / 10 shares), a holding period of 5 years, and $1x of earnings and profits ($10x earnings and profits / 10 shares) attributable to such portion for purposes of section 1248.

(iii) *Subsequent disposition.* (A) Several years after the merger, FP disposes of all of its FS stock in a transaction governed by section 964(e). At the time of the disposition, FS stock has decreased in value to $210x (a post-merger reduction in value of $90x), and FS has incurred a post-merger deficit in earnings and profits of $30x.

(B) Pursuant to paragraph (d)(1)(ii) of this section, for purposes of determining the amount of gain realized on the sale or exchange of stock that has a divided portion, any amount realized on such sale or exchange is allocated to each divided portion of the stock based on the relative fair market value of the stock to which the portion is attributable at the time the portions were created. Immediately before the merger, the value of the FS stock in relation to the value of both the FS stock and the FT stock was one-third ($100x / ($100x plus $200x)). Likewise, immediately before the merger, the value of the FT stock in relation to the value of both the FT stock and the FS stock was two-thirds ($200x / $100x plus $200x). Accordingly, one-third of the $210x amount realized is allocated to the FS portion of each share and two-thirds to the FT portion of each share. Thus, the amount realized allocated to the FS portion of each share is $7x (one-third of $210x divided by 10 shares). The amount realized allocated to the FT portion of each share is $14x (two-thirds of $210x divided by 10 shares).

(C) Pursuant to paragraph (d)(3) of this section, any earnings and profits (or deficits) accumulated by the surviving corporation subsequent to the reorganization are attributed to the divided portions of shares of stock based on the relative fair market value of each divided portion of stock. Accordingly, one-third of the post-merger earnings and profits deficit of $30x is allocated to the FS portion of each share and two-thirds to the FT portion of each share. Thus, the deficit in earnings and profits allocated to the FS portion of each share is $1x (one-third of $30x divided by 10 shares). The deficit in earnings and profits allocated to the FT portion of each share is $2x (two-thirds of $30x divided by 10 shares).

(D) When FP disposes of its FS stock, FP is treated as disposing of each divided portion of a share of stock. With respect to the FS portion of each share of stock, FP recognizes a gain of $2x ($7x value − $5x basis), which is not recharacterized as a dividend because a deficit in earnings and profits of $1x is attributable to such portion for purposes of section 1248. With respect to the FT portion of each share of stock, FP recognizes a loss of $3x ($14x value − $17x basis).

(f) *Effective date.* This section applies to exchanges occurring on or after January 23, 2006.

■ **Par. 10.** Section 1.884–2 is amended as follows:

■ 1. Paragraphs (c)(3) through (c)(6)(i)(A) are revised.

■ 2. Paragraphs (c)(6)(i)(B), (C), and (D) are added.

■ 3. Paragraphs (c)(6)(ii) through (f) are revised.

■ 4. Paragraph (g) is amended by adding a sentence at the end.

The revisions and additions read as follows:

§ 1.884–2 Special rules for termination or incorporation of a U.S. trade or business or liquidation or reorganization of a foreign corporation or its domestic subsidiary.

* * * * *

(c)(3) through (c)(6)(i)(A) [Reserved]. For further guidance, see § 1.884–2T(c)(3) through (c)(6)(i)(A).

(B) Shareholders of the transferee (or of the transferee's parent in the case of a triangular reorganization described in section 368(a)(1)(C) or a reorganization described in sections 368(a)(1)(A) and 368(a)(2)(D) or (E)) who in the aggregate owned more than 25 percent of the value of the stock of the transferor at any time within the 12-month period preceding the close of the year in which the section 381(a) transaction occurs sell, exchange or otherwise dispose of their stock or securities in the transferee at any time during a period of three years from the close of the taxable year in which the section 381(a) transaction occurs.

(C) In the case of a triangular reorganization described in section 368(a)(1)(C) or a reorganization described in sections 368(a)(1)(A) and 368(a)(2)(D) or (E), the transferee's parent sells, exchanges, or otherwise disposes of its stock or securities in the transferee at any time during a period of three years from the close of the taxable year in which the section 381(a) transaction occurs.

(D) A corporation related to any such shareholder or the shareholder itself if it is a corporation (subsequent to an

event described in paragraph (c)(6)(i)(A) or (B) of this section) or the transferee's parent (subsequent to an event described in paragraph (c)(6)(i)(C) of this section), uses, directly or indirectly, the proceeds or property received in such sale, exchange or disposition, or property attributable thereto, in the conduct of a trade or business in the United States at any time during a period of three years from the date of sale in the case of a disposition of stock in the transferor, or from the close of the taxable year in which the section 381(a) transaction occurs in the case of a disposition of the stock or securities in the transferee (or the transferee's parent in the case of a triangular reorganization described in section 368(a)(1)(C) or a reorganization described in sections 368(a)(1)(A) and (a)(2)(D) or (E)). Where this paragraph (c)(6)(i) applies, the transferor's branch profits tax liability for the taxable year in which the section 381(a) transaction occurs shall be determined under § 1.884–1, taking into account all the adjustments in U.S. net equity that result from the transfer of U.S. assets and liabilities to the transferee pursuant to the section 381(a) transaction, without regard to any provisions in this paragraph (c). If an event described in paragraph (c)(6)(i)(A), (B), or (C) of this section occurs after the close of the taxable year in which the section 381(a) transaction occurs, and if additional branch profits tax is required to be paid by reason of the application of this paragraph (c)(6)(i), then interest must be paid on that amount at the underpayment rates determined under section 6621(a)(2), with respect to the period between the date that was prescribed for filing the transferor's income tax return for the year in which the section 381(a) transaction occurs and the date on which the additional tax for that year is paid. Any such additional tax liability together with interest thereon shall be the liability of the transferee within the meaning of section 6901 pursuant to section 6901 and the regulations thereunder.

(c)(6)(ii) through (f) [Reserved]. For further guidance, see § 1.884–2T(c)(6)(ii) through (f).

(g) * * * Paragraphs (c)(6)(i)(B), (C), and (D), are applicable for tax years beginning after December 31, 1986, except that such paragraphs are applicable to transactions occurring on or after January 23, 2006, in the case of reorganizations described in sections 368(a)(1)(A) and 368(a)(2)(D) or (E).

■ **Par. 11.** In § 1.884–2T, paragraphs (c)(6)(i)(B), (C), and (D) are revised to read as follows:

§ 1.884–2T Special rules for termination or incorporation of a U.S. trade or business or liquidation or reorganization of a foreign corporation or its domestic subsidiary (Temporary).

* * * * *

(c) * * *

(6) * * *

(i) * * *

(B), (C), and (D) [Reserved]. For further guidance, see § 1.884–2(c)(6)(i)(B), (C), and (D).

■ **Par. 12.** Section § 1.6038B–1 is amended as follows:

■ 1. Paragraphs (b)(1)(i) and (b)(1)(ii) are revised.

■ 2. The text of paragraph (g) is redesignated as paragraph (g)(1) and the first sentence is revised.

■ 3. Paragraphs (g)(2), (g)(3), and (g)(4) are added.

The revisions and addition are as follows:

§ 1.6038B–1 Reporting of certain transfers to foreign corporations.

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(b) *Time and manner of reporting*—(1) *In general*—(i) *Reporting procedure.* Except for stock or securities qualifying under the special reporting rule of § 1.6038B–1(b)(2), and certain exchanges described in section 354 or 356 (listed below), any U.S. person that makes a transfer described in section 6038B(a)(1)(A), 367(d) or (e), is required to report pursuant to section 6038B and the rules of § 1.6038B–1 and must attach the required information to Form 926, ''Return by a U.S. Transferor of Property to a Foreign Corporation.'' For special rules regarding cash transfers made in tax years beginning after February 5, 1999, see paragraphs (b)(3) and (g) of this section. For purposes of determining a U.S. transferor that is subject to section 6038B, the rules of §§ 1.367(a)–1T(c) and 1.367(a)–3(d) shall apply with respect to a transfer described in section 367(a), and the rules of § 1.367(a)–1T(c) shall apply with respect to a transfer described in section 367(d). Additionally, if in an exchange described in section 354 or 356, a U.S. person exchanges stock or securities of a foreign corporation in a reorganization described in section 368(a)(1)(E), or a U.S. person exchanges stock or securities of a domestic or foreign corporation pursuant to an asset reorganization described in section 368(a)(1) (involving a transfer of assets under section 361) that is not treated as an indirect stock transfer under § 1.367(a)–3(d), then the U.S. person exchanging stock or securities is not required to report under section 6038B. Notwithstanding any statement to the contrary on Form 926, the form and attachments must be attached to, and filed by the due date (including extensions) of the transferor's income tax return for the taxable year that includes the date of the transfer (as defined in § 1.6038B–1T(b)(4)). For taxable years beginning before January 1, 2003, any attachment to Form 926 required under the rules of this section is filed subject to the transferor's declaration under penalties of perjury on Form 926 that the information submitted is true, correct and complete to the best of the transferor's knowledge and belief. For taxable years beginning after December 31, 2002, Form 926 and any attachments shall be verified by signing the income tax return with which the form and attachments are filed.

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

* * * * *

(g) *Effective dates*—(1) This section applies to transfers occurring on or after July 20, 1998, except for transfers of cash made in tax years beginning on or before February 5, 1999 (which are not required to be reported under section 6038B), except for transfers described in paragraphs (g)(2) through (4) of this section, and except for transfers described in paragraph (e) of this section, which applies to transfers that are subject to §§ 1.367(e)–1(f) and 1.367(e)–2(e). * * *

(2) The rules of paragraph (b)(1)(i) of this section as they apply to section 368(a)(1)(A) reorganizations (including reorganizations described in section 368(a)(2)(D) or (E)) apply to transfers occurring on or after January 23, 2006.

(3) The rules of paragraph (b)(1)(i) of this section that provide an exception from reporting under section 6038B for transfers of stock or securities in a section 354 or 356 exchange, pursuant to a section 368(a)(1)(G) reorganization that is not treated as an indirect stock transfer under § 1.367(a)–3(d), apply to transfers occurring on or after January 23, 2006.

(4) The rules of paragraph (b)(1)(i) of this section that provide an exception from reporting under section 6038B for transfers of stock in a section 354 or 356 exchange, pursuant to a section 368(a)(1)(E) reorganization or an asset reorganization under section 368(a)(1) that is not treated as an indirect stock transfer under § 1.367(a)–3(d), apply to transfers occurring on or after January 23, 2006. The rules of paragraph (b)(1)(i) of this section that provide an exception from reporting under section 6038B for transfers of securities in a section 354 or 356 exchange, pursuant to a section 368(a)(1)(E) reorganization or an asset

reorganization under section 368(a)(1) that is not treated as an indirect stock transfer under § 1.367(a)–3(d), apply only to transfers occurring after January 5, 2005 (although taxpayers may apply such provision to transfers of securities occurring on or after July 20, 1998 and on or before January 5, 2005 if done consistently to all transactions). See § 1.6038–1T(b)(i), as contained in 26 CFR part 1 revised as of April 1, 2005, for transfers occurring prior to the effective dates described in paragraphs (g)(2) through (4) of this section.

■ **Par. 13.** In § 1.6038B–1T, paragraph (b)(1)(i) is revised to read as follows:

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

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(b) *Time and manner of reporting*—(1) *In general*—(i) [Reserved]. For further guidance, see § 1.6038B–1(b)(1)(i).

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Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: January 17, 2006.

Eric Solomon,

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

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DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

50 CFR Part 20

RIN 1018–AU04; 1018–AU09; 1018–AU13; 1018–AU28

Migratory Bird Hunting; Approval of Tungsten-Iron-Copper-Nickel, Iron-Tungsten-Nickel Alloy, Tungsten-Bronze (Additional Formulation), and Tungsten-Tin-Iron Shot Types as Nontoxic for Hunting Waterfowl and Coots; Availability of Environmental Assessments

AGENCY: Fish and Wildlife Service, Interior.

ACTION: Final rule; availability of Final Environmental Assessment and Finding of No Significant Impact.

SUMMARY: The U.S. Fish and Wildlife Service (we, us, or USFWS) approves four shot types or alloys for hunting waterfowl and coots and changes the listing of approved nontoxic shot types to reflect the cumulative approvals of nontoxic shot types and alloys. In addition, we approve alloys of several metals because we have approved the metals individually at or near 100% in nontoxic shot. We have prepared a Final Environmental Assessment and a Finding of No Significant Impact in support of this decision.

DATES: This rule takes effect on February 27, 2006.

ADDRESSES: The Final Environmental Assessments for the shot types and the associated Findings of No Significant Impact are available from the Division of Migratory Bird Management, U.S. Fish and Wildlife Service, 4501 North Fairfax Drive, Room 4091, Arlington, Virginia 22203–1610. You may call 703–358–1825 to request copies.

The complete file for this rule is available, by appointment, during normal business hours at the same address. You may call 703–358–1825 to make an appointment to view the files.

FOR FURTHER INFORMATION CONTACT: Dr. George T. Allen, Division of Migratory Bird Management, 703–358–1714.

SUPPLEMENTARY INFORMATION:

Background

The Migratory Bird Treaty Act of 1918 (Act) (16 U.S.C. 703–711) and the Fish and Wildlife Improvement Act of 1978 (16 U.S.C. 712) implement migratory bird treaties between the United States and Great Britain for Canada (1916, amended), Mexico (1936, amended), Japan (1972, amended), and Russia (then the Soviet Union, 1978). These treaties protect certain migratory birds from take, except as permitted under the Acts. The Acts authorize the Secretary of the Interior to regulate take of migratory birds in the United States. Under this authority, the U.S. Fish and Wildlife Service controls the hunting of migratory game birds through regulations in 50 CFR part 20.

Deposition of toxic shot and release of toxic shot components in waterfowl hunting locations are potentially harmful to many organisms. Research has shown that ingested spent lead shot causes significant mortality in migratory birds. Since the mid-1970s, we have sought to identify shot types that do not pose significant toxicity hazards to migratory birds or other wildlife. We addressed the issue of lead poisoning in waterfowl in an Environmental Impact Statement in 1976, and again in a 1986 supplemental EIS. The 1986 document provided the scientific justification for a ban on the use of lead shot and the subsequent approval of steel shot for hunting waterfowl and coots that began that year, with a complete ban of lead for waterfowl and coot hunting in 1991. We have continued to consider other potential candidates for approval as nontoxic shot. We are obligated to review applications for approval of alternative shot types as nontoxic for hunting waterfowl and coots.

We received applications for approval of four shot types as nontoxic for hunting waterfowl and coots. Those shot types are:

1. Tungsten-Iron-Copper-Nickel (TICN) shot, of 40–76 percent tungsten, 10–37 percent iron, 9–16 percent copper, and 5–7 percent nickel (70 FR 3180, January 21, 2005);

2. Iron-Tungsten-Nickel (ITN) alloys composed of 20–70 percent tungsten, 10–40 percent nickel, and 10–70 percent iron (70 FR 22625, May 2, 2005);

3. Tungsten-Bronze (TB) shot made of 60 percent tungsten, 35.1 percent copper, 3.9 percent tin, and 1 percent iron (70 FR 22624, May 2, 2005, Note: This formulation differs from the Tungsten-Bronze nontoxic shot formulation approved in 2004.); and

4. Tungsten-Tin-Iron (TTI) shot composed of 58 percent tungsten, 38 percent tin, and 4 percent iron (70 FR 32282, June 2, 2005).

We reviewed the shot under the criteria in Tier 1 of the nontoxic shot approval procedures contained in 50 CFR 20.134 for permanent approval of shot as nontoxic for hunting waterfowl and coots. We amend 50 CFR 20.21(j) to add the shot types to the list of those approved for waterfowl and coot hunting.

On August 24, 2005, we published a proposed rule to approve the four shot types as nontoxic (70 FR 49541). The applications for the approval of the shot types included information on chemical characterization, production variability, use, expected production volume, toxicological effects, environmental fate and transport, and evaluation, and the proposed rule included this information, a comprehensive evaluation of the likely effects of each shot, and an assessment of the affected environment.

The Director of the U.S. Fish and Wildlife Service has concluded that the spent shot material will not pose a significant danger to migratory birds or other wildlife or their habitats, and therefore approves the use of the four shot types as nontoxic for hunting waterfowl and coots.

We received one comment in response to the proposed rule. However, the commenter raised no issues that caused us to reconsider our approval of the shot types as nontoxic.

The metals in these shot types have already been approved in other nontoxic shot types. In considering approval of these shot types, we were particularly concerned about the solubility and bioavailability of the nickel and copper